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Editorial Note

One of the aims of *Policy Quarterly* is to generate informed discussion on a wide range of topics and issues bearing upon public policy and management in New Zealand (and elsewhere for that matter). The leading article in this issue of the journal is fully consistent with this objective. In it, Kerry McDonald makes some challenging arguments about what he sees as problems of leadership in the New Zealand state sector, problems which he believes are important not only because they diminish the performance of the state sector but also because, in his view, they adversely affect New Zealand's general economic performance. McDonald's article is an edited version of a speech he gave in February this year to a conference on 'Corporate Governance in the Public Sector', in which he was reflecting, among other things, on what he sees as the lack of progress made by the government in addressing issues identified a few years ago by the State Sector Standards Board, which he chaired.

Because of the strongly critical nature of McDonald's arguments, the State Services Commissioner, Mark Prebble, has accepted the opportunity given to him by *Policy Quarterly* to respond. Readers will note that in his response he expresses his disappointment at what he sees as a 'large number of unsubstantiated assertions' in McDonald's article. For its part, *Policy Quarterly* is content to let readers make their own judgements about the assertions made by both contributors, keeping in mind the fact that the journal seeks to limit the extent of referencing details found in fully academic publications, and that central to McDonald's arguments are his references to two reports – one by the Treasury on aspects of public service performance, and the other by the Ministry of Health on the current state of the ministry. In his response, the State Services Commissioner does not specifically comment on either of these reports, but focuses in more general terms on performance management and the State Sector Development Goals.

In the second article, Rebecca Lineham addresses issues of 'downwards' accountability on the part of 'comprehensive assistance missions', such as the Regional Assistance Mission to Solomon Islands (RAMSI), in which New Zealand is a partner. She argues that because the success of such operations rest heavily on the generation and maintenance of local consent, mechanisms for oversight and review must incorporate processes for handling local input and dissent, and must be just as rigorous as accountability to donors, sponsors and contributing governments. She offers suggestions to that end, while recognising the difficulties inherent in fulfilling such obligations.

The next article – by Patrick Nolan – is based on the author's successful doctoral research, and examines the advantages and disadvantages of four ways of lifting the incomes of New Zealand families. Nolan argues that policymakers should now look beyond the full implementation of the Working for Families reforms to these other options, which are generally less complex and administratively costly, and better able to overcome other barriers to lifting incomes, and which could be components of a single income assistance system.

The final article in this issue makes a further contribution to the debate on governmental responses to climate change. Massey University economist, Peter Read, proposes the use of policy instruments designed to drive the preferential adoption of two types of technology – involving carbon-conservative commercial processing of land products – with tradability generating the cash flow needed to finance the necessary capital investments.

In sum, as with previous issues of *Policy Quarterly*, there are in this latest one many bones of contention on matters of public policy and public management, which can generate further discussion. The co-editors of the journal look forward to receiving contributions on these and any other topics, in line with the editorial policy stated on the back cover.

Robert Gregory
Co-Editor

The Critical Role of Leadership in the New Zealand State Sector

Kerry McDonald

Introduction

If New Zealand is to be able to arrest its steadily deteriorating economic performance and position compared with many other countries, particularly Australia, one thing it must do urgently is to radically improve the quality of leadership and performance within its central government agencies. Substantial economic and social benefits will flow from such remedial action, but high costs will be paid if it is not taken.

There are major weaknesses in capability and performance in the New Zealand public sector, particularly in the public service. They reflect the lack of an integrated, coordinated and strategic, 'whole of government' approach to important social and economic issues; a failure to address a number of clear and serious systems deficiencies; a willingness to accept poor performance and results, in spite of the adverse impact on New Zealand's economic performance and living standards; and insufficient openness and transparency in regard to the sector's performance and results.

These weaknesses are evident in inconsistent and sometimes manifestly inadequate leadership in the sector; a lack of attention to important organisation and systems issues; poor policy design and implementation and weak administrative and operational performance; unacceptable and costly performance failures; and, ultimately, poor results – especially in terms of the economy, social outcomes and living standards generally. The poor results seem to have led to less open and informative performance monitoring and communication.

There are many capable people and good organisations in the public sector, performing to a good – sometimes excellent – standard. It is unfair to them, and all New Zealand citizens, that the major and systematic weaknesses have not been and are not being addressed. They have been clearly evident for some years now.

The wider context

There has been a continuing failure of New Zealand's leaders and policies to deal with the continuing deterioration in New Zealand's economic performance and standards of living compared with Australia and many other economies. At the same time there has been a sharp increase in the competitive and other pressures facing New Zealand – e.g. China, India, international tax reform, sustainability, Australia's policies and performance, new international business strategies, biosecurity, trade negotiations and climate change – and our responses to these pressures have generally been piecemeal and limited. There has been insufficient attention paid to important economic and social objectives. Between 1960 and 1999 New Zealand's growth in exports per capita was less than half (45%) of Australia's, and only 41% of the OECD average rate of increase. Over the same period New Zealand's productivity growth performance was worse – only 40% of Australia's and 25% of the OECD average. Then, between 2000 and 2005, New Zealand's productivity trend growth rate declined to only half the trend growth rate between 1992 and 2000, from 2.5% per annum to 1.1% per annum. From 1999 to 2006, Australia's exports per capita increased 66% and New Zealand's by only 36%. Information recently available from Statistics New Zealand suggests that productivity growth in the 'market' sector may have been in line with Australia's in recent years, which means that in the 'non-market' sector, of which the public sector is a major part, productivity performance has been very poor. A recent study (Rennie, 2007) supports that view and argues that, based on an analysis of a range of social indicators, the massive increase in government spending in recent years, some $20 billion, has not produced better outcomes.

As exports per capita and productivity are critical determinants of living standards, these trends are particularly serious. It must also be noted that New Zealand's current account deficit at over 9% of GDP is amongst the largest in the OECD, and is about twice what might be sustainable. In addition, New Zealand's net international investment position is one of the worst amongst developed economies. It continues to deteriorate, weakening the current account outlook. Better growth rates in several recent years primarily reflected abnormally high and unsustainable increases in terms of trade, net immigration and labour participation. New Zealand's capital:labour ratio, 95% of Australia's in the late 1970s, is now only some 70%, which has serious implications for future relative productivity improvement and incomes. Australia's recent superannuation changes highlight New Zealand's relatively weak policy settings and performance.

Clearly, it is essential that New Zealand lifts its game – but where does the public sector sit in all of this?

Serious shortcomings

The post-1987 major reforms in the New Zealand public sector were fundamental and pervasive. They had a very substantial positive impact through the development of a more efficient, effective, results-oriented and accountable public sector. The more decentralised and targeted approach allowed greater scope for capable leaders and managers to innovate and improve performance. Inevitably, there were aspects that have required reworking, as well as unfinished business, but the benefits of the reforms were clearly very substantial.

However, since the major reforms there has been little further progress, and in some respects things have gone backwards. In its report on state sector organisations, including the public service, the State Sector Standards Board (SSSB) (2002) highlighted areas of significant concern which continued to require serious attention. These included:

- quality of leadership;
- quality and effective use of performance management systems;
- inadequate attention to training and development of staff;
- lack of focus on succession planning and career development;
- the need for a remuneration strategy;
- orientation to 'whole of government' approaches;
- emphasis on outputs at the expense of outcomes.

Four years on there is no evidence of significant, sector-wide initiatives or improvement. A Treasury report on aspects of public service performance (reported in the *National Business Review*, 19 March 2004) concluded that 'Managing for Outcomes' is part of a strongly worded State Services Commission (SSC) aspiration to improve the effectiveness of government expenditure. However, it observed that departments and agencies have managed to avoid many of the more onerous aspects of the new regime, according to an evaluation of the content and quality of the statements of intent prepared in the last financial year. In the words of the report, 'Departmental capacity to undertake meaningful organisational capability appraisal appears limited. Departments do not have a clear picture of their current state or future capability requirements, or access to common capability appraisal metrics'. It was also noted that outcome indicators of performance measures are virtually non-existent in the majority of 2003/04 statements of intent; that the identification of risk and risk management was very limited; that departments tend to assert linkages to each others' outcome sets, rather than describe how collaboration or shared outcome contributions will work; and that interdepartmental collaboration occurs despite the system, not because of it. Where real collaboration does happen, it does so only because determined professionals on the ground make it happen.

Organisational capability is a critical issue. It is a major determinant of what can be achieved, to what standard and at what cost. Improving it is a vital part of overall performance improvement. Yet departmental capacity to undertake meaningful organisational capability appraisal appears limited, and agencies do not have a clear picture of the current state of their organisation or of future capability requirements, or access to common capability appraisal metrics. For example, a recent report on the current state of the Ministry of Health (2006), one of the New Zealand public sector's largest organisations, with a critical role in terms of the living standards of New Zealanders, found that the ministry has no strategic plan and that there is none for the health sector; that it is oriented to process tasks, not key priorities and objectives; that it has an inward-looking, directorate-oriented, silo approach; that it lacks key performance indicators to enable measurement of progress; that it has weak performance management and orientation to plan targets; and that it has a risk-averse culture with slow and reactive decision making. I also note a Treasury report (see *New Zealand Herald*, 16 February 2007) which states that there was an 8% fall in hospital productivity between 2001 and 2004, compared to a 1% increase in the previous three years. Treasury also found that only 25% of the activities carried out by New Zealand's 21 district health boards were actually measurable!

Obviously, these are serious weaknesses, and especially remarkable since the Ministry of Health is not a new organisation, its previous chief executive was in the role for a number of years, and New Zealand now has a third-term government which has put considerable focus on the health sector.

In my judgement, two initial conclusions can be drawn. First, there are serious weaknesses in the capability and/or willingness of some public sector leaders – both officials and ministers – to actually lead and manage their responsibilities and organisations. Secondly, important sector-wide systems and processes – e.g. planning and goal setting, performance monitoring and management, staff training and development, performance improvement, consequence management, and the related central leadership and oversight – are inadequate in both their design and operation.

The root cause of this situation seems to be a lack of leadership, capability and commitment in addressing these important issues, exacerbated by aversion to change and the risks involved, and a willingness to accept, even to prefer, weak or poor performance rather than risk change. The absence of a decisive political constituency for improvement is also relevant. This reflects, at least in part, the lack of openness and transparency on good performance indicators, although the frequent incidents of performance failure reported in the news media are a strong, albeit informal, indicator of performance.

Where progress is being made it is generally being led by individual chief executives, using their own initiative and sometimes with support or encouragement from ministers. Where leadership is capable, improvement is evident, and performance reflects this; and these improvements highlight what could be achieved on a sector-wide basis. As Graham Scott (2001, p.xxii) has commented:

> the best public management in New Zealand is demonstrably as good as it gets anywhere in the world. There are, however, numerous innovations that have begun with great promise, but that have not been followed through and some lie neglected. We have talked incessantly about some problems but left them unsolved, such as the identification and development of top managers.

Delegation and performance

A key feature of the 1980s–90s reforms was the increase in the authority delegated to chief executives, especially in the public service. There were also major changes in the wider state sector, where the role of boards and directors became more significant, and often successful. This created the opportunity for capable chief executives to lead and improve the performance of their organisations.

Unfortunately, the key supporting systems for ensuring that the benefits were gained consistently on a sector-wide basis were not developed or implemented, or were done so on a limited and ineffective basis. That essentially remains the current position, and the absence of an effective systematic approach, particularly in the public service, to managing and improving performance is a fundamental and costly weakness.

It is notable that this has been the situation for quite a few years now and that the problem is widely recognised, but decisive steps have not been taken to remedy the position. That sends a signal about New Zealand's approach to public sector performance – that good performance and performance improvement are not priorities for the sector's leadership.

Why is a systematic sector-wide approach so important?

Leadership

Capable leadership, in all its forms, is less about style and personality, though this has some relevance, and much more about learned techniques and methods and experience. Importantly, the required leadership capability is different from role to role and between levels in any organisation. A good organisation has the requisite, capable leadership at all levels.

The leader of an organisation, e.g. a public service chief executive, must be able to lead that organisation – to think strategically, set goals and objectives, develop a team, manage performance, achieve outcomes, plan and so on. A key part of the role capability is 'organisational leadership': the knowledge, skills and experience to develop and improve the capability of the organisation to perform, to work *on* the organisation and not just *in* it. Ministers, at a different level and with a different role, need other forms of leadership capability in guiding and overseeing chief executives and their performance.

Leadership capability varies considerably amongst public sector executives and amongst ministers, as it can do in any organisation. Some are experienced, talented and capable and others are less so. The variation is not surprising and partly reflects experience, including exposure to good training and development – and to good leadership. This variation in capability is clearly evident in the variation in performance amongst public sector organisations. Some perform well, others less so, and some clearly struggle.

The steps taken to improve the standard and consistency of public sector leadership have been very small, in relation to the size and significance of the issue, and there are still no *effective*, sector-wide systems or processes to achieve the required outcomes.

There is similar variation in the leadership capability of ministers, who are selected through a political process. Most come from backgrounds that gave little or no exposure to the requisite leadership skills for their present role, which include organisational leadership and guiding struggling chief executives on their performance and on organisational development. Short, well-focused workshops for ministers, to outline, inform and remind, could be very productive, but the SSSB's recommendation on this was not taken up.

A more substantial and systematic approach to developing consistent high capability amongst public sector leaders would improve the sector's performance markedly. In organisational terms this would simply be reducing or removing unwanted variance in performance – a classic case for Six Sigma methodology. There is a leadership development programme presently in place, but it is too limited to be effective.

The problems caused by the variability of leadership partly reflect and are compounded by the weak approach to performance management, particularly in the public service.

Performance management

Good performance management is critical for any organisation. It needs to be based on an agreed role description and performance objectives. It must entail regular formal review meetings (at least two per year) with a manager who is experienced and capable, and at the organisation level of the person whose performance is being reviewed, or preferably higher. It must assess performance fairly and frankly against the agreed criteria, reaching an agreed outcome, or with a process to resolve differences.

The outcome must lead to good performance being rewarded and poor performance being appropriately sanctioned. The outcomes should include an agreed training and development programme. Where there are serious performance problems there must be personal counselling and an agreed development plan, which leads to sufficient improvement or exit from the role. The formal meetings should be complemented by regular informal meetings.

There is a performance management system in the public service, but it is ineffective in managing the performance of public service senior executives. This is evidenced by the poor performance of some individuals and organisations, over sustained periods, including the acceptance of poor performers continuing in their roles and the reappointment of some to new senior roles. The system is more akin to a plan review, based on data collection and analysis, than a personal performance review. The reviewers generally lack the experience in sufficiently senior roles that would have allowed them to develop the necessary judgement and other skills needed to effectively review a chief executive's performance. It is also questionable whether they have the required technical skills and knowledge for the role.

Properly reviewing a person's performance is a difficult and demanding task, and unless it is done to a high standard the results will be poor, to the detriment of the employee, the organisation, the sector and policy outcomes. The results will also lack the robustness and credibility needed to support serious consequences for failure to perform, given the present legal framework. This is probably another reason for ongoing poor performances.

These problems with performance management also appear to be present within organisations as well, not just with chief executives, limiting the ability of organisations to improve their performance.

Many public sector employees regard performance management negatively, as a disciplinary tool rather than as a positive input into their capabilities and career development. Thus, although the public service operates on the basis of delegated authority, it lacks the complementary systems necessary to operate efficiently and effectively in this way.

'Whole of government' outcomes

There has been an inadequate emphasis on and progress towards 'whole of government' outcomes, even though this has been a stated priority for some years. In a good organisation, which comprises a number of divisions, each of these is led by a manager with delegated authority from the centre. Each manager will be judged on the basis of his/her divisional result, and the impact of their work on the whole organisation. For example, a new group-wide IT system may be proposed. It may be advocated as being in the best interests of the whole, but often divisional managers will have discretion as to whether to adopt or not, as in the public sector. If opting out of the group solution turns out to be a bad decision their performance will be marked down accordingly.

However, in the public sector there is little evidence of any consequences from a failure to act beyond a narrow interest, and a great reluctance to mandate 'whole of government' or best practice solutions. And the negotiation of them is generally a slow, difficult and inefficient process. This is a major issue for the sector as it also frustrates the transfer, development and adoption of good/best practice, access to scale economies, common approaches to IT and other systems, and the achievement of a credible, 'whole of government' approach.

Organisational development

Organisation development and performance is a key area for leadership accountability, but it is an area of particular weakness in the public sector. Some organisations are making progress but many are not, because they are not alert to the significance of the issue, particularly when the leader lacks the relevant knowledge and experience. In such circumstances the absence of a systematic, sector-wide framework has serious consequences.

Organisation development is important because it improves the design of an organisation and its ability to achieve its purpose effectively and efficiently. It starts with basic issues such as what roles should be established, at what level in the organisation, then includes the systems and processes that link roles, including the setting of tasks and the management of performance.

Organisations are typically hierarchical, with the more complex and difficult work being done at higher levels in the organisation. Basically, the middle and lower levels operate the business within the existing organisation, systems and processes, while the higher-level roles should be primarily focused on improving the organisation and its performance.

Without a well-designed performance management system, properly applied, it is common for senior executives to 'dip down' and focus excessively on the work and performance of the subordinates, rather than on the typically more difficult but vital improvement work that their role description requires. This is a widespread failing, one which means that the subordinates are frustrated by excessive supervision and oversight and the important work of the more senior roles is not completed. This is a classic recipe for organisational weakness and performance failure.

In contrast, an effective process of organisational development will increase the amount of work that is delegated to the lower levels of the organisation, giving these employees more discretion and opportunity to exercise judgement and to perform to a higher level, together with the requisite training. Typically, in an organisation that is performing at a high standard much more work is being undertaken at the lower levels of the organisation, because those employees have developed the capability and been given the opportunity. This is a virtuous-circle process because as lower-level employees develop increased capability and leadership skills they typically become more engaged with the business and, given the opportunity to contribute their ideas, often become a powerful force in improving performance. They know much more about what goes on at the bottom of the business, which is typically the key operational/service delivery/customer-facing area. This process is not only good for the organisation but also good for its employees, whose roles are enriched and capability enhanced. As more work is done at the lower levels of the organisation there is greater opportunity at higher levels to focus more intensively on organisational improvement.

The state sector would benefit very considerably from this sort of development, but without capable organisation leadership and guidance from the centre it is unlikely to happen.

Policy capability

There are now grounds for concern about the New Zealand public sector's policy capability. There seem to be numerous examples of policies that have been poorly designed and implemented in recent years, and much ineffective administration. These failings attract substantial coverage in the daily and business news media and in question time in Parliament; they are costly to immediate stakeholders; and they can cause serious frustration in the wider community.

The lack of ready access to meaningful and reliable performance indicators exacerbates the position, as does the perception of expenditure increases not matched by better outcomes (e.g. in health, education and welfare). Political and official public comment often seems more oriented to denying weakness or failure than to frankness. And many officials now seem increasingly reluctant to engage in and inform public debate on policy and other issues.

An important related issue is the absence of any real sense or evidence of a sound strategic policy framework, for either social or economic policy. There are political agendas, but nothing reflecting quality analysis, oriented to national objectives.

Two examples are illustrative. The Kyoto treaty ratification was a contentious political choice. Ratification was justified with a clear statement of what the implications would be for New Zealand, including the expectation of substantial economic benefits. The subsequent policy design and consultation process had some good features, but it quickly became clear that the political framework for the policy was rather speculative and that the policy process lacked the capability to deal with the relevant, complex economic, scientific and social issues. Not only was this disconcerting for those who collaborated with the process, but involvement in it became an increasingly risky and costly exercise. The ultimate result, after the policy had been implemented, was its collapse, as analysis errors and other problems emerged. Yet this policy has major implications for important elements of the New Zealand economy, such as agriculture, fishing, forestry, mining, manufacturing, transport, and for the exports that the country is so dependent on.

The electricity policy position is broadly similar. Since the mid-1980s energy policy development has been contentious and often ill-founded. The focus has typically been on the interests of the suppliers rather than the users, with the allocation of risk biased against users. There has been no obligation to supply, a lack of clarity about supply-side obligations and considerable opportunity for the supply side to game or otherwise exploit the market. A real problem has been that the policy makers appear to have lacked understanding of the issues and their significance, and the capability to develop sound policy. There is now less confidence amongst energy users that policy will take reasonable account of their interests and their significance for the New Zealand economy, in competition with more political objectives such as sustainability and the need to be active on climate change. The latter are important, but there needs to be a rigorous and balanced assessment of policy options, their economic, social and environmental impact, and sound policy design.

Sustainability is a key issue for New Zealand, but the greatest threat to New Zealand's sustainability is its poor and still deteriorating economic performance, with its adverse impact on living standards and the capability to manage and conserve the environment and address the country's social and international obligations.

The current state of the forestry sector reflects these sorts of policy problems. New Zealand has a large investment in exotic forests, but it is difficult to see how this will be realised, given the major investments in plant and infrastructure, and the economic energy supply needed for the value-adding processing that is essential to get an economic return on the forests. The uncertain policy environment for such investment is a serious problem.

Another feature of the current policy process is the reduced public engagement by officials in constructive and informative ways, such as outlining options and debating solutions. Nor do officials now seem obliged to give 'free and frank' advice to ministers, which has been one of the foundations of our Westminster-style democracy.

Why is public sector performance not a top priority?

There is so little focus on and concern with public sector performance because not many people understand the issues; and because there is little voter interest in the subject – except when something goes badly and publicly wrong – the political incentive to change is not strong. The added cost to business and detriment to the economy and the New Zealand community from poor public sector performance are only narrowly understood and generally not recognised as being important, particularly as the costs are typically intangible, diffuse and remote from most individuals.

For these reasons the development of in-house leadership capacity and commitment is probably the only real answer.

Conclusion: what is to be done?

New Zealand faces the challenge of being a small and relatively remote economy in a world in which most other countries are growing faster, are more competitive where it counts, and are outstripping New Zealand in terms of living standards. It is also a world of increasing risks which need to be astutely assessed and responded to, such as climate change, conflict, environmental capacity and so on.

The country cannot afford to have those difficulties compounded by poor policy design, implementation and operation and an inefficient public sector. These problems not only erode the living standards of New Zealanders but they also undermine New Zealand's credibility internationally and its capacity to engage credibly and effectively with other nations. In particular, its relative economic decline compared with Australia, which shows no sign of reversing, will have increasingly significant consequences for that relationship.

Decisive action needs to be taken, particularly by government leaders. The focus needs to be on sound policy, oriented to longer term objectives and not short-term political objectives. Business is, typically, getting on with business, in the interests of shareholders and other stakeholders, but there is some reluctance to invest in New Zealand. The policy and tax environment, the policy risk and attitude to business and the economic outlook are all significant negative influences. At the Big End of Town there has been a real hollowing out, including a downgrading by multinationals of their presence in New Zealand, which has serious consequences.

The public sector is part of the problem, for the reasons outlined above, but it should, and must, be a key part of the solution. Business has the discipline of markets, but the public sector generally does not. It does, however, have the advantage of a single, dominant and powerful owner and an integrated structure. Most of the present problems reflect an unwillingness, or inability, to use this structure effectively.

There must be decisive action because the consequences of the ongoing relative decline, particularly compared to Australia, are becoming increasingly serious. To this end I recommend an urgent review of the SSC's performance management system and processes. This should be carried out by a small expert working group, focusing on their effectiveness and potential for improvement, with preliminary results reported within three months. This group should recommend what further work needs to be done to make the necessary changes, with a view to beginning implementation within 12 months.

In addition, there should be a more comprehensive review of the public sector, focusing on its institutions, policies, systems and processes, and particularly its effectiveness and efficiency, identifying weaknesses and what needs to be changed if the sector is to realise its potential. This review should be conducted by an independently led group comprising appropriate expertise, with a majority membership from outside the sector. It should report within 12 months, with the aim of changing policies within 18 months. The key areas demanding the attention of such a group would be: the role and performance of the SSC and central agencies, particularly in relation to performance improvement and ensuring better outcomes; the quality of public service leadership and how to improve and sustain it; the whole area of employee development and succession planning; the achievement of more consistent, higher performance standards across the sector, including how to implement best practice and beneficial common solutions and a more effective orientation to 'whole of government' outcomes; improving the planning and reporting process, making it more effective and meaningful, including introducing a public reporting system based on meaningful key performance indicators; ministerial interaction with the public sector, especially with chief executives, and how to improve the effectiveness of these relationships; and how an efficient public sector should work.

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Kerry McDonald is Chairman of the Bank of New Zealand, and a full-time company director. He is a former director of the New Zealand Institute of Economic Research, and a former chief executive of Comalco (NZ) Ltd. He has been closely involved in the theory and practice of developing high performance organisations. He chaired a governmental committee which oversaw the restructuring of the Department of Conservation after the Cave Creek tragedy, was chairman of the State Sector Standards Board in the early 2000s, and has been a member of several government advisory and other groups.

A Response to Kerry McDonald from Mark Prebble, State Services Commissioner

Introduction

Kerry McDonald's article may be reduced to two basic propositions. First, all is not well in the state sector, and, although there are many shining examples of good performance, there is a need for more system-wide improvement. I agree with that. Second, there has been a lack of any progress in state sector improvement since the 1980s. I disagree with that.

For a paper being published in a serious policy journal, McDonald's article contains a disappointingly large number of unsubstantiated assertions. Many of them, I know from personal experience, are simply untrue, but there is no space to respond to them all. In spite of that, I consider that his underlying thesis is important and deserves a response.

To understand what he is saying it is useful to consider his underlying theory, and then his use of data.

The theory: good, but not sufficient

McDonald explains that a focus on 'whole of government' outcomes, supported by best practice organisational development, enforced through thorough performance management and inspired by top class leadership, is a recipe for sector success. There is no serious debate about any of these items; nor do I claim that the New Zealand public sector exhibits best practice in all these areas.

The article is less coherent, however, in translating the high-level managerial principles to the whole of the public sector. Most management theory tends to work at the level of the organisation, but McDonald's critique oscillates between comments about individual organisations and agencies and comments directed at a system level. As a result, it is not easy to translate his high-level assertions into a blueprint for system success.

But the complexity of translating managerial theory to a system level is only a technical point. The more significant difficulty is with attempting a simple translation of private sector management to the public sector context. Of course it is helpful to have a single direction and a unified approach, but its general absence in most western public sectors is not simply a question of weak-willed leadership. McDonald asserts that the public sector has 'the advantage of a single, dominant and powerful owner and an integrated structure'. But that apparent advantage would be real only if it were appropriate to expect all facets of government endeavours to be directed in a single direction.

In fact, pluralistic democracy means that all governments have a multitude of goals at any one time. Different government goals often conflict; consider for a moment the inherent tension between security and freedom. Having multiple goals is doubtless inefficient, and probably bad management, but it is not bad government. On the contrary, governments that do sustain a single motivating directing course, through periods longer than a crisis, are characterised by a lack of freedom, a stifling of innovation and social stagnation.

But even without going as far as considering the (very important) questions of democracy, any theory of good government management must be broader than the components that McDonald has listed. For example, the accessibility of government services to the people of New Zealand, and the trustworthiness of government practices and employees, are both critical to a well-ordered society. Such matters don't appear to be within his consideration, but as a long-serving public servant I believe they are at least as significant as the managerial issues he has highlighted.

Overall, therefore, I agree with his prescription as far as it goes. But without a fuller understanding of public management machinery, managerialism is not sufficient.

The data: old and selective

The evidence that McDonald most relies on is his own State Sector Standards Board report of 2002. He asserts that 'four years on there is no evidence of significant, sector-wide initiatives or improvement'. In arriving at that conclusion he has chosen to ignore the work of the Review of the Centre, to ignore the subsequent amendments to the State Sector Act and the introduction of the Crown Entities Act, to ignore the introduction of the Senior Leadership Management Development scheme, and to ignore the strengthening in performance management. These are a set of improvements all begun by Michael Wintringham. He has also chosen to ignore the now two-year-old Development Goals for the State Services. None of these initiatives are a secret. All are explained on the State Services Commission website. They may have deficiencies, but it is not true to deny that they exist. To claim, as McDonald does, that there has been 'no commitment to change' is to wilfully ignore a major programme of improvement that has been initiated by the State Services Commission and is building substantial momentum.

Though he has raised many points, I will confine my specific rebuttal to two areas: performance management and the development goals.

Every public service chief executive has a job description (agreed by and with the government), and all public service chief executives have a formal performance review, undertaken usually by me, sometimes by a deputy commissioner on behalf of the state services commissioner. This review process includes gathering feedback from ministers, peers, staff and stakeholders, and assessment of formal documents. This review is against formal expectations set out by me, as the employer. The performance review meeting specifically provides for professional development discussions and decisions. In addition, there are regular, usually monthly, meetings between a deputy commissioner and every public service chief executive; furthermore, deputy commissioners and their staff regularly interact with second- and sometimes third-tier managers and staff outside head offices and Wellington.

Where performance issues are identified, individual chief executives are required to take steps to address them. The details of how they are to respond depend, appropriately, on the circumstances and the nature of issues. All of these attributes are specifically listed in McDonald's proposed approach. What he has not mentioned, but I presume he endorses, is that the process is private.

Performance management is not normally carried out in public, therefore I do not expect him to be aware of the times I have required remedial action from a chief executive or when I have rewarded a chief executive for good performance; these are matters properly between the employee and the employer.

This brings me to my second point. In addition to continually improving the quality of the performance management *process*, I have been concerned to put the word *management* back into performance management. In May 2005 the government agreed that the State Services Commission should lead the achievement of the Development Goals for the State Services – a system-wide approach to good management. The overall goal is:

> A system of world class professional State Services serving the government of the day and meeting the needs of New Zealanders.

For New Zealanders to lead healthy and satisfying lives, they need highly professional government agencies to deliver the outcomes sought by government. For government agencies to be world class, they need the best possible systems and the best possible staff, operating with high levels of integrity.

The state services currently perform well. However, as the world continues to move forward, fresh initiatives are needed to ensure excellent performance. The Development Goals programme, overall, seeks to lift the performance of the state services, at both the organisation and system levels, in order to deliver better results for government and for New Zealanders.

The overall goal is supported by six, more specific development goals for the state services, which reflect judgements about the key things that need to change at a system-wide level if the state services are to advance towards the overall goal. A first national report against these goals was published in July 2006 (refer to www.ssc.govt.nz/sdg-report06): a quick glance through this, and the accompanying specific Rotorua study, would have shown McDonald that agencies are developing their people, and working with others to improve the quality of services and decision making.

Having said this, I am not complacent about opportunities for further improvement, and, consistent with good process, each public service chief executive has a plan to advance the goals. My reviews of their performance include their contribution to improvement of their own agency and to the system as a whole. In addition, the State Services Commission is undertaking more comprehensive research about progress of the goals, which will be published later this year.

Conclusion: the significance of the issue

I agree with Kerry McDonald that New Zealand's performance overall must improve. I also agree with his point that state sector performance is vital in that improvement. That's why I've devoted my whole career to working in this area.

There is no basis, however, for asserting, as he appears to do, that the performance of our state sector is the largest explanation of why New Zealand does not top world rankings. If that were so, it would presumably show up in comparative studies of state sector performance. On the contrary, repeated international comparisons by organisations such as the Davos World Forum, the World Bank and Transparency International rate the performance of the New Zealand government among the best in the world.

I agree that, overall, the public sector is still not good enough, but I disagree with the assertion that it is not good.

Downwards Accountability and Consent in Comprehensive Assistance Missions

Rebecca Lineham[1]

Introduction

Peace operations and comprehensive assistance missions rely heavily on retaining local consent; one critical factor in achieving this is the accountability of the mission to the government and people of the country in which it serves. Mechanisms for oversight and review, and processes for handling local input and dissent, may be one way in which an operation can enhance accountability. The difficulty lies in finding ways to ensure that accountability to local actors is just as rigorous as accountability to donors, sponsors and contributing countries.

Comprehensive assistance missions

The international community is still experimenting with various types of post-conflict peace support and stabilisation missions. Comprehensive assistance missions – which span both the traditional peace support sectors of law and order, and areas more commonly left to aid partners, such as good governance and economic development – are even more experimental. In our own region, the Regional Assistance Mission to Solomon Islands (RAMSI) is the most prominent example.

On a spectrum of peace operations – with traditional armed peacekeepers interposed between formerly warring parties at one end of the spectrum, and international transitional administrations filling the vacuum of government at the other end – comprehensive assistance missions draw from both ends. On one hand, the range of tasks undertaken by comprehensive assistance missions is almost as broad as that undertaken by an interim administration. On the other hand, like a traditional peacekeeping mission, a comprehensive assistance mission works at the invitation of and as a partner to an elected government.

Just as traditional peacekeeping must retain the consent of the local people and political leaders, so too must a comprehensive assistance mission work on the basis of an invitation which could be withdrawn at any time. And just as an interim administration must find ways, in lieu of an elected government partner, to build local ownership of the new post-conflict environment, equally must a comprehensive assistance mission concern itself with not undermining or appearing to undermine the authority of the host government at any stage, while preparing local partners to take back full management.

Developing accountable mechanisms for oversight and review of the mission that engage and are owned by local leaders and the local population is one possible way of helping a comprehensive assistance mission to build a stronger consent environment at the outset of the mission. In addition, processes established early on for locals to provide constructive input and for handling dissent and disagreement between the operation, the government and the people may go some way towards averting a destabilisation of the consent environment when dissent inevitably arises later on. In short, when the local population has a means for registering their ideas and their grievances, and feels as though they are receiving a fair hearing, they are less likely to pursue those grievances through less constructive avenues.

Consent environments

The United Nations Department of Peacekeeping guidelines (1995, p.15) state that

> [l]egitimacy is the most important asset of a peacekeeping operation. It rests on an understanding that the operation is just and is

1 The views of the author are her own and in no way are intended to reflect New Zealand government policy or the views of New Zealand's Ministry of Foreign Affairs and Trade.

representative of the will of the international community as a whole rather than some partial interest.

Without external authorisation and endorsement by the appropriate bodies an operation would be considered illegitimate and possibly illegal under international law. However, this definition fails to recognise that an operation's legitimacy comes from two sources – external authorisation and internal consent within the country of operation. Without internal consent an operation would be considered an assault on sovereignty and an intervention tantamount to an act of aggression against the state.

Internal consent – political and popular – forms a critical part of the operation's legitimacy. How to retain the agreement of the host government and the local population often dominates the minds of those who lead and govern peace operations. Without the blessing of the government and the grassroots it is impossible for the operation to exist, let alone have impact. At the most extreme, should a host government withdraw consent, an operation is essentially forced to leave. Even in cases where the government does not withdraw its consent for the operation, but actively undermines the operation, it can be made near impossible for the operation to achieve its goals. Similarly, where government consent exists but the local population does not support the operation, it can become the target of attack, forcing it to abandon certain functions, and be actively resisted by local partners, preventing the mission from achieving any sustained change.

Changes to the internal consent environment are common in all peace operations. The tide of support falls and rises as the operation moves through various phases. This is particularly the case in transitional administrations and comprehensive assistance missions. The changes experienced by the recipient country can be sudden and dramatic, and may be unwanted by the less scrupulous in society. Misunderstanding, wilful or genuine, of the operation's intent can also affect levels of consent. Criticism and dissent can be disheartening for an operation set up with the best of intentions. They can be equally threatening to the operation's existence, more so when the criticism comes from quarters of influence. Since much of the most unsettling criticism is made by self-serving dissenters to mask expedient objectives, it can be tempting for missions to bypass the actual criticisms and move directly to trying to improve the consent environment by diplomatic means. There can be definite value in working that route. At the same time, not addressing the actual criticisms can have risky consequences. Albeit that much of the criticism is made for illegitimate reasons, it is often based on some perception of legitimate cause, and there is often at least some legitimate criticism too. Leaving those grievances unaddressed leaves room for dishonest actors to manipulate the situation and create a larger public grievance. It also prevents the mission from learning and recognising the inevitable mistakes and weaknesses that any mission will have.

If an operation can find ways to address criticisms before they become major issues of public concern, it may be more likely to avoid some of the tidal shifts in the consent environment. This will also help to prevent self-serving dissenters using public forums to raise illegitimate criticisms and misleading the public. This is the point at which the operation's mechanisms for accounting to the local population come into play. The better equipped an operation is to receive, process and respond to suggestions, complaints and grievances from the local population, the more likely it is to retain its local legitimacy and consent for longer, and be effective.

Downwards accountability

Most local criticism of international assistance and peace operations has tended to focus on the perception – rightly- or wrongly-based – that the operation wields far too much power with too little control by locals. Enter the mechanisms of democratic accountability: the accounting for one's actions and decisions to the people they affect, and enabling the people to participate in decision making and governance. These mechanisms are primarily concerned with preventing excess of power.

The Brahimi report on peacekeeping (2000, p.2) noted the 'importance of holding individual officials at headquarters and in the field accountable for their performance'. The techniques for doing so are highly underdeveloped in all international operations. Even where operations have developed reporting, review and complaints mechanisms they have largely been disempowered by being kept internal. Performance review and oversight is critical to enhancing the transparency of international operations.

The practice of democratic accountability is important to international peace operations for many reasons, not least because its manifestations – transparency, checks and balances on power, local participation, and local ownership of governance – are likely to confer greater legitimacy on the operation. There is also a strand of thought, with more than a little credibility, that it is inconsistent with the intended ends of a peace operation for it not to be a bastion of democracy itself.

In a functioning democracy, democratic accountability is assured through the processes established to practice that democracy (most usually through representative politics and elections). Through the practice of participatory decision making and representative politics, legitimacy for the governing structure in the country derives from the people. How to create mechanisms of democratic accountability in a comprehensive assistance mission, however, is less straightforward. All international assistance or administrative missions have struggled to find a 'downwards' balance to their ultimately 'upwards' accountability to donors and authorising bodies. The struggle is heightened for the comprehensive assistance mission, which must constrain itself, as much as possible, to working through its government partner, and not appearing to establish a parallel system of government. It is also integral to the development objectives of a comprehensive assistance mission that it model local empowerment and ownership by being fully and firstly accountable to the local partners it is seeking to develop.

Consultation with and involvement of the local community is one of the most important means for an operation to build local ownership, and identify problems and effective solutions. The United Nations handbook *Multi-Disciplinary Peacekeeping* (United Nations Department of Peacekeeping Operations, undated, pp.10-11) notes that:

> In its peacekeeping and peace-building efforts, the operation is best advised to work through existing local authorities and community elders and its peace initiatives must be closely tailored to indigenous practices of conflict management, provided these do not contradict accepted international standards of human rights and humanitarian law.

The question, however, of who in the local community a comprehensive assistance mission is to consult, and how, does not have an obvious answer. The issue is particularly sensitive since any community consultation undertaken by the operation must be done without being seen as undermining the operation's partnership with the government, or the government's sovereignty. Compounding the problem is the fact that often the government in a fragile state does not have well-developed mechanisms by which it can itself receive public input and monitor public opinion. If an operation was to offer the community accessible methods for participation it may attract the sort of input that should be more appropriately addressed to the government.

Rather than creating a centralised – and therefore more seemingly 'parallel' – system of democratic accountability, an operation can institute a range of processes for ensuring that local critique can be received and replied to. Through local consultation, input and feedback – using mechanisms such as involvement of locals in implementation planning, internal and transparent mission investigatory processes, a mission ombudsman, and a stronger governance role by the authorising body – a comprehensive assistance mission may find many means for enhancing its accountability and thereby its legitimacy and credibility.

Involvement in operation and implementation planning

One of the sources of local criticism of comprehensive assistance missions is that those in charge of managing the operation do not understand the local environment, yet are in sole charge of deciding what should be implemented, when and how.

One way of gaining a greater degree of local ownership in a peace operation is to consult over the appointment of the operation's key managers. Rather than having the authorising body alone appoint a head of mission, some form of consultation and agreement with the host government over such high-level appointments would get better buy in and local support. This has been used before – in the United Nations Transitional Administration in Eastern Slavonia (UNTAES) the head of the mission, the special representative of the secretary-general, was appointed in consultation between the two parties (Serbia and Croatia) and the Security Council.

Another method is the creation of joint administrative structures responsible for implementing aspects of the operation's mandate. In Kosovo this was done by way of the Joint Interim Administrative Structure (JIAS), which was given policy guidance by an Interim Administrative Council made up of four United Nations Interim Administration Mission in Kosovo (UNMIK) representatives and four local people. The JIAS had the power to make recommendations to the special representative, who could either accept the recommendations or otherwise had to explain the reasons for not accepting them. In East Timor, prior to the formation of the first government, a Transitional Administrative Council, consisting of four representatives from the United Nations Transitional Administration in East Timor (UNTAET) and four local personnel, gave policy guidance to the East Timor Transitional Administration. In UNTAES in Eastern Slavonia, the head of the operation, the transitional administrator, established a Transitional Council consisting of one representative each from the government and three local population groups (Croat, Serb and minorities). It was advisory only, and the transitional administrator was not required to obtain consent for decisions, in order not to risk being held captive to vetoes. UNTAES also established 13 Joint Implementation Committees consisting of Serb and Croat representatives, covering a range of sectoral issues such as the refugee return, health and education.

The value of each of these models is the high-level engagement by locals in the direction and management of the operation. Each model is workable for a comprehensive assistance mission.

Oversight of operation personnel by internal mission processes

A second, and not insignificant, source of criticism are the actions of mission personnel. It has now been well documented in every peace operation globally that peacekeepers and their civilian comrades have been involved in illegal, immoral and insensitive activity. Peacekeepers have, unfortunately, been involved in prostitution, smuggling, slavery and even murder. This immediately detracts from the credibility of an operation. But even when an individual's actions are of less obvious malevolence the operation can be brought into serious disrepute. Relationships between expatriates and locals that are dishonest or go sour, cultural insensitivity such as heavy drinking, inappropriate clothing and unsafe driving, all are lightning rods for criticism from the local population. While most missions do their best – some better than others – to stamp out and control such behaviour, it is almost inevitable that such activity will be engaged in by a few.

When the actions of a few disrupt the good name of an operation, it is more likely that it will face challenges to the immunity of its personnel. A local community needs to see that, just as is the case for them in their own justice system, wrong behaviour is investigated, judged and punished.

While the military forces have generally well-developed processes for investigating reports of such activity, there is almost no equivalent for the civilians in a mission. With civilians now numbering many more than military personnel, particularly in a comprehensive assistance mission, this exposes a glaring gap in the accountability of an operation. Even where an operation does have some form of internal investigatory and censure process for individuals found to be bringing the operation into disrepute, this is usually closed off to locals, internal and anything but transparent.

Comprehensive assistance missions could greatly benefit from having an accessible complaints and investigatory mechanism within the operation for handling complaints about such activity. In order to be properly accountable, such a process would require formal hearings, powers of investigation, and the authority to make binding judgements, including repatriation of individuals for prosecution in their home territory and the waiving of immunity for an individual who has acted illegally during his/her free time. Decisions could then be reported to the local community. Rather than the operation appearing to be less credible because of the actions of a few 'bad eggs', it would develop an accountability chain that made it very clear to the local population that the operation would not tolerate any kind of misbehaviour by its personnel. Its legitimacy and credibility are likely to be improved.

While all operations routinely require immunity from the domestic law in the host country for personnel in order to take place, this immunity is not absolute in that it can be waived by the Head of the Mission concerned. It is also not intended to confer complete immunity from any legal system, but only from the host country. It is premised on the false assumption, that there will always be some legal system which would have jurisdiction. In regard to lifting immunity in the country of the actual peace operation, this would only be done if the host country's legal system was considered appropriate to be able to deal with the allegations concerned. In virtually all circumstances, that is unlikely. The real problem is therefore that the legal processes somewhere else, which should in theory 'stand behind' immunity from the law in the country of operation, either do not confer extra-territorial jurisdiction, or there are major practical difficulties of ever making it work (such as gathering evidence) (Ladley, 2005).

So, at least some practical and visible accountability (by waiver in some cases, and by external prosecution in others) needs to be clear to the local population if this critical element of accountability is to be believed. Ensuring that operation personnel do not have impunity from all law (i.e., that contributing countries have the ability to extend extra-territorial jurisdiction over all members of its assistance mission) is very important. At the moment, very few countries have the legal provisions to do so. If an individual is repatriated and tried in their home country for a criminal offence in the country of operation, the results of such trials and hearings need to be fed back to the local community.

Oversight by a jointly-directed ombudsman's office

In addition to internal mission processes, a more independent process for investigating complaints would also help improve accountability. In a comprehensive assistance mission – where the operation works in partnership with the host government – such a mechanism, jointly headed by an independent government appointee and an independent appointee appointed by the authorising body, could also contribute towards building local capacity and political responsibility and ownership. The mechanism could operate in a similar way to an ombudsman's office – accepting broader complaints relating to operation policy, or to individuals where the complainant was not satisfied with the outcome of the internal mission investigatory process.

The establishment of independent ombudsman's offices, mandated to address concerns with a peace operation, is becoming more common and has been recommended by the United Nations secretary-general, in a report on the protection of civilians in armed conflict. Described by one researcher, Frederick Rawski (2002, p.116):

> Partly in response to growing concerns about abuses by UN staff and the lack of transparency of UN field missions generally, Ombudsperson offices have been the main vehicle established at the mission level to resolve claims of abuse. … In theory these institutions ensure that the mission as a whole acts in a way that is consistent with its mandate, and with international human rights standards generally.

Ombudsman's offices have been established during a number of operations, including in Bosnia, Kosovo and East Timor. Each one has had differing mandates. The Bosnian ombudsman was restricted to examining the actions of local civil administration institutions only, and could not address the actions of the international operation. In Kosovo, the ombudsman's office is able to address all activities and processes (local and international) except for the NATO-led civilian policing component of the operation, KFOR. In East Timoro the ombudsman was authorised to address action by any international or local institution.

The most openly available information relates to the Kosovo ombudsman's office. The Kosovo ombudman's office was established to:

> promote and protect the rights and freedoms of individuals and legal entities and ensure that all persons in Kosovo are able to exercise effectively the human rights and fundamental freedoms safeguarded by international human rights standards, in particular the European Convention on Human Rights and its Protocols and the International Covenant on Civil and Political Rights. (Ombudsperson Institution in Kosovo, 2004)

Proving the local appetite for such mechanisms, in the year July 2003–June 2004, 4,000 people contacted the Kosovo ombudsman and 420 cases were provisionally registered. The ombudsman in Kosovo has also written a range of reports on wider issues, including the division of powers in UNMIK and the legality of total immunity for UNMIK personnel. The publicly available reports from the Kosovo ombudsman provide a real insight into the types of concerns and issues facing the local population, greatly enhancing the transparency of the operation.

Something similar – a Joint Steering Committee – was established as part of Australia's original Enhanced

Cooperation Program (ECP) in Papua New Guinea. The Joint Steering Committee of the ECP consisted of representatives from both Australia and Papua New Guinea. It provided an oversight mechanism that could respond to local petitions and complaints by allowing that '[a]ny member of the Joint Steering Committee may put in writing any complaint regarding the conduct of a Designated or Related Person and regarding implementation of Article 8 [relating to jurisdiction].'[1] That complaint then became the subject of consultation between Papua New Guinea and Australia through the Joint Steering Committee.

Whichever means is used, providing a dedicated and independent mechanism by which the local population, at any time, can register serious complaints about the activities or processes of the operation would markedly improve the democratic accountability and transparency of any mission.

Oversight by the operation's authorising body

The oversight of an operation is one of the first things decided when the international community considers how best to establish a peace mission of any kind. Ultimately, every peace operation is overseen by the body or organisation which authorises the mission – be it the United Nations or a regional body such as NATO or the Pacific Islands Forum (as in RAMSI's case).

Some bodies are better experienced than others in overseeing peace operations. The United Nations, for example, oversees multiple peace operations which must report to the Security Council periodically as determined by the operation's mandate. Reporting to the UN Security Council is supposed to allow an opportunity for review and guidance of the operation. In doing so, the Security Council has at its side the UN Department of Peacekeeping Operations, which continuously studies best practice and lessons learnt from each operation. Other bodies, particularly some regional bodies, are less experienced.

The way in which an operation is overseen is vitally important to how it operates. Strong governance will help the mission to stay on task and prevent any gradual 'mission creep'. Ultimately, the oversight body is the final arbiter of changes to and withdrawal of a mission. Currently it is usual, however, that the oversight body is only in receipt of reporting from the mission itself. While a host government may make representations to that oversight body, there is little ability or process for the authorising body to receive regular reporting from the host government and local population.

The level and quality of oversight of peace operations (even by the UN Security Council) has occasionally given rise to suggestions that the UN's now inoperative Trusteeship Council be revived. The Trusteeship Council, a modern equivalent, or a replication of its powers in a committee of a regional body required to oversee a peace operation, may assist in more thorough oversight of such operations.

The UN Trusteeship Council had three primary responsibilities: to consider reports from the administering power; to accept petitions from inhabitants; and to provide for periodic visits to the region under trusteeship. In addition, the Trusteeship Council was empowered to formulate questionnaires on the political, economic, social and educational advancement of the inhabitants of the trust territory. These questionnaires, reports, petitions and visits would form the basis of an annual report to the General Assembly regarding the trusteeship.

Adoption of the functions of the Trusteeship Council by a standing committee of an operation's overseeing body would better ensure that those who oversee operations are able to receive reporting from the operation and make changes, hear from the people of the country, including the host government, and undertake their own research. This combination of oversight functions immediately provides some balance of operation accountability to its masters with accountability to the local people and government. The avenue of local petition direct to the oversight body would clearly be one of last resort – lest the oversight body be inundated with spurious or self-serving appeals. But should legitimate and high-level differences of opinion arise, particularly between the host government and the peace operation, the oversight body would be well placed and qualified to act as an interlocutor.

1 Article 9(5), Joint Agreement on Enhanced Cooperation between Australia and Papua New Guinea, 30 June 2004 (entry into force: 13 August 2004).

Conclusion

With the addition of the sorts of tried and tested oversight and investigatory mechanisms discussed above – a fully empowered oversight committee in the authorising body, a jointly-staffed ombudsman's office, an investigatory and complaints mechanism within the operation, and joint implementation/management consultative committees – a comprehensive assistance mission would have many more processes for addressing issues of dissent. Should a consent environment start to destabilise, any and all of those mechanisms should be able to appropriately address the concerns and prevent a larger public grievance from forming and unsettling the operation's consent environment.

Comprehensive assistance missions have been shown to be valuable instruments of change in post-conflict environments; with their 'whole of government' approach, they are able to provide a coordinated approach to security and development. To remain credible and supported they must show that they are willing to accept input, feedback and critique from the local population. This paper has examined but a few of the potential mechanisms for improving the downwards accountability of a mission. Others that could be explored include performance reviews that relate an operation's mandate directly to the individual performance assessments of operation personnel, jointly developed and managed exit strategies, and flexible approaches to operation structures that can better take account of local input. Rather than shutting off the avenues of critique – leaving public media the main vehicle – an operation which is truly accountable to the people will offer simple processes for hearing the people's voices, and will demonstrate an honest willingness to respond even when it means self-censure, admitting fault and making changes. Regrettably, it has been shown that by not having such avenues, even the most supported operation faces unwarranted and disproportionate condemnation.

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Lifting Families' Incomes

Patrick Nolan[1]

Introduction

On 27 May 2004 the minister of social development announced a number of tax-benefit reforms (collectively known as Working for Families), to be phased in by 1 April 2007 (Nolan, 2005). These reforms increased the generosity and lowered the clawback of the Family Tax Credit, established the In-Work Tax Credit, indexed the Working for Families Tax Credits to inflation, removed the child components of main welfare benefits, changed the assessment, generosity and abatement of the Accommodation Supplement, and increased the Childcare and OSCAR Subsidy rates.[2]

Working for Families will account for an additional $1.6 billion of welfare spending per annum, significantly reduce child poverty, and improve financial incentives to work for many sole parents. Yet there are concerns over the complexity and administrative cost of these reforms, financial disincentives to work facing secondary earners, exclusion of recipients of main benefits from some assistance, and extension of assistance to middle-to-high income families. Further, personal income tax burdens have been increasing due to the failure to increase income tax thresholds with inflation since 1998, and labour productivity and wage rates remain much lower in New Zealand than in Australia. This paper thus argues that with the milestone of full implementation of Working for Families being reached, focus should now move beyond these reforms to a broader agenda for lifting families' incomes.

To encourage debate on this agenda, this paper provides an assessment of four policy instruments for lifting families' incomes. These are the:

- minimum wage;
- personal income tax scale (thresholds, rates and base);
- family and working tax credits; and
- main welfare benefits.[3]

The following section of this paper discusses trade-offs required in the design of income assistance policies and how increasing population heterogeneity makes reconciling these trade-offs more difficult. Four sections then summarise key issues related to the instruments for lifting families' incomes. A conclusion summarises the general strengths and weaknesses of these instruments and emphasises the need for greater integration and reduced complexity in the design of income assistance policies.

Diversity and complexity

The design of income assistance policies requires trade-offs between objectives to be made. For instance,

1 The author acknowledges helpful comments on this article given by Bob Stephens and John Prebble, both of Victoria University of Wellington, Susan St John of the University of Auckland, Jean-Pierre De Raad of the New Zealand Institute of Economic Research, and Jan Tame of the Inland Revenue Department. The views expressed, and any errors, in this article are solely the responsibility of the author.

2 This paper uses the recently introduced names for the Working for Families Tax Credits (formerly Family Assistance). The four programmes are the Family Tax Credit (formerly Family Support), Minimum Family Tax Credit (formerly Family Tax Credit), In-Work Tax Credit (formerly In-Work Payment) and Child Tax Credit (replaced by the In-Work Tax Credit but also grandfathered to ensure no 'losers'). A fifth credit, the Parental Tax Credit, is not discussed. A similar re-branding of these programmes occurred prior to the 1999 election and drew the following comment from the Hon Dr Michael Cullen: 'The other issue that I really am totally baffled by is this issue of the change of names. ... As soon as one changes the name of anything of this sort in legislation, it means that the forms have to be changed. That will create additional expenditure for no purpose at all. I have, I suppose, just a sneaking suspicion that perhaps part of the reason for this is that it gives the Government an excuse for a larger advertising campaign on this legislation between now and the election' (Hansard, 20 May 1999).

3 Given space constraints this paper omits discussion on accommodation and childcare assistance and child support. Discussion of these programmes can be found in Stephens (2003) and Cronin and Chapple (2007).

competitive labour markets do not generally adjust wages (paid to individuals) according to the number of children in a worker's family. Yet in order to ensure families have adequate incomes, policies target assistance according to family size. Consequently, when wages are low and family sizes large the income from work could fail to provide an adequate family income and be less than the income from transfers when not working. As a consequence of this dilemma, the design of income assistance needs to balance the goals of encouraging the supply of labour and ensuring adequate incomes, and this balance has to be found within a constraint of limited government funds (Mendelson, 2005; Nolan, 2006).

Reconciling trade-offs between objectives has become increasingly difficult due to changes in patterns of family structures, labour market outcomes and policy settings. In the decades since 1984 New Zealand has experienced significant changes in family structures, including the breakdown of the breadwinner model of social arrangements, increasing numbers of sole-parent families and increasing numbers of dual-income families. Important changes in the labour market have also taken place, with labour market liberalisation being associated with increasing part-time and casual work, variations in weekly hours of work and variations in wage rates. There has been a decline in employment among prime working-aged men, particularly low-skilled workers, and an increase in women's employment rates and representation in managerial and professional occupations (Callister, 2004).

Further, while the social assistance and income tax systems were largely devised as separate systems, large proportions of the population are now affected by both systems simultaneously (Stephens, 1997). This greater interaction reflects changes in family structures, labour market outcomes, and the designs of tax-benefit programmes, such as the taxation of main welfare benefits and the provision of supplementary assistance to non-beneficiaries. Over the last 20 years the income tax system has taken an increasingly prominent role in the provision of social assistance payments. This role has expanded further with Working for Families (Nolan, 2005).

These changes, particularly increased heterogeneity of family structures and incidence of part-time and part-year work, increased the complexity of designing income assistance programmes. Greater variations in hours of work, for instance, have made it increasingly difficult to design hours-based thresholds to encourage people to move from part-time to full-time employment. Further, by the early 1980s increased numbers of social assistance recipients made responding to changes in the level and incidence of poverty through increasing levels of main welfare benefits more fiscally costly. Consequently, additional demands were placed upon supplementary assistance and private charity to address areas of emerging needs (Stephens, 1999). These additional demands upon supplementary assistance themselves led to increased complexity, due to the administration and compliance issues associated with these programmes.

The Working for Families reforms are the flagship of the Labour-led government's response to these issues. While there is much to commend in these reforms, it has been argued that they failed to recognise a number of implications of increasing diversity for the income assistance system (Nolan, 2005). This article thus aims to encourage debate on a broader agenda for lifting families' incomes through providing an assessment of four policy instruments for doing so.

Minimum wage

On 1 April 2007 the largest increase in the minimum wage over the last two decades took effect, with the rate for people 18 years and over increasing from $10.25 to $11.25 per hour and for people aged 16 and 17 from $8.20 to $9.00 an hour. The government's goal is to increase the adult minimum wage to $12.00 an hour by the end of 2008 if economic conditions permit. Concepts of fairness of reward and socially acceptable incomes are key reasons for having a minimum wage. However, raising the minimum wage may do little for affected workers for two reasons. First, increasing the minimum wage will increase the cost to employers of hiring low-wage workers relative to other inputs and could reduce demand for low-wage labour (Brown, 1999). Secondly, the increase in the minimum wage may translate in little extra take home pay as wage increases reduce the income assistance that people on low and middle incomes may be entitled to (NZIER, 2007).

An increase in the minimum wage will raise a worker's gross wage income (assuming they are not laid off or change their hours), but the change in their take home pay (net income) is less clear, being subject to a complex set of tax-benefit programmes. The New Zealand Institute of Economic Research (NZIER, 2007) estimated the gains from minimum wage increases for three family types for a range of hours of work. These estimates included income taxes, the ACC levy, clawback of main welfare benefits, and clawback of the Working for Families Tax Credits and the Accommodation Supplement. They showed that:

- The largest group of minimum wage workers was single people without children. The increase in the minimum wage to $11.25 increased the gross income of a single person working for 10 hours by $10.00 per week. Of this, however, they kept only $1.26 more in the hand, with $8.74 being clawed back by the government. For a further minimum wage increase to $12.00 (a gross increase of a further $7.50) this person kept only 95 cents more in the hand.
- A sole parent at 20 hours of work received no extra income in the hand from the increases in the minimum wage due to the dollar-for-dollar clawback of the Minimum Family Tax Credit (interaction with the ACC levy meant that the wage increase slightly reduced net income).[4]
- Calculations for partnered parents also showed that clawback can leave little income from the minimum wage increase in the hand. More generally, part-time workers (accounting for significant proportions of low-wage and sole parent workers) were particularly likely to lose the bulk of any increase in the minimum wage through clawback.

The NZIER concluded that many of the people that minimum wage increases aim to assist are the same people losing most, if not all, of their wage increases through clawback. Interaction between wage rates and tax-benefit programmes means that even significant increases in minimum wage rates (or more general increases in wage rates for low-wage workers) may do little for these workers' net incomes, incentives for paid work and standards of living. It is thus necessary to recognise that individual policies that aim to lift gross wages will be affected by their interaction with the personal income tax scale and the clawback of income assistance.

Personal income tax

Clawback of minimum wage increases is one example of the interaction between wage rates and tax-benefit programmes. A more general example of this interaction is reflected in how the distributions of wage rates and hours of work (making up gross incomes) determine the coverage of personal income tax rates and levels of tax burdens. This can be illustrated by comparing differences in gross incomes and tax burdens in New Zealand and Australia.

The OECD's recent *Taxing Wages* report concluded that a family at average gross manufacturing earnings with two children under 12 would face a lower tax wedge (including income taxes, superannuation contributions, social security levies and family tax credits) in New Zealand than in Australia. Yet this result is driven by differences in the distributions of gross incomes, rather than by relatively low income tax rates or generous tax credits (as claimed by some commentators), with New Zealand having relatively low labour productivity and wage rates. A partnered household with one worker at average manufacturing wage and two children under 12 would have an average gross weekly income of NZ$805.00 in New Zealand but in Australia this would be AU$1,054.40. Adjusting the tax wedge for these differences in gross incomes illustrates that workers in New Zealand face higher tax wedges, as at most income levels the same income (adjusting for differences in the costs of goods and services) is taxed more highly and the levels of tax credits provided are lower.[5]

Changes to the distributions of wage rates and hours of work thus influence the coverage of personal income tax rates and levels of tax burdens. Wage increases, for example, mean that over time people slip into higher income tax brackets unless income tax thresholds also increase (fiscal drag). Yet in New Zealand since 1 April 1998 the lower and middle personal income tax rates and thresholds have remained unchanged, and a new

4 The Minimum Family Tax Credit underwent an inflation adjustment of around two per cent from 1 April 2007. While recipients' total net incomes may increase due to this adjustment, they would receive no additional income in the hand from the minimum wage increase.

5 While some commentators claim that in New Zealand income taxes are lower on low incomes and higher on high incomes than in Australia, even a cursory comparison of tax scales and other transfer programmes illustrates that this is incorrect. Average income tax rates are only lower in New Zealand than in Australia at very high incomes (around NZ$180,000) (ANZ, 2006).

top rate and threshold were introduced on 1 April 2000. To illustrate the extent of this fiscal drag, increasing income tax thresholds to account for inflation between 1 April 2000 and the final quarter of 2006 would require thresholds of:

- 15% up to $11,330 (currently $9,500);
- 21% up to $45,315 (currently $38,000);
- 33% up to $71,550 (currently $60,000); and
- 39% on income above $71,550.

Based on these thresholds and using the Treasury's 'ready reckoner' for estimating the revenue effects of changes to tax thresholds, rates and bases (Treasury, 2006), the effect of fiscal drag can be estimated as being in the order of an additional $1 billion in income tax revenue per annum. (This figure is only a broad estimate of magnitude as it does not include estimates of the behavioural or macroeconomic effects of fiscal drag.) This ongoing increase in taxation due to failure to increase tax thresholds with inflation has a real impact on family incomes, leads to increasing incentives for income tax avoidance and evasion, and has amplified the growth in trans-Tasman income differentials (reducing the income tax base which, *ceteris paribus*, means forgone tax revenue).[6]

Increasing tax thresholds to account for inflation from 1 April 2000 would provide individual workers at a wage rate of $11.25 with the same dollar benefit ($2.11 per week) whether they work 10, 20 or 40 hours per week. In contrast, if tax relief was provided through lowering income tax rates by two per cent (leaving thresholds at their 1 April 2000 levels) at a wage rate of $11.25, workers would receive $2.25 at 10 hours of work and $9.00 at 40 hours of work. In general, a reduction in tax rates provides a benefit that increases with incomes and hours of work, whereas an increase in tax thresholds provides an equal (capped) benefit to all people with incomes above the new threshold, irrespective of their total incomes or hours of work. For these reasons, *ceteris paribus*, a tax rate reduction is likely to have a higher fiscal cost than an increase in tax thresholds. The two per cent income tax rate reduction would, for example, account for a fiscal cost in the order of $1.6 billion per annum compared to $1 billion to increase income tax thresholds to offset fiscal drag since 1 April 2000.

Under the personal income tax schedule (based on individual incomes), the tax changes above would also provide single people and single-income couples (with and without children) on the same incomes with the same dollar benefit. Some commentators have proposed providing tax relief through allowing couples to split their incomes for tax purposes. However, moves towards a broad-based and low-rate tax system over the last 20 years have reduced the dispersion between primary and secondary earners' marginal tax rates and consequently the potential for income splitting to provide tax relief. Income splitting poorly targets assistance to low-income households, with almost 80% of the expenditure on income splitting going to the top 20% of earners (Nolan and Fairbrother, 2005). Income splitting would discourage secondary earners from working and would increase administrative complexity.[7] Among OECD countries there has been a clear movement away from income splitting, partly motivated by desires to fund reductions in income tax rates through increasing tax bases.

Family and working tax credits

Family and working tax credits are able to provide tax relief on a more targeted (less fiscally costly) basis than changes to personal income tax scales, and as they are generally provided through personal income tax systems they are seen to more strongly reinforce work effort than main welfare benefits (Alstott, 1995; Nolan, 2005). The use of working tax credits is often part of a reform strategy emphasising active labour market policies (Adler, 2004). In New Zealand family and working tax credits provide assistance only to families with children (Nolan, 2006).

The Working for Families reforms represent a significant increase in the generosity of family and working tax credits in New Zealand and will bring about a significant reduction in the headcount rate of child poverty (Perry, 2004). Financial incentives for sole parents to work will be improved, but secondary

6 Although Working for Families also creates work disincentives for secondary earners, these are larger with income splitting. Further, although income splitting would provide low-wage primary earners with a small improvement in their work incentives, this would not be as large as the incentives created by Working for Families.

7 Johnson (2005) considered Working for Families prior to the extension of the reforms following the 2005 general election. However, this extension reinforces the conclusions he reached, as the majority of higher income families receiving the extension are likely to be partnered.

earners will face increased financial disincentives for labour supply, which is significant given the increasing proportion of expenditure going to partnered families (increasing from approximately one third to one half of the recipients of the Working for Families Tax Credits) (Johnson, 2005).[8] There will be an increase in the compliance and administration costs of the tax-benefit system, particularly due to the extension of an hours-based eligibility criterion, and the greater receipt of assistance by working families may increase demand for combining the administration of assistance of tax-based and welfare-based programmes. Concerns over the accuracy of payments to eligible recipients and ineligible recipients fraudulently receiving payments will become more prominent (Nolan, 2005).

As noted above, under the Working for Families reforms an hours-based eligibility criterion now applies for both the Minimum Family Tax Credit and the In-Work Tax Credit. Yet basing assistance on a prescribed number of hours of work is inconsistent with the market-based setting of employment conditions, as a feature of many employment contracts is that an employee's hours of work may fluctuate with seasonal or economic conditions. Having thresholds based on work hours (in addition to abatement based on income) would increase the complexity of administration and may lead to greater uncertainty regarding the level of assistance available when making the transition from benefit to work and when hours of work and earned incomes fluctuate. Removing the hours-based eligibility threshold for the In-Work Tax Credit would improve financial incentives for some primary earners to supply labour and would not lead to any fall in recipients' assistance from Working for Families (Nolan, 2005).

The tight targeting of the Minimum Family Tax Credit means that under-payments or over-payments are relatively likely for this programme. Since this programme's establishment in 1986, liberalisation of the labour market has been reflected in greater part-time and part-year work, and family structures have become less stable and more heterogeneous. Recipients of the Minimum Family Tax Credit are therefore increasingly likely to change circumstances during the income tax year, and although the Inland Revenue Department can automatically adjust entitlements during the year for many taxpayers, the tight targeting of the Minimum Family Tax Credit reduces the effectiveness with which this assistance may respond to these fluctuations. With the extension of this programme under Working for Families, these difficulties will become more common. Removing the Minimum Family Tax Credit would provide sole parents who take up this programme with relief from the poverty traps that it creates, although this could lead to some sole parents delaying their exit from the Domestic Purposes Benefit and could lower the level of assistance they receive from Working for Families (Nolan, 2005).

The levels of assistance provided by the Family Tax Credit currently increase with the ages of children in the family. These age-related scales are based on the assumption that children become more expensive as they age. However, the strength of this assumption has been questioned, particularly by research in the United Kingdom which found that age-related scales in tax-benefit programmes in that country overestimated the extra costs of older children. There is a paucity of research on families' spending on children by age of child in New Zealand against which to judge the age-related scales in the Working for Families Tax Credits. Yet providing greater assistance to families with younger children would recognise the greater difficulties that these families face in allowing both caregivers to work in the labour market (female participation increases strongly with age of children (Johnston, 2005)). Subsidising the withdrawal from the labour market of a caregiver with young children would also accord with child development objectives.

Main welfare benefits

Working-aged benefits differ in the degree to which they emphasise short-term fluctuations in need, such as temporary loss of employment and support for childrearing, or longer-term incapacity to work due to invalidity or sickness. The total numbers of people in receipt of a main welfare benefit have fallen since 1999. Yet there have been concerns at the rates at which, in response to increases in work requirements associated with the Unemployment Benefit and Domestic Purposes Benefit, recipients have switched to the Invalids Benefit and Sickness Benefit in order to remain eligible for assistance. To address this switching, measures to provide intensive employment support to people able to work have been extended to the Invalids Benefit and Sickness Benefit recipients.

As well as the active labour market policy of intensive employment support, the government has revisited a proposal developed by the fourth Labour government in 1989 for a single core benefit, where recipients receive a core benefit with supplementary assistance provided on the basis of need rather than benefit category. These reforms could significantly simplify and reduce the administrative and compliance costs of the main benefit system. Such simplification, however, presents many challenges, including possible creation of short-term fiscal losses for some families, and requires significant political support. For many families short-term losses from simplification would likely be offset through increased rewards from work effort and changes to other components of the income assistance system.

The core benefit reforms, along with the shifting of the child component of main benefits into the Working for Families Tax Credits, represent a significant shift in the balance of the income assistance system towards supplementary assistance, with the Working for Families Tax Credits now accounting for a fiscal cost greater than either the Unemployment or Domestic Purposes Benefits. The balance of the tax-benefit system has not been shifted to this degree since the 1991 reductions in main benefits, yet the indexation of the Working for Families Tax Credits will mean that, unlike after the 1991 reforms, the annual increase in main benefits for inflation will not erode the relativities between main and (previously non-indexed) family and working tax credits.

The New Zealand Child Poverty Action Group has argued that the Working for Families Tax Credits should not be targeted on the basis of work effort and that the child component of main welfare benefits should be restored (St John and Craig, 2004; St John, 2006). These arguments reflect a concern with immediately reducing child poverty. However, the relatively low degree of targeting of the Family Tax Credit would mean that increasing the generosity of this programme to offset any losses to low-wage families from the removal of the Minimum Family Tax Credit and In-Work Tax Credit would lead to a significant increase in fiscal costs of the Working for Families Tax Credits. By increasing levels of main benefits, this approach would also fail to reduce the poverty traps facing low-wage families created by benefit abatement.

The abatement of main benefits is a major contributor to poverty traps, where, due to taxation and the clawback of assistance, families have little or no financial incentive to increase their incomes or hours of work. Currently Domestic Purposes beneficiaries receive relatively good returns from part-time work. Returns for part-time work for beneficiaries without children are less strong, as they face higher rates of benefit abatement than Domestic Purposes Benefit recipients on earned income between \$80 and \$180 per week. For all beneficiaries financial incentives for full-time work are less strong, however, as once full abatement of the main benefit is faced there are relatively few financial rewards from increasing hours of work until it is possible to exit the benefit. Disincentives for full-time work are strongest for Domestic Purposes beneficiaries, as due to the lower rates of abatement at lower income levels and the higher levels of unabated assistance the benefit exit point is reached later for beneficiaries with children. The Minimum Family Tax Credit aims to improve financial incentives for full-time work for families with children, but creates poverty traps of its own.

This discussion illustrates a key trade-off when aiming to improve financial incentives to work through lowering benefit abatement at lower income levels: lowering this abatement comes at an economic cost of increasing abatement further up the income distribution (unless levels of assistance are also reduced, which may sacrifice income adequacy objectives). The degree to which these economic costs further up the income distribution outweigh the benefits from reduced abatement depends on numbers of people affected, estimated behavioural responses to financial incentives from income assistance programmes, and value judgements regarding the income distribution.

Conclusion

This article contains a general assessment of four ways of lifting families' incomes. The general advantages and disadvantages of these approaches are summarised in Table 1. Although discussed separately in this paper, the four approaches should be seen as components of a single income assistance system. As the case of the minimum wage illustrated, for example, it is important to recognise that individual policies that aim to lift gross wages will be affected by their interaction with taxation and the clawback of income assistance. Government policy often fails to take an adequately integrated view of these policies.

Table 1: General advantages/disadvantages of income assistance programmes

Minimum Wage	Personal Income Tax Schedule
• Supports concepts of fairness of reward and socially acceptable incomes • Reduces demand for low-wage labour • Low (static) fiscal cost to government, but increases costs faced by businesses • Effectiveness at lifting incomes reduced by poverty traps	• Simple • Broadly received • Fiscally costly (rate changes more costly than threshold changes, *ceteris paribus*) and low poverty reduction effectiveness • Reduction (although often small) in poverty traps
Family and Employment Tax Credits	**Main Welfare Benefits**
• Complex design • Able to target assistance on basic criteria (e.g. joint taxable income, numbers and ages of children) • Cost-effective way of providing moderate levels of assistance to many households • Seen to reward work effort, although they create poverty traps	• Complex design • Able to narrowly target assistance • Cost-effective way of providing a lot of assistance to relatively few households • Able to respond to fluctuations in need or family circumstances • Create poverty traps

Government policy must also recognise limits to the role of the income assistance system and the need to remove unnecessary complexity. The current system is complex because it aims to tailor assistance to a wide variety of needs, yet complexity leads to significant administration and compliance costs and a system designed to be responsive being far from it. If the rationale for new programmes is to offset the impact existing programmes are already having on families (e.g. due to fiscal drag or poverty traps), then reform of existing programmes is required, not new programmes. Without this discipline there is a risk that the legacy of recent and proposed reforms will be an unsustainably complex and costly income assistance system.

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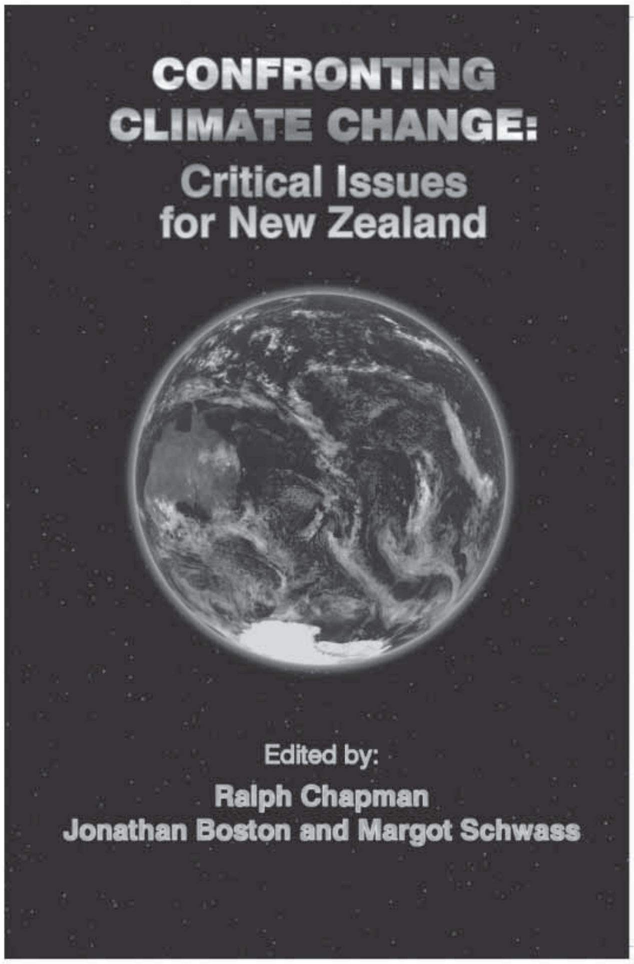

Climate change is real; it is happening even faster than previously thought and it is powerfully influenced by human activities. As events like Hurricane Katrina, the shrinking of ice-caps and the calamitous 2003 European heatwave remind us, climate change is not a future threat; it already profoundly affects the world we live in.

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Policy Instruments for a Sustainable Future

Peter Read[1]

Introduction

> One thing that really does worry a lot of us is the idea of a single aggregate tipping point for the earth as a whole – a shift to a state that may be much less amenable for human life. (Steffan, 2006)

> The chances of unexpected climate effects should not be underestimated, as clearly shown by the sudden and unpredicted development of the Antarctic ozone hole. (Crutzen, 2006)

> There is a mismatch between those [in the South] who may be vulnerable to climate change and those [in the North] who can afford to do anything about it. … [but] Insurance against catastrophes is thus an argument for [the North] doing something expensive about greenhouse gas emissions. (Schelling, 1992)

When the ozone hole appeared, a technological remedy was to hand – the substitution of chloroflurocarbons (CFCs) by hydrochloroflurocarbons (HCFCs) – which was implemented quickly by effective international agreement and regulatory enforcement imposed upon a willing industry. Nevertheless, ultra-violet (UV) radiation damage has persisted for many decades as a consequence of this 'surprise', which was due to a previously unknown effect of high altitude ice crystals in concentrating CFC's and accelerating their known capacity to destroy ozone.

At present we are hearing reports of surprise lakes of water detected underneath Antarctic ice sheets; in Al Gore's documentary *An Inconvenient Truth* we see surprise rivers of water disappearing down 'moulins' in the Greenland glaciers, and we hear of surprisingly high measured losses of ice from that vast island. Do these little surprises add up to precursor signals of a much more rapid collapse of Greenland's ice cover, and maybe the West Antarctic Ice Sheet too, than has previously been imagined possible?

We do not know the answer to that, but it is common sense rather than alarmism to consider what precautionary measures may be taken to make us better prepared to avoid such a situation should these fears, or fears regarding the imminence of other possible runaway climate processes, prove to be well founded. Sea level rises of 40 feet are a climatic catastrophe that must be avoided. That prospect points to the need to adopt an outcome-based approach – identifying what it is that policy must seek to prevent – to the notion of dangerous climate change, rather than relying on expert opinion as to a 'safe' level of greenhouse gases or 'safe' rate of change of average surface temperature (King, 2006). There can be no 'expert opinion' as to the behaviour of a non-linear dynamic system, such as earth's climate, removed to a state far different from any experience.[2]

This paper focuses on policy instruments designed to drive the preferential adoption of two technology types – involving carbon-conservative processing of the products of the land commercially as food, fibre and fuel (biofuel) – whilst, through tradability, generating the cash flow needed to finance the necessary capital investments. These are technologies for getting carbon dioxide (CO_2) out of the atmosphere, and technologies for stocking it (or carbonaceous material derived from atmospheric CO_2) somewhere other than in the atmosphere.

1 The author is grateful to Jonathan Boston, Mick Common and Paul Ormerod for their helpful comments. All responsibility for the views expressed rests with the author.

2 Of course, there have been levels of CO_2 of 500 ppm (parts per million) or more in the very distant past, but not imposed suddenly on a climate system adapted, over the last half million years, to between 180 and 300 ppm. We have extremely poor understanding of the dynamics of the climate system in such conditions, with some potentially crucial feedback mechanisms a matter for speculation rather than analysis.

Carbon neutrality for New Zealand

Article 3.3 of the Rio Climate Change Convention of 1992, where there are threats of serious or irreversible damage, calls on the parties to the convention to take cost-effective precautionary measures without delay on account of a lack of full scientific certainty. Unlike article 4.2(d) – from which hangs the process that began with the 1995 Berlin Mandate and ended with the 2001 Marrakesh Accords to the Kyoto Protocol – article 3.3 is a principle to which the parties are committed individually, and does not require the conference of parties to agree on what action to take collectively.

It has been shown that cost-effective precautionary action is, prima facie, possible through the world-wide adoption of two technology types (Read and Parshotam, 2007).[3] Neither of these types involves low emissions energy, and both are, through bio-energy systems yielding close substitutes for fossil fuels, fully compatible with the highly durable technologies of thermal power generation and locomotive internal combustion engines (whether reciprocating or gas turbine) (Smil, 2006). Thus, they do not shorten the useful life of most existing energy sector assets. But they do involve a change in investment behaviour, from investing in extracting fossil fuels to investing in land use improvements designed to co-produce biomass for bio-energy raw material, along with traditional products of the land.

For practical purposes,[4] the photosynthetic fixing of carbon in biomass is the basis for the only technology type that gets CO_2 out of the atmosphere. Thus, biosphere carbon stock management means improving and expanding the ways we use land so as to grow more plants and trees – potentially a big bonus for agriculture and forestry. Once fixed, the stocking of carbon elsewhere than in the atmosphere can be:

- pre-combustion: standing forest;
- post-combustion: CO2 capture and sequestration (CCS);
- partial combustion: pyrolysis to yield bio-oils plus stable carbon biochar that can be permanently stocked in the soil, raising fertility;
- nothing to do with combustion: wooden houses and other structures.

To clarify subsequent discussion, it is useful to note at this point that *tradable proportional obligations*, with the proportionality increasing over time, will emerge in this argument as the preferred policy instrument: for example, a tradable requirement on transport fuel sellers to include a rising proportion of sustainably produced biofuel in their product sales, and a tradable requirement on sellers of fuel for other uses, and on agricultural and other emitters of methane (CH_4) and nitrous oxide (N_2O), to offset a rising proportion of their emissions through carbon storage. 'Tradable' means that the obligation could be discharged by contracting it to a third party – Shell, for example, could contract its obligation to BP, Solid Energy to Meridian, or both to Weyerhaeuser Inc – thus securing the market efficiency that comes through the 'equi-marginal' principle (Kolstad, 2000).

It is obvious that a 100% obligation to use zero emissions technologies is, as regards its carbon cycle impacts, equivalent to a zero emissions cap. Assuming we have accurate forecasts of demand, there are, similarly, equivalent levels of proportional obligation for any less ambitious cap on emissions. However, the psychology is quite different. The emissions cap creates an accountants' paradise, setting one firm against another, and one country against another, in a punitive zero sum game, where the greater the burden on others, the less that is required of oneself. In contrast, a measure that imposes a required rate of take-up of policy-desirable technology types now, and which projects increasing take-up in the future, releases entrepreneurial energy to get ahead in the race for market share and competitive advantage with the new technologies.

In the competition between business-as-usual technologies and policy-desirable types of technology, the policy objective must be to squeeze out investments in the most undesirable technologies (such as, for

3 This paper proved controversial with reviewers for *Climatic Change*, and carries the comments of the latest reviewers, along with my rejoinders. The upshot of this was that I was invited to submit an editorial essay setting out the ideas involved in our Holistic Greenhouse Gas Management Strategy in a less rigorous framework than a formal article. This will be published in due course, along with invited commentaries from a variety of experts, on the lines of Paul Crutzen's editorial essay of August last year.

4 Keith and Ha-Duong (2003) have proposed washing CO_2 out of the atmosphere with amine solution in large structures looking like power station cooling towers. Per contra photosynthesis, this can be done in the middle of a desert and might be an important technology if there were a shortage of fertile land.

instance, the conversion of coal to gasoline).[5] This can be done by setting clear but flexible obligations for increasing adoption of the policy-desired technology types. Clarity comes from a commitment to use long-run flexibility to maintain the squeeze on undesirable technologies: the obligation is progressively raised so as to take up market expansion in excess of a dwindling policy-acceptable quantum of fossil fuel use.

As a small trading nation, New Zealand can, if appropriate, source its biofuel from overseas, as it does oil now. So, given the turnover of the vehicle fleet and the availability now of flexi-fuel vehicles, the biofuel proportion of New Zealand's fuel consumption could rise to nearly 100% by 2020. On cost grounds, offsets by other emitters could take the form of CCS (CO_2 capture and sequestration), if practicable – say, in the depleted Maui field – related to very low cost supplies of coal. But mostly, for a decade or so until land becomes scarce, offsetting would be by new forest plantations, maybe overseas. With a clear policy steer, it seems that 100% offset could also be achieved before 2030. Together, these would make New Zealand 'carbon neutral' and easily meet any conceivable post-2012 Kyoto commitment. Meeting the 2008–2012 commitment may also be feasible through such offsets, but would be difficult owing to a late start with appropriate policy.

Innovative investment

> ... the development and widespread adoption of new technologies can greatly ameliorate what, in the short run, sometimes appear to be overwhelming conflicts between economic well-being and environmental quality. (Kneese and Schultz, 1975)

The implication of Kneese and Schultz's remark above is that the behaviour that matters for policy success is investment behaviour that can embody the innovations that amount to policy-desirable technological change: for instance, CFC's are replaced by HCFC's, and acid rain is handled by flue gas desulphurisation, both by investing in new technology.

There are two interpretations of 'innovation'. It can mean the development and adoption of newly researched technologies by a pioneer firm, or it can mean the adoption of already developed, or partially developed, technologies by a follower firm that has previously relied on traditional technology. The first – what some would regard as true innovation – could be the design and development of a tidal flow generator and its installation and use in Cook Strait. Such innovation often leads to commercial failure, with follower firms learning from the pioneer's mistakes.

The second – what can be called imitative – innovation is innovative for the following firm even though it is not for the economy as a whole. Mostly the second, imitative innovation is what is meant in this paper, with investments in the widespread diffusion of policy-desirable technologies that are already quite well known and are low risk to the economy as a whole (and that likely result also in incremental technological progress, through learning by doing). Thus, the crucial questions for an effective response to the Kyoto commitment are about whether such imitative innovation becomes widespread, yielding a qualitative change in the stock of capital goods. Will households buy high efficiency light-bulbs? Will they insulate their ceilings and windows? Will they buy hybrid cars? Will there be a bus to catch? Will small- and medium-sized enterprises drive their machinery with efficient electric motors? Will they use diesel-powered delivery vans?

In relation to the threat of rapid or abrupt climate change, the questions are more specific, since the policy-priority technology types are more limited. Will the big oil firms invest in ethanol production, and in a gasohol distribution network with a high proportion of ethanol in the fuel? Will vehicle importers import flexi-fuel vehicles that can run on gasohol as easily as on gasoline? Will fuel suppliers cease drilling and excavating, and start tilling and cultivating for their raw materials?

Risk reduction for the firms involved can come from measures that give certainty about the type of investment that is needed and assurance that adopting policy-priority technology will not result in competitive disadvantage. That is what is achieved by the adoption of proportional tradable obligations. The required technology type is specified, and all competing firms

5 Even if the processing plant incorporates CCS (CO_2 capture and sequestration), any liquid fuel produced will lead to dispersed emissions of fossil fuel-derived CO_2 and continue the policy-adverse shifting of carbon stocks from deep underground into the atmosphere. This does not apply if it is a coal-to-hydrogen process, but a hydrogen-fuelled transportation system is decades off – too distant if the concern is threatened ACC (anthropogenic climate change).

have to comply, so that the pioneering risk of being first is removed.

Problems with a carbon price

Were it not for the burden of accumulated doctrine in environmental economics, that is all that would need to be said and this article would end here. But there is obviously some contradiction if it is possible to say, as Stern does:

> The first essential element of climate change policy is carbon pricing… . Putting
>
> an appropriate price on carbon ... means that people pay the full social cost of their action ...
>
> … But the presence of a wide range of other market failures and barriers mean that carbon pricing alone is not sufficient. Technology policy … is vital to bring forward the range of low-carbon and high efficiency technologies that will be needed to make deep emissions cuts. (Stern, 2006, p.308, introducing Part IV on policy responses for mitigation)

Of course, it is possible to treat Stern's first priority as mere rhetoric. Nobody knows what the full social cost of carbon is. But rhetoric usually serves a purpose and here it reflects the economists' gut instinct that, if we can get prices right, the market will, with help from Adam Smith's invisible hand, reach an equilibrium that is the best of all possible worlds (providing the question of income distribution has been settled equitably by a non-market process). Or, if it be an invisible foot, will at least do better than any alternative.

Addressing that instinct, it might first be remarked, to the wider public that is unfamiliar with the esoterica of modern economic theory, that the market paradigm, which hangs from the analysis of competitive general equilibrium (CGE) formalised by Arrow and Debreu (1954), is in tatters at a very fundamental level. CGE relies on complete futures and complete contingency markets (i.e. on known probability distributions of all possible outcomes at all future points in time, and on the existence of insurance markets where the cost of wrong commercial decisions can be offset against the profit from correct choices).

The work of Stiglitz (1994), summarised in the curiously titled 'Whither Socialism?', has revealed the informational infeasibility of this paradigm; the work of Simon (1997) on 'bounded rationality' reveals the impossibility of market agents making use of such information were it available; and empirical studies of consumer choice by Kahneman et al. (1991) reveal phenomena of loss aversion and status quo bias that are incompatible with the neo-classical axioms of consumer choice. So we have an invisible foot, and the question is, does it score goals? Can a price on carbon do better than the alternative advanced here?

Obviously a carbon price will do something, and we must first note what kind of thing the invisible foot can do well, and where it trips up. For this we can do no better than these words written before modern mathematical economics set off on its eventually fruitless long march in pursuit of Adam Smith's conjecture:

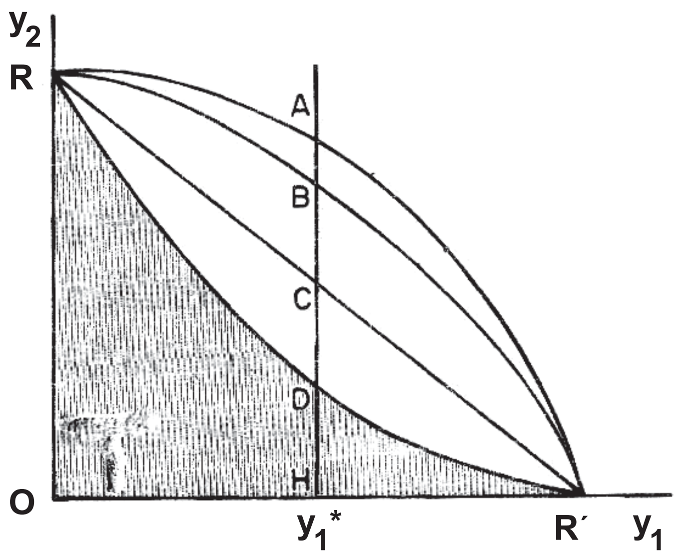
> Market prices, however, reflect the economic situation as it is and not as it will be. For this reason they are more useful for coordinating current decisions, which are immediately effective and guided by short term considerations, than they are for coordinating investment decisions. (Scitovsky, 1954)

So, in situations involving immediate outcomes, prices can do a good job: for instance, the recently-introduced congestion charge is highly effective in causing Londoners to catch a bus rather than drive into the city.[6] The complications of modern economic theory mean that the effect of a carbon tax on current decisions is hard to predict, but if it is not sufficient the tax can be increased to get the desired effect – as is the case in London where the congestion charge has gone up from its initial £5 to £8. With a price on carbon, maybe people will switch the lights off, tread lightly on the throttle, catch a bus and so on. Such good resolutions tend to wear off with time, unless reinforced by progressive price increases or continuing moral suasion through public education campaigns such as those EECA (the Energy Efficiency and Conservation Authority) mounts so well.

Precautionary action and carbon prices

However, in relation to climate change it is not these decisions that greatly matter, but the investment

6 I am grateful to Paul Ormerod for suggesting this example.



decisions discussed previously, and it is there that price signalling does the bad job noted by Scitovsky. Before turning to some practical considerations relating to the carbon price, however, and its relation to tradable proportional obligations, we must note a specific problem with carbon pricing in relation to the threat of abrupt or rapid climate change. Largely forgotten by policy makers, it is clearly apparent in the seminal text on applying CGE theory to environmental policy:

> If it is [a] sufficiently strong detrimental externality, … [it] must produce a non-convexity in the social production set. (Baumol and Oates, 1988, p.116)

The diagram, adapted from Baumol and Oates, illustrates the situation. The curve RAR´ is the convex production possibility frontier familiar to Econ 101 students. It is developed from the assumption of diminishing returns to scale in the production of two goods, y_1 and y_2 – say, consumption goods for this generation and consumption goods for future generations.[7] By doing without now and investing for the future, more is available to our descendants. At the simplest level of analysis, neglecting the difficulties of modern theory noted above, a point such as A is selected by market forces where the slope of the curve, equal to the discount factor,[8] represents the willingness of investors to forgo current consumption in order to profit from investment. The higher the discount factor – the greedier we are and the less we provide for the future – the steeper the slope and the further point A moves to the right and downwards, forcing future generations to suffer a lower level of consumption, y_2, since we have chosen a higher value of y_1.

Suppose we take RAR´ to represent a situation where today's consumption causes no environmental damage. However, if the already excessive stock of greenhouse gas is increased by current consumption, then future production is diminished by the impact of resulting climate change, and the production possibility frontier looks like RBR´. The invisible foot can still score well, providing that the externality enters the price system – for example, through a carbon tax – with the point where the slope equals the discount factor now somewhat to the left of y_1. Thus, market forces result in more 'doing without' by the present generation. This results in more investment to reduce environmental damage and/or compensate future generations. That is what Kyoto is all about.

If, however, the externality is sufficiently severe, the production possibility function falls to RCR´, a straight line that has constant slope and which therefore does not have a unique point where the slope equals the discount factor: the invisible foot shoots wide. Worse still is the environmental catastrophe pictured by RDR´, where the market will drive the system to either R or R´, scoring an own goal of starvation and extinction in either the first half or second half of the game. Given that future generations aren't fielding a team today, and that turkeys don't vote for Christmas, it is obvious what choice would be made. It is this that leads Baumol and Oates (1988, p.31) to conclude that the choice, as regards the level of mitigating activity, must then 'somehow be made collectively, rather than by automatic market processes'.

The heuristic argument employed here is no substitute for a formal dynamic analysis that takes account of uncertainty regarding the impact on future generations of investments made in the present; or of the possibility of alternative investments in sustainable technology,

7 This is to play a little fast and loose with the production possibility frontier concept, which is normally concerned with alternative goods produced in current time (or the timeless world of CGE). However, the Baumol and Oates example of soot from a power station smokestack causes production of electricity (y_1) to damage the productivity of a laundry (y_2) hanging out its washing to dry. Such unidirectional causality from y_1 to y_2 is consistent with the movement in time from this generation to future generations.

8 The discount factor = 1+r, where r is the discount rate or the risk-adjusted rate of interest.

rather than business-as-usual technology, retaining hope of the RAR′ world. Perrings (1987) moves beyond the comparative statics of Baumol and Oates to analyse the linked economy–environment system, with time playing an essential role, and concludes:

> It follows that a high discount rate that raises the current rate of exploitation of environmental resources will be associated with increasing disposals, increasing environmental damage, increasing uncertainty and consequent higher still discount rates in the future. (p.136)

Perrings shows that relying on markets to resolve environmental problems generates increasing uncertainty, progressive myopia and heightened risk – which we may judge an unacceptable risk in relation to the UNFCCC's (the United Nations Framework Convention on Climate Change's) article 3.3.

Keeping both baby and bath-water

However, the teaching of environmental economics has stuck with the static analysis of Baumol and Oates and has nothing to say on the crucial issue raised by Kneese and Schultz, i.e. how to stimulate investment in policy-desirable technological change.[9] That may not matter if climate change is the very long-term problem of gradual change envisaged by the architects of the Kyoto Protocol, and indeed by the IPCC (2001). But it does matter – traditional teaching is of no avail – if concerns regarding Steffan's tipping point prove to be well founded.

> A universal uniform carbon tax is not a solution I can imagine. … No greenhouse taxing agency is going to collect a trillion dollars per year in revenue. … Reduce the tax by an order of magnitude and it becomes imaginable, but then it becomes trivial as greenhouse policy. (Schelling, 1992)

The traditional teaching remembered by economic advisers within governments does not equip them to appreciate that, if the need is to step back from Steffan's brink, practicable levels for a carbon price may not drive the needed technological change fast enough. Policy makers must understand the strong theoretical grounds for believing that price mechanisms cannot succeed[10] where tradable proportional obligations can (hopefully, providing we are not already so far over the brink – given that time lags in the system prevent us seeing the consequences of our actions to date – that escape from a 40-foot rise in sea levels is already impossible).

But to abandon Kyoto is both unnecessary and undesirable. However poorly designed it may be in relation to tipping point concerns, it is the cement of international collective action on climate change, and a necessary framework for addressing the long-term concerns of article 4. So action under article 3.3 must be complementary to Kyoto and addressed to different concerns: e.g. addressing the threat of a tipping point. As regards policy measures, if Kyoto commitments are to be achieved through emissions permit trading, complementarity can be achieved by imposing the obligation as a condition of permit issue, as described elsewhere (Read, 2006). If the carbon tax proposal is revived, a similar result can be achieved by a tax relief mechanism, though with less certainty of effect, due to the problems with prices discussed above.

Practical aspects of tradable proportional obligations

Commercial behaviour

Schelling's order-of-magnitude reduction in carbon price is what results from the proportional obligation approach. Progressively raising the proportionality

9 Of course, research economists do better – *vide* section 6.5.3 in IPCC (2001). But, as for the textbooks, neither 'innovation' nor 'investment' feature in the index of Baumol and Oates (1988). Of eight texts drawn at random from the library shelves, three follow suit (Tietenberg, 2006; Gilpin, 1999; and Perman et al., 1999; four (Perrings, 1987; Common, 1988 and 1995; and Neary and van Wijnbergen, 1986) mention investment in the index, mainly from a macroeconomic perspective; and only one (Kolstad, 2000) mentions innovation/invention, though with no discussion of motivation for, or barriers to, investment in innovations beyond the conventional assumption that a carbon price (in the climate change context) would be more effective than regulation.

10 Conventional investment appraisal requires a cash flow estimate both for such investments and for investments in the next best (business-as-usual, say) alternative *over the decade or so life of the asset*. But all market players have is a history of the price for fossil fuels and a very short run of data on the price of carbon, the first highly volatile and the second different in different places and subject to policy makers' changing priorities. The European Carbon Exchange price for December 2007 settlement fell from ~16 euros a year ago to <2 euros in February 2007. The price for 2008 settlement was more stable but still fell from ~18 to ~14 euros per tonne CO_2 over the period. Yet it is the *difference* between these two highly uncertain future prices that would determine a conventional investment appraisal, uncertainty that leads to the use of a very high risk adjusted rate of interest for the investment appraisal and thus to a low elasticity of demand to invest in policy-desirable innovation, and hence to an apparent need for very high carbon prices.

involves incurring the financing costs of investing in an increasing proportion of policy-desirable innovative output. It means that the cost of funding investments in innovation is spread across the whole volume of sales, resulting, in the current context, in an order-of-magnitude smaller price on carbon than is arrived at by a static, CGE-based approach to the marginal cost of emissions reductions (i.e. the rhetorical 'full social cost').

This parallels commercial practice, where innovation is funded out of super-normal profit retained by successful firms whose products are sufficiently attractive for them to be priced at above production costs. The obligation requires all firms to retain more profit – i.e. to raise prices a little – in order to fund the additional cost of investments in the two policy-desired technology types relevant to tipping point threats. That such investments are likely to be low-cost, possibly even profitable, follows from the high prospective cost of 'peak oil' and the high value of co-producing timber with biomass energy raw material.

Equity

The rise in prices involved represents the carbon price induced by the proportional obligation. Such a carbon price is one that makes sense to the consumer and voter: it is passing on the costs of doing business in a policy-acceptable way. The consumer accepts price increases due to real costs without question, as has been the case with the yo-yoing price of petrol in the last year.[11] Such a small carbon price is preferable to the widely canvassed notion of exposing New Zealand to the world price of carbon, since energy taxes are highly regressive (Common, 1988); preferable, that is, until such time as proportional obligations come to be widely recognised as the preferred way of meeting Kyoto commitments, and the world price of carbon falls to its level in New Zealand.

Apart from domestic equity, there is the North-South equity issue raised in our initial quotation from Schelling (1992) – an inequity that is exacerbated, at least in the view of the South, by the historic responsibility of the North for most of the current excess stock of CO_2 in the atmosphere. Given the comparative advantage of the South in the land-based activities involved in the two policy-preferred technology types, growing biomass and terrestrial stocking of carbon, implementation of proportional obligations will result in substantial investment in, and technology transfer to, a large number of developing countries.

As discussed elsewhere (Read and Parshotam, 2007), this can provide the basis for sustainable rural development and economic growth led by exports of liquid biofuels. Since the agents for these direct foreign investments and technology transfers are private sector firms driven by tradable proportional obligations, the transfers involved are manifestly not a substitute for official (government to government) assistance, an issue of concern to the China and G77 group.

Earmarked taxes

This is one of several advantages (apart from equity aspects) enjoyed by proportional obligations (or the tax relief alternative mentioned above) relative to proposals for taxes, or to permit auction revenues that expose New Zealand to the international price of carbon as dummy for the unknown full social cost.

Among other things, such exposure extracts profits that could be used for financing policy-desirable investment. It has been suggested that this loss of private sector investment finance could be remedied by recycling the tax or auction revenue into a fund for policy-desirable investments (Ward, 2007). Quite apart from the capacity of the investment process to assimilate the very large cash flows involved in a carbon price set at the international level, and setting aside the traditional Treasury resistance to earmarking tax revenues, this procedure would involve public finance accountability, introducing unnecessary transactions costs and hampering the deployment of entrepreneurial initiative.

For instance, under public accountability, transactions would need to be transparent, with a level playing field between, say, one prospective owner of marginal land for energy plantations and another. But an entrepreneur, operating under a proportional obligation, could offer a high reward to the first landowner to take the plunge,

11 It is unimaginable that such price variation would have been accepted if it had arisen as a tax on road fuel varying at the month-to-month whim of the minister of finance – witness the European fuel tax protests of 2000–2001 (Mitchell and Dolun, 2001) and the 'fart tax' demonstrations in New Zealand.

and lower payments to follow-on landowners taking lower risks. Such discrimination, extracting surplus value and cutting costs, is natural to entrepreneurs but foreign to the use of taxpayers' money, which has to be seen to be fair.

Also, private sector entrepreneurship, operating under limited liability, can make mistakes and go broke, whereas publicly-funded programmes become embedded in permanent bureaucracies, with a tendency to throw good money after bad. So the design of a policy instrument, besides protecting the consumer from needless price increases, should also aim to channel cash flows through the private sector, as is the case with tradable proportional obligations.

Conclusion

In relation to avoiding the greatest dangers from climate change, the policy-preferred technology types are biotic fixation of CO_2 and various storages of carbon out of the atmosphere. Rising levels of tradable proportional obligations are an effective instrument for driving take-up of these technology types. An implicit carbon price finances a rising volume of policy-desirable innovation. This runs counter to common perceptions that market mechanisms can address serious damage risks, and that exposing New Zealand to the world price of carbon would be an effective approach. Future Kyoto commitments are easily met, providing a substantial proportion of the storages are consistent with the Kyoto Protocol's rules (e.g. afforestation). The carbon price that results might be quite small given the apparently long-term high cost of oil[12] and low cost of carbon storage in forest plantations. Certainly it will be smaller than the world price established under the cap and trade approach (unless other parties also adopt similar policies). In keeping the price of carbon quite low, domestic equity problems are substantially ameliorated, and problems in the internationally competitive at-risk sector are also substantially addressed.

12 With prices at 2006 levels, biofuels are commercially attractive. The policy concern that gives rise to a price on carbon is to ensure that biofuels are supplied sustainably, unlike current operations in Indonesia, where tropical forest is being burned down to make way for bio-diesel palm oil plantations; there is also concern over sustainability safeguards in the current discussions on US–Brazil biofuels trade (Kenfield, 2007).

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