The Institute of Policy Studies, School of Government at Victoria University of Wellington

POLICY Quarterly

Volume 6 – Number 1 – February 2010

Special Issue: After Copenhagen

The Institute of Policy Studies, School of Government at Victoria University of Wellington

POLICY Quarterly

Volume 6 – Number 1 – February 2010

Policy Quarterly (PQ) is targeted at readers in the public sector, including politicians and their staff, public servants and a wide variety of professions, together with others interested in public issues. Its length and style are intended to make the journal accessible to busy readers.

The journal welcomes contributions of about 4,000 words, written on any topic relating to public policy and management. Articles submitted will be reviewed by members of the journal's Editorial Board and/or by selected reviewers, depending on the topic. Although issues will not usually have single themes, special issues may be published from time to time on specific or general themes, perhaps to mark a significant event. In such cases, and on other occasions, contributions may be invited from particular people.

Subscriptions: The journal is available in PDF format on the IPS website: www.vuw.ac.nz/ips/pq. Readers who wish to receive it by email should register as *PQ* subscribers ips@vuw.ac.nz. This service is free.
For all subscription and membership enquiries please e-mail ips@vuw.ac.nz or post to Institute of Policy Studies, P.O. Box 600, Wellington.
Electronic Access: The IPS directs interested individuals to its website: www.vuw.ac.nz/ips/index.aspx where details of the Institute's publications and upcoming events can be found.

ISSN: 1176 - 8797 (Print)
ISSN: 1176 - 4325 (Online)
Volume 6, Number 1 – February 2010
Design & Layout: Aleck Yee
Production: Alltex Design

Institute of policy studies

Victoria University of Wellington – Te Whare Wānanga o te Ūpoko o te Ika a Māui – School of Government – Te Kura Kāwanatanga

Cover Photo © Kristian Buus / Greenpeace
http://www.greenpeace.org/new-zealand/campaigns/climate-change

Editorial Note

Welcome to this new issue of *Policy Quarterly (PQ)*. We hope you find the new format appealing and accessible. With the recent retirement and resignation of various academic staff in the School of Government and the appointment and five new staff members, we have taken the opportunity to refresh the editorial board of *PQ*. Paul Callister remains on the board, and is joined by four new members: Dr David Bromell, Dr Valentina Dinica, Dr Michael Di Francesco and Dr Mike McGinnis. I am very grateful to those who have contributed their services to *PQ* in the recent past (i.e. editing and reviewing submissions) and those who have offered to assist during the next few years.

I would also like to thank the School of Government Trust for its generous agreement to fund the bulk of the direct costs of publishing PQ for the next three years. This places PQ on a firm financial footing and significantly reduces the extent to which the IPS will need to seek other sources of funding.

As we enter 2010 and a new decade, there is a plethora of important international and domestic policy issues confronting New Zealand. On the global front, critical issues include the regulation of financial markets, managing the large fiscal deficits that have arisen in the wake of the financial crisis in late 2008 and early 2009 (and the related risks of default in the case of certain European countries), and responding to the rise of China as an economic giant (including the related issues of trade, exchange rate management and global economic governance).

Addressing the consequences of the UN climate change conference in Copenhagen will also be high on the agenda. Plainly, progress was much less than many had hoped. Accordingly, the immediate prospects of the global community successfully concluding a new, legally-binding multilateral agreement (whether a Kyoto-plus or a new protocol) to take effect when the first commitment period under the Kyoto Protocol expires at the end of 2012 are now poor. In the medium-term, of course, much will depend on domestic policy developments in the US: if the Senate eventually passes legislation establishing a comprehensive and effective emissions trading scheme, then there is a reasonable chance of negotiating a satisfactory multilateral post-2012 arrangement; but if not, then the days of relying on multilateral approaches to mitigate climate change look bleak. Instead, there may be no alternative but to rely on a bottom-up approach, based on domestic, bilateral and regional arrangements. These are most unlikely to deliver the level of emission reductions that many leading scientist consider necessary if we are to avoid dangerous climate change – partly because national targets will lack stringency, and partly because there will be insufficient incentives for investment in green technologies.

This issue of *PQ* includes brief perspectives on the Copenhagen conference from five contributors: Phil O'Reilly (the chief executive of Business New Zealand), Peter Neilson (the chief executive of the New Zealand Business Council for Sustainable Development), Mark Belton (the managing director of Permanent Forests International, and a leading expert on forestry issues), Paul Melville (a policy analyst with the Fonterra Cooperative Group) and Geoff Keey (the political advisor for Greenpeace New Zealand). As these contributions highlight, the Copenhagen conference was not a complete failure, with good progress on a number of important issues – especially on measures to address deforestation and the establishment of the Global Alliance to address greenhouse gas emissions from the agricultural sector. The problem, of course, will be how to maintain the momentum on these issues if the wider negotiating framework remains highly uncertain.

This issue of *PQ* also includes contributions on four other important issues. Terry Stokes, the head of the School of Government, discusses the relative weighting of research and teaching in universities and suggests changes to the performance-based research fund (PBRF) in the interests of ensuring that applied research is not disadvantaged. Susan St John considers the recent controversy over the full-funding of accident compensation in New Zealand and argues that the current policy framework is misguided. Christina Hood evaluates the National-led government's key change to the emissions trading scheme at the end of 2009, namely the shift from historical grand-parenting of free units to an uncapped production-based allocation, and questions the fiscal sustainability, equity and environmental effectiveness of the new policy. Finally, in the context of the current review of the legislation governing electoral finance, Alec Mladenovic explores the philosophical principles that should guide how democracies regulate the funding of political parties and electoral campaigns. Fundamentally, he argues that more attention needs to be given to the principle of political equality, in particular the norm of equal opportunities for political influence.

A variety of important policy issues will be canvassed in future issues of PQ, including the likelihood of special issues addressing the following subjects: regulatory policy frameworks and the advantages and disadvantages of a Regulatory Responsibility Act; the funding and consequences of infrastructure investment; ethics and public policy; political finance and related constitutional issues; and health policy issues. Papers on other policy-related matters are, of course, always welcome.

Jonathan Boston

Phil O'Reilly[1]

Reducing emissions in New Zealand after Copenhagen

The outcomes from Copenhagen were less definite than many hoped. The major disappointment was in not achieving an internationally agreed CO_2 reduction target, and everything else flowed from that, including not much progress towards international emissions trading.

But there were some good outcomes. From a New Zealand perspective the progress towards rules on land use was helpful. It is imperative that rural landowners are not unnecessarily hindered by unsympathetic rules preventing them from changing the use of their land from forestry to agriculture.

There was also a win for New Zealand in prompting the formation of a group of countries prepared to undertake research on science-led developments for agriculture. This research is crucial for New Zealand if we are to avoid our key export sector being penalised because of animal emissions. We are all looking forward to some scientific breakthroughs that can help us minimise this impact.

Phil O'Reilly is Chief Executive of Business New Zealand.

The importance of food security was also recognised. More generally, there were advancements in international thinking around relevant issues and a shared commitment to ongoing work. These are all positive.

We also learned more about what would be required to get emissions trading operating among more countries.

To a certain extent this boils down to future actions by the US and China. Because of the strengths of their respective economies both of these need to be involved to get other countries to sign up to any future international agreement.

During the Copenhagen meeting China assumed leadership of the developing nations in attendance, arguing that they should not be subject to independent verification of their emissions reductions.

This position was rejected by developed nations, led by the US. However, the US did not occupy a commensurate leadership role among developed nations, having arrived at the conference without a clear position on emissions reductions.

Without a domestic agreement on the issue, the US was not in a position to lead others on the global stage. Before the US can take that role in the future it must pass domestic legislation to limit emissions, and with increased political opposition to the Obama administration at home, this might not be easily achieved.

This does not mean we will never get international emissions trading. There is a groundswell in favour of it in many countries and some form of trade emerging between at least some nations is likely in the medium term. So should we, as some suggest, do nothing about reducing emissions?

This would be wrong. Regardless of what is happening on the international scene, it still makes sense to try and limit our greenhouse gas emissions, as a prudent precautionary measure – prudent not only in terms of minimising risk to the environment, but also in terms of ensuring an environmentally positive brand for our exports.

This is the reason why the previous Labour-led government and the current

National government both framed legislation for an ETS.

There is a great deal of difference between the scheme legislated for by the Labour-led Government and the one subsequently passed by the current National Government.

Labour's legislation would have capped the quantum of free carbon permits available to businesses, imposing enormous costs on the productive sector. Business NZ was extremely concerned at this prospect and committed a lot of time and resources to environmental and economic analysis and modelling to help ensure that these potential impacts were widely understood.

In particular, we were concerned that any proposed scheme should have an intensity-based allocation method for free carbon permits. Under this approach, at-risk enterprises would get a level of protection that would increase or decrease in step with production. In other words, under an intensity-based allocation method, enterprises would not be penalised for increases in productivity and economic growth would be encouraged, rather than penalised as it would have been under Labour's scheme.

National's scheme has incorporated the intensity-based approach and also has other features that reduce the risk to New Zealand enterprises. Notably, the price for carbon emissions will be limited to no more than $25 per tonne of CO_2 until the end of 2012. There will also be a further moderation of the price whereby permits to emit can be surrendered at a rate of one permit for every two tonnes of CO_2 emitted – this effectively reduces the carbon price cap to $12.50 per tonne emitted.

Importantly, National's emissions trading scheme has a built-in review mechanism so it can be improved according to changing circumstances. Relevant circumstances include whether and how many countries are also adopting emission reduction targets and moving to price CO_2 into their economies. The first review will be next year.

While there are clear advantages in National's scheme in comparison with the previous one, many businesses will still have some doubts about having an ETS at all. In light of the failure of the Copenhagen process to reach any shared understanding on an early beginning to international emissions trading, this is understandable.

In Copenhagen's wake, the New Zealand scheme is one of only two formal schemes in existence, the other being the EU's. New Zealand's scheme is significantly more comprehensive than the EU's, in covering all greenhouses gases and all sectors including agriculture.

Clearly, the lack of international emissions trading partners is a key problem for New Zealand's scheme, and undoubtedly it will be high on the agenda in the first review of the scheme in 2011. The main problem with having an ETS in advance of many others in the world is that it will impose a price on carbon within the New Zealand economy, with there being no such additional cost in the economies of competitor nations. On an enterprise basis, it means New Zealand enterprises having to pay higher energy costs than competitor firms overseas from 1 July this year. The significance of this can hardly be overemphasised. It will have a major flow-on economic impact on every New Zealander.

Obviously, another matter to be considered in the ETS review next year will be whether its moderating mechanisms – the carbon price cap and amount of free permit allocations – are adequate to offset this competitive disadvantage.

The fact that the Australian ETS has been put on the backburner will also need to be considered by the review. There is thus a need for some caution as the future shape of our ETS is considered. But we should not lose sight of the fact that there are significant benefits to New Zealand's actions to date towards reducing carbon emissions.

Being able to attract consumers who want low-carbon goods and services is extremely important. There is an enormously increased sensitivity among consumers all around the world towards the need to go easy on the environment by producing goods and services with the smallest environmental footprint possible. No longer confined to a small greenie fringe, this is now a mainstream movement. Household shoppers, mothers, kids and more are all making their preferences felt.

The recent debate about palm oil in chocolate and use of palm kernels as feedstock is a good example of consumers refusing to accept a product they viewed as environmentally undesirable.

Consumer groups can now influence customers almost instantaneously via the internet. The ability for certain products to be blacklisted all around the world within a matter of hours or days is a huge power that can make or break a product or a brand.

New Zealand producers have the opportunity to be ahead of the curve and ensure their products are acceptable to this huge and growing market for sustainability. This is the context in which we should view New Zealand's steps so far towards emissions reductions including our work towards an ETS. Of course, reducing emissions doesn't begin and end with emissions trading – there are many ways in which we can stem emissions growth, all capable of bringing extremely positive environmental branding for us. The low-carbon challenge brings a

There is an enormously increased sensitivity among consumers all around the world towards the need to go easy on the environment by producing goods and services with the smallest environmental footprint possible.

number of difficulties but many of these will also have the effect of sharpening our abilities and our wits.

What will we need to be able to take advantage of the opportunities furnished by this change in customer desires? Key factors will be innovation, science, technology and skills. These aren't things that come in a box - they are the outcomes of a good education system and good science and innovation frameworks.

We will need to focus hard on the kinds of skills that come out of our high schools and tertiary education institutions and will need to ensure that we have enough science graduates and enough opportunities for them to contribute and innovate.

These are areas where as a nation we have quite a bit of work to do. And for individual businesses, adaptability will be important. Businesses that will succeed best will be those that can adapt, adopt new technologies, and create new products and services that are fit for new consumer desires.

The Copenhagen conference failed to get an agreed reduction target or international ETS in the short term, but for the long term it has signalled that the nations and consumers of the world care greatly about environmental sustainability. How New Zealand producers react to that signal will make a big difference to our economic sustainability.

Peter Neilson

The Copenhagen Climate Conference
It Still Takes Two to Tango

When we were 16 or 17 our girlfriends were always keen on going to a dance but the males were usually very reluctant dancers. By about 10 o'clock two couples would finally make it onto the floor and then everyone would be up for dancing. By 12 o'clock the band would be packing up and everyone would be saying we should have started earlier.

At Copenhagen most of the countries present had a better offer for emission reductions to table, but it needed the United States and China to go onto the dance floor to really get the party going. The US, while offering to help contribute to $100 billion a year in assistance from 2020 for least developed countries facing the full impact of climate change, did not move beyond an emissions reduction target of 17% below 2005 levels by 2020. This reduction is in the Waxman Markey Bill passed by the House of Representatives in 2009.

One of the first things US climate change negotiator Todd Stern said when appointed was that he would not take a 'dead letter' agreement back to the United States. US agreement to a climate change treaty requires a two-thirds majority agreement of the US Senate, unless fast-track approval legislation is passed, as has been done for trade negotiations in the past. When the Kyoto Treaty was negotiated, the US delegation headed by Al Gore raised expectations that the US would be an active participant in reducing emissions. The Clinton administration did not submit the Kyoto Treaty to the Senate because it knew it would not be supported. President Obama's offer to the Copenhagen talks was not so good that it would require China to respond or the European Union and other developed countries to increase their offerings. New Zealand and other countries at Copenhagen were mandated to lift their offerings if a US–China agreement with sufficient ambition was made. The Copenhagen conference came about a year too early for the US administration to know what it could best offer. Therefore, no one else had a reason to put up their best offer.

While Copenhagen was not as successful as it might have been, it did represent some solid progress:

- All of the major emitters were engaged in finding a solution, a big advance on the Kyoto Treaty.
- There was broad agreement that the world should aim at a maximum increase of average global temperatures of 2°C (even if the Group of 77 of less developed countries would have preferred 1.5°).
- $100 billion per year in finance from developed countries to help less developed countries adapt to climate change has been agreed from 2020, along with opening to scrutiny the emission reduction performance of all countries with commitments.

The sting in the tail is that achieving the 25%–40% emission reductions needed to hold temperature rises to the agreed 2°C will require all developed countries, including New Zealand, to increase their current emission reduction targets. Current emission cut offers on the table fall 4 billion tonnes short of the level scientists advise will be needed to have only a 50% chance of achieving the agreed temperature cap.

The biggest change since 2005 is who is now relevant to the debate. Previously it

Peter Neilson is Chief Executive of the New Zealand Business Council for Sustainable Development. He attended the COP15 climate change talks at Copenhagen as a member of the delegation of the World Business Council for Sustainable Development.

was the EU and developing countries. Now, for the first time the US, China, India and Brazil are taking formal responsibilities. The other major emitting bloc, the EU, is also prepared to cut further once the emitting heavyweights make more ambitious reduction commitments.

The reality is that while we have huge sympathy for the issues faced by the less developed nations from climate change, they have little to trade at the table. Developed countries – and the fast developing nations – have the greatest potential to change their emissions profiles and have the biggest share of total emissions.

So what happens now?

- Countries will put their emission cut commitments on the table by 1 February 2010, and list what they are going to do to mitigate and adapt (with these pledges being subject to review, reporting and verification).
- The US emissions trading scheme law will probably pass the US Senate in the first or second quarter of this year – a vital part of securing significant commitments from the major emitting and developing nations, including the US, European Union, China, India and Brazil.
- A more comprehensive world agreement should be negotiated this year, probably in time to be put before the US Senate for ratification after mid-term elections in November. Alternatively, President Obama might get fast-track approval powers, as have been given previous presidents for trade negotiations.

One of the biggest steps which must be taken before the end of 2010 is to persuade senators and congressmen from the US Midwest to increase their ambitions to reduce emissions. President Obama has been careful to move no further than what the US Senate is likely to support. The aim this year is to have a legally binding agreement, ratified by the Senate unless otherwise authorised. While there is considerable enthusiasm for action on climate change on the east and west coasts of the US, each state has two votes in the Senate. The senators from Midwest states, which have a high dependence on coal, agriculture and traditional smokestack industries, will need to persuade their constituents that they will not be adversely affected by an agreement on climate change or the introduction of an emissions trading scheme.

So the debates, in New Zealand and abroad, over the extent of emission cut commitments and how to achieve them, so well canvassed in the past year here, will be had again.Importantly, they are going to take place now within the required context of the agreed global target the scientists tell us is necessary. Through all this New Zealand needs to take care not to lose some significant gains made at Copenhagen.

... the new global clean-economy market will be very large and potentially very profitable.

The draft agreement text, although still to be signed, will deliver us the benefits of flexible land use. If the draft text holds – and no one exercises an unforeseen veto – then we will be able to harvest trees planted before 1990 and replant on another site without incurring a carbon penalty. There is also recognition that carbon is embedded in wood products and does not all return to the atmosphere on felling.

Our historical land use flexibility advantage needs to continue. For example, at current meat and wool prices many farmers are finding it more profitable to grow trees. For others it will mean a switch to dairying or other production while replanting forests on marginal land. These proposals are not a potential veto issue at the moment for any of the major players. However, we need to be vigilant to ensure it remains that way, even if wild cards are played by other nations during the negotiations.

So what are the business implications? There will be a huge market in abatement technology to cut emissions in the US, China, India, Brazil, the EU and in the other developed economies. Consumer awareness of the environmental impact of goods and services through the whole supply chain will grow. The US is particularly keen on finding the cheapest possible ways of mitigating and cutting emissions and so will have a reasonably open regime for importing emission reduction offsets from anywhere in the world.

At Copenhagen in December I listened to the US secretary of agriculture speak of agriculture, while responsible for 7% of the US emissions problem, being a potential source of 20% of the country's solution. He sees this coming through changes in land use, biosequestration and soil carbon.The New Zealand initiative for a global research partnership to find ways of reducing agricultural emissions offers us the potential for new export industries built around new mitigation and adaptation technologies, such as an inoculation to reduce methane produced by ruminant animals.

Clearly, transport fuels for aircraft and shipping, important to New Zealand, are going to be part of the new global agreement – and this will result in businesses striving for greater efficiency, using new technology and more environmentally friendly fuels. Skilful marketing will also be needed. In Copenhagen there were protesters calling for the world to go vegetarian or vegan, claiming this would cause fewer emissions than producing food from animals. While intuitively obvious yet factually wrong, the 'buy local' and 'food miles' campaigns have to be addressed.There is a risk that simplistic slogans will be used to frame the debate, with people thinking 'I care, therefore I'm doing something' if governments do not take action.

However, as a result of the widely supported new agreement, the new global clean-economy market will be very large and potentially very profitable. Herein lies a significant opportunity for government, researchers and business to leverage this together in the national interest.

Mark Belton

REDD Progress at Copenhagen

While there has been widespread grief about the stalled UNFCCC (United Nations Framework Convention on Climate Change) process following COP15 at Copenhagen, there were some areas of positive progress.[1] One of the most notable was in the development of agreements on reducing emissions from deforestation and forest degradation (REDD). REDD was excluded from the Kyoto Protocol because at the time the policy and methodological issues were considered too difficult to resolve.

An object lesson on the importance of reducing emissions from tropical rainforest destruction occurred in the year following the Kyoto COP 3 meeting, when a major El Niño event which spread across South East Asia caused severe drought, widespread fires and destruction of forests and forest peat soils. As much as a third of global CO_2 emissions during this extreme climate event in 1998 could be attributed to destruction of tropical forest.

It took eight years, until COP 11 in Montreal, for REDD to regain traction within the UNFCCC, when agreement was reached to launch a two-year initiative to examine the potential of REDD. This subsequently lead to the decision at COP 13 to include a somewhat expanded concept of REDD, so-called REDD-Plus, in the Bali Action Plan on mitigation strategies, in preparation for anticipated agreements at Copenhagen. At Bali the findings of the Fourth Assessment Report of the Intergovernmental Panel on Climate Change were presented and rainforest destruction and degradation was identified as accounting for as much as 17.3% of annual global emissions – in the order of 8 giga-tonnes per annum.

However by 2008-2009, in the midst of a global recession, reduced drivers of deforestation, more effective actions by rainforest nations to counter illegal rainforest removals (especially by Indonesia and Brazil), and in the absence of a major El Niño event, emissions from destruction of forests may have dropped to as low as 10% of the global greenhouse gas (GHG) emissions. I mention this wide range in rainforest emissions to illustrate their huge variability, and the complexity of factors involved, and the challenges that lie ahead for design of effective

Mark Belton is Managing Director of Permanent Forests International. He attended the COP Bali and Poznan conferences with the New Zealand government delegation and the Copenhagen conference as a guest of Victoria University of Wellington. Permanent Forests specialises in the origination and design of environmentally and socially sustainable carbon forestry projects. Projects worked on have included large-scale forest sequestration programmes in New Zealand and combined afforestation and REDD programmes in the rainforest regions of the Brazilian Amazon and South East Asia. Permanent Forests also brokers 'high-quality' forest offsets to both voluntary and Kyoto markets.

REDD methodologies, particularly the determination of national baselines.

To halt destruction and degradation of tropical rainforests is unquestionably of critical importance to maintain their huge carbon stocks and to conserve evolution's most outstanding terrestrial ecosystems. REDD provides a unique opportunity for placing a sufficiently high value on intact rainforest ecosystems so as to beget a multitude of actions for their conservation. In this regard the challenge is to develop policies, methodologies and regulations that will facilitate the considerable financial transfers required to support these actions while simultaneously achieving other desired outcomes, notably sustainable economic development and nature conservation, the defining elements that make up REDD-Plus.

REDD is particularly difficult territory to navigate and thus far much of the path-finding work has been undertaken outside the UNFCCC, in the voluntary market, and through REDD capacity-building initiatives such as the UN-REDD programme, the World Bank Forest Carbon Partnership, and by countries such as Norway (support of Brazil's Amazon Fund) and Australia (REDD partnerships with Indonesia and Papua New Guinea). In the circumstances of 'catching up with the play' on REDD, the COP 15 sub-groups working on policy and methodological agreements made significant progress.

The ad hoc working group on cooperative action (AWG-LCA) drafted a policy agreement that provided for REDD-Plus mitigation actions (and various non-REDD initiatives) to be funded under a proposed climate facility. The draft reached the final stages of preparation with minimal unresolved (bracketed) text; however, its completion was thwarted in Copenhagen's final chaotic days. The AWG-LCA draft prepared the ground rules for financing REDD-Plus from developed countries, and between the lines appears to have left room for private funding. Unfortunately, detail on 'who is to pay, how much, when and how' was not mapped out, and seems still a long way from being resolved.

A text on REDD-Plus methodologies was agreed upon by the Subsidiary Body for Scientific and Technical Advice (SBSTA) and subsequently adopted by the COP. Its key decisions included recommending that historical emissions provide the baselines for REDD with adjustment for national circumstances, and recognition of the need for full and effective engagement with indigenous peoples. The issue of accounting at a national or sub-national (project-based) level was covered by providing for establishment of 'robust and transparent national forest monitoring systems, and if appropriate, sub-national systems as part of national monitoring systems'.

The three-page Copenhagen Accord set an objective of limiting global warming to a maximum of 2°C, but did not specify any emission reduction targets. However, the accord made a firm financial commitment requiring developed countries to facilitate the provision of US$30 billion to developing countries over 2010–2012 ...

The sub-text on inclusion of sub-national systems 'if appropriate' is prescient of how project-based REDD initiatives might be provided for. Private sector interests have the potential to deliver massive funding for REDD, and to deliver innovative designs in pursuit of the very real potential for large-scale and low-cost generation of REDD project offsets, albeit with all the social responsibility, sustainable development and conservation goals included. The arbitrage opportunity for profit between generation cost and on-sale value in carbon markets, and the level of regulatory surety (de-risking) will determine the scale of private sector financing and engagement. Developing countries hosting REDD national fund-based programme can be expected to charge fees or levies on their carbon exports. The alternative (of private project-based approaches) risks transfer pricing scams that would dwarf those that have long shamed the tropical timber trade, whereby very little of the value of the rainforest product, in this case carbon offsets, remains in the country of origin, the greater part ending up in offshore accounts in tax-efficient jurisdictions.

Developing countries have become highly sensitised to economic neo-colonialism, whereby their remaining rainforest assets risk being permanently locked up under REDD conservation agreements – effectively a loss of sovereignty – while the wealth generated from REDD offsets is realised elsewhere. Hence the emergence of the 'national funds' approach, championed by Brazil with its Amazon Fund.

In the absence of a Kyoto successor agreement, the sub-group agreements on REDD will remain stranded and largely ineffective. It is possible that the UNFCCC process has reached an impasse that cannot be breached, at least in the urgent time-span required to reign in GHG levels. Copenhagen forcefully demonstrated a 'new play' at the table of climate change politics, and while 120 heads of state equivocated under the UNFCCC process, former outsiders, the US and four major developing countries (China, India, Brazil and South Africa) by-passed the old Kyoto club nations and delivered the Copenhagen Accord 'fait accompli'.

The three-page Copenhagen Accord set an objective of limiting global warming to a maximum of 2°C, but did not specify any emission reduction targets. However, the accord made a firm financial commitment requiring developed countries to facilitate the provision of US$30 billion to developing

countries over 2010–2012, increasing to US$100 billion per annum by 2020, to help them reduce emissions and adapt. REDD funding is provided for within this financial commitment.

REDD was also strongly endorsed in the accord text:

> We recognize the crucial role of reducing emissions from deforestation and forest degradation and the need to enhance removals of greenhouse gas emissions by forests and agree on the need to provide positive incentives to such actions through the immediate establishment of a mechanism including REDD-plus to enable the mobilization of resources from developed countries.

The accord (unlike the SBSTA text) gives explicit recognition of the need for GHG removals by forests, making room for inclusion of afforestation and reforestation (A/R) sequestration alongside REDD. This is critically important because demand for fuel wood and timber is a major driver of deforestation, and in the absence of supply-substitution from A/R programmes developing countries have no hope of achieving forest conservation through 'stand alone' REDD programmes. It is instructive that New Zealand was only able to implement sustainable harvesting of indigenous forest with the passage of the Forests Amendment Act 1993, and finally choke-off native forest harvesting. This was only possible because by this time a growing surplus of wood from our planted forests rendered native timber economically insignificant.

With the Copenhagen Accord the US has taken on the mantle of global (co)–leadership on climate change, potentially sidestepping (and knee-capping) the UNFCCC process. The US's focus is very much on what it can achieve domestically, then 'internationalising' those actions. However, it remains to be seen whether the US can sustain a leadership role, given the swing against the Democrats ahead of the mid-term elections in late 2010, and the now very real risk that the Kerry-Boxer Bill containing the proposed US cap-and-trade system may not be supported in the Senate. It is notable that the US cap-and-trade design provides for up to a billion offsets per annum to be sourced offshore, a clear preparation for massive inflows of low-cost REDD credits. This would serve to reduce the entry cost of a US cap-and-trade system and help appease major emitter industries. The ability to harness REDD has therefore become critical to the US aspirations to introduce a cap-and-trade scheme. Interestingly, the Kerry-Boxer Bill provides for a country fund approach to REDD financing and explicitly excludes direct project-based approaches.

By the time post-Kyoto compliance markets are activated, either under a new international agreement or alternatively by way of domestic cap and trade regimes in the US and Europe, REDD programmes in the major rainforest countries should be ready to contribute.

The USís suitability for leadership is also undermined by it having the lowest 2020 emission target (and second highest per capita emissions levels) amongst the developed economies.

Notwithstanding the difficulties ahead for reaching an effective global agreement on climate change, under either the UNFCCC or some grouping of the worldís leading economies, REDD has clearly become accepted as a key mitigation strategy. In the absence of a global agreement, it is almost certain that REDD will be part of bilateral or regional initiatives. While international negotiations continue, REDD capacity-building initiatives will continue in concert, as will REDDís involvement in voluntary markets. By the time post-Kyoto compliance markets are activated, either under a new international agreement or alternatively by way of domestic cap and trade regimes in the US and Europe, REDD programmes in the major rainforest countries should be ready to contribute.

New Zealand is already contributing globally to REDD by virtue of its log and wood product exports. These and other managed forest wood supplies substitute for wood that otherwise would have to be sourced from the worldís primary forests. At this time there is no price recognition for this; however, opportunities could arise in the future, with developing countries linking their REDD programme with wood imports to specifically address leakage issues.

The New Zealand government should be preparing the ground for bilateral and regional agreements to enable REDD units to enter the New Zealand ETS, thereby providing New Zealand emitters with access to offsets in the lower-cost range, whilst supporting constructive outcomes in developing countries with respect to their indigenous people, sustainable economic development and rainforest conservation.

1 I would like to thank Bryan Smith for his helpful comments in preparing this paper.

Paul Melville

International Emissions Policy and Agriculture

The Copenhagen climate conference is now history and there is presently some debate on what the conference achieved and what the events that occurred there will mean for the future of international climate change negotiations.

Most reflections on Copenhagen have focused on the apparent inability of the conference to make sufficient progress towards a legally binding treaty. These reflections perhaps do not recognise the efforts under way outside the main negotiating focus to address issues of importance to the pastoral sector.

It was hoped that the conference would establish a work programme on agriculture. Unfortunately this was not finalised despite widespread support. However, New Zealand was successful in launching a global research alliance on agricultural greenhouse gases.

Global alliance

The announcement of the global alliance was an important achievement from Copenhagen, albeit separate from the official UNFCCC (United Nations Framework Convention on Climate Change) negotiations. Formation of the alliance will improve the global co-ordination of funds spent on agricultural emissions mitigation research. It is well recognised that, in order to reduce global emissions to levels recommended by the Intergovernmental Panel on Climate Change, global agricultural emissions must be managed. It is also well recognised that current mitigation options can only make a small dent in agricultural emissions. Meanwhile, world demand for food production continues to grow. To solve this challenge, there is an unquestionable need to research new methods to abate greenhouse gas emissions from agriculture.

Fonterra is supportive of the formation of the global research alliance and looks forward to continuing to work with the government in funding the existing Pastoral Greenhouse Gas Research Consortium.

Details of how the global alliance will function will be decided at the inaugural senior officials' working meeting of the alliance, to be held in Wellington in April 2010. New Zealand negotiators tell us there will be a number of research groups which will co-ordinate research under different work streams, such as pastoral farming, rice farming and intensive livestock. We also understand that there will be no commitment to give money to a central pool, but rather members will have the ability to fund individual projects as they see fit. We support this proposal as it allows members to retain control over the projects they are financing. The end result should be a stronger flow of funds to agricultural mitigation research, and better use of those funds due to a greater level of co-ordination between nations.

Agricultural work programme

There are a number of issues that are unique to agriculture within international policy to reduce greenhouse gas emissions. For example, there is a crucial need to maintain food security while reducing emissions; limited mitigation options are currently available to farmers; and there is a need to develop tools that more accurately measure emissions at their source (rather than aggregating emissions at the food processor level).

The issues facing agriculture are

Paul Melville is a sustainable dairying policy analyst at the Fonterra Cooperative Group.

evident by having a quick look at the domestic emissions trading schemes currently being developed in Australia and the United States, as well as the emissions trading scheme under way in Europe. None of these countries treat agricultural emissions in the same way that they treat smoke stack emissions.

By including agricultural emissions in a separate work programme, the international community can begin to address those issues that have led to the disconnect between the all-gases all-sectors approach of the Kyoto Protocol and the 'fossil gases only' approach of most governments.

In addition, it is important that a work programme quantifies food security concerns to ensure that, in attempting to address climate change, the global community does not negatively affect the world's most vulnerable people by reducing their access to food. While international agreements need to place a cap on global emissions and reduce this over time, we cannot simply force agricultural producers to cut emissions at any cost. As the minister responsible for international climate change negotiations, Tim Groser, has said, 'If, in the area of livestock production, "mitigation" simply means "cut production" – we do not have a sustainable way forward.'[1]

Agriculture needs to be included in global emissions policy but it needs to be in a way that seeks to balance the twin global issues of food security and climate change,

Some will argue that food security concerns are unavoidable once the reality of climate change is faced because, if agricultural emissions growth continues unabated, the negative effects on third world nations from climate change may be even greater than those from reduced food production. This is one of the reasons a work programme is needed: we cannot simply 'cut production', but we can equally not simply continue with 'business as usual'. Agriculture needs to be included in global emissions policy but it needs to be in a way that seeks to balance the twin global issues of food security and climate change.

Effect of delay on Fonterra

Many commentators have noted correctly that if the USA and China reach an agreement outside the UN process it will provide direction to the negotiations and increase the possibility that an international treaty will be agreed to. A USA-China agreement itself may hinge on the ability of the US to pass clean energy legislation currently being considered in the Senate. Until these things occur, it is hard for member nations to commit to reductions.

Fonterra recognises the global importance of this current phase of negotiations. However, this phase also raises many questions for Fonterra. Under the New Zealand emissions trading scheme (ETS) the price of emissions units is capped until the end of the Kyoto period (December 31, 2012). After this time participants will need to source units from various market mechanisms. As limited direction has emerged about the characteristics of a post-Kyoto framework, this makes it difficult for participants to have any cost certainty for emissions liabilities post-2012. For example, beyond 2012 we do not know how many units our government will have to auction, or what international markets will be available to us to source units.

The New Zealand emissions trading scheme was largely designed assuming a Kyoto-type framework would operate. This may yet be a valid assumption. The ETS wisely allows for reviews every five years, with the first in 2011. If international negotiations for a second commitment period have not concluded by the time of the review, there may be a strong argument for conducting a second review of domestic policy once negotiations are finalised that can allow for emergent international developments to be reflected in the New Zealand ETS.

As we look back on Copenhagen, there remain many unanswered questions. Hopefully the path forward will become clearer in the coming months. Fonterra understands that New Zealand negotiators had little control over the events that led to the lack of progress towards agreement on a post-Kyoto framework at Copenhagen, but we recognise that inroads have been made on issues important to New Zealand and we commend our negotiators for this.

1 Tim Groser, New Zealand statement to the UN climate change conference high-level segment, 12 December 2008.

Geoff Keey

A Momentary Lapse of Reason?

What did the person on Easter Island say when cutting down the last tree? That was a question posed to US academic Professor Jared Diamond by a student in a lecture on how societies appear to knowingly overshoot their resources. He referred to the incident in his book Collapse: why civilisations choose to fail or survive, which describes a string of societal collapses as a result of failing to address environmental problems.

Professor Diamond's book ought to be compulsory reading for all the negotiators and politicians and their advisers involved in the climate negotiations because they are repeating errors Diamond identified in his book: wrong values, poor strategic choices and denial.Copenhagen was so disturbing precisely because the world's leaders know they face a serious threat to humanity and yet failed to properly address it.

To understand why Copenhagen failed, it is important to look behind the publicly visible and immediate causes – such as incompetent Danish chairing and an impracticable negotiating text – to the underlying reasons behind the failure.

Why was there a 200-page negotiating text?

During the 2009 UNFCCC (United Nations Convention on Climate Change) negotiations many countries, New Zealand included, seemed unready to negotiate. Negotiators lacked a mandate from their capitals to consolidate text and come to the compromises needed to make progress. This lack of a mandate led to the 200-page text with its thousands of brackets that negotiators faced at Copenhagen.

The two ad-hoc working group chairs were able to take the initiative to consolidate the text only after the threat of a further Danish text emerged at Copenhagen.Sadly, this effort was sabotaged by the United States during the process of handing over the negotiating text from the working group on long-term co-operative actionto politicians.The US ambushed the hand-over process with demands and refused to allow the hand-over to occur until its demands were met. After 10 hours of stalemate, the US got its way, opening a retaliatory floodgate of demands from other countries. The effect of this was to destroy the practicality of the negotiating text.

New Zealand's own strategy was part of the problem. New Zealand failed to meet the commitment it made in Poznan by delaying announcement of its target. Then, when asked to provide information on the proportion of its target that would be met through offsetting, forestry or domestic emission reductions, New Zealand refused, saying that there were too many uncertainties to provide that kind of information, despite Environment Minister Nick Smith giving projections about the emissions trading scheme in Parliament.

Geoff Keey is the political advisor for Greenpeace New Zealand and was a member of Greenpeace's international political team at the climate change negotiations throughout 2009.

Developing country concerns about comparability have been exacerbated by the low level of ambition of developed countries, in terms both of numerical targets and the relative amount of domestic emission reductions versus offsetting through clean development and land use, land-use change and forestry(LULUCF).

New Zealand's best contributions in 2009 were probably when negotiators were in UNFCCC chairing roles, rather than implementing government policy.

The underlying problems with the negotiating texts and the lack of progress relate to three main issues.The new US administration's failure to make progress in the Senate on climate change legislation has meant the US negotiators were not ready to strike a deal. This fed into the wider lack of ambition from developed countries (on both finance and targets). This in turn fed into the widely differing views of what constitutes a fair distribution of effort.

Added to this mix was a marked shift in power towards China and its allies in the BASIC group of countries (Brazil, China, South Africa and India).

The emergence of China

Along with the rest of the BASIC group, China is a now a dominant player in climate change. Rising emissions and a strong economic position have given China considerable power in the negotiations. Its approach at Copenhagen appeared to be driven by the desire to preserve development space and avoid long-term targets it considers would result in an unfair distribution of effort. A factor in China's reticence was anxiety over whether low-carbon development will deliver the rate of development China needs to avoid civil unrest. Lesser factors included increasing advocacy from climate sceptics and a common belief that climate change negotiations are a Western plot to constrain China's development.

China's controversial blocking of the 80% by 2050 target for developed countries appears based on its concern about the level of per capita emissions developing countries would be allowed under a global goal of 50% cuts by 2050 and a developed country goal of 80% cuts by 2050. China's assessment is that this would allow developed countries to pollute at twice the rate of developing countries. Put bluntly, why would China willingly agree to a long-term path that allows its strategic competitors to pollute at twice the level of its own citizens?

Long-term comparability, rather than external verification of its emissions, may be the real bottom line for China which might have conceded verification in Copenhagen if it had received something in return from the US. However, without the backing of Congress, President Obama had nothing to offer.

The BASIC countries are now consolidating their position by proposing to fund adaptation for vulnerable countries, taking the diplomatic initiative from developed countries.

Comparability is a critical issue in climate change negotiations

Three approaches have emerged at climate change negotiations during year: a justice approach that is based on principles of historical responsibility, historical debt and an equal share of a common resource, for which Bolivia is an obvious proponent; a baselines approach that compares targets against 1990 baselines, favoured primarily by the European Union; and abatement costs, which is favoured by those countries that have failed to reduce emissions (such as New Zealand and the United States) and so have a greater amount of work to do to reduce emissions. The UNFCCC approach of responsibility and capability appears to have slipped off the agenda entirely.

Developing country concerns about comparability have been exacerbated by the low level of ambition of developed countries, in terms both of numerical targets and the relative amount of domestic emission reductions versus offsetting through clean development and land use, land-use change and forestry(LULUCF). Offsetting and forestry imply that developed countries are deferring structural change to their economies and developing countries are concerned that offsetting will mean that cheaper abatement in their countries will be sold to developed countries, leaving them with considerably tougher emission reductions when it is their turn to take on unilateral targets.

New Zealand's approach of having a 50% reduction by 2050 and relying almost exclusively on offsetting and forestry sets a particularly bad example.

Developed countries, for their part, are facing political pressure as firms in their countries compete with firms in developing countries like China and India.The opaque political system in China exacerbates concerns within developed countries that claimed emission reductions may not be real.

Ultimately, comparability goes to the core of diplomatic gaming at the climate change negotiations. Political leaders are acting like the proverbial farmers in the 'tragedy of the commons': unless they show leadership to put aside some of their national interest in favour of the global interest, everyone suffers. A common understanding of comparable effort may be needed to enable leaders to have the courage to tackle climate change.

The Copenhagen Accord

On first reading, the Copenhagen Accord looks promising. However, the fine print on emission reductions and financing shows that it is a backwards step from the Bali Action Plan.

The proposed developed country targets are bottom-up targets.This ignores science and undermines the UNFCCC process, which is based on setting a science-based aggregate target

and then agreeing to individual targets that will deliver the aggregate.This bottom-up approach will fail to deliver the kind of reductions needed to avoid dangerous levels of climate change because countries will not be forced into ratcheting up their effort.This has been shown in the pledges seen to date in the accord, which are at the lower end of pledges being proposed in a UNFCCC context.

Further, the pledge on short-term finance is not what it seems. The British government has already admitted that its fast-track finance is largely a reclassification of existing funding and may include money that has already been spent.This is likely to be repeated elsewhere.

The long-term financing is also very problematic. The pledge itself is very weak, merely supporting a goal of mobilising finance, with no explicit commitment to deliver. The financing is also proposed from such a wide variety of sources that it is unclear what the $US100 billion per annum by 2020might mean in practice.

The UNFCCC has carefully provided guidance to countries over the status of the accord to ensure parties understand that it has no legal weight, and only time will tell what weight it has. At the time of writing, the BASIC countries have agreed to support the accord, but are seeking at least five sessions of the ad-hoc working groups before COP 16 in Mexico.

Within ASEAN, Malaysia, Brunei and Vietnam seem very unlikely to support the accord, while Indonesia and Singapore are likely to support it. The Philippines and Thailand are likely to support the accord but only offer aspirational targets. A number of other developing countries are also likely to associate with the accord to access finance, but also only offer aspirational targets. The Marshall Islands is offering a 40% cut by 2020 to up the moral pressure on developed countries.A group of Central and South American countries, led by Bolivia and Cuba, refuse to support the accord, as does Tuvalu. Developed countries will almost certainly all join the accord.

Challenges for New Zealand

New Zealand will need to be better prepared than it was last year. This was most publicly reflected in New Zealand's handling of the Commonwealth Heads of Government Meeting. Prior to the meeting, Foreign Affairs Minister Murray McCully publicly announced that New Zealand didn't want the time taken up with 'Copenhagen issues', despite clear signals that climate change would dominate the agenda. At the meeting New Zealand came with an offer of agricultural research that was so clearly mismatched to the occasion that Prime Minister John Key was forced into a public u-turn by the other leaders present.

There are signs that New Zealand is no longer viewed as a serious player in climate change negotiations: the United States claimed the credit for the agricultural alliance in its media release; John Key was publicly dropped from a BBC debate at Copenhagen and appears to have been excluded from the core group negotiating the accord; and New Zealand appears to have been dropped from a ministerial chairing role during the second week of the negotiations. All of this occurred despite New Zealand being a contributor to the Greenland Dialogue.Consequently, New Zealand needs to be wary of moves away from the UNFCCC process.This move is about large countries taking control from weaker ones. New Zealand is likely to be a loser if the UNFCCC process is sidelined. At least at the UNFCCC the country has a veto; outside the UNFCCC process, New Zealand may be presented with agreement text and asked to sign.

New Zealand needs to act on the advice of the prime minister and listen to vulnerable countries. One of the biggest disappointments for me has been observing ministers launch into strong criticism of countries that are merely asking for action needed to enable them to survive.If New Zealand risked being completely wiped off the map, wouldn't we expect our leaders and diplomats to be strident too?New Zealand sends its soldiers overseas to kill on lesser provocations.

The global challenge

On the present track the world is headed towards at least 3°C warming by the end of the century. This has dire implications for huge numbers of people. If it happens, it will almost certainly be the kind of disaster that has befallen past civilisations.

Developed countries will need to face up to their responsibilities on both targets and financing to build confidence in the negotiations. Unless they are willing to deliver emission cuts of at least 40% below 1990 levels by 2020, major emitting developing countries will strongly resist taking on commitments. Without significant new finance, poorer developing countries will have no incentive to take action.

Major developing countries will need to realise that a right to development may well be irrelevant if climate change wipes out their capacity for development through drought, desertification, salt water inundation and other impacts.

The leadership of all countries will need to show the courage to find common ground on what is their fair contribution to a science-based effort to tackle climate change. Subordinating scientific evidence of likely impacts in favour of short-term nationalistic economic gains is the sure path to failure.

The deserts of Iraq were once the agriculture-driven cradle of civilisation. It is a lesson our leaders should never be allowed to forget.

There are signs that New Zealand is no longer viewed as a serious player in climate change negotiations: the United States claimed the credit for the agricultural alliance in its media release; John Key was publicly dropped from a BBC debate at Copenhagen ...

Terry Stokes[1]

Two Cheers for Research

My title is an adaptation of a passage from an essay by E.M. Forster:

> Two cheers for democracy: one because it admits variety and two because it permits criticism. Two cheers are quite enough: there is no occasion to give three. Only Love the beloved Republic deserves that. (Forster, 1965, p.78)

His general point is that 'there lies at the bottom of every creed something terrible and hard for which the worshipper may one day be required to suffer' (ibid., p.76), and, in particular, that democracy, as an ideal, is not something we should place upon a pedestal and worship uncritically. I think that is also true of research, and of its role in a university. I will argue that, while research is a distinguishing characteristic of higher education, it should not be seen as an absolute good. If narrowly conceived, or over-emphasised, research can limit what universities aspire to, and are able to provide.

Is research really commonly represented as an unalloyed good, especially in relation to universities? I think so. For example, we find this on the web site of the University of Sydney:

> At the heart of the University's mission is a fundamental moral commitment to intellectual discovery and development. Our students benefit through research-led teaching. Our creativity and discovery deliver cultural, social, economic and political benefits to the community.
>
> The University's reputation is directly linked to the quality of our research. As our reputation as a research-intensive university grows, so too does our ability to attract and retain high-performing staff and outstanding research students. Research is at the core of everything we do.[2]

The University of Western Australia goes even further on its web site, saying: 'An emphasis on research and research training is a defining characteristic of UWA.'[3]

Victoria University of Wellington holds a similar regard for research. Its research policy states, *inter alia*:

> All academic staff have the right *and are required* to conduct research and engage in scholarship and to publish their findings. ... [emphasis added]
>
> The requirement to undertake research is a career expectation ...[4]

This is consistent with the first statement of the National-led government's view. A recently released Ministry of Education *Draft Tertiary Education Strategy* states:

> Universities have three core roles:
> - to undertake research that adds to the store of knowledge
> - to provide a wide range of research-led degree and post-graduate education that is of an international standard
> - to act as sources of critical thinking and intellectual talent.

The document goes on to say:

> The Government expects universities to:
> - enable a wide range of students to successfully complete degree and post-graduate qualifications
> - undertake internationally recognised original research

Professor Terry Stokes was educated at Macquarie University and the University of Melbourne. He taught and held a postdoctoral fellowship at Deakin University, and was a lecturer and senior lecturer at the University of Wollongong. He was a Counsellor to the Australian Research Council (ARC), and has served as Director of Research Services at Monash University and as Assistant Secretary in the Office of the National Health and Medical Research Council. He was successively Pro-Vice-Chancellor at Central Queensland University, and General Manager, Higher Education and Regulation in the Victorian Office of Training and Tertiary Education, before working as a tertiary education consultant. In January 2008 he took up the position of Head of School in VUW's School of Government.

- create and share new knowledge that contributes to New Zealand's economic and social development, and environmental management.

This emphasis on research in universities is comparatively recent, essentially a post-World War II phenomenon. Writing in 1852, in the preface to *The Idea of a University*, John Henry Newman said:

> The view taken of a University in these Discourses is the following: – That it is a place of teaching universal knowledge. This implies that its object is, on the one hand, intellectual, not moral; and, on the other, that it is the diffusion and extension of knowledge rather than the advancement. If its object were scientific and philosophical discovery, I do not see why a University should have students; if religious training, I do not see how it can be the seat of literature and science. (Newman, 1907)

Cardinal Newman (1801–1890), a prominent Anglican convert to Catholicism, developed these views as rector of the then newly-established Catholic University of Ireland (now University College, Dublin). His book is seminal in the study of higher education, although I suspect it is now more cited than actually read, by non-Catholics at least. At the time, however, Newman was articulating a view held by others: for example, Benjamin Jowett (1817–1893). Jowett was regius professor of Greek, the great translator of Plato's works (in which capacity I personally first encountered him), master of Balliol College and vice-chancellor of Oxford University. Logan Pearsall Smith records Jowett as saying: 'Research! Research! A mere excuse for idleness; it has never achieved, and will never achieve any results of the slightest value' (Smith, 1938, p.169).

Jowett's vehemence derives from the threat he saw posed to the tutorial system he championed by the developing enthusiasm for research, modelled on the German universities. Jowett's 'ideal was to have undergraduates read out essays to tutors, particularly on ancient philosophy and history, and to discuss them with those tutors. He did not wish to train researchers but to develop powers of mind and of clear, cogent expression which would equip undergraduates to take their place in public life' (Mayr-Harting, 2007).

Basic research leads to new knowledge. It provides scientific capital. It creates the fund from which the practical applications of knowledge must be drawn.

So how did the teaching-focused conception of the university espoused by Newman and Jowett transmogrify into the research-dominated one we now have? My thinking on this issue has been strongly influenced by an address given at Leeds Polytechnic in 1990 by the foundation chair of the Australian Research Council, Don Aitkin. Professor Aitkin, for whom I then worked, is a distinguished political scientist who went on to become the vice-chancellor of the University of Canberra. He proposed 'a three-period model of the development of the modern university':

> Period I: from the first degree-granting universities in Europe, beginning with the University of Bologna in 1088, to World War II
> Period II: post-World War II to the 1980s
> Period III: from the 1980s to now.

Of the first 850 years Aitkin says: 'Period I universities as a whole were places of teaching and scholarship, but not notably for research. And the research that was done was mostly of small scale, and relatively cheap' (Aitkin, 1991, p.236).

These were Newman's and Jowett's universities; though, as noted, the seeds of Period II were sown in Germany by Wilhelm von Humboldt, who sought to have the universities demonstrate and promote the process of the discovery of knowledge. As the 20th century got under way, the Humboldtian idea took root across the Atlantic in the United States, and, not without debate, later in the United Kingdom, though not really in the Dominions. Thus we find the 1924 New Zealand royal commission on university education saying: 'The function of a university is not so much to conduct researches as to train students to that inquiring attitude of mind which inevitably makes them investigators' (cited in Malcolm and Tarling, 2007, p.91).

The history of New Zealand universities, and Australian universities, in the first half of the 20th century is that of teaching institutions in which some academics strove, largely unsuccessfully, to ignite interest in research. An example was 'A statement by a group of teachers in the University of New Zealand', which asserted: 'We do not accept the point of view that teaching is the main function of the University. ... The two activities of the University, teaching and research, should be co-ordinated and combined' (Allan et al., 1945). The signatories to this statement included Karl Popper, then at the University of Canterbury. Until after the war talented graduates went to Britain to do their research training, and, for the most part, their research. Popper, of course, left for Britain immediately after the war.

It was Vannevar Bush who ushered in Aitkin's Period II, with his report to United States president in 1945, *Science: the endless frontier*. The key argument of this was that:

> Basic research leads to new knowledge. It provides scientific capital. It creates the fund from which the practical applications of knowledge must be drawn. New products and new processes do not appear full-grown. They are founded on new principles and new conceptions, which in turn are painstakingly developed by research in the purest realms of science. (Bush, 1945)

Bush is asserting a linear model of innovation, very convenient for basic researchers but not much supported these days. Unexpected practical applications do emerge from basic research, but practical problems also succumb to a direct approach and such work is often inspired by 'market push'. However, that's a story for another time.

Vannevar Bush had a special place for universities in his vision:

> Publicly and privately supported colleges and universities and the endowed research institutes must furnish both the new scientific knowledge and the trained research workers. These institutions are uniquely qualified by tradition and by their special characteristics to carry on basic research. They are charged with the responsibility of conserving the knowledge accumulated by the past, imparting that knowledge to students, and contributing new knowledge of all kinds.

His last sentence captures the traditional view of what universities do – with which, by the way, I have no quarrel. To fund his vision Bush successfully argued for the creation of the National Science Foundation (NSF). Massive American government support for basic research in the universities through the NSF, and through national institutes of health, copied in Britain, Australia, New Zealand and many other countries, was the engine of universities in Period II. Among its principles, as articulated by Bush, was that:

> Support of basic research in the public and private colleges, universities, and research institutes must leave the internal control of policy, personnel, and the method and scope of the research to the institutions themselves. This is of the utmost importance.

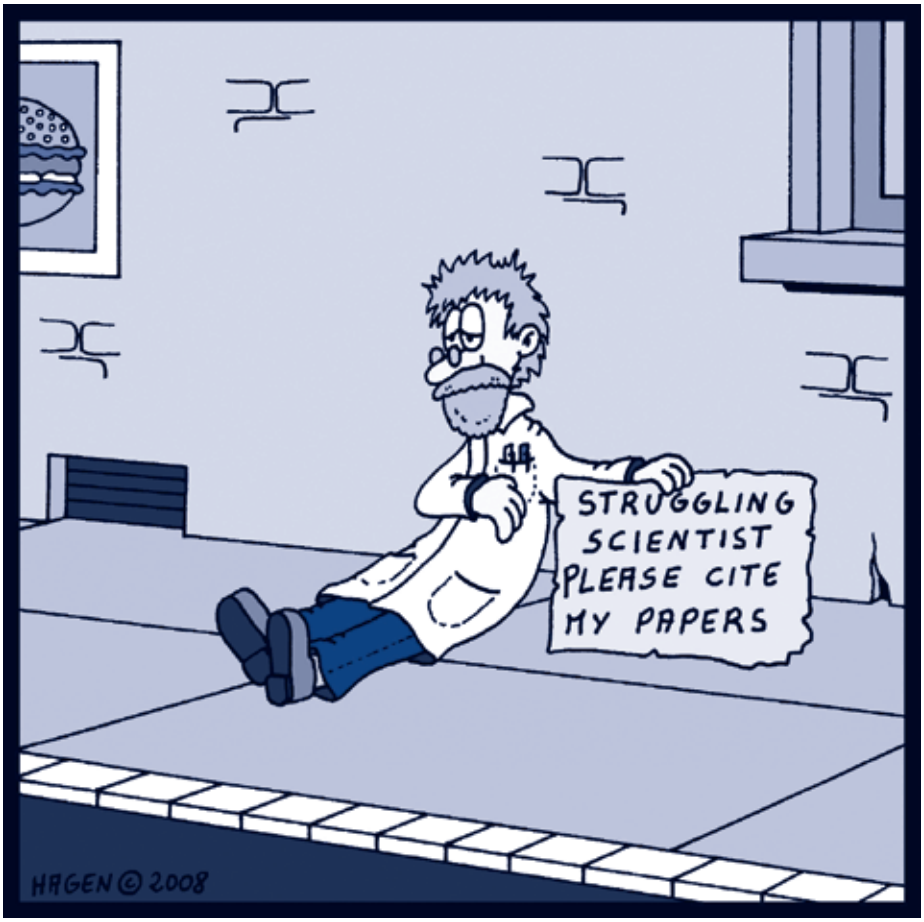
Even more important still was the way in which decisions were made about who would be funded and the results evaluated: peer review – namely the evaluation, by experts in the relevant field, of a research proposal for which a grant is sought, or of a paper proposed for publication. More colloquially we might say: Trust us, we know which of us should get your money – and whether the results we got were worthwhile. Or, as a captain of industry once put it to me: 'Just slip the cheque under the door and bugger off quietly.'

Little wonder, then, that peer review should be popular among researchers as a way of deciding things in research. I shall be returning to peer review, and its limitations. But before that, my first cheer for research. As Don Aitkin says, after the explosion of research funding following World War II,

> The result has been an astonishing advance in the knowledge that humanity has of the physical universe and of its own part in the universe, an advance that is perhaps without any precedent in human history. The flowering of research in the second half of the 20th century is arguably our century's most useful gift to the 21st century … (Aitkin, 1991, p.238)

Motherhood and apple pie surely have nothing on research as a self-evident 'good thing'. Well, perhaps. There's always the Pandora's Box problem: there are some things that perhaps we shouldn't know – such as how to make weapons of mass destruction. We will be returning to that issue; but for the present, it would be churlish, indeed absurd, to deny the triumphs of research, in terms of either pure understanding or practical application.

But before we get too carried away – an awful lot of dross was produced along with the bullion. The standard measure of whether basic research results are valuable is citation of the publication in which those results appear by later publications. Citations acknowledge intellectual debt. Other things being equal, the more often a work is cited, the more important and influential the results are taken to be. Various caveats are necessary: self-citations and negative citations, for example. But even negative citations can be impressive if there are enough of them and they go on for a long period of time. There is a whole research field – bibliometrics – devoted to this, and into which I cannot go very far here. I just want to point to one or two well established bibliometric findings with fundamental implications



5

for research policy. The first is that most research publications don't rate very well. In his classic paper, Derek de Solla Price observes:

> It seems that, in any given year, about 35 percent of all the existing papers are not cited at all, and another 49 percent are cited only once … . Only 1 percent of the cited papers are cited as many as six or more times in a year … (Price, 1986, p.107)

So much for the problem of self-citation. In fact, more recently, Hamilton (1990) found that '55% of the papers published in journals … did not receive a single citation in the five years after they were published'. The figures vary by discipline and type of publication, and there are arguments in the literature about the exact level of uncitedness (Pendlebury, 1991). The point is simple, though: if one is to judge by citations, a great many journal articles are never read by anyone other than the author, the journal editor and the referees.

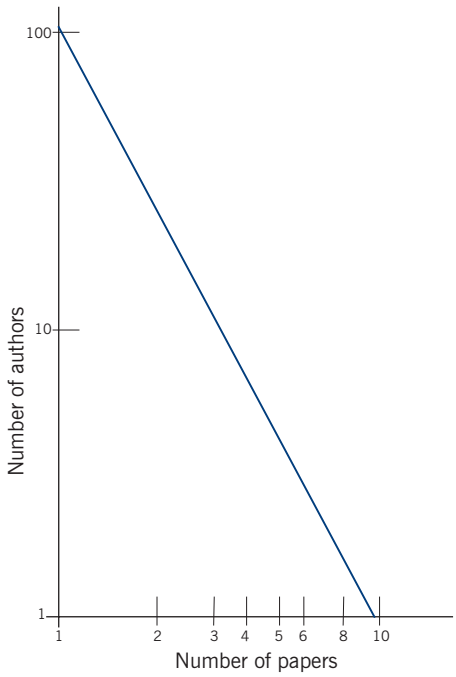
Moreover, citation frequency is logarithmically distributed. That is, of those papers that do get cited, as noted most receive only one or a few citations, and a tiny percentage have most of the impact. So, to take one example, high energy physics: in a database with 234,885 citeable papers, of the most highly cited papers, 10.66% had more than 50 citations, 5.79% had more than 100 citations, 1.29% had more than 250 citations, 0.38% 500 or more citations and 0.13% had more than 1,000.[6]

This is true of productivity as well as impact. Lotka's (1926) Law is an inverse-square law of productivity which states that the number of people producing n papers is proportional to $1/n^2$.

This means that for every 100 researchers who publish one paper, there are 25 who publish two; 20% of authors will publish five papers or more; 10% at least ten. Another way to put this is that 10% of authors produce more than 50% of all papers, and 2% produce a quarter of all papers (Price, 1986, p.41).

Many studies have been done to see whether Lotka's Law holds in various disciplines. In some fields it is confirmed: an example is finance (Chung and Cox, 1990). In others an even higher exponent – 3 or 3.5 – has been proposed as best fitting the data. But the general point is well established: a few researchers are responsible for most of the publications.

Figure 1: Lotka's Law[7]



Taking these two general findings together, we can say that *most researchers are unproductive, and their work has little or no impact*. Therefore, to optimise research outcomes and their impact, funding should be focused on a few, really a very few, talented researchers, and not the many talentless ones. In policy terms, where the quantity and quality of the research is the primary concern, an implication of this is to favour research-only organisations, such as the crown research institutes in New Zealand and the CSIRO in Australia.

Nevertheless, as we have seen the New Zealand universities are expected by government to undertake research as well as teaching. And since 2003 university research been assessed and rewarded through the Performance-Based Research Fund (PBRF). In my view, at least as implemented at Victoria University, the PBRF flies in the face of the bibliometrically-established realities about research just discussed. All academic staff who are employed for a minimum of one day a week on average, or 0.2 FTE, and whose employment functions include a substantial contribution to research and/*or teaching* degree-level programmes are eligible. Although institutions may choose not to submit an Evidence Portfolio (EP) for some eligible staff, those staff are then automatically rated 'R' – research inactive.[8] At Victoria University submission of an EP was compulsory in the recent internal round for those expected to be in position for the next, 2012 external round.

This contrasts with the British Research Assessment Exercise (RAE), on which the PBRF was generally modelled.[9] Higher education institutions there selected research-active staff for inclusion from their eligible staff. In the last, 2008 RAE, 61% of eligible permanent academic staff were selected and 38% of all academic staff (Higher Education Funding Council for England, 2009, p.12). A key difference is in the reporting aspect: in the United Kingdom those who are not submitted do not appear in the denominator, whereas in New Zealand they do.[10] Another is that in New Zealand, academics are individually scored and graded, whereas in the RAE it is 'units of assessment' – broadly speaking, equivalent to departments – that are rated.

Victoria University has a minimum expectation of a 'C' grade for those who are not new to research – defined as those having 'produced a reasonable quantity of quality-assured research outputs, acquired some peer recognition for their research, and made a contribution to the research environment within their institution'.[11] But this does not reflect the reality of research capacity among academics, here or anywhere else.[12]

The operation of the PBRF would be considerably improved if individual academics could choose whether to have their research evaluated. Even when they do, the time available to them, or elected by them, to do that research should be a factor as well; although implementing that may be easier said than done. Otherwise, it seems inevitable that many will do poorly in the PBRF. But it is also a case, I think, of the tail wagging the dog. The PBRF represents 20% of government funding to universities, and 10% of all university income. At Victoria University, research accounts

for about 10% of all revenue (Victoria University of Wellington, 2008, p.43). The preponderant majority of all income received by the university – whether from government or from students themselves – is for teaching. The notional split at Victoria University of Wellington between teaching and research duties for academics is 40:40 (with the remaining 20% covering administration, service to the university and service to the community). Even that, which underestimates the actual focus on research, is out of whack with funding purpose and reality (unless, perhaps, you decide to impute 40% of academic salaries to research).

Teaching is the primary responsibility of the university, the primary source of its income from government and of its income from the students themselves. Ross Guest, professor of economics at Griffith University in Australia, recently pointed out that 'Given that research performance is measured and extrinsically rewarded more systematically than teaching performance, effort and performance is biased toward research' (Guest, 2009). There is, of course, no national evaluation of teaching performance to compare with the PBRF. As a head of school, I cannot require that the teaching done by my staff be assessed and see the results in the way that PBRF scores are provided to me. Nobody tells me that I must manage the performance of poor teachers, in contrast with the requirement for detailed reporting on how I am managing those with poor PBRF scores. As Guest notes, there is

> A well-established economic principle … that when buyers cannot discern the quality of a product being offered for sale (in this case teaching quality) they tend to offer a price commensurate with average quality. This means that good teachers are paid less than they are worth and poor teachers are paid more. (ibid.)

Clearly we need to measure teaching performance at least as routinely as we do research if it is to be valued properly in the university environment. But we also need to reward good teaching at least as much as we do good research. Of course there are, now, teaching awards at Victoria University, as well as national teaching awards. But if teaching excellence is truly to be co-valued with research there needs to be a tangible, dollar reward for it on at least the same scale as the PBRF: that is, somewhere around 20% of government funding to universities. And, while good researchers feel rewarded when they are asked to do more research, good teachers do not feel so rewarded when they are asked to do more teaching. This means that a substantial amount of any 'performance-based teaching fund' would need to find its way into academic salaries.

... we need to measure teaching performance at least as routinely as we do research if it is to be valued properly in the university environment.

As well as over-emphasising research, the PBRF also emphasises one kind of research at the expense of another. The key problem is the way in which the research is assessed. Overwhelmingly it is other academics who make these judgements. The peer review panels for the 2006 PBRF quality evaluation consisted almost exclusively of academics.[13] Even in an area like business and economics, the panel was composed entirely of academics: there were no business people; there were no Treasury officials; no *users* of research, nobody who might comment on whether any of this business and economics research improved business bottom lines or helped frame government economic policy.

The dominance of peer review – trust us, we know how good we are – is very evident, and it is hardly surprising that good 'pure' or 'basic' researchers would be happy with this arrangement. But *applied* research, which seeks to solve problems, is ill-served by the PBRF because the people with the problems are not asked how good the proposed solutions were at addressing them. And it is applied research that is most important in places like the School of Government. Our primary stakeholders are the public sector agencies, not eminent academic researchers elsewhere in New Zealand and around the world.

Government is by no means the only field of university research where applied research is most important. To take one random further example, I would venture to suggest that educational research which had no impact on teaching or learning would be an entire waste of money, regardless of how well cited it might have been in academic research.

Of course, researchers who work on applied problems can also publish their work in academic journals, and many of those in my school do. But such journals are, by and large, not read by senior public officials, who prefer face-to-face communication or read the reports they have commissioned. There is a cost to this need to serve two masters – the time and effort taken to convert a report to a government department into an article published in an international journal is very considerable, and necessarily reduces productivity (everything has to be done twice). Moreover, to get something published in an international journal can mean stripping the New Zealand content out to meet off-shore demands. This has to be done because New Zealand-based journals – such as this one – are regarded as inferior publication vehicles.

There is, however, some glimmer of hope. I referred earlier to the Ministry of Education's *Draft Tertiary Education Strategy 2010–2015*, released in September 2009. There we find the government arguing that:

> New Zealand must have a strong contribution to research and innovation from the tertiary education sector. Research-driven innovation will be a major factor in helping New Zealand industries to become more productive.

And the strategy goes on to say:

> The Performance-Based Research Fund has been successful in promoting quality improvements, and will continue to enhance research quality. We will look at whether the Performance-Based Research Fund is working well for all parts of the sector.

Perhaps this is a hint that it might be appreciated that it is not working well for applied research. The next PBRF round is in 2012. I earnestly hope that it leavens the peer review panels with research users from both the private and public sectors.

I have argued that widespread engagement in research by university academics is not the best policy for optimising research output and impact, pure or applied. Is there any other reason to want to have large numbers of academics doing research? There is one very commonly advanced argument: that teaching is improved by being done by active researchers. So, for example, it can be found in university mission statements such as that of the University of Sydney, cited earlier: 'Our students benefit through research-led teaching.' And we find it in the Ministry of Education's *Draft Tertiary Education Strategy*:

> Research needs to inform teaching, both in academic and applied settings. This enables the development of human capital, as tertiary education institutions play a key role in spreading knowledge and in transferring technology through teaching.

As with many shibboleths, there is not a great deal of evidence for the teaching–research nexus. One recent study which looked at what there is found that:

> the evidence ... suggests that research and quality teaching are not contradictory roles. However, we cannot conclude from the information at hand that the link is strongly positive. The evidence indicates the relationship may be modestly positive, though it is likely to be stronger at postgraduate than under-graduate levels. The overall quality of the statistical analyses on which these conclusions are based is not high. (Zaman, 2004)

Another study notes:

> At the level of the individual member of staff, the simple models of staff who are heavily productive in research outputs being the most effective teachers, or that high productivity in research results in effective teaching, are clearly suspect. (Jenkins, 2004, p.11)

On the other hand, it did find that 'In the UK, there is clear evidence that, while many mission statements … state the importance of the link, few teaching or research strategies have clear mechanisms for delivering the teaching–research link' (ibid., p.31).

In universities we teach the things we know we know (or think we know) to our students. We try to resolve the known unknowns: that is, we do research.

A teaching–research nexus is not very plausible in relation to beginning undergraduates: their teaching could hardly be informed by research they could not yet understand. A researcher who is a talented teacher might, however, communicate something of the excitement and importance of their research in a first-year lecture. So let's say the association is weak, rather than absent.

On the other hand, students working for research-based masters degrees and doctorates can surely be satisfactorily supervised only by academics who themselves hold such degrees and are active in research. It is important, too, to remember that the universities in New Zealand have a unique role as the only institutions awarding research qualifications. Here I think the nexus is strong. At some point in the more senior undergraduate courses, and certainly at honours level, students need to be introduced to research, in terms of both substantive content and method. Here, too, there is a need for good teaching to be informed by research. So the need for some teaching to be informed by research can justify many, if not most, academics being engaged in research – the extent of such an engagement depending upon the levels at which they teach.[14]

But I think there is bit more to be said in favour of research. Donald Rumsfeld, sometime US defense secretary, has been much mocked for saying:

> There are known knowns. These are things we know that we know. There are known unknowns. That is to say, there are things that we now know we don't know. But there are also unknown unknowns. These are things we do not know we don't know.[15]

Partly this mockery is because he missed out something rather critical: the things we think we know, but which we don't (because they aren't true); in this case that Iraq had weapons of mass destruction. Still, he has a point, albeit rather clumsily put. In universities we teach the things we know we know (or think we know) to our students. We try to resolve the known unknowns: that is, we do research. But most importantly we accept that this research will, from time to time, not merely add to our stock of knowledge, it will transform it entirely, as we discover unknown unknowns.

The scholasticism of the schoolmen in the medieval universities was fundamentally doctrinaire, and much the worse for it. What a commitment to research, the Humboldtian ideal, bequeaths to the contemporary university, and to its teaching, is, above all, a horror of dogma. And there's my second cheer for research: it is antithetical to dogmatism. (Mind you, it won't have been long since you last heard something like: 'The overwhelming consensus of scientific opinion is …'. Often

it is said by a journalist or a politician but, sadly, rather too frequently it is said by a scientist.)

So we may say, two cheers for research: one because it has given us so much knowledge of the world and ourselves, and two because it fights dogmatism. But, as E.M. Forster said, 'Two cheers are quite enough: there is no occasion to give three. Only Love the beloved Republic deserves that.' I have suggested that there are some aspects of research in New Zealand universities, and at Victoria University of Wellington, which mean we need to withhold the final cheer. Most academics are not capable of truly outstanding research, and should not be compelled to try. The balance between teaching and research is currently awry, with the latter excessively rewarded to the detriment of the former. And the kind of research rewarded is too narrow, rewarding basic research at the cost of applied research.

1. This is an edited version of an inaugural professorial lecture, delivered on Tuesday 17 November 2009.
2. http://www.usyd.edu.au/ro/rmp/importance_research.shtml.
3. http://www.research.uwa.edu.au/.
4. http://policy.vuw.ac.nz/Amphora!~~policy.vuw.ac.nz~POLICY~000000000945.pdf.
5. My thanks to my colleague Professor Bob Gregory, who used this cartoon in his own inaugural lecture earlier in 2009. Reproduced by permission.
6. http://www.slac.stanford.edu/spires/play/citedist/. Note that the data are not cumulative (i.e. a paper with 512 citations is only counted in the 500+ category, not in the 50+ and 100+ categories).
7. Drawn by Amanda Cunningham after Price (1986), p.39.
8. Tertiary Education Commission.
9. Likely to be metrics- rather than peer review-based, at least for some fields, in future, and renamed the Research Excellence Framework.
10. Jonathan Boston, personal communication.
11. https://intranet.victoria.ac.nz/research-office/policy-and-services/PBRF/grades.html#c.
12. I do not have the space to do so here, but it is instructive to compare the spread of outcomes by level (excellent to poor) in peer-review driven exercises such as the PBRF and the RAE, with the distribution which bibliometric data shows: the latter offers a much harsher judgement. For example, compare Trends in measured research quality: an analysis of PBRF Quality Evaluation results (Ministry of Education, 2008) at http://www.educationcounts.govt.nz/__data/assets/pdf_file/0018/29403/PBRF_-_report.pdf., figure 4, p.17, which shows a distribution of research output scores with a distribution not far from normal.
13. Tertiary Education Commission.
14. In the light of the earlier discussion of the distribution of talent in research, however, it should be noted that much of the research undertaken by academics which is justified by their teaching responsibilities will be pretty low quality research.
15. Press conference at NATO Headquarters, Brussels, Belgium, 6 June 2002.

References

Aitkin, D. (1991) 'How research came to dominate higher education and what ought to be done about it', *Oxford Review of Education*, 17 (3), pp.235-47

Allan, R. et al. (1945) 'A statement by a group of teachers in the University of New Zealand' reproduced in *NZ Science Review*, 46 (1-3), pp.72-3

Bush, V. (1945) *Science: the endless frontier*, Washington: United States Government Printing Office, accessed online at http://www.nsf.gov/od/lpa/nsf50/vbush1945.htm

Chung, K. and R. Cox (1990) 'Patterns of productivity in the finance literature: a study of the bibliometric distributions', *Journal of Finance*, 45 (1), March, pp.301-9

Forster, E. (1965) *Two Cheers for Democracy* (originally published 1939), Ringwood: Penguin Books

Guest, R. (2009) *The Australian*, 7 October

Hamilton, D. (1990) 'Research papers: who's uncited now?', *Science*, 250, pp.1331-2

Higher Education Funding Council for England (2009) *Selection of staff for inclusion in RAE2008*, http://www.hefce.ac.uk/pubs/hefce/2009/09_34/#exec

Jenkins, A. (2004) *A Guide to the Research Evidence on Teaching Research Relations*, York: Higher Education Academy, http://www.heacademy.ac.uk/assets/York/documents/ourwork/research/id383_guide_to_research_evidence_on_teaching_research_relations.pdf

Lotka, A.J. (1926) 'The frequency distribution of scientific productivity', *Journal of the Washington Academy of Sciences*, 16 (12), pp.317-24

Malcom, W. and N. Tarling (2007) *Crisis of Identity? The mission and management of universities in New Zealand*, Wellington: Dunmore

Mayr-Hartin, H. (2007) 'The Oxford tutorial', http://www.lawrence.edu/news/pubs/lt/spring07/oxford.shtml

Ministry of Education (2009) *Draft Tertiary Education Strategy 2010–2015*, released end of September, http://www.minedu.govt.nz/theMinistry/Consultation/TertiaryEducationStrategyDraft/TertiaryEducationStrategySep09.aspx

Newman, J. (1907) *The Idea of a University*, London: Longmans, Green and Co., available at http://www.newmanreader.org/works/idea/

Pendlebury, D. (1991) 'Science, citation, and funding', *Science*, 251, pp.1410-11

Price, D. (1986) *Little Science, Big Science ... and Beyond* (originally published 1963), New York: Columbia University Press

Smith, L. (1938) *Unforgotten years*, London: Constable

Victoria University of Wellington (2008) *Annual Report 2008*, at http://www.vuw.ac.nz/annualreports/2008/2008-Annual-Report.pdf

Zaman, M. (2004) *Review of the academic evidence on the relationship between Teaching and Research in Higher Education*, London: Department for Education and Skills

Susan St John[1]

ACC the lessons from history

Introduction

The 2008 National-led government, concerned with what it saw as an explosion in costs, claimed that the Accident Compensation Corporation (ACC) board did not have the skills to secure the financial stability of the ACC scheme. In March 2009 the minister, Nick Smith, dismissed the chair of the board, Ross Wilson, and appointed in his place accountant John Judge.

As at June 2009, ACC's reported outstanding claims liability was $23.8 billion, while invested reserves were just $10.4 billion. The $13.4 billion 'unfunded' liability had grown from $8.4 billion the year before. This 'blow-out' reflected a rising number of claims, increased costs, a poorly-performing share market, and, most importantly, accounting changes to the actuarial assumptions behind the valuation of outstanding claims.

While income exceeded expenditure for the 2008/2009 financial year by $1 billion, the change in value of outstanding claims had resulted in a reported loss of $4.8 billion. The minister described the choices ahead for ACC as 'pretty ugly', and insisted that without change 'ACC is on course to go broke'. He claimed:

> This will go down in New Zealand history as the biggest corporate loss of any entity, public or private, and is actually bigger than any deficit that the government has run collectively across all portfolios. (Sunday Star-Times, 2009)

The Labour opposition pointed out that a surplus of revenue over current expenditure meant that ACC was more than paying its way. Unfortunately, Labour did not question the underlying presumption that ACC should be fully funded. Instead, ACC spokesman David Parker argued that, to ease the burden on levy payers, the 2014 date for the full funding of historic claims should be extended.

The funding debate is full of semantic ambiguities that confuse the debate. In this article, 'full funding' or 'full pre-funding' means funding in an insurance sense: the actuarial requirement that current assets are sufficient to meet all accrued obligations. 'Pre-funding', a more general term, implies a scheme that has some assets but is not necessarily fully funded. A pay-as-you-go (PAYG) scheme may have contingency reserves, but a reserve fund is not an essential part of PAYG.

In late 2009 the National government introduced the Injury Prevention, Rehabilitation, and Compensation (IPRC) Amendment Bill, with changes to levies and entitlements designed to 'facilitate cost containment' and to improve financial 'reporting and accountability'. While the date for achievement of full actuarial funding was extended from 2014 to 2019, the principle of fully funding ACC to ensure sustainability was strongly reinforced.

By this time, serious questioning of the funding requirement had begun.[2] The purpose of full funding for a private insurer is clear: policy holders require

Susan St John is an Associate Professor in the Department of Economics at the University of Auckland, Co-Director of the Retirement Policy and Research Centre, and a member of the ACC group.

certainty that their claims can be met if the firm should go out of business. In any given year, enough revenue must be raised to meet the costs of that year's claims, no matter when they fall due.

On the other hand, critics argued that there was as little economic rationale for fully funding ACC as there would be for fully funding education or state pensions. Governments do not have to fully fund. They do not face the prospect of insolvency and can always fund their social commitments from higher levies or taxes. Social insurance schemes in other countries are generally not fully-funded, but some reserves may be held. In the case of the United States social security programme, for example, the trust fund holds government bonds as a reserve buffer for periods of deficit that might arise, say in a recession (Rejda, 1984).

In the case of New Zealand, the New Zealand Superannuation Fund (NZSF) may be seen as a device to smooth tax rates in the light of demographic change, but falls far short of fully funding New Zealand Superannuation. The money invested in NZSF might equally have been used to repay debt or increase other assets such as infrastructure.

In a somewhat ahistorical context, Littlewood (2009) mounted a persuasive argument for the ACC fund to be abolished, with ACC placed on a pure, PAYG basis. Levies could be set on whatever basis was appropriate, but, he argued, the ACC should not itself manage a fund of invested assets. Requiring ACC to be fully funded, he argued, exposes the Crown to unnecessary financial risk (Littlewood, 2009).

This paper argues that ACC should return to its original inception as social insurance with PAYG principles, but that our history points in the direction of the need for a buffer of reserves, set at a level agreed to by all relevant political parties.

History matters

> When you are peering into the future to see where you are going it is not at all a bad idea to remember where you have been. (Woodhouse, 1999)

The purpose of this paper is to locate the funding debate in a frame that reflects ACC's history over more than 40 years. This history reveals that there is nothing new in the current ACC debate. From the beginning there were tensions between the view that ACC was insurance and should be funded as such, and the view that ACC was more like a welfare system and could have a PAYG basis. Rather than be prisoners of our history, we could draw important lessons from it for future policy development.

... it is ... argued that the [ACC] scheme can only be stable if it is fully funded. [The] whole point of having social insurance is to enable society to escape from the strictures of private insurance.

Workers' compensation rights

The first workers' compensation legislation, introduced in 1900, required limited no-fault compensation for accidents at work. In an amendment in 1943, every employer was obliged to insure against the risk. There were criticisms of the profits of private insurers, and a further amendment in 1947 gave the state-owned insurer the monopoly on this business. Then, from 1951, it was opened up to private participation once more (with 61 insurers) as a result of pressure from the industry (Campbell, 1996, p.16; Royal Commission of Inquiry on Workers' Compensation, 1967, p.80).

Woodhouse found this 'interpolation' of private insurers into what was essentially mandatory social insurance inappropriate and 'extremely expensive', with no corresponding advantages (Report of the Royal Commission of Inquiry on Workers' Compensation, 1967, p.90).

Operating under the Workers' Compensation Act 1956, the scheme was financed by a system of differential premiums that reflected industry risk. It was run on insurance principles, including being fully funded and tightly circumscribed, with limited no-fault benefits for 'workers' only, with the right to sue for damages in cases where it was believed that fault could be proven. Demarcation between work and non-work accidents was a clear problem:

> the dividing line between a man hurt on his way to work and the one injured within the factory gates has at times been so thin as to be almost imperceptible. (Young, 1964, as quoted in Royal Commission of Inquiry on Workers' Compensation, 1967, p.82)

The shortcomings of that scheme provoked Woodhouse's radical rethink of how a modern society should treat accidents. One key parametric change (Royal Commission of Inquiry on Workers' Compensation, 1967) was to see that, in determining fair compensation, it did not matter whether or not the accident was at work, nor did it matter who was at fault. Woodhouse argued that the revolutionary 24-hour/7-day ACC scheme he proposed should not be based on private insurance principles. It required an entirely new frame, more fitting to the social innovation it represented.

ACC was to be social insurance

Thus, the 1967 Woodhouse Report suggested that the replacement for workers' compensation should be viewed as *social insurance*. As Woodhouse emphasised:

> As the scheme will be a Government scheme of social insurance it must in the final resort receive the backing of the state ... It is for this reason that a formal system of funding cannot be regarded as essential to the stability of the whole scheme. (Report of the Royal Commission of Inquiry on Workers' Compensation, 1967, p.175)

This clarity has been lost in the current debate in which the goal of fully funding ACC has become the tail that wags the

dog: it is now argued that the scheme *can* only be stable *if* it is fully funded. Yet the whole point of having social insurance is to enable society to escape from the strictures of private insurance. The benefits under social insurance can be more redistributive and comprehensive than under private insurance. The small print does not have to limit coverage and scope, and evolution or change of the scheme is not only possible, it is desirable as new risks emerge. Weekly compensation for long-term accidents can be inflation- and wage-growth-adjusted – a near impossibility for private insurance; and, importantly, the scheme does not have to meet the funding standards of private insurance.[3]

Far from these disappearing as economies develop, as Barr (2001) argues, the 21st century has new risks and insecurities that increase rather than lessen the need for social insurance. Nowhere is this more true than for the provision in an increasing unpredictable world of full compensation and rehabilitation for all accidents on a no-fault basis.

The funded basis of the 1972 Accident Compensation Act

In the 1967 royal commission report, Woodhouse suggested that a levy of 1% of all wages would approximately replace the existing insurance premiums. In the first years of ACC the outgoings for current accidents would be less than income. Although this surplus was to be invested in the short term, there was no suggestion that the scheme would operate on a full-funding basis. Built-in inflation adjustments, wage indexation and the subsequent expansion to meet new needs would make full funding entirely inappropriate. Furthermore, Woodhouse intended that the levy rate be fixed, with additional funds in the future to come from general taxation as and if required (see Royal Commission of Inquiry on Workers' Compensation, 1967, p.176)

While it is possible and logical to fund social insurance by general taxation on a PAYG basis, Woodhouse argued that he had to take account of the premiums on industry that were already in place. To change to general taxation would unduly benefit industry. Accordingly, he said 'logical argument is an insufficient reason for shifting these costs in such a fashion' (ibid., p.171). However, he did recommend a flat rate levy with no risk- or performance-based differentiation as a more appropriate way to finance ACC. Reserves were seen as a useful by-product which would cover a contingency such as a major earthquake, but not essential to PAYG.

The Law Commission's report in 1988 notes how the unavoidable transition from workers' compensation to ACC contributed to the subsequent misunderstandings:

> [it] left behind for some people the misconception that it is simply a new means of obtaining cover against new risks, it is wrong and a cause of confusion to think of it in this way. This scheme is not in any sense an insurance system (New Zealand Law Commission, 1988, S2)

The report of the 1970 select committee, chaired by George Gair, was strongly influenced by the insurance basis of workers' compensation. Thus, the 1972 Accident Compensation Act legislated an insurance-based approach, with differential levies set by order-in-council, with possible penalties and rebates.

The scheme also paralleled its predecessor in being set up on an apparently fully-funded basis, requiring actuarial reports at five-yearly intervals to assess whether levies were 'sufficient to meet the current and future liabilities of the Fund' (Accident Compensation Act 1972, p.7).

Campbell (1996) questions whether these requirements as set out in the act implied a clear obligation for a funded scheme 'in the strict sense'. It appeared not to have operated this way in the 1970s. Woodhouse is in no doubt that this piece of the act was based on a misconception of the nature of the scheme, and he noted in 1979 that his views and those of the commission 'had been on a collision course for some time':

> The notion that an instrumentality of the State engaged upon the administration of a social welfare programme should be obliged to act on a private enterprise funded principle of finance is, in my opinion, based on economic misconceptions. In the present context it is unnecessary on any grounds of prudence, such a system is far more expensive in operation than the method of pay as you go and I think it is unfair to those who may later be asked to pay the extra costs. (Woodhouse, 1979)

... it is unnecessary on any grounds of prudence, such a system is far more expensive in operation than the method of pay as you go and I think it is unfair to those who may later be asked to pay the extra costs.

In 1977 Geoffrey Palmer was sceptical that the idea of full funding made much sense. He pointed to the event of rapid inflation in the 1970s and the emergence of a long tail of claims, which 'makes the estimate of contingent liabilities very much a matter of guesswork'. But, he claimed,

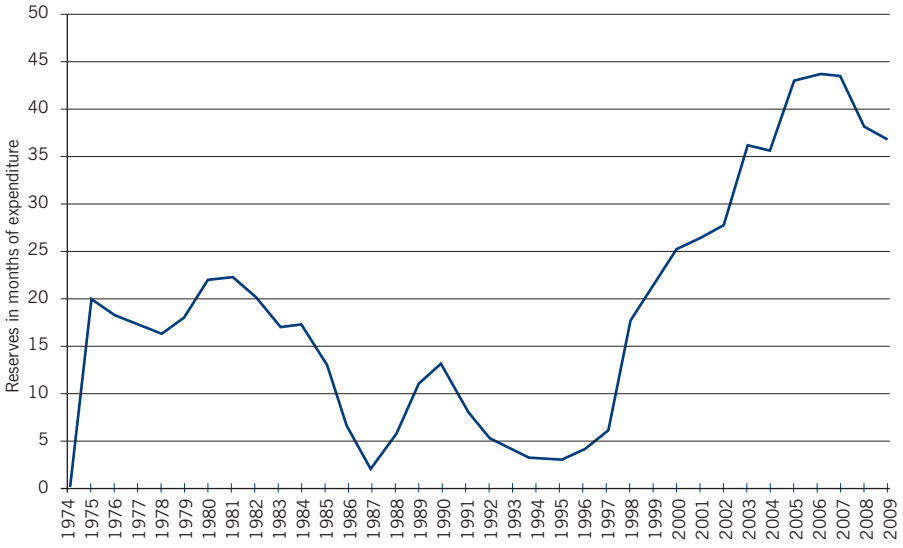
> it may be worthwhile preserving the pretence of a funded scheme until the plateau is reached and it is possible to know with some certainty what the annual payout would be under a [PAYG] scheme (Palmer, 1977, p.202)

Palmer described the end result as 'a curious mixture that provides useful insulation and flexibility'. Thus, the

arrangements as they evolved in the 1970s were a pragmatic mix of PAYG and pre-funding. Eventually, as the scheme matured, with stable demographics it would be expected that inflows would equal outflows. At this point, the scheme would be essentially PAYG.

Nevertheless, the National government's 1980 Cabinet caucus committee, chaired by Derek Quigley, under pressure from employers and failing to see the point made by Woodhouse recommended a PAYG basis which was then endorsed in the Accident Compensation Act 1982 (s.19).

Figure 1: ACC reserves in months of expenditure



Source: St John, 1999, p.161, and ACC annual reports, 1997-2009

Funding and the 1980s

By 1980 the ACC fund had reserves equal to 20 months of expenditure (see Figure 1). There was pressure from employers for a return of these funds, as they were concerned about their levy costs. However, as Woodhouse later reflected, the build-up in funds should not have been regarded as evidence that levies were too high:

> 'The fact that the scheme had some years to run before it reached maturity was never discussed. Nor was it said that an upgraded workers' compensation scheme would have been far more costly. Instead, the early confusion about the nature of the reserves as a painless side advantage of a still maturing scheme led directly to their remarkable political decision that they could now be eroded in order to supplement a reduction in the levies. It was rationalised on the basis that the scheme should now become a pay as you go operation – a method the system was already operating.' (Woodhouse, 1995)

The National government's 1980 decision has been widely derided as ill-fated. Rennie (2003, p.348) refers to it as 'disastrous', producing a 'short-term reduction in levies but a subsequent 'blow out' in levy rates and the obliteration of reserves'. Chapman (2009), however, locates the problem in the non-stipulation of a minimum level of reserves that should have been maintained under PAYG.

By 1985 levies had been reduced by 30%, and by March 1986 the reserves had fallen to less than was considered necessary to support a PAYG scheme (Rennie, 2003, p.340). By 1987 reserves were down to only two months' worth of expenditure (Figure 1), with claims of a cost blow-out and angry demands for review and cutbacks. In response, levies were increased sharply, 238% on average. There was recognition that the PAYG scheme had to have sufficient emergency reserves for an unforeseen event such as a major earthquake, in addition to six months of estimated expenditure, but this was never enacted (Chapman, 2009). By 1990 the reserves were back to 13 months, amid strident demand for review of this 'costly' scheme.

In its 1988 report on the ACC scheme, the Law Commission made several recommendations to address the many perceived problems of ACC. They had this to say about the role of reserves in their proposed draft legislation for a new act:

1. In estimating its income needs for any financial year, the Corporation shall set aside a sum amounting to not less than half its estimated expenditure for that financial year as a reserve fund.
2. The Corporation may draw on that reserve fund as a source of working capital and to meet any unforeseen contingency. (New Zealand Law Commission, 1988, p.154)

The report was largely ignored and the subsequent lack of attention to the determination of an appropriate level of reserves, and the purpose of those reserves, paved the way for the future funding debate.

Funding and the 1990s

In 1990, National repeated the cycle by once again bowing to employer pressure and reducing levies. 'The result was another serious rundown in reserves over the next five years [see Figure 1] creating the conditions once again for claims of a blow-out in costs, possible insolvency, and thus the need for sharp levy increases in the future' (St John, 1999, p.160). Employers had been resentful of the tail of long-term claimants and their obligation to fund non-work accidents. National MP Bill Birch had fomented this resentment by claiming costs had mushroomed out of control between 1985 and 1990, and calling for cutbacks and more individual responsibility. The result was the Accident Rehabilitation and Compensation Insurance Act 1992. This was supposed to make ACC 'fairer' by scaling back benefits and reintroducing more of an insurance basis: for example, by removing non-work accidents from the earners' account, and by renaming levies as premiums (St John, 1999, p.163). The ACC was, however, kept on a PAYG basis in the meantime. By 1995, reserves were again down to only three months of expenditure (Figure 1).

By 1997 reserves had improved to

equal six months of expenditure and the then chair of ACC suggested that levy reductions were possible, amid lobbying by business interests. In the 1996 Budget, however, large tax cuts had been announced by the minister of finance. In December 1997, while the average employers' premium was reduced by 10%, the earners' premium was increased from 70c to $1.20, perhaps to partly offset the 'inadvisable' tax cuts of 1997–98 (St John, 1999). Under the new GAAP (generally accepted accounting practice), 'whole of government accounting', the increase in funding of ACC would have had favourable consequences for the operating surplus and balance sheet.

It is at this time that the government began to talk of requiring ACC to be fully funded over 15 years to align it more with private insurance. This was to allow a greater degree of competition, and, by signalling this direction, to somewhat mollify disappointed employer interests (St John, 1999, p.169).

The levy increases and the move to full funding were hotly debated, with the leader of the opposition asking the minister for accident rehabilitation, compensation and insurance, Jenny Shipley, to explain the sudden conversion to full funding:

> Does the Minister recall telling a women's forum in Auckland as recently as March: 'I want to bring the average levy down over the next 3 years.' If so, when did her road to Damascus conversion on the need to move to a fully funded scheme occur? (Clark, *Hansard*, 4 December 1997)

The minister responded in terms that have echoes in the debates of 2009:

> The members may scoff, but they should go back and look at their own history in managing the accident compensation scheme. We are trying not only to bring the scheme to a mature state in terms of all the accounts but to get the four accounts under control. It is in the interests of workers and levy payers to see that accident compensation does fund itself so that we can have confidence in the 24-hour cover of that scheme. (Shipley, *Hansard*, 4 December 1997)

The Accident Insurance Act (AIA) 1998 required employers to purchase accident insurance for their employees, and legislated for full funding of the motor vehicle (MV) account and earners' account. Premiums were to reflect the full funding of the current year's accidents and funding of the outstanding claims liability by no later than 30 June 2014. A clear connection was made between full funding and private insurance principles of incentives at numerous times in the debates. For example:

> The sorts of things that have influenced me are when I visit, for example, a motorway development in Auckland where the employer and the workers tell me how proud they are of their non-accident record even though they are a major construction company, then in the next breath they tell me how they resent the fact that they are lumped together with other employers who have lousy work records. Those workers and those employers are entitled to have the experience-rating mechanism reward them for their performance. The only way we can do that is to go to the full funding of the scheme. (Shipley, *Hansard*, 2 December 1999)

In 1999, facilitated by the move to full funding (Caygill, 2003, p.400), private competition was introduced for work accidents. Labour had, however, promised to repeal the AIA if elected in late 1999, so that the privatisation experiment was to be short-lived.

While Labour failed to appreciate adequately the connection between the goal of actuarial full funding and the end game of privatisation, *Hansard* reveals that from time to time there had been glimpses of insight:

> Ruth Dyson was absolutely spot on when she said that the reason the Government is doing this right now is to get that scheme ready for privatisation. Just as the employers' account has been privatised, the motor vehicle account is the next on the block. But in order to get it into shape for privatisation, the Government has to bring it into the fully funded scheme. (Dalziel, *Hansard*, 20 May 1999)

The curious 2000s

The election of Labour saw the social insurance principles of ACC firmly reinstated. The purpose of the new Injury Prevention, Rehabilitation, and Compensation Act (IPRC) 2001 was to 'reinforce the social contract represented by the first accident compensation scheme' (preamble). It also reversed the privatisation experiment of the AIA which had seen the employers' account opened to competition, removed the term 'insurance' from the title, and renamed premiums as 'levies'.

Surprisingly, Labour kept full actuarial funding by 2014 for the scheme as a whole, including the non-earners' account in the IPRC. Did it not just pave the way for the new government in 2008 to claim that ACC was insolvent? Was it the influence of Treasury? Was it to enable higher levies to produce more favourable operating surpluses under the GAAP accounting rules?

A possible scenario is that Labour wanted to prevent the Quigley and Birch scenarios ever again threatening the security of the scheme. Perversely, the stick of full funding has threatened the

The purpose of the new Injury Prevention, Rehabilitation, and Compensation Act (IPRC) 2001 was to 'reinforce the social contract represented by the first accident compensation scheme' ...

scheme anyway, even when reserves have actually been at an historic high in the last decade (see Figure 1).

Although Labour's conversion to full funding ACC has been hard to understand, it is unmistakable that it saw the move to full funding as a good thing:

> As a consequence of improved performance by ACC, its overall unfunded liability has reduced considerably and some schemes are now approaching full funded status.
>
> ... I do remember that the National Government that held office before 1984 ran down the reserves of the corporation dramatically and put it on the point of insolvency, but of course that is not possible under the full funding model formula. (Cullen, *Hansard*, 14 March 2000)

Another explanation might lie in the fiscal conservatism of the Labour government: Caygill argued that while full funding was a precursor to competition, it could be justified on its own merits. Quite clearly, the consolidation of ACC into the Crown accounts would involve the accrual of future liabilities and require levies to meet more than current needs.

> This may seem a trivial argument for retaining full funding and indeed there are stronger arguments (for example the more accurate costing requirement of any proposed change to the level or form of future benefits). On the other hand, I suspect the balance sheet argument would be sufficiently persuasive for any future Minister of Finance. (Caygill, 2003, p.400)

From 2000 to 2007 (see Figure 1) the value of ACC's reserves increased significantly. Most of the growth was due to retained investment income and strong returns in equity markets, but the economy was also strong and levy revenue was higher than forecast. ACC used the extra funds from the surplus to expand the investment portfolio in order to accumulate sufficient funds to cover the claims liability. The stated aim in the ACC annual report for 2007 was for ACC to be fully funded (ACC, 2007, p.49).

2008–09: ACC under attack

Labour bought into the concept of full funding, at least in part, because of the extreme pressure it witnessed on ACC under the PAYG approach in the 1980s and 1990s, with each period leading to large levy rises and accusations of insolvency and entitlement cuts. Although the 2000s produced a large increase in reserves, it was not large enough to meet the requirement for full funding by 2014. The scheme was thus vulnerable once again to National's claims that the scheme was in crisis and 'technically insolvent'.

In 2009 the ACC minister, Nick Smith, used the full funding requirement as a justification for sharply increased levies and reduced ACC entitlements. However, even after share market losses in 2008, reserves were still at about 37 months of expenditure (Figure 1). The justification for full funding was the GAAP accounting requirements imposed on the government, even though these have applied selectively and should be no more applicable to ACC than to New Zealand Superannuation or health care costs (Littlewood, 2009). The driver of full funding is arguably a political and ideological agenda.

Repeating the scenario of the late 1980s, it is also convenient for the government to raise revenue via ACC levies as this will strengthen the GAAP accounts and offset the effect on the operating surplus of what may be viewed as 'fiscally inappropriate' tax cuts granted by National in late 2008. In a repeat of former history, the employers have been mollified with the promises of privatisation and competition for the work account, and by the fact that the bulk of the increase in levies would be raised from employees and motor vehicles.

Lessons to be learned

What can be learned? There are clear patterns from our past. Both pure PAYG and full-funding concepts have been used by the National government in power to attack ACC. Labour in turn failed to see the dangers of full funding and failed to question the flawed basis of using GAAP rules for a social insurance scheme when it had the opportunity (Littlewood, 2009). It also failed to point out why some level of reserves is required under a social insurance-PAYG type scheme.

The experience of PAYG is that reserves can be quickly dissipated in an evolving scheme, leading to panic about cost blow-outs and financial failure. Destabilising increases in levies follow. The more recent experience is a variation on that theme. This time, instead of reserves disappearing under PAYG, reserves have been growing strongly for some years with economic growth and favourable asset markets. The benchmark, however, has become some mythical fully-funded nirvana and the stability of the scheme is now determined by actuarial projections that are notoriously difficult to make. '[Actuarial projections] as a scientific exercise are almost as pointless as the debate in mediaeval scholasticisms as to the number of angels that can dance on the head of a pin' (Clayton, 2003, p.460).

If full funding is actually achieved at any point, share markets may still crash again, or the discount rate may fall, or the ACC may have to accommodate unforeseen expenditures or new risks in an uncertain world. Full funding is therefore a chimera as well as an inappropriate goal. The current full-funding 'crisis' may force the partial privatisation of ACC,

Both pure PAYG and full-funding concepts have been used by the National government in power to attack ACC. Labour in turn failed to see the dangers of full funding and failed to question the flawed basis of using GAAP rules for a social insurance scheme when it had the opportunity

when what is required is a dispassionate investigation of what design of ACC, including the financing arrangements, is in society's best interests.

There is a way to prevent these destabilising attacks. First, we need to acknowledge that ACC is a form of social insurance and has clear advantages over private insurance. Second, we need to acknowledge that while full funding is an inappropriate goal, a buffer of reserves can be useful and prudent. The reserves could be, say, set as a range of years of expenditure, or set in relation to levy income, as the Law Commission (1988) suggested. A possible rationale is to have a contingency fund sufficient to meet a large disaster and to allow practical day-to-day management, especially in unusual times such as a recession.

While levies should never be adjusted in a discontinuous way to meet some reserve objective, the level of reserves should be allowed to fluctuate in line with the economy and markets. This would give employers, individuals and markets a degree of certainty about levies over the short-to-medium term. The entitlements and design of ACC should be reviewed, independently of any actuarial projections, to ensure New Zealand has the best possible scheme. Unfortunately, it is not presently clear how to achieve the multi-party political agreement and the economic understanding that this solution requires.

1 The author thanks Michael Littlewood, Claire Dale, Jonathan Boston and Bob Stephens for helpful comments on earlier drafts but alone is responsible for views expressed in this paper.

2 For example, a forum on ACC funding was held on 15 December 2009 at the School of Business, University of Auckland. See www.rprc.ac.nz.

3 This is in some ways the core of the argument. The accounting standards of private insurance require full funding, i.e. that, each year, the company raises enough revenue to cover the all the current and future costs of accidents incurred in that year.

References

ACC (2007) *Accident Compensation Corporation Annual Report 2007*, Wellington: ACC

Barr, N. (2001) *The Welfare State as Piggy Bank: information, risk uncertainty and the role of the state*, Oxford: Oxford University Press

Campbell, I. (1996) *Compensation for Personal Injury in New Zealand*, Auckland: Auckland University Press

Caygill, D. (2003) '1990s: decade of change', *Victoria University of Wellington Law Review*, 34 (2), pp.392-406

Chapman, J. (2009) Unpublished commentary on M. Littlewood's paper on PAYG funding for ACC, Massey University

Clayton, A. (2003) 'Some reflections on the Woodhouse and ACC legacy', *Victoria University of Wellington Law Review*, 34 (2), pp.449-63

Littlewood, M. (2009) 'Why does the Accident Compensation Corporation have a fund?', *PensionCommentary*, 2009-1, Reitrement Policy and Research Centre, University of Auckland Business School

New Zealand Law Commission (1988) *Personal Injury: prevention and recovery,* Wellington: New Zealand Law Commission

Palmer, G. (ed.) (1977) *The Welfare State Today: social welfare policy in New Zealand in the seventies*, Wellington: Fourth Estate Books

Rejda, G. (1984) *Social Insurance and Economic Security*, New Jesey: Prentice Hall

Rennie, D. (2003) 'Administering Accident Compensation in the 1980s', *Victoria University of Wellington Law Review*, 34 (2), pp.329-49

Royal Commission of Inquiry on Workers' Compensation (1967) *Compensation for Personal Injury in New Zealand. Report of the royal commission of inquiry*, Wellington: Government Print

St John, S. (1999) 'Accident compensation: a fairer scheme?', in P. Dalziel, J. Boston and S. St John (eds), *Redesigning the Welfare State in New Zealand: problems, policies, prospects*, Auckland: Oxford University Press

Sunday Star-Times (2009) 'The painful bills about to wallop your wallet', http://www.stuff.co.nz/sunday-star-times/news/2952015/

Woodhouse, O. (1979) 'Aspects of the accident compensation scheme,' *New Zealand Law Journal*, 18, pp.395-405

Woodhouse, O. (1995) 'Accident compensation in 1995', paper presented at the launch of the coalition on ACC, Wellington, 4 December

Woodhouse, O. (1999) 'ACC: integraton or demarcation?', paper presented at the 'Rebuilding ACC beyond 2000' conference, Wellington

Christina Hood

Free Allocation in the New Zealand Emissions Trading Scheme
A Critical Analysis

Introduction

In November 2009 the government passed significant amendments to New Zealand's emissions trading scheme (ETS), barely two months after the legislation was introduced. Submitters were given two weeks to make written submissions, and some were asked to appear for oral submissions with only a few hours notice. Very little economic analysis of the legislation was released by the government at the time or has been since.

This paper provides an introduction to, and critical analysis of, the key change to scheme: the shift from historical grandparenting of free units to an uncapped production-based allocation. Decisions around long-term allocation will drive major investments and steer New Zealand's emissions track over the coming decades.

Christina Hood is an energy and climate change policy analyst. She worked as a policy adviser to the minister for energy and climate change issues during 2002–2005, and is the co-author (with Colin James) of *Making Energy Work: a sustainable energy future for New Zealand* (Institute of Policy Studies, 2007). She won the Prince of Wales Prize for the best science student at the University of Otago in 1993 and holds a PhD in physics from the California Institute of Technology.

Background: the New Zealand emissions trading scheme

New Zealand's ETS, first passed into law in late 2008, is unique internationally in that all sectors of the economy are to be phased in by 2015: electricity generation, energy, industrial processes, transport fuels, agriculture and forestry.

Under the ETS, entities that are responsible for greenhouse gas emissions (such as fuel importers, cement manufacturers, dairy processors, or those clearing forests) are required to submit one New Zealand unit (NZU) to the government for each tonne of emissions. Those undertaking compliant forestry activity are entitled to receive units.

Some emissions-intensive sectors, such as industry and agriculture, will receive free allocations of units, ostensibly to protect their international competitiveness. Other sectors, such as electricity generation and liquid fuels, will be required to purchase (domestically or internationally) units to surrender to the government. As international Kyoto-compliant units are acceptable under the scheme, the price of NZUs will be capped at the international price of emissions.

Carbon leakage and free allocation

There is substantial economic analysis showing that once there is widespread international emissions pricing, the least-cost domestic response is economy-wide pricing with no exemptions or free allocation (for example, see Montgomery, 1972; Stavins, 2007; NZIER/Infometrics, 2009). However, there is a common concern that without widespread international action, emissions pricing could cause emitters to lose competitiveness or even relocate to jurisdictions that don't price emissions, leading to both job losses and higher global emissions. This effect is known as carbon leakage.

This concern is often overstated, both environmentally and economically. Although the competitiveness of some sectors will certainly be affected by emissions pricing, analysis shows that this does not generally lead to major economy-wide issues or major increases in emissions (IEA, 2008; WRI, 2008).

Nonetheless, free allocation of units

forms part of every emissions trading scheme currently being developed. It aims to support the competitiveness of affected sectors until the world transitions to more widespread emissions pricing, or at least to uniform action across sectors. It can be thought of either as compensation for assets stranded by the policy change, or else as a production subsidy to be phased out as competitors introduce emissions pricing.[1]

New Zealand's 2008 ETS used a 'grandparenting' approach to allocation: that is, the free allocation was to be a fixed number of units based on historic levels of emissions. Energy-intensive trade-exposed industries and the agriculture sector were to receive a fixed annual allocation of units until 2018, set at 90% of 2005 emissions, phasing out to zero by 2030.

Under grandparenting, new investments or expanded production do not receive any allocation. This could lead to lost investment in the short term, but avoids locking in high emissions activity that could be uneconomic in the future. It also ensures that the allocation of new capital investment across different sectors of the economy is efficient for the new environment in which emissions are priced, thus promoting a lower carbon economy as a whole.

The 2009 ETS amendments change the free allocation from grandparenting to a production-based (also called intensity-based) approach, in which units are awarded per unit of current production. Under production-based allocation, new investments and increased production receive the same level of support as existing activity, so are encouraged. There is, however, a risk of locking in uneconomic high emissions activities, leading to inefficient allocation of capital between various sectors of the economy. Even though firms are awarded units for free, they still have an incentive to improve emissions intensity at the margin, because any efficiency improvements free up permits that can be sold at the full market price.

Cost of free allocation to the wider economy

Intuitively and according to economic theory, providing protection to some sectors means the rest of the economy will face greater costs. As the specialist adviser to the parliamentary select committee, Dr Suzi Kerr, put it:

> Not having effective reduction policies in every sector would raise the costs of compliance to the economy as a whole. Excluding a sector from the emissions trading system or providing high levels of free allocation to some firms imposes high costs on all other sectors and firms who must cover the costs of those emissions through taxes. (Kerr, 2009)

At an emissions price of $100/+$CO_2$, free allocation of 30 to 40 million units per annum is an annual cost to government of $3-4 billion.

Results of New Zealand general equilibrium modelling (NZIER/Infometrics, 2009) suggest there is no impact or even a small benefit to the economy as a whole from free allocations. This result hinges on the assumption that few mitigation opportunities exist in the protected sectors, so introducing an emissions price simply leads to output being curtailed, with flow-on negative consequences in the wider economy. Other economic analyses argue that significant abatement opportunities do in fact exist (Bertram and Terry, 2008), in which case free allocation would clearly be welfare-diminishing.

Even if we assume that free allocation comes at no overall cost to the economy, there can still be significant effects. Again to quote Kerr (2009):

> Free allocation redistributes the cost of climate policy away from the owners of protected firms, who tend to have higher than average incomes, toward all taxpayers. It also significantly raises the overall cost of the climate policy to the economy. A policy that is fiscally neutral can still have large damaging effects on the parts of the economy and society that do not receive free allocation.

International experience

Unlike the economy-wide coverage of the New Zealand ETS, overseas schemes tend to cover only the energy, industy and sometimes transport sectors.

Empirical analysis of a proposed ETS for the United States shows that a free allocation in perpetuity of 13–21% of the total number of units issued would fully compensate private industry for equity losses, or equivalently a 50% allocation phasing out to zero by 2025 (Bovenberg et al., 2003; Stavins, 2007).[2]

Legislation currently being considered by the United States Senate proposes a similar split: roughly 17% of the total value of allocation to 2050 will accrue to private industry (Stavins, 2009a). Trade-exposed emissions-intensive industries receive an initial allocation of 15% of total units, decreasing over time in line with the overall cap, and phasing out to zero after 2025. Within this cap, allocation is production-based (Stavins, 2009b).

Under the European Union's ETS, trade-exposed industries (around 25% of emissions in the scheme) receive free allocation for 100% of their emissions if they are using best practice technology. There is a capped pool for allocation to these industries which declines with the overall reduction target (European Union, 2009).

The proposed Australian carbon pollution reduction scheme (CPRS) initially provides 94.5% free allocation to highly trade-exposed energy-intensity sectors and 66% to moderately exposed sectors. Both phase out at 1.3% per annum for the first ten years, with the phase-out rate reset five-yearly thereafter (Wong, 2009).[3] Free allocation is initially around 20% of total units, but this pool is uncapped and expected to rise as industrial

production growth outstrips the 1.3% phase-out rate (Australian Government, 2008).

Economic modelling of the Australian proposals shows that production in some sectors, particularly aluminium, would be affected, suggesting that some free allocation may be warranted. However, there does not appear to have been any analysis on the optimal level of this support from the perspective of the economy as a whole. Interestingly, carbon leakage is not observed in the modelling until emissions prices of well over AU$200/tCO2. (Australian Treasury, 2008)

Free allocation in the New Zealand ETS

The amended New Zealand ETS is closely aligned to the proposed Australian CRPS, and uses production-based free allocation. Agriculture and high emissions-intensity sectors are to receive a 90% free allocation per unit of production; moderate intensity sectors a 60% free allocation. Both are phased out at 1.3% per annum, with this rate fixed in legislation.

Figure 1 shows the free allocation of units to industry and agriculture expected under the previous and current legislation,[4] compared to two target levels for New Zealand emissions: a 50% reduction on 1990 levels by 2050 (the government's current target), and an 80% reduction. Note that while the 50% and 80% curves give an indication of the number of NZUs that might be issued, they do not actually represent a cap on New Zealand's total domestic emissions: under the New Zealand ETS, emissions can be arbitrarily high as long as additional units are purchased offshore to cover them.[5]

Note that these curves ignore units generated by (and used to cover) the growth and harvest of post-1990 plantation forests. Forestry has been excluded because it is cyclical: at some times it generates significant units, in others these need to be repaid as forests are harvested. Over the long term it is assumed to net out to zero.

The projections represented by the dashed and black lines were released by the minister for climate change issues, Nick Smith (Smith, 2009a), and minister of finance, Bill English, respectively.[6] Neither of these data sets was made available to the public at the time when the legislation was open for public submissions, and the second was only recently released under the Official Information Act.

Several important points can be noted in relation to Figure 1:

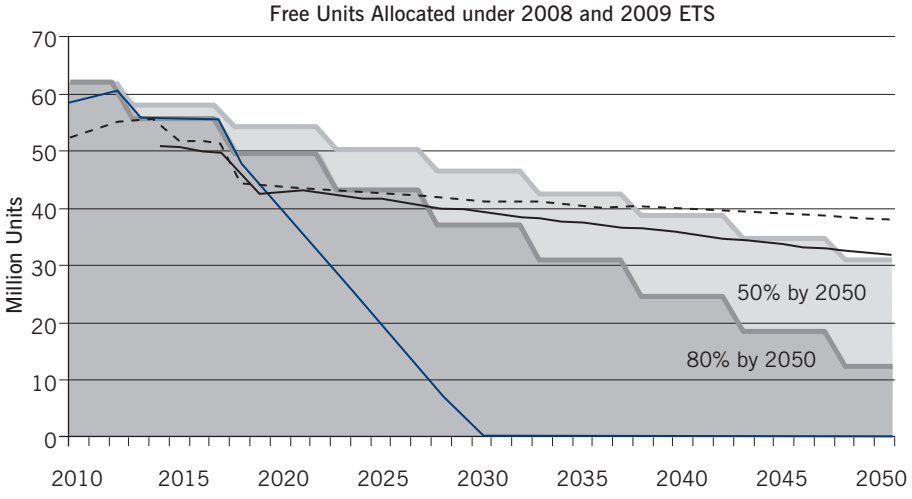
- The total allocation is very high compared to overseas schemes. Under the 2009 legislation, most NZUs will be allocated for free to cover emissions in industry and agriculture.
- Until around 2020, both the 2008 and 2009 schemes provide comparable, very high, levels of free allocation. Beyond 2020, the 2009 allocation phases out much more slowly.
- The free allocation under the 2009 legislation declines by less than 1% per annum. Although allocation per unit of production phases out at 1.3% per annum, production levels increase with time, partially offsetting this.
- Under production-based allocation, the small changes in assumptions between the dashed and solid curves have significant impacts on allocations (and hence fiscal implications).[7]
- If the 1.3% phase-out rate continues, the scheme may not be compatible with the government's 50% emissions reduction target, depending on how quickly production grows in the subsidised sectors.
- If New Zealand takes on a more ambitions target closer to 80% reductions by 2050, the 1.3% phase-out rate is far too gradual.

The very high level of free allocation in the New Zealand ETS means that unlike in overseas schemes, there is no specific allocation of units for transition in the residential or small business sectors, or to fund emissions reductions programmes. This is partly because New Zealand's gross emissions are now much higher than the 1990 baseline, so the entire pool of units is taken up covering just the agriculture and industry sectors. The free allocation also comes at a considerable fiscal cost: at an emissions price of $100/tCO2, free allocation of 30 to 40 million units per annum is an annual cost to the government of $3–4 billion.

Criticism has been levelled at the assumption underlying the solid and black curves, namely that the 1.3% phase-out rate will remain unchanged when the legislation will be reviewed every five years.[8] There are two major reasons why this assumption is appropriate. First, the 1.3% rate is set in legislation and will remain fixed unless a future government amends the law. The analysis presented in Figure 1 is therefore of the law as it currently stands.

Second, the government's communications relating to the 2009 amendments assume that the rate will remain unchanged, including graphs (presumably based on the black curve of Figure 1) to illustrate how a 1.3% phase-out rate is consistent with a 50% by 2050 target (see appendix of Hood (2009)). The government's message

Figure 1: Long-term free allocation of units to agriculture and industry under the 2008 ETS (blue line) and two government estimates for the 2009 ETS dashed and solid, and possible emissions reduction targets for New Zealand of 50% and 80% reduction on 1990 levels by 2050 (grey areas)



has been that, all things being equal, there is no reason that the rate need change.

Of course, Figure 1 only shows the level of free allocation to industry and agriculture, not actual emissions levels. Emissions are expected to continue rising, and by 2030 New Zealand's total gross emissions in the dashed-line data set of Figure 1 reach 80 million tonnes. With rising emissions, New Zealand will need to meet its targets largely through purchasing units internationally. As the international price of emissions units escalates, this will become an increasingly expensive strategy. At some point there will need to be a clear signal to investors of the need to transition to a low-carbon economy.

At present there is no long-term stable carbon price path on which to base investment decisions. It therefore falls on governments to signal the expected policy settings well into the future. The current signals – that substantial free allocation should still be in place in 2050 – run the risk of locking in inappropriate investment, especially where investment decisions are made around long-lived assets in the short term.

The value of free allocation

Under the 2008 legislation, free allocation would have phased out quickly, leaving the government with surplus units after 2020. These could have been sold to fund tax changes, debt reduction or climate programmes. With the 2009 amendments, the government has instead chosen to allocate virtually all NZUs for free to industry and agriculture.

The forgone revenue to the government resulting from the change has been estimated by the Treasury to be $110 billion to 2050, assuming a modest emissions price of NZ$50 per tonne (Treasury, 2009). With a more plausible (IPCC, 2007; OECD, 2009; Australian Treasury, 2008) emissions price rising to NZ$100 by 2050, the cost to the government approaches $200 billion.

Economic theory suggests that using any surplus units to reduce debt or general taxation, rather than maintaining subsidies, would have the greatest benefit economy-wide. However, there would also have been the opportunity to fund transitional assistance for households and small businesses, support clean technology, and undertake emissions reductions such as energy efficiency. The proposed United States legislation takes this approach, with 80% of the scheme's proceeds being directed to householders over the life of the scheme, both directly and through programmes (Stavins, 2009a).

Unfortunately, the government has not undertaken (or at least released) any economic analysis of the optimal means of allocating units in the New Zealand scheme, so it is unclear why the decision was made to allocate all units to agriculture and industry.

Breakdown of allocation – agriculture and industry

Figure 2 shows the breakdown of units allocated to the agriculture and industry sectors.

Industry

There are two obvious changes brought in by the 2009 amendments. First, the initial allocation has decreased by around one third. Because eligibility rules have been changed to match the draft Australian legislation, fewer New Zealand firms are expected to qualify.

Second, allocation remains more or less constant, because production increases at roughly 1.3% per annum, matching the 1.3% phase-out in support. These data sets clearly do not provide for any significant new entrant activity, such as expanded methanol and cement production, a coal-to-urea plant or a coal-to-liquid fuels plant (plans for all of which are being actively developed). These would see the allocation rising significantly.

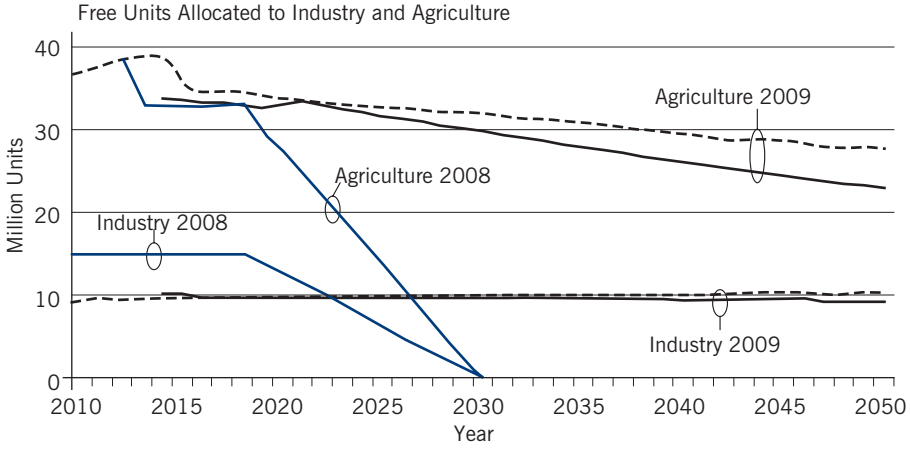
The initial level of assistance appears similar to that proposed in other markets. To see this, consider a hypothetical New Zealand ETS that includes only the transport (25MT emissions) and energy (22MT emissions) sectors. In this market, 10MT of free allocation is around 20% of total units. But the New Zealand timeframe for assistance is clearly longer, and likely to be overcompensating firms, based on US experience (Stavins, 2007).

The allocative baseline (number of units awarded per unit of production) is to be set at historic New Zealand sectoral average emissions. Firms producing with better than average efficiency will receive more units than they require, and vice versa for low-efficiency producers. Particularly in sectors where only a single plant operates, this choice of baseline sends a message that business as usual is all that is expected.

However, the New Zealand legislation also allows Australian baselines to be imported directly into the New Zealand scheme. For example, New Zealand sectors can be deemed eligible for assistance because their Australian counterparts are, even if they would not have been otherwise. In this case the New Zealand ETS must use the Australian baseline. This raises the potential of further significant windfalls or costs to firms, and uncertain costs to the taxpayer.

The effect of the change in allocation methodology coupled with a generous

Figure 2: Long-term free allocation of units to the agriculture and industry sectors under the 2008 (blue lines) and 2009 (black dashed and solid lines) ETS



Example: Holcim's investment in a new cement plant

Holcim is considering replacing its current cement plant, increasing production and reducing emissions intensity. If the new plant is not built, incremental demand would be met with imports. At a carbon price of $50 per tonne, free allocation is roughly as shown in Table 1.

Table 1: Potential value of free allocation to Holcim

	Existing plant + imports	New plant
Production	500,000 tonnes at 0.93tCO2/t	880,000 tonnes at 0.75 tCO2/t
Imports	380,000 tonnes at 0.87 tCO2/t	
Holcim emissions	465,000 tonnes p.a.	660,000 tonnes p.a.
Global emissions	797,000 tonnes p.a.	660,000 tonnes p.a.
Emissions cost to firm and taxpayer, 2008 legislation	Firm $2.32 million p.a. Taxpayer $20.9 million p.a.	Firm $12.07 million p.a. Taxpayer $20.9 million p.a.
Emissions cost to firm and taxpayer, 2009 legislation[9]	Firm: $5.0 million p.a. Taxpayer $18.2 million p.a.	Firm: $0.9 million p.a.[10] Taxpayer: $32.1 million p.a.

choice of baseline is illustrated in the example below, that the government has put forward to illustrate their preference for production-based allocation: Holcim's pending decision on a new cement plant.

Holcim has said it would not have invested in the new plant under the 2008 legislation. Under the 2009 legislation there is clearly a strong incentive to upgrade: note that the company's costs decrease substantially even though its emissions rise.

However, the incremental cost to the taxpayer of supporting the new plant is substantial: $14 million per annum. It employs roughly the same number of people, so there are not significant employment benefits. Global emissions are reduced by 137,000 tonnes, but at $50/tCO2 this should only cost $6.85 million.

Also consider the $18 million per annum of free allocation to the existing plant. If the plant's production was replaced by imports, global emissions would decrease, not increase. The plant supports around 130 direct jobs, so $18 million is around $140,000 per job per year.

It may be the case that these high levels of subsidy are necessary and desirable based on the plant's contributions to the wider economy, but this would need to be demonstrated through careful analysis.

Obviously, these costs are highly dependent on the emissions price assumed, so the intention is not to draw concrete conclusions. Rather, this example is intended to illustrate that detailed cost-benefit analysis of individual allocation decisions could be very important where large wealth transfers are involved.

Agriculture

Returning to Figure 2, it is clear that the majority of free allocation is to the agriculture sector.

No overseas jurisdictions currently plan to price agricultural emissions. However, there is a bipartisan political consensus in New Zealand that matching this 100% level of cover would be unaffordable here. This is because New Zealand's emissions profile is unique for a developed country: agricultural emissions make up nearly half of total emissions, so to exclude them completely would place a significant additional burden on other sectors of the economy.

Although agriculture is not given 100% cover, Figure 2 shows that the current legislation provides a very high level of ongoing free allocation. The benefits and costs of this support to the economy as a whole, rather than simply to the agriculture sector, should be considered. An allocation of 30 million units per annum (an opportunity cost of $3 billion per annum at an emissions price of $100 per tonne) may be a poor investment compared to alternatives.

Dr Suzi Kerr made this point in advice to the select committee:

> It is very costly to taxpayers and the economy as a whole to maintain this high level of protection. To raise the taxes to pay for it we need to distort economic activity (people work and save less when their earnings are taxed). In the US the cost of raising taxes is in the order of 40c in every dollar. It is probably similar in New Zealand, i.e. it costs the economy around $1.40 for every dollar worth of free allocation given to specific sectors.
>
> Free allocation should certainly be removed as our competitors enter the agreement. It should be phased out relatively quickly even if they do not. This is for the same reasons that we do not subsidise our agriculture even though the US and EU do. The benefits to the protected activities are vastly outweighed by the costs to the economy as a whole. The phase out of free allocation in the existing bill was probably already too slow on economic grounds. (Kerr, 2009)

Without detailed cost-benefit analysis it is not clear what level of support is optimal, and whether these units would provide a better return elsewhere. It seems irresponsible to commit up to $3 billion per annum of taxpayer funds without more careful consideration.

Agricultural interests have argued that there are few emissions reduction opportunities in the sector, so pricing will simply lead to cuts in production. However, New Zealand's experience in removing agricultural subsidies in the 1980s should be remembered. This change, while painful for many at the time, brought significant benefits in the long run and demonstrated the tremendous innovative and adaptive capacity present in the sector. It would be wrong to assume

that protecting the status quo is the best and only option.

Discussion

As outlined above, free allocation on a production basis tends to drive investment toward subsidised sectors, potentially locking in high-emissions activities. One way to ameliorate this is for allocation to be clearly transitional. Investors must be made aware that over the lifetime of their plant, the expectation is that they, and their competitors, will face the full price of emissions. In this regard, free allocation can be thought of as bridging support for industries that are competitive now and will be competitive under global emissions pricing, but may suffer during the transition. In the New Zealand ETS, this signalling could be achieved by capping the pool of units available for free allocation, with this pool declining at least in line with overall target levels.

Another key issue is setting appropriate baselines, particularly in a small economy like New Zealand's where sectoral emissions may be far from the global average, and where there is often only one firm of any consequence per sector. The current legislation potentially creates significant windfalls to firms, and gives only weak signals for change. Moving to best-practice benchmarking (as done in the European ETS) would ensure that firms face a continual incentive to improve.

Then there are the issues raised by linking so closely to the yet-to-be-established Australian scheme, as discussed by Wilson (2009). The structure of the two economies is very different. Support that is cost effective in the Australian economy may not be in New Zealand's. Rigid coupling to the Australian scheme could therefore lead to further distortion of New Zealand investment decisions, at a cost to the economy as a whole. If an Australian scheme is implemented, the decision to directly import eligibility and baseline regulations into the New Zealand ETS effectively cedes sovereignty over these issues.

The most important concern with free allocation is, however, not so much with the nature of allocation (grandparented or production-based), but rather the level of allocation, particularly over the long term. The current New Zealand scheme seems highly likely to over-compensate firms. Detailed cost-benefit analysis is needed to find both the optimal level of free allocation, and the optimal way of recycling ETS revenue more generally.

Finally, allocation decisions have clearly not been subject to proper analysis and scrutiny. Compare this with the government's annual budget process. If, for example, a new energy efficiency programme is proposed, it must demonstrate a very high benefit-cost ratio to proceed. Spending decisions are balanced against all other government priorities – education, health, superannuation and so on – and against overall taxation and debt levels. If free allocation in the ETS were subject to the same scrutiny, this would soon flush out whether it is in fact a good investment. Would, for example, corporate tax cuts provide a better return than subsidising existing emissions intensive sectors?

free allocations were subject to the same budget scrutiny as other government spending, they may well not pass the test of being wise use of taxpayers' funds.

The slow phase-out also fails to send the signal to investors that there will need to be a transition to full market pricing in the medium term.

One way to address these concerns would be to cap the pool of units available for free allocation, with this pool reducing over time to ensure support is phased out much more quickly. Within the cap, allocation on a production basis could continue, retaining the positive characteristics of an intensity-based approach.

The government has argued that any long-term analysis shouldn't be taken seriously, because there will be reviews of the legislation. But leaving it to future governments to amend the scheme on an ad-hoc basis creates enormous uncertainty for long-term investors (IEA, 2007). It would be better to put in place a framework now that sets a more realistic pathway for allocations into the future, so that major amendments are less likely. An allocation methodology with bipartisan political support is needed, underpinned by strong cost-benefit analysis and a clear view on where global emissions pricing is headed.

Unlike in overseas schemes, there are no units set aside to fund transitional assistance or programmes for the residential, small business, electricity generation or transport sectors, or to fund tax and debt reductions.

Conclusion

The free allocation provided by the 2009 legislation leaves only weak incentives for subsidised industries to change and is likely to over-compensate them for the impact of emissions pricing; hence, it is likely to be expensive for the wider economy while generating few environmental gains.

The problem is not the production-based allocation per se; rather, it is that the total level of allocation is high, uncapped and only phasing out very slowly (or for industry, not at all). Unlike in overseas schemes, there are no units set aside to fund transitional assistance or programmes for the residential, small business, electricity generation or transport sectors, or to fund tax and debt reductions. If the legislation's

The first scheduled review of the scheme is in 2011. As the ETS will only be coming into operation at this time, there will be a temptation for this review to be cursory. Instead, the review provides an opportunity for the proper cost-benefit analyses to be undertaken to inform decisions on how ETS revenues should be best allocated for the benefit of New Zealand as a whole.

1 Providing a subsidy for a number of years allows assets to depreciate, so can be seen as equivalent to a compensation payment (Kerr, 2009).
2 This assumes compensation to all affected market participants, not just trade-exposed energy-intensive industries.
3 The phase-out rate is set by regulation, so can be reset without passing new legislation.
4 All curves include a small allocation to 2018 to partially cover deforestation of pre-1990 forests.
5 Under the Kyoto Protocol the New Zealand government receives a free allocation of units corresponding to its target level. If this regime persists, the 50% and 80% curves represent these free units received by the government.
6 The dashed line data set ends in 2030 but is tracking linearly at that time, so has been extrapolated linearly to 2050.
7 The dashed line data set assumes agricultural production grows at around 0.7% p.a. and industrial production at 1.5% p.a. The solid line data set has agricultural production increasing at 0.7% p.a. until 2020, with zero change thereafter, and industrial production rising at around 1.3% p.a. to 2030 and 1% p.a. thereafter.
8 The minister called Treasury's analysis to 2050 'fantasyland' (Smith, 2009b).
9 Assumes New Zealand industry average emissions of 0.81tCO2/t, estimated from production levels at Holcim and Golden Bay Cement
10 This cost is low because the new plant benefits from a high allocative baseline, set in part by the old, inefficient plant. The baseline can be reset under the legislation, but governments will be likely to be reluctant to do so because it would reduce the incentive for firms to upgrade.

References

Australian Government (2008) *Carbon Pollution Reduction Scheme: Australia's low pollution future*, Canberra: Australian Government, http://www.climatechange.gov.au/publications/cprs/white-paper/cprs-whitepaper.aspx

Australian Treasury (2008), *Australia's Low Pollution Future: the economics of climate change mitigation*, Canberra: Australian Government, http://www.treasury.gov.au/lowpollutionfuture/default.asp

Bertram, G. and S. Terry (2008) *The Carbon Challenge: response, responsibility and the emissions trading scheme*, Wellington: Sustainability Council of New Zealand, http://www.sustainabilitynz.org/docs/TheCarbonChallenge.pdf

Bovenberg, A. et al. (2003) *Efficiency Costs of Meeting Industry-Distributional Constraints under Environmental Permits and Taxes,* Tilburg University Netherlands, http://arno.uvt.nl/show.cgi?fid=10443

European Union (2009) *Directive of the European Parliament and of the Council amending Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading scheme of the Community,* Brussels: European Parliament, http://register.consilium.europa.eu/pdf/en/08/st03/st03737.en08.pdf

Hood, C. (2009) *Submission to the Finance and Expenditure Select Committee on the Climate Change Response (Moderated Emissions Trading) Amendment Bill,* Wellington: New Zealand Parliament, http://www.parliament.nz/NR/rdonlyres/6C882B6B-0972-4EFF-A0F6-EB5D5789FB19/115616/49SCFE_EVI_00DBHOH_BILL9597_1_A14707_DrChristinaHo.pdf

IEA (2007) *Climate Policy Uncertainty and Investment Risk*, Paris: International Energy Agency

IEA (2008) *Issues Behind Competitiveness and Carbon Leakage*, Paris: International Energy Agency

IPCC (2007) *Climate Change 2007: Mitigation. Contribution of Working Group III to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change*, Cambridge and New York: Cambridge University Press

Kerr, S. (2009) 'Final comments in response to committee queries from Dr Suzi Kerr, Independent Specialist Adviser', Wellington: New Zealand Parliament, http://www.parliament.nz/en-NZ/PB/SC/Documents/Advice/4/d/0/49SCFE_ADV_00DBHOH_BILL9597_1_A19677-Final-comments-in-response-to.htm

Montgomery, W.D. (1972) 'Markets in licenses and efficient pollution control programs', *Journal of Economic Theory*, 5, pp.395-418

NZIER/Infometrics (2009) *Economic Modeling of New Zealand Climate Change Policy*, Wellington: Ministry for the Environment, http://www.climatechange.govt.nz/documents/economic-modelling-of-new-zealand-climate-change-policy/

OECD (2009) *The Economics of Climate Change Mitigation: policies and options for global action beyond 2012*, Paris: OECD

Smith, N. (2009a) Media briefing, http://www.scoop.co.nz/stories/HL0911/S00141.htm

Smith, N. (2009b) Questions for oral answer, 17 November 2009, Wellington: New Zealand Parliament

Stavins, R. (2007) *A U.S. Cap and Trade System to Address Global Climate Change*, Washington: The Brookings Institution

Stavins, R. (2009a) *The Wonderful Politics of Cap-and-Trade: a closer look at Waxman-Markey*, Cambridge: Harvard University, http://belfercenter.ksg.harvard.edu/analysis/stavins/?p=108

Stavins, R. (2009b) *Worried About International Competitiveness? Another look at the Waxman-Markey cap-and-trade proposal*, Cambridge: Harvard University, http://belfercenter.ksg.harvard.edu/analysis/stavins/?p=117

Treasury (2009) *Climate Change Response (Moderated Emissions Trading) Amendment Bill – clarification of further information request regarding cumulative Government debt*, Wellington: New Zealand Parliament, http://www.parliament.nz/NR/rdonlyres/6396FE21-A7E2-4E68-B2D5-EDC79B92A38D/117125/49SCFE_ADV_00DBHOH_BILL9597_1_A19789_Clarification.pdf

Wilson, P. (2009) 'To Harmonise Or Not To Harmonise, Should That Be The Question? Emissions trading schemes in New Zealand and Australia', *Policy Quarterly*, 5 (4), pp.3-12

Wong, P. (2009) *Details of Proposed CPRS Changes*, Canberra: Australian Government, http://www.climatechange.gov.au/~/media/publications/cprs/CPRS_ESAS/091124oppnofferpdf.ashx

WRI (2008) *Leveling the Carbon Playing Field: international competition and U.S. climate policy design*, Washington: Peterson Institute for International Economics and World Resources Institute

Alec Mladenovic

Electoral Finance Reform in New Zealand: A Need for a Conceptual Framework

Introduction

Democracies include arrangements which facilitate collective or social decision making in the formal public arena (Cohen, 2001, p.49; Geddis, 2003, p.53).[1] These arrangements, established and supported by legal systems, comprise various 'institutions, practices, and procedures' (Geddis, 2003, p.53). They include voting rights, rules for the organisation of elections (voter eligibility, electoral or representation systems, electoral finance) and the framework for decision making by the legislature and executive (Cohen, 2001, p.49).

The electoral system plays an important role in a well-functioning and legitimate democracy. Elections provide a pivotal opportunity for the members of a democracy to exercise collective decision making. Ideally, the outcomes of elections, and the social decisions that subsequently flow from them, should be accepted by the citizens as binding. That is, these outcomes and decisions, which affect all citizens, should be authoritative and enforceable. For reasonable citizens to consider themselves necessarily bound requires that they be convinced that the democratic process that produces such decisions is legitimate (Geddis, 2001, pp.11-12).

An important feature of the democratic process is the indispensable and permeating role of money (Ewing and Issacharoff, 2006, p.1). As the 1986 royal commission on New Zealand's electoral system commented, '[i]t is perfectly legitimate and, indeed, highly desirable that those interested in the political process raise and spend money to further their political objectives' (Royal Commission on the Electoral System, 1986, p.183). Money is, however, an important determinant of political power (Alexander, 1989, p.10). Its prevalence and importance in the democratic process raises public concerns about whether those funding the process are able to exert inappropriate or disproportionate political influence, thereby undermining the democratic ethos (Geddis, 2001, p.6). The familiar aphorism 'he who pays the piper calls the tune' alerts us to this potentiality. In short, money has the ability to make a lie of the democratic slogan 'rule of the people, by the people, and for the people' (ibid.).

To mitigate the 'toxic consequences' (Geddis, 2001, p.6) of money in the political process, many democracies have introduced some form of regulation for political finance (see, for instance, Alexander, 1989; Alexander and Shiratori, 1994; Ewing and Issacharoff, 2006; Williams, 2000). A well-designed and reliable regulatory regime importantly

Alec Mladenovic recently completed studying for a Master of Public Policy within the School of Government at Victoria University of Wellington, and has worked briefly as a research assistant at the IPS.

The National-led government's discussion paper identifies seven guiding principles: equity; freedom of expression; participation; transparency; accountability; legitimacy; and clarity

contributes to the legitimacy of the democratic process and, hence, to the binding nature of high-level social decisions that emanate from it.

The National-led government is currently reviewing the regulation of electoral finance.[2] Consistent with the discussion above, the governmental review has stated: 'It is generally agreed that New Zealand needs to regulate electoral campaigning and political party funding so that we can have confidence in the outcome of parliamentary elections and the integrity of our democratic system' (Ministry of Justice 2009b, p.6).[3]

But this statement prompts the fundamental question of what particular principles and values characterise and inform the democratic system whose integrity is to be protected. These principles and values in turn should help to determine the structural composition of the relevant democracy in terms of the form of the particular set of political structures, institutions, practices and procedures adopted. Geddis explains this as follows:

> Adopting a stance on the meaning of democracy and the nature of the voting system required to produce legitimate and binding social decisions has practical implications for the way in which actual, real world election practices should reflect these ideals. It involves making a commitment to an interlocking set of argument clusters. These interdependent claims about the world that both support and rely on each other for their validity relate to the function of electoral speech in a democracy, the appropriate part the government should play in setting up the rules of electoral debate, and the role of voters and candidates in the democratic process. These commitments support the legal rules that are applied to regulating the activity of different actors in the election contest. Therefore, we find that any debate over how the electoral process should be constructed inevitably involves having to engage in deeper disputes over the fundamental nature and purposes of democracy. (Geddis, 2001, p.10)

This article has two principal objectives. First, I claim that the current governmental review of electoral finance is seriously deficient in that it has failed to probe adequately and define the philosophical and ethical foundations for regulatory reform. The review has proposed seven 'guiding principles'. However, these have been weakly developed and presented without an in-depth analysis of the kind indicated by Geddis. Further, the review to date has not shown how the guiding principles have been used to evaluate and justify the various proposed options for the regulatory system. There is thus a risk that New Zealand may end up with a regulatory system that is inconsistent across all aspects of electoral finance and that fails to measure up to the democratic ideals that are most important to its citizens.

Second, as a way of addressing such deficiencies, I discuss two alternative conceptual frameworks for viewing the electoral process: the aggregative vision and the conditional vision. In discussing the conditional vision, I introduce and defend Joshua Cohen's principle of political equality (Cohen, 2001) as representing democratic ideals that are compatible with the conditional vision.

New Zealand's review of electoral finance

Background

The present governmental review of electoral finance follows the repeal in March 2009 of the controversial Electoral Finance Act 2007 enacted by the previous, Labour-led government.[4] That act was responsible for a number of sweeping regulatory changes. The most controversial change was the introduction of significantly tighter regulation of third parties – that is, non-candidate and non-party political actors – wanting to influence election outcomes by running parallel campaigns.[5] This included:

- requiring a person to apply to be 'listed' as a third party with the Electoral Commission if they anticipated spending more than $1,000 on advertisements relating to a constituency candidate or more than $12,000 on election advertisements in total;
- requiring a listed third party to appoint a financial agent;
- limiting a listed third party's election expenses during a regulated election period to a maximum amount of $4,000 for election advertisements relating to a constituency candidate, and to a maximum amount of $120,000 for any other purpose; and
- requiring a listed third party and the Electoral Commission to disclose information about certain donations received and election expenses incurred by the third party.

Furthermore, the true regulatory burden on listed third parties was accentuated due to the Electoral Finance Act potentially, and in all likelihood, extending the regulated election period substantially beyond the previously regulated period of three months immediately prior to polling day (which has since been reinstated in the amended Electoral Act 1993).[6] As a result, for the 2008 general election the regulated period was more than 10 months.

The regulation of third parties under the Electoral Finance Act was widely criticised as representing a serious affront to citizens' democratic right to free speech.[7] Much of the political scrummaging concerning the act was therefore centred on its implications for the right of third parties to engage financially in the electoral process, and this was the major cause of its ultimate rejection. Given this experience, the regulation of third parties is likely to be the most politically sensitive issue in the current governmental review.

The proposed guiding principles

The National-led government's

discussion paper identifies seven guiding principles: equity; freedom of expression; participation; transparency; accountability; legitimacy; and clarity (Ministry of Justice, 2009c, p.11). The stated aim is for these principles to 'both guide the development of electoral finance law and be incorporated in the purpose section of the new legislation' (ibid.). The discussion paper does not, however, elaborate on the principles. Instead, readers are directed to the government's issues paper (Ministry of Justice 2009b, pp.10-11) for further information on the first six principles (the seventh principle, relating to clarity, was added at the discussion paper stage).

The guiding principles, as formulated, do not offer a robust, coherent framework for evaluating different options for electoral reform. In particular, there appears to have been no attempt made to date either to explore or to understand the intrinsic meaning and role of democracy in New Zealand. The development of an electoral process, including its foundational principles, ideally should take place in the context of discussion about the relevant democratic ideals and their implications for arrangements needed to support social decisions which will be accepted by the citizenry as legitimate and binding.

Without a firm philosophical or ethical foundation, it is very difficult to have an educated sense of the precise meanings of relevant democratic principles, how they should be weighted and how any conflicts between them should be resolved. The inevitable tension that arises in the democratic process between freedom of expression and equal opportunities for effective political influence is a prime example here.[8] As a result, the immediate concern is that electoral finance reform will fail to reflect New Zealand's commitment to important democratic values.

Application of the guiding principles

The discussion paper explains that: 'The use of guiding principles is helpful when reviewing complex and detailed matters such as electoral finance rules. Such principles can provide direction and ensure comprehensive improvements to the law' (Ministry of Justice, 2009c, p.11). However, leaving aside the problems with the guiding principles discussed above, there is no evidence in the discussion paper to indicate how these principles, or any other criteria, have been applied in developing and evaluating alternative options for electoral finance reform.

For instance, consider the two options proposed for the regulation of spending by third parties on elections (Ministry of Justice, 2009c, pp.32-5). One option is to retain the status quo. This option therefore enshrines the present, largely laissez-faire approach to the regulation of third parties. It implicitly assigns an overwhelming importance to third parties' right to freedom of expression, while the principle of equity seems to have very little weighting. As the discussion paper does not evaluate the option against the guiding principles, it is not clear on what basis it has been proposed or how any trade-offs between the principles have been resolved. Moreover, the option would yield an internally inconsistent and inequitable approach within the regulatory system. Compared to third parties, the spending of political parties and constituency candidates would be tightly restricted during an election period. There is no obvious principles-based explanation provided for why third parties should be largely exempt from limits on their election activities while direct electoral participants are, by comparison, tightly controlled.[9]

Under the other option – referred to as the 'proportionate regulatory scheme' – third parties intending to spend on election activities above some set threshold would first need to register with the Electoral Commission. Each registered third party would then be limited in the overall amount they could spend on election activities during a regulated election period. This option is differentiated from the regulatory scheme for third parties under the Electoral Finance Act 2007 (see above) because its design would 'be weighted in favour of freedom of expression, and be simple and easy to comply with' (Ministry of Justice, 2009c, pp.33, 34). Although the detailed design of the option is not provided, the discussion paper suggests some possible key features. These include third parties, while being required to identify themselves in any election advertisements, not having to account for and disclose the sources of any political donations they receive (ibid., pp.33, 35).

The proportionate regulatory scheme appears to be considerably more sympathetic to the principle of equity. It implicitly recognises that money is an essential resource for political activity in democratic states, and that the ability to control resources contributes to political influence. As such, the option implies the need for a regulatory system to impose some limits on the use of resources by wealthier citizens and, hence, curtail political speech. However, given that we are not yet informed about the finer details of the scheme, it is not possible to provide a more specific assessment of the extent to which a principle of equity may be satisfied. Moreover, the caveat that the scheme should 'be weighted in favour of freedom of expression' stands out ominously. Once again, the discussion paper does not substantiate – by reference to the guiding principles, or any other criteria – why freedom of expression should be given higher consideration. Not presenting any reasoning diminishes the option's credibility. Additionally, the possible watering down of the scheme by not requiring third parties to account for and disclose political donations is similarly concerning. This would render the scheme largely ineffective. It is easy to imagine third-party front groups or organisations being formed to serve simply as repositories for political contributions by those seeking to influence the outcome

It implicitly recognises that money is an essential resource for political activity in democratic states, and that the ability to control resources contributes to political influence.

The framework must ensure that all reasonable participants can be satisfied that the electoral process is fair and just because it gives all actors the opportunity for effective political participation

of an election whilst protecting their anonymity.

Conceptual frameworks for electoral finance reform

In this section I address the issue of a conceptual framework appropriate to electoral finance reform. I begin by discussing two different visions of the electoral process: the *aggregative vision* and the *conditional vision* (Geddis, 2001). These two visions or models broadly cover the debate on electoral finance in liberal democracies. Each takes a different stance on the meaning of democracy and the preconditions for democratic processes. The aggregative vision supports freedom of expression as the paramount democratic principle, which is to be vigorously defended. By contrast, the conditional vision places less emphasis on freedom of expression, supporting a more egalitarian view of elections. As part of discussing the conditional vision, I introduce Cohen's principle of political equality (Cohen, 2001). Finally, I defend this principle and conclude that it provides a robust conceptual framework for considering New Zealand's electoral finance reform.

Aggregative vision

The fundamental assertion of the aggregative vision is that the raison d'être of the electoral process is to sum up (or aggregate) the votes representing the preferences of self-interested citizens residing in a pluralistic society, and nothing more. Put simply, political power is then given to those who have the support of the majority of voters (Geddis, 2001, pp.7, 13). Accordingly, the aggregative vision might be viewed by some as supporting a fairly crude or unsophisticated mechanism for collective or social decision making at the highest level of society.

Freedom of expression in the electoral process is upheld as being sacrosanct and generally not to be compromised by other democratic ideals or, indeed, any other considerations. The United States regulation of electoral finance epitomises this approach. In fact, restricting political speech in the United States for the purpose of curtailing freedom of expression is deemed by the courts to be unconstitutional. Significantly, then, the aggregative vision is opposed to the notion of fairness as an overriding value in the electoral process. Instead, citizens appear as free combatants or competitors in the democratic process, where they tussle against each other, with few constraints, to form or support a majority that will best serve their self-interests. While participation in the process is guaranteed to individuals through formal or negative rights that proscribe their exclusion from the process, citizens are not guaranteed substantive or positive rights entitling them to meaningfully or efficaciously engage. Therefore, under the aggregative model, one person one vote, a competitive politics in a 'marketplace of ideas' that is 'unruly, contentious, and bare-knuckled', and the absence of any significant limits on freedom of expression represent the hallmark of a legitimate electoral process (Geddis, 2001, pp.12-15).

The 'marketplace of ideas' belief assumes that curbing speech harms democracy in two ways. First, it reduces the quantity of information available to voters for selecting the optimal outcome to maximise their utility. Second, it results in unjustifiably favouring certain social interests among the myriad of social interests when, as assumed under the aggregative vision, there is no such entity as the 'common good'. These arguments provide the justification for the state not intervening in the electoral process except to ensure that the aggregate preferences of voters are accurately determined (Geddis, 2001, p.16).

Conditional vision

In contrast to the aggregative vision, the conditional vision demands from the electoral process much more than simply counting voters' preferences. It also expects certain standards and values that attribute to the electoral process a sense of legitimacy – based on some notion of equal opportunity for participation – felt by *all* members of the electorate (Geddis, 2001, p.7). It therefore presents 'a "voting-plus" account of why an election is considered to form a legitimate means of allocating public power. Such an account requires that we broaden our concept of an election to encompass more than an opportunity to cast a ballot for or against some particular individual or issue' (Geddis, 2003, p.60). Hence, bare-knuckled competition – of the free-market kind – in the electorate, together with a voting system to determine majority rule, is not the *sine qua non* under the conditional vision.

As a consequence, the structure of the electoral process and whether it is regarded by voters as legitimate is imperative. If the electoral process is so regarded, social decisions produced by it, though ultimately determined by majority vote, are recognised and accepted by the collective as binding, whatever the actual outcomes of voting (Geddis, 2001, p.20). The spotlight, then, is acutely targeted on 'a wider process of public decision-making, comprised of its own particular set of rules, institutions, and practices. These rules, institutions, and practices are in turn embedded in, and informed by, a broader "vision" of democracy' (Geddis, 2003, p.60).

There are, however, implications for the design of the regulatory framework around the electoral process. The framework must ensure that all reasonable participants can be satisfied that the electoral process is fair and just because it gives all actors the opportunity for effective political participation (Geddis, 2001, p.17; Rawls, 1999, pp.197-8). Moreover, to ensure its own legitimacy, the state must level the playing field so that no political actor is in a position to unfairly influence the outcome (Geddis, 2003, p.70). The electoral processes and regulation of electoral finance in Canada and Britain exemplify the conditional vision.

A principle of political equality

Cohen's principle of political equality, which fits within the conditional vision, prescribes norms or standards applicable to arrangements in a democratic society for making high-level binding social decisions.[10] According to Cohen, the principle 'applies to the framework for making authoritative and enforceable collective decisions and specifies, inter alia, the system of rights and opportunities for free and equal members to exercise political influence over decisions with which they are expected to comply and that are made in their name'. (Cohen, 2001, p.49)

The principle of political equality is stated in three parts:

1 Equal rights of participation, including rights of voting, association, and office-holding, as well as rights of political expression, with a strong presumption against restrictions on the content or viewpoint of expression, and against restrictions that are unduly burdensome to some individuals or groups;
2 A strong presumption in favor of *equally weighted votes*; and
3 Equal opportunities for effective political influence. This last requirement … condemns inequalities in opportunities for holding office and influencing political decisions (by influencing the outcomes of elections, the positions of candidates, and the conduct of inter-election legislative and administrative decision making).[11] (ibid.)

While there is an assumption that the principle of political equality should apply in its entirety to arrangements relevant to democratic decision making, in any given situation there may be conflict between and amongst the norms underlying the principle (ibid.). Where such tension arises, the implementation of the principle will require a weighting of the three norms:

> the force of saying that arrangements for making binding collective decisions are to accommodate all three components is that, when conflicts emerge, we can't say a priori which value is to give way. *In particular, if we accept this three-part principle then we allow that we may need to regulate speech to avoid certain kinds of inequalities in opportunities for political influence.* (ibid., pp.49-50, emphasis added)

The third norm of the principle of political equality – equal opportunities for effective political influence – mirrors the well-known standard of equality of opportunity (ibid., p.50).[12] This standard requires that 'one person ought not to have greater chances than another to attain a desirable position because of some quality that is irrelevant to performance in the position' (ibid.). Cohen refers to this as a statement of the '*concept* of equal opportunity', noting that 'different *conceptions* of equal opportunity are distinguished by the interpretations they give to "irrelevant to performance"' (ibid.). Using Rawls' conception of equal opportunity, 'irrelevant to performance in the position' means that the only factors that ought to be considered relevant to attaining positions of interest are a person's motivation to succeed and their ability to perform in the position (ibid.; Rawls, 1999, p.197).

In the domain of politics, 'the relevant position is *active citizen* in the formal arrangements of binding collective decision making' (Cohen, 2001, p.50). Those who are equally motivated and able to participate as active citizens in the formal arrangements of binding collective decision making should have identical chances to wield influence (ibid.). In particular, this conception of equal opportunity requires that economic status be excluded as a relevant factor in the electoral process and that political finance be regulated if the legitimacy of the democratic process is to obtain (Geddis, 2001, p.20; Rawls, 1999, pp.197-8).

In defence of the principle of political equality

A significant argument for the view that the government should have limited involvement in the electoral process and there should be a right to unrestricted political speech (the aggregative vision) emerges from the belief that curtailing freedom of expression strikes at the heart of democracy because it disengages citizens from the democratic process (Cohen, 2001, pp.69-70). Crucial to this viewpoint is the notion of the inherent role of *individual responsibility* in a democracy. Individual responsibility involves each person having the right to decide for him or herself how much information they need in the democratic process and whether the information is reliable (ibid., p.70). This contingency of individual political responsibility implies that restricting the quantity of speech in the process of collective decision making is antithetical to a proper and fundamental conception of democracy.

Although persuasive, this argument may be challenged by applying moral reasoning which pits it squarely against the norm of equal opportunities for political influence. Central to this counter-argument is the question of how citizens ought to be properly regarded within the democratic process (Cohen, 2001, p.72). The critical analysis begins by observing that the argument against restriction of free speech adopts a narrow view of the citizen's role in a democracy (and, hence, a narrow conception of democracy itself). Consistent with the élite theories of democracy, citizens' interests are prioritised on the basis that they can be met entirely through their role as members of an audience. Citizens are an audience absorbing the messages of élite political competitors, rather than political actors constructively participating in the political process by contributing to the content (ibid.).[13]

Individual responsibility involves each person having the right to decide for him or herself how much information they need in the democratic process and whether the information is reliable

An alternative view – supported by Cohen as a more accurate account of political sociology – casts citizens as having a substantially more expansive role in the democratic process. This view leads naturally to a broader conception of democracy. Citizens are not only an audience for élite political actors, but also bona fide participants in the democratic process, expressing themselves through speech and action. They are seen more sanguinely as capable, if they wish, of effectively influencing political discourse (Cohen, 2001, p.72; Geddis, 2001, p.20).

This account of political sociology was supported by Hannah Arendt. Arendt asserted that human plurality is the basic condition of both action and speech Arendt, 1998, pp.7, 175). And it is through speech and action that human beings have the means to expose their distinctness (ibid., p.176). Moreover, the initiative of speech and action is inseparable from what it means to be human (ibid.). But this view of human beings as both speakers and actors in a pluralistic society requires citizens to be granted equal opportunities for effective political influence.

Arendt reminds us of another important consideration in thinking about the normative ideal of democracy. Participatory democracy is vital in her interpretation of the concept of power and ongoing survival of the public realm. For Arendt the public realm is held together by the dynamic of action and speech – the prerequisite for all forms of political organisation. And action and speech are made possible only by the proximity of human beings in the *space of appearance* (ibid., pp.200-1). The danger for democracy is disappearance of human power – presenting as collective action and speech – leading to the destruction of political communities, and democracy itself. Hence, Thomas Jefferson 'had at least a foreboding of how dangerous it might be to allow the people a share in public power without providing them at the same time with more public space than the ballot box and with more opportunity to make their voices heard in public than election day' (Arendt, 2006, p.245).

As well as being compatible with a wider conception of democracy, a goal of equalising opportunities for political influence is supported by principles of justice. John Rawls and Michael Walzer are particularly influential here. Rawls (1999, p.197) believed that measures are needed to safeguard 'a fair opportunity to take part in and to influence the political process'. Importantly for electoral finance regulation, Rawls considered that the familiar democratic principle 'one person one vote' may not provide enough protection against the unfair exclusion of some members of society from the political forum because of the political system's reliance on private sector funding.[14] For Rawls, a just constitutional system – that is, one based on the fulfilment of the principle of participation – is prevented when the demands of the prevailing interests overpower the political forum (ibid., p.199).

Walzer's proposed regime of complex equality limits the mobility of each social good to its own distributive sphere. This implies that the acquisition of a social good should not lead to a situation of dominance: that is, the possession of one social good belonging to its own distributive sphere cannot be converted into dominance over other social goods attached to their respective distributive spheres. In the case of electoral finance, this means that citizen A's wealth – acquired, say, in the sphere of the market economy – should not be allowed to become a dominant good such that it provides him or her with an advantage over citizen B in the sphere of politics (Walzer, 1983, p.298). According to Walzer's thesis, this stipulates democracy as the system of social organisation where politics is the domain of action and speech. The political sphere is therefore immune to social goods that rightly belong to, and whose influences are restricted within, other distributive spheres: 'Citizens come into the forum with nothing but their arguments. All non-political goods have to be deposited outside: weapons and wallets, titles and degrees'. This represents 'complex equality in the political sphere': the opportunity for all citizens to participate in the political forum which affects their lives is equalised (ibid., pp.304, 310).

The ideal of a broad-based democracy is jeopardised by the potential for wealth to influence politics. Walzer (1983, p.310) observed that the deprivation of power in the United States is largely caused by the controlling influence of money in the sphere of politics. Similarly, Geddis (2001, pp.6, 20) noted that a significant, and most unjustifiable, reason for inequalities in the power of social actors is the relatively higher wealth possessed by some participants, and suggested that this is a major concern for democracy. And Alexander and Shiratori (1994, p.1) have written about the conversion of economic power into political power by those who are more economically privileged. The repercussions for healthy democracy (and, hence, for citizenship), both immediate and generational, are damaging, as Walzer warns:

> The endless spectacle of property/power, the political success story of the rich, enacted and re-enacted on every social stage, has over time a deep and pervasive effect. Citizens without money come to share a profound conviction that politics offers them no hope at all. This is a kind of practical knowledge that they learn from experience and pass on to their children. With it comes passivity, deference, and resentment. (Walzer, 1983, pp.310-11)

Conclusion

The current governmental review of electoral finance regulation in New Zealand is taking place in a philosophical and ethical vacuum. This calls for taking a position on the meaning of democracy and the nature of the corresponding electoral process needed to ensure that social decisions made at the highest level of society are perceived by the citizenry as being legitimate and binding. In the absence of such a framework, there is a risk that the resulting regulation will not be consistent with the democratic ideals which most New Zealanders uphold. Further, there is the likelihood that the reform will not be internally consistent and equitable across all aspects of electoral finance, or across all participants in the democratic process.

The aggregative and conditional visions of the electoral process provide two opposed conceptual frameworks for electoral finance reform. As discussed,

Cohen's principle of political equality, which fits within the conditional vision, is compatible with realising the fullest potential of democracy, including the potentiality of all citizens to meaningfully engage as actors in the electoral process. Moreover, it is cognisant of principles of justice. Further, the principle of political equality is consistent with the New Zealand Bill of Rights Act 1990, which provides that '[e]veryone has the right to freedom of expression, including the freedom to seek, receive, and impart information and opinions of any kind in any form' but that this right may be limited where doing so 'can be demonstrably justified in a free and democratic society'.[15]

Implementing the principle of political equality, in particular the norm of equal opportunities for political influence, implies that the role of money in the electoral process should be tightly regulated, despite the effect of reducing the quantity of political speech. In particular, it requires proper and thoroughgoing regulation of the expenditures of third parties, as is the case in Canada and Britain.

1 I would like to thank Jonathan Boston, Andrew Geddis and Paul Harris for their helpful comments on earlier versions of this article.

2 The governmental review was launched on 1 April 2009 with the release of a scope paper (Ministry of Justice, 2009a). This was followed by an issues paper released for consultation on 22 May 2009 (Ministry of Justice, 2009b). A discussion paper containing the government's proposals was then released for consultation on 28 September (Ministry of Justice, 2009c). The final part of the review – the legislative stage – is now under way. New electoral finance law is expected to be passed by the end of 2010 to take effect in time for the 2011 general election.

3 This is essentially reiterated in the foreword to the issues paper (Ministry of Justice, 2009b, p.2), where the minister of justice, Simon Power, wrote: 'Electoral finance law is central to the integrity of New Zealand's democratic system.' The minister's statement is repeated in his foreword in the discussion paper (Ministry of Justice, 2009c, p.3).

4 The current (interim) regulatory regime for electoral finance is, once again, largely contained in the Electoral Act 1993 (as amended on 1 March 2009).

5 Despite the Electoral Finance Act having been repealed, many of the regulatory changes it made have been retained in the interim regime. That said, the treatment of third parties has reverted to the largely laissez-faire approach that existed before the act. This approach means that third parties are only indirectly constrained in how much they may spend on advertising that specifically supports, or appears to support, the election of a candidate or a political party. Positive advertising of this kind must first in effect be authorised by the candidate or party being promoted by the advertising and, as a result, be accounted for within the candidate's or party's election spending limit. Third parties are unrestricted in how much they may spend on other forms of parallel campaigning, such as negative ('attack') advertising or issue advocacy.

6 The Electoral Finance Act required that where a general election is held in the year in which Parliament is due to expire, the regulated period is the longer of the period beginning on 1 January of that year and ending with the close of polling day, or the period beginning three months before polling day and ending with the close of polling day.

7 It appears that anger generated by the Electoral Finance Act is slow to dissipate in some quarters, particularly in regard to the effects on the rights of third parties. For example, an editorial in a leading newspaper commented: 'Labour's Electoral Finance Act was an anti-democratic disgrace. One of its worst features was curtailing the rights of those who wanted to spend their own money throughout an entire election year in trying to gain a particular outcome' ('Caped crusader's plan flawed', *Dominion Post*, 2 October 2009, p.B4).

8 Ewing and Issacharoff (2006, p.7) have posed this dilemma in the form of the following question: 'Where is the ideological centre of gravity in the event of conflict?'

9 The lack of consistency in this regard was not lost on the 1986 Royal Commission on the Electoral System: 'In the same way that limiting spending by candidates is illogical if parties are not similarly restricted, it is illogical to limit spending by parties if other interests are not also controlled. Supporters or opponents of a party or candidate should not be able to promote their views without restriction merely by forming campaign organisations "unaffiliated" to any party or candidate contesting the election. Nor should powerful or wealthy interest groups be able to spend without restriction during an election campaign while those most directly involved are restricted' (Royal Commission on the Electoral System, 1986, p.193).

10 This principle is consistent with John Rawls' 'liberties of equal citizenship' (Rawls, 1999, p.173). To be sure, a principle of political equality is not the only prerequisite for ensuring that a system of collective decision making is binding. Further relevant requirements are that decisions be fundamentally just in accordance with some suitable notion of justice, and that they promote the general welfare. Nonetheless, the standards established by a principle of political equality will typically subordinate other factors, with the exception of the most basic precepts of justice (Cohen, 2001, p.49).

11 It may be arguable, at least prima facie, that the second part of the principle (equally weighted votes) forms a subset of the third part (equal opportunities for effective political influence). Although Cohen does not clarify this, my interpretation is that the two parts should be viewed as mutually exclusive, for the following reason. The second part is in my view equivalent to the familiar democratic notion of 'one person one vote'. However, satisfying this notion should not imply that the third part necessarily holds. For instance, unequal opportunities for effective political influence on the part of the constituents of a society due to, say, differences in the holdings of wealth, are a valid concern despite an electoral system that mandates equally weighted votes.

12 It also corresponds with Rawls' principle of (equal) participation (Rawls, 1999, pp.194-5).

13 For an early discussion of an élite theory of democracy, see Schumpeter (1987, chapter 22).

14 The Royal Commission on the Electoral System came to the same conclusion, noting that this requires that electoral finance should not be 'completely uncontrolled' (Royal Commission on the Electoral System, 1986, pp.7, 183).

15 New Zealand Bill of Rights Act 1990, sections 14 and 5.

References

Alexander, H.E. (ed.) (1989) *Comparative Political Finance in the 1980s,* Cambridge: Cambridge University Press

Alexander, H.E. and R. Shiratori (eds) (1994) *Comparative Political Finance Among the Democracies*, Boulder, Colorado: Westview Press

Arendt, H. (1998) *The Human Condition*, second edition, Chicago: University of Chicago Press

Arendt, H. (2006) *On Revolution*, New York: Penguin Books

Cohen, J. (2001) 'Money, politics, political equality', in A. Byrne, R. Stalnaker and R. Wedgwood (eds), *Fact and Value: essays on ethics and metaphysics for Judith Jarvis Thomson*, Cambridge, Massachusetts; London: The MIT Press

Ewing, K.D. and S. Issacharoff (eds) (2006) *Party Funding and Campaign Financing in International Perspective*, Oxford; Portland, Oregon: Hart Publishing

Geddis, A. (2001) 'Democratic visions and third-party independent expenditures: a comparative view', *Tulane Journal of International and Comparative Law*, 9, pp.5-107

Geddis, A. (2003) 'Three conceptions of the electoral moment', *Australian Journal of Legal Philosophy*, 28, pp.53-78

Ministry of Justice (2009a) *Review of Electoral Campaigning and Political Party Funding: topics to be considered*, scope paper released 1 April, Wellington: Ministry of Justice

Ministry of Justice (2009b) *Electoral Finance Reform: issues paper*, released May, Wellington: Ministry of Justice

Ministry of Justice (2009c) *Electoral Finance Reform: proposal*, discussion paper released 28 September, Wellington: Ministry of Justice

Rawls, J. (1999) *A Theory of Justice,* revised edition, Cambridge, Massachusetts: Harvard University Press

Royal Commission on the Electoral System (1986) *Report of the Royal Commission on the Electoral System: Towards a Better Democracy,* Wellington

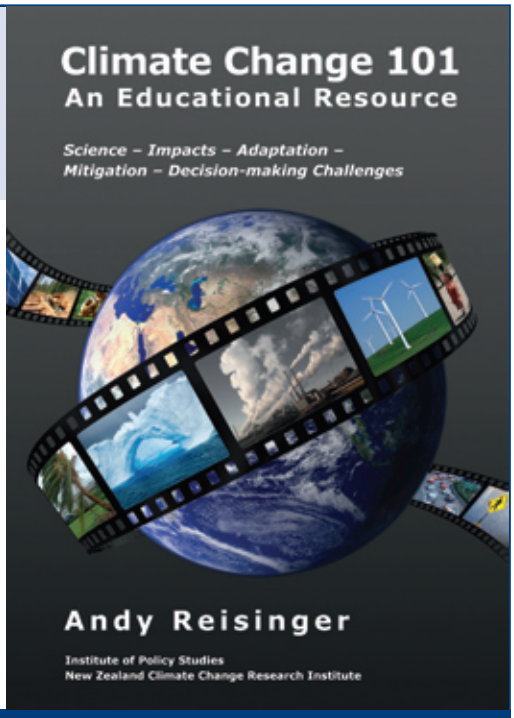
Schumpeter, J.A. (1987) *Capitalism, Socialism and Democracy*, sixth edition, London: Unwin Paperbacks

Walzer, M. (1983) *Spheres of Justice: a defense of pluralism and equality*, New York: Basic Books

Williams, R. (ed.) (2000) *Party Finance and Political Corruption*, Basingstoke: Macmillan Press

CLIMATE CHANGE 101: An Educational Resource

by Andy Reisinger (co-author: Lenny Bernstein)



Climate change is widely recognised as the most important issue now facing humanity. Proposals to reduce emissions or to adapt proactively to future climate changes often result in intense public debate about the urgency, feasibility, and cost, as well as the appropriate balance, of responses to climate change. A better and much broader understanding of the causes and effects of climate change, together with the options for mitigation and adaptation at the global scale, is critical for such societal discussions to be fruitful. Climate Change 101 – An Educational Resource provides a clear, succinct, and measured summary of our current knowledge of climate change, its potential impacts, and the scope for reducing greenhouse gas emissions and adapting to inevitable changes.

Climate Change 101 draws its substance mostly from the findings contained in the Fourth Assessment Report of the Intergovernmental Panel on Climate Change. But it also highlights more recent scientific developments and illuminates the key issues that underpin the current international negotiations for a new global agreement on climate change. This book is intended as an educational resource for anyone seeking a robust scientific overview of the complex and interdisciplinary challenge that climate change represents for the global community.

An Institute of Policy Studies and New Zealand Climate Change Research Institute co-publication
by Andy Reisinger (co-author: Lenny Bernstein)
Publication November 2009
Format A4 Paperback, pp 303
ISBN 978-1-877347-34-4 Price - $45 (including P&P within New Zealand)
Place your order by email, phone, fax or mail to
Institute of Policy Studies, Victoria University of Wellington
Email ips@vuw.ac.nz Telephone +64 4 463 5307 Fax +64 4 463 7413
PO Box 600, Wellington, New Zealand
An invoice will be issued with your order

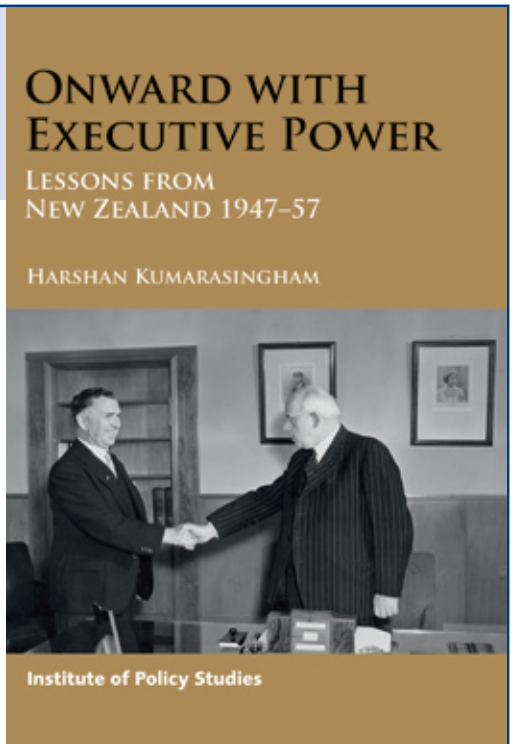
Institute of policy studies

New Zealand Climate Change Research Institute
Te Pūtahi Hurihanga Taiao

Onward with Executive Power

Lessons from New Zealand 1947-57

By Harshan Kumarasingham



Onward with Executive Power – Lessons from New Zealand 1947-57 includes new and exciting research on constitutional, political and policy developments during the late 1940s and 1950s, a critical stage in the evolution of New Zealand as a modern, independent state. The period was characterised by a significant evolution in New Zealand's relationship with Britain, the passing of the Statute of Westminster, the first transfer of power between Labour and National, the strong leadership styles of Fraser and Holland, the abolition of the Legislative Council, a landmark waterfront strike, and an ambivalent attitude towards full national independence. Importantly, too, the period had major ramifications for the conduct of politics during the remainder of the century, certainly until the recent era of proportional representation. In particular, it underscored and entrenched the 'elected dictatorship' available to post-war prime ministers and single-party governments. Onward assesses the lessons of the Fraser-Holland era for contemporary New Zealand politics and highlights how many of the central issues of the immediate post-war years remain with us and are still unresolved.

Dr Harshan Kumarasingham completed his Ph.D on the Westminster System from Victoria University of Wellington, which won the Sir Desmond Todd Memorial Prize.

An Institute of Policy Studies publication by Harshan Kumarashingham
Publication February 2010
Format – A5 paperback, pp 194
ISBN 978-1-877347-37-5 Price $27.00 (including P&P within New Zealand)
Place your order by email, phone, fax or mail to:
Institute of Policy Studies, Victoria University of Wellington
Email: ips@vuw.ac.nz Telephone +64 4 463 5307, Fax + 64 4 463 7413
PO Box 600, Wellington, New Zealand.
An invoice will be issued with your order.

Institute of policy studies