

Comments on Draft NZPC Report on Local Government Funding and Financing

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The following comments focus exclusively on Chapter 8: ‘Adapting to Climate Change’.

1. Chapter 8 is very thorough, balanced and well-crafted. It takes the challenge of adapting to climate change seriously; it demonstrates a keen understanding of the many uncertainties, risks, and policy issues facing policy-makers (locally, nationally and internationally); and it provides a useful framework for thinking about the possible policy responses.
2. As I prepare these comments I am in London. Last week the UK experienced its hottest ever recorded temperature, and the warm weather caused significant disruption to transport systems (especially rail) due to fires. And right now a town in the midlands of the UK has been evacuated due to the risk of a dam collapsing – the result of intense and exceptional rainfall. Such events highlight what is in store as the century progresses. They also underscore the need for sound anticipatory governance, including a focus on prevention, precaution, proactive interventions, pre-event risk reduction, enhancing the resilience of systems and structures, etc. etc.
3. I agree with much of what the chapter says, including, for instance:
 - a. the need for a much better understanding among policy-makers regarding the nature of the risks that climate change poses;
 - b. the need for a systematic shift to a dynamic risk paradigm which reflects the increasing, cumulative, and cascading nature of the risks generated by climate change, and hence the potential for rapidly changing risk profiles;
 - c. the need to incentivise risk reduction and minimise moral hazard;
 - d. the fact that private insurance will be of little help in addressing the problems of funding climate change adaptation;
 - e. the need to pursue at least two high-level goals – long-term cost minimisation and distributional fairness;
 - f. the desirability of using new and more flexible decision-making tools, such as dynamic adaptive pathways planning;
 - g. the desirability of community participation in decision-making to tackle climate-related risks;
 - h. the need for more consistency (and a stronger precautionary approach) with respect to the various legislative and regulatory frameworks that guide local government decision-making
 - i. the fact that there are conflicting principles over how the various costs of adaptation (including for public infrastructure and private adaptation costs) should be funded; and the fact that there is no 'correct' policy answer to question of how the costs should be shared between the many affected parties – instead there are a range of possible answers depending on how the various relevant principles are weighted and applied.
4. I largely agree with recommendations 8.1, 8.2, 8.3 and 8.4; but I have a few reservations about recommendations 8.5 and 8.6. I explain my reservations below.

5. The allocation of responsibilities for climate change adaptation, including funding:

- a. The draft Report raises a fundamental *policy* issue – or rather a *constitutional* issue – namely: where, in terms of the tier or level of government, should overall responsibility lie for managing the impacts of, and adaptation to, climate change? For instance, should it lie primarily, if not solely, at the ‘national’ issue level, and hence with central government, or should it lie primarily at a sub-national level? And should the various different responsibilities for adaptation be allocated differently? The draft Report mentions such issues, but I don’t think it tackles them adequately. In particular, it would be helpful to list the relevant principles (i.e. as they apply to climate change adaptation) more clearly and precisely, and discuss their implications more fully.
- b. I recognize that many different principles have been advocated and applied over the centuries to determine the proper allocation of responsibilities across the different tiers of government, and the very same principles (e.g. subsidiarity and supplementation) have sometimes be applied differently by different countries. As a result, there are marked differences in the nature and extent to which various responsibilities, such as health care, education, housing, and social services, are devolved or centralised. Some countries, like New Zealand, Ireland and the UK, are highly centralised, with relatively few (major) responsibilities allocated to sub-national government. Others, like Australia and the US (both federal states) and Denmark and Sweden (both unitary states) are much more decentralised. There is probably no ‘correct’ approach – although it is worth noting that some responsibilities, such as the conduct of foreign affairs and security, are universally allocated to central government (for good reasons) while others, such as rubbish collection, are almost universally allocated to sub-national government.
- c. A related constitutional and philosophical question concerns the nature of the ‘defining functions’ of the state or what might be regarded as ‘inherently governmental functions’. In this regard, the idea of ‘remedial responsibility’ is highly relevant. In many situations, such as responses to (and efforts to avert) natural disasters, only governments have the capacity to act effectively and authoritatively; individual citizens and voluntary organizations do not. This capacity and formal authority generates a moral responsibility to intervene (e.g. to protect the public interest or minimise harm and suffering).
- d. New Zealand has a strongly centralist tradition. It is doubtful this will change in the near future. After all, there is a great deal of path dependence in the system, and major institutional, cultural, and political constraints on fundamental constitutional reform.
- e. I think our centralist tradition will contribute to widespread public (and political) expectations that the central government should have primary responsibility for managing (and bearing) most of the costs of climate change adaptation. In other words, central government will increasingly be looked upon as the ‘first responder’ rather than the provider of ‘last resort’ assistance (or back-up reinforcements when all others fail).
- f. Such expectations will be reinforced by:
 - i. The national nature of the challenges. Yes, the impacts of climate change will all, in a sense, be ‘local’, but they will be so widespread across the country, and so serious, that they will not be regarded simply as ‘local’ issues.
 - ii. The desire for national solidarity in the face of existential and catastrophic risks.
 - iii. The precedent set by the creation and activities of EQC and the National Disaster Fund for earthquakes and other natural disasters.
 - iv. The precedents set by governmental responses to the Christchurch and Kaikoura earthquakes, including the establishment of CERA and the

allocation of most decision-making responsibilities and powers for the recovery process to the central government.

- v. The likely need for compulsory measures to minimise harm in the face of climate change impacts (e.g. legally-mandated measures to remove buildings and infrastructure assets that are in harm's way). Such compulsion could well be extensive in vulnerable towns and cities.
- vi. The sheer scope and scale of the challenges that the country will face, and the fact that most sub-national governments have only limited administrative capabilities and very limited financing options.
- vii. The fact that most social assistance and social services, including health care and social housing, are centrally funded. In the context of (large-scale) managed retreat, only central government will have the capability to undertake the coordination tasks, including service integration, required.

6. Covenants:

With respect to the idea of developing some form of covenant that would make consents by local councils subject to an assumption of risk by the owner and be attached to the title of the property (p.221):

- a. I am not a lawyer, so I cannot offer a legal opinion on such a proposal. Nevertheless, I have various reservations:
 - i. ***Interdependencies and externalities***: private dwellings or businesses that are constructed in areas that are likely to be at risk from coastal erosion or flooding as the century progresses may end up generating costs and risks for non-owners even if the owners receive no public compensation for their losses. For instance, if the structures have to be removed (in the face of coastal erosion) and the owners lack the resources to undertake such action, the burden will fall on ratepayers and/or taxpayers. Also, private dwellings require infrastructure (e.g. transport services, water services, electricity, etc.). Unless such infrastructure is fully-funded by the owners, which is unlikely under current policy frameworks, the costs (and eventual losses) will fall on ratepayers and/or taxpayers. More generally, whether or not the risks/liabilities are privatized or socialized, there will be costs for society as a whole. Large private costs often have significant (and damaging) public consequences.
 - ii. ***The contents of the covenants***: will the proposed covenants be able to be drafted in order to take account of all possible future risks associated with climate change, including those that we don't yet know about?
 - iii. ***The decision of the courts***: The events in Christchurch following the major earthquakes in 2010-11, not least the decisions of our senior judges, surrounding compensation for properties located in areas zoned as 'red' are salutary. They suggest to me that it would be unwise to predict how the courts in the future will interpret such covenants and assess their implications for public policy. Note that the courts decided, in relation to 'red-zone' properties, that the owners of properties which were uninsured should nevertheless receive (some form of) compensation because the losses they suffered were deemed to be caused not by the earthquakes, but by the zoning decisions of the government ... Government decisions in the future may likewise be seen to override the provisions of covenants.
 - iv. ***Political economy***: We should not ignore the political economy of a situation where there might in the future be significant numbers of property owners with covenants of the kind suggested. Such people are also voters. They will exercise their democratic rights. Governments can, and do, override

privately-agreed arrangements; they change laws (sometimes the same law regularly); and they abandon long-standing conventions.

7. Social insurance and risk-pooling:

The draft correctly highlights the long tradition in NZ of social insurance and societal risk-pooling (e.g. for sickness, accidents, natural disasters, adverse events, etc.), as well as cost-sharing across the different tiers of government. The draft rightly acknowledges that this tradition is likely to have a bearing on how future governments respond to climate-related risks and disasters. But several comments are in order:

- a. The draft outlines **three conditions** which it argues should apply under any social-insurance scheme. Two of these conditions are questionable.
- b. **The first condition** is that ‘losses should not be compensated, or costs met, if they are avoidable by taking sensible actions in the light of what is known about risks’. But:
 - i. This condition – as a general policy principle – is highly questionable. It does not apply to sickness or ACC in NZ – and for very good reasons; instead, policy-makers have adopted a no-fault approach. As a result, people are covered irrespective of how a sickness or accident occurred or who caused it. Adopting a different approach would generate enormous practical and ethical problems. It would also have damaging and perverse consequences. Imagine if health-care workers were told that they would not get sick pay or free medical treatment if they pick up a disease at work (because necessarily their work involves an increased risk of contracting a disease)! The mind boggles.
 - ii. Applying the condition to climate change adaptation funding would be extremely difficult: What is ‘avoidable’? What are ‘sensible actions’? What risks are ‘known’ and by whom, and when? Who would judge? How much do we want to spend on litigating such matters? Lawyers would have a field day. This is precisely why the ACC scheme is based on a no-fault presumption – and prevention is incentivised via other policy mechanisms.
- c. **The second condition** is that ‘schemes should prompt actions to reduce risks before disaster’ strikes. This is sensible, but much depends on how such a condition is applied.
- d. **The third condition** is that ‘schemes should include some co-funding, that is a distribution of costs across the social insurance funder and recipient’. I accept that in some situations co-funding may be desirable, but this is not always the case. Moreover, there is room to debate in many situations what proportion of the costs should be co-funded.
 - i. The example cited in the draft Report relates to leaky homes; the allocation in this case involved 1/3 of the costs being borne by taxpayers, 1/3 by local government (i.e. ratepayers), and 1/3 by homeowners. But this kind of cost-sharing is rare in relation to social insurance schemes. In most cases of social insurance (e.g. for sickness, accidents, unemployment, etc.) co-payments by recipients are a very small proportion of the total costs (e.g. a few percent); in some cases there are no co-payments (e.g. health ‘insurance’ in the UK). Of course, those who cannot work because of ill-health or accidents are not usually *fully* compensated for their loss of income. Earnings-related schemes are usually capped, and in most cases the compensation is set at about 70-80% of previous earnings. But such arrangements are not normally thought to constitute ‘co-payments’.
 - ii. The whole point of social insurance is that citizens pay a contribution (via a levy or taxation) and are then entitled to (often earnings-related) income replacement and other specified assistance (e.g. medical treatment, disability-related services, etc.) if they meet the requirements of the scheme. Costs are

controlled under such arrangements only partly (and sometimes not at all) by the use of co-payments.

- iii. In thinking about cost-sharing arrangements for climate change adaptation, it is important, if precedents and analogies are to be used, that the *correct* ones are selected. It is also important to have regard to the different kinds of costs that are likely to arise, who the relevant ‘parties’ or ‘stakeholders’ are, and what their respective capacities to contribute might be.
- iv. Note that under the Public Works Act, private individuals and businesses who lose their properties via compulsory orders are *fully* compensated for their property losses (through an agreed formula/process); they are not expected to make ‘co-payments’ to the Crown.
- v. We should not forget that direct financial losses are only part of the issue, say, in relation to managed retreat. For many people the loss of their community and the loss of ‘place’ and identity will be of considerable importance, and such losses are difficult, if not impossible, to monetise (let alone provide compensation for).

8. Central government assistance for adaptation measures by local government:

The report proposes the following approach:

- a. **For land transport infrastructure** which is the responsibility of local government: expanding current NZTA funding arrangements to deal with climate-related impacts and for co-funding local roads – with extra central government funding being conditional on various standards and requirements being met; and
- b. **For water services** (i.e. the three waters) and river infrastructure (i.e. for river management and flood control): establishing a new Crown agency (e.g. a Climate Resilience Agency) somewhat like NZTA that would oversee a new Local Government Resilience Fund (that would co-fund infrastructure costs, including relocation and rebuilding, with the Fund’s share based on council need and capacity).
- c. I can see merit in such proposals, at least for managing most of the adaptation funding issues that are likely to arise over the next few decades for sub-national government.
- d. But I am not sure if such mechanisms will be adequate for the longer-term (e.g. post-2040), especially if NZ is eventually faced with multi-metre sea-level rise (as seems increasingly likely). For instance, even a metre of sea-level rise will have significant implications for cities like Dunedin, Christchurch, and Wellington. The impacts on council infrastructure (including land transport facilities and water services) will be large, and the costs of relocating, rebuilding, and reinforcing exposed infrastructure will be substantial (i.e. many billions of dollars). The issue of protective structures is also likely to arise in some instances – e.g. dykes to protect valuable urban assets. Some of these structures could be very expensive. The scale of the challenges will raise important questions about decision-rights: who will be making the key decisions that affect the lives and futures of tens of thousands, perhaps hundreds of thousands, of citizens – and on what basis? I think these matters need more detailed consideration. There are also important policy coordination issues that require attention (see below).

9. Support for private citizens and businesses:

- a. I think the summary of the arguments for and against public funding of private adaptation costs is very fair (see pp.231-233). As you will be aware, I find the arguments in support of (some) public funding persuasive, and given NZ’s political, legal, and cultural traditions, I think public funding (i.e. from central government) is inevitable. Hence, the issue is not *whether* such funding will be provided, but *how much, to whom, and under what conditions*. I realise that such issues probably go

beyond the terms of reference of the Productivity Commission, but it is not possible to discuss the issue of central government financial support towards the costs that climate change will impose on local government without thinking about the funding of private adaptation costs. This is because of the nature and scale of the challenges, and the close interconnections and interdependencies between public and private costs – and hence the significant policy coordination issues that will arise.

- b. In this context, the draft Report correctly notes, in several places, that adaptation will pose *significant coordination issues*. Some of these will involve coordination across different levels of government and between governmental and non-governmental agencies; some will involve coordination between different functional activities (e.g. spatial planning, the funding of infrastructure, the funding of emergency management, the funding of compensation, etc.); and some will involve coordination within particular levels of government. I think these coordination issues need more detailed attention in the Report.
- c. Take, for instance, the issue of managed retreat – which will be increasingly widespread and pressing as the century progresses (although, of course, if it is not ‘managed’, it will be ‘unmanaged’, and even more of a mess). Managed retreat, certainly on any significant scale, will entail lengthy planning processes, extensive citizen participation and engagement, and careful coordination of the required public investments in, and funding of: a) land transport infrastructure; b) water services infrastructure; c) other infrastructure (e.g. ports and airports, where relevant); d) public health care facilities; e) schools and other educational facilities; f) compensation (if any) for lost business assets; and g) compensation for lost private dwellings. Coordinating such arrangements will be a formidably complex and fraught process in some situations (e.g. relocating part of the Wellington central business district). The Report does not really begin to tackle such problems. But they can already be anticipated and foreseen. I realize that any careful analysis of the various policy options would be major undertaking. But I think the report could at least highlight the challenges that await future decision-makers and note that new planning, funding and governance are likely to be necessary to manage the scale and scope of the policy challenges.
- d. Finally, consider carefully the implications of the following policy framework: suppose governments (central and local) agree to fund protective structures and climate-resilient public infrastructure, but make no provision for the public funding of private property losses (i.e. public compensation) in the face of sea level rise, coastal erosion, and more severe flooding risk: the highly likely result (in a democracy) is that there will very strong (and irresistible) political pressure for the construction of protective structures to safeguard human settlements even in situations where such structures are clearly not cost-effective, nor viable long-term solutions. In other words, the absence of public compensation will generate a highly sub-optimal asymmetry in the policy/political process which will almost certainly result in much higher long-term costs (for society) and many inequities. It might be objected that the asymmetry can be ‘managed’ by imposing strict (cost-effectiveness) criteria on the funding of protective structures. But such an objection fails, in my view, to recognize how democratic political systems tend to work. In other words, the criteria will probably not survive their first serious test!