CONSTRAINING GOVERNMENT REGULATION

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Contents

List of Abbreviations

ACC	Accident Compensation Corporation
CED	Committee for Economic Development (United States)
EDC	Economic Development Commission
ERMA	Environmental Risk Management Authority
GAAP	Generally accepted accounting principles
GDP	Gross domestic product
GST	Goods and services tax
HSNO	Hazardous Substances and New Organisms Act 1996
IMF	International Monetary Fund
IRD	Inland Revenue Department
LAC	Legislative Advisory Committee
LEG	Cabinet Legislation Committee
MMP	Mixed Member Proportional electoral system
MP	Member of Parliament
OECD	Organisation for Economic Cooperation and Development
OIRA	Office of Information and Regulatory Affairs (United States)
OMB	United States Office of Management and Budget
OSH	Occupational safety and health
OSH	Occupational Safety and Health Service of the Department of Labour
RIA	Regulatory Impact Analysis
RIS	Regulatory Impact Statement
RMA	Resource Management Act 1991
SNA	System of national accounts

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Summary and overview

If governments were perfect, all laws and regulations would enhance human welfare and there would be no need for this report. Unfortunately, governments are not perfect. As a result, some laws and regulations may reduce citizens' welfare.

Section 2, Evidence of the Need for Regulatory Reform, documents the existence of actual, material and pervasive regulatory harms. It cites many cases of apparently law-respecting and productive citizens whose lives have been ruined emotionally and financially by existing legislation. There can be no doubt that the hopes and aspirations of much greater numbers are being thwarted. Other, less harrowing cases point to material adverse effects on investment in New Zealand.

A preliminary examination of the legislation underlying these cases points to deep-seated flaws. Some regulations appear to create monopoly situations rather than alleviate them. Others can be exploited for anti-competitive purposes. Some allow the unscrupulous to extort money from businesses simply because it is cheaper to pay them off than to resist their demands. Some regulations transfer wealth from the less well off to the better off, contrary to normal notions of equity.

Legislation commonly seeks to impose outcomes, essentially regardless of cost or the existence of diverse personal preferences. Such legislation stops individuals from achieving outcomes that balance marginal benefit and marginal cost. Denial of freedom of contract is a common feature. There is a pattern of resistance to compensation for regulations that take lawful rights, particularly in the environmental area.

Section 2 also documents widespread concerns amongst legal experts about the poor quality of much legislation. Some concerns relate to deficient policy analysis – such as inadequate problem definition, failure to establish that legislation is needed and legislation that fails to give effect to the intended policy. Legislators sometimes appear to regulate in ignorance of the existence of the common law. It is asserted that they sometimes issue laws as symbolic public action, rather than as practical solutions to real problems. There are also concerns about inaccessibility and content. Legislation sometimes fails to comply with constitutional principles.

Many of the experts' concerns support the inference that legislators sometimes rush to legislate with a view to solving the problems later. Concerns about premature legislation and poorly drafted legislation point to this problem.

The deluge of new and amending laws and regulations that emerges annually from parliament and the executive branch of government (as distinct from the legislature) is consistent with such concerns. No small business can be expected to be able to comply knowingly with the welter of laws and regulation to which it is subject. In general small businesses must fly blind. Larger businesses may have invested so heavily in reputation that 'flying blind' is not an option. These businesses are more likely to invest in ascertaining the implications of complex regulations and in attempting to comply with them, even if the costs are very high. Even so, compliance costs are, in general, proportionally larger for smaller firms.

Governments commonly acknowledge that the costs of complying with regulations are excessive and undertake to reduce them. Their lack of success indicates in itself that

the problems cannot be solved by minor adjustments. If it were easy it would have been done.

Section 2 acknowledges that New Zealand does not appear to stand out from many wealthy industrialised countries; concerns about onerous regulatory burdens are an international phenomenon. In the United States, research indicates that most federal government regulations would fail a strict cost-benefit test. New Zealand's ongoing economic decline relative to other nations suggests that New Zealanders can less afford to tolerate the situation.

Section 3, What is Regulatory Reform About?, examines the relationship between regulation and two broad aspects of human welfare – liberty and prosperity. It defines regulatory reform and discusses the relationship between regulation, liberty, economic freedom and government spending.

Regulations include laws, formal and informal orders and subordinate rules issued by all levels of government, and rules issued by non-governmental or self-regulatory bodies to which governments have delegated regulatory powers. This definition is economic. Under a legal definition, Acts of parliament are sometimes referred to as primary legislation and regulations and by-laws as subordinate legislation.

As defined, regulations do not include the common law. The common law is by far the dominant source of the legal rules that govern the interactions between citizens. The three pillars of the common law are the laws of tort, property and contract. As comprehensive as it is, the common law is not in itself a complete legal system. Some problems governing interactions between citizens, such as non-point source pollution, may be better addressed by regulation.

Regulations known as public law and regulations of a constitutional nature govern the rights of the citizen in relation to the state. Some regulations provide for taxation in order to fund state-provided public goods and, more controversially, redistribution programmes. Others may provide for the better enforcement of existing laws – the so-called police power of the state. A third category of regulation provides for the state to use what is known as its power of eminent domain to override existing property rights in the pursuit of the public interest.

Regulatory reform refers to changes that improve regulatory quality – changes that enhance the performance, cost-effectiveness, or legal quality of regulations and related government formalities.

Regulatory reform obviously encompasses the elimination of excessive regulations. Less regulation of private interactions between citizens implies greater reliance on the common law for governing those interactions.

Regulatory reform is not about the elimination of all rules. Civil society cannot exist without rules. Where there is no law there is no freedom. Rules that do not limit government provide no protection for minorities against majoritarian abuses.

Regulatory reform should be neither pro- nor anti-business. Nor should it favour big businesses at the expense of small businesses. In a civil society all benefit from sound laws, properly enforced. Nor is the goal of minimising the costs to businesses of complying with regulations a proper objective for regulatory reform. It is total costs

and benefits that matter. Compliance costs are a relatively small component of total costs.

Regulations can enhance, reduce, or eliminate liberty. *Liberty* is the *freedom* to act in one's own interests, subject to the duty to comply with rules that protect the like freedoms of others. Regulations can curtail liberty directly by prohibiting a course of action, or indirectly by expanding the range of duties that constrain freedom of action.

Liberty is sometimes also defined as the absence of the coercion that sees one person forced by threats of (illicit) harm to serve as the means to someone else's ends. One person's legal *duty* is another person's legal *right*.

Respect for the rights of others, as in the instruction "keep your hands to yourself", requires self-restraint, the absence of unfettered selfishness. Well-defined, well-enforced rights secure personal autonomy, including security in legitimate rights to property. They allow people to choose to stay apart, untroubled by unwanted trespass and theft, or to come together. This liberty facilitates transactions in general, and commerce in particular. It follows that regulations that undermine security in individual rights to property undermine personal autonomy. Common law rights traditionally have this 'negative right' character that constitutes a liberal conception of justice.

The concept of 'positive' or 'welfare' rights stands in opposition to this liberal conception. Welfare rights can take the form of a legal claim on the production of others without any obligation on the recipients to provide value in return. In one perspective, this approach differs from the liberal conception 'only' in defining a legal harm to include a failure to confer a benefit on others when one is capable of doing so. This, and other forms of positive rights, may make a moral duty a legal obligation. Advocates of welfare rights may also have a negative view about the adequacy of private benevolence in alleviating hardship. Others may see income equality as a desirable social goal in itself.

While critically reviewing these arguments, the report does not seek to impose a conclusion on the reader. It concludes pragmatically that the strongest case for forced redistribution by the state is that which is directed at alleviating poverty or redressing some types of grievances.

Regardless of where one stands on this debate, positive rights have the potential to affect the coherence of a legal system from the perspective of those who are subject to it. Yale constitutional scholar Lon Fuller's eight 'routes to disaster' in any system of law and University of Manchester political philosopher Hillel Steiner's test of the compossibility of a legal system are relevant here. The practice of legislating for positive rights can also exacerbate the conflict within any democratic political system between the desirability of protecting political minorities and the drive to exploit them.

The discussion draws a distinction between the vital and necessary laws and regulations that govern the relationship between the state and the individual (such as those that provide for democracy and prohibit arbitrary arrest and punishment) and regulations that problematically override the common law in governing the interactions between individuals. The report suggests that laws that override the common law, prohibit freedom of contract and attempt to impose predetermined outcomes, should be regarded with particular suspicion.

The analysis of the relationship between regulations and prosperity focuses on one aspect of liberty. It is called *economic freedom*. A growing literature has established that high levels of economic freedom, if sustained, are associated with high levels of prosperity. Economic freedom is about freedom of action, freedom of exchange and security in person and in legitimately obtained possessions. The institution of private property is essential to obtaining even a moderate level of economic freedom. Regulations that reduce economic freedom are potentially bad for prosperity and human welfare.

Government spending is an alternative to regulation. Research suggests that the growth in government spending and taxation to the levels widely reached amongst industrialised countries during the last 25 years has retarded the rate of improvement in general living standards.

Section 4, Various Reform Initiatives and Experiences, reviews the experience with regulatory reform in particular amongst member countries of the Organisation for Economic Cooperation and Development (OECD) and more widely in recent decades. The OECD reports that the history of regulatory reform is not one of coherent government strategy, but rather of reactions to changing crises and opportunities. Achieving regulatory reform by design rather than circumstance is a serious challenge. In contrast, it finds that impressive gains are achievable from economic liberalisation.

Attempts by many countries to improve their regulatory processes and institutions are reflected in requirements to produce regulatory impact statements, comply with a code of good regulatory practice, and conduct cost-benefit analyses. Other experiences reviewed in this section include those involving various types of watchdog agencies, sunset provisions, opt out provisions, *ad hoc* reviews, self-regulation and regulatory budgets.

The OECD reports that all attempts by member countries to adopt coherent regulatory reform have been blocked or delayed. It suggests that impediments to attempts to reduce regulatory excesses arise from voter failure, partisan interest group behaviour, the problems with political decision making under majority rule, and bureaucratic behaviour. Section 4 ends with the OECD's proposed seven rules for regulatory reform.

Section 5, Why Reform is so Difficult – Public Choice Theory, reviews the insights provided by the economic literature on regulation as to why regulatory excesses persist, notwithstanding widespread concerns and the prolonged OECD-wide efforts to reduce them. The literature establishes that the observed pattern of regulations cannot be explained by theories that presume that governments regulate in the interests of the representative voter, or of the citizenry at large.

Theories of problems with majoritarian voting systems, interest group behaviour, regulatory capture, political and bureaucratic self-interest and 'judicial failure' all appear to have some credibility in explaining the persistence of regulatory excesses. This literature makes it easier to understand how majoritarian democracies not only put minorities at risk but can, at the same time, adopt policies that a majority would oppose, given the chance to do so.

A further subsection documents the importance of ideas for understanding why regulatory excesses can occur and persist. Collectivist notions, voter ignorance and indifference, the role of prejudice and the vulnerability of public opinion to alarmist

and populist claims can all put pressure on politicians to regulate unwisely in the heat of the moment.

Section 5 ends with a summary of Gordon Tullock's assessment of options for addressing these underlying problems. In his view there is general support amongst the experts for bicameral legislatures and majority support for greater use of referenda. The notion of requiring more than a simple majority for legislation of a constitutional nature is seldom criticised directly but it would be a concern if it impeded the removal of regulatory excesses. There is a clear view in favour of curtailing bureaucratic discretion, encouraging competition between departments, and contracting out government activities.

Section 6, Constitutional Aspects of Regulation, explores the constitutional aspects of the problem of persistent regulatory excesses. The discussion considers the following three fundamental elements of constitutionalism – democracy, the separation of powers, and the rule of law.

Aristotle is widely regarded as the founder of the philosophy of constitutional government. He distinguished between a *constitutional democracy* – one that protects minority rights and thereby limits the exercise of government power – and the (despotic) alternative of a *majoritarian democracy* that allows a majority to coerce a minority. Over two thousand years later Alexis de Tocqueville raised the possibility of a democracy based on paternalistic intrusive government that sapped a people of their independence, initiative and self worth.

The discussion of the *separation of powers* focuses on the importance of an independent judiciary, dedicated to applying the law of the land rather than creating it, and the rise in the (unconstitutional) doctrine that sovereignty resides in parliament rather than in the people. Factions that control parliament can combine to pass laws that a majority of voters would oppose.

The discussion of the subtleties of the constitutional concept of the *rule of law* forms the basis for the remainder of this report. Constitutional scholars see it as difficult to exaggerate its importance. One describes its presence as "an essential precondition for all civilized life".

When governments are constrained to conform to the rule of law they are constrained in respect of the content of the laws and regulations that they can pass. Aristotle used the term the rule of law to distinguish it from the alternative of the rule of man (that is, of a particular ruler or ruling body).

The doctrine has much in common with the view noted in section 5 that the law to be applied in relation to any particular dispute is something that must be discovered through legal scholarship and wisdom rather than created by a ruling body.

The existence of the rule of law is more obvious in its absence than its presence. Its presence is characterised by an attitude of restraint, respect by all individuals and groups of an obligation to comply with the law and the absence of arbitrary coercion by governments or any other groups. Any total failure of a legal system to comply with just one of Fuller's eight 'routes to disaster' would mean the absence of the rule of law. The legislation, whose excesses were documented in section 2, appears to be deficient when tested against Fuller's criteria.

Positive guidelines for the presence of the rule of law are said to require that: (1) rules of conduct must be general in application; (2) general laws must be abstract; and (3) rules of conduct must be equal in application. Such prescriptions necessarily imply an attitude of restraint by parliaments in respect of the form and content of laws and regulations.

The discussion also highlights the constitutional importance of the concepts that there should be no taxation without the (general) consent of those being taxed and that compensation must be paid for takings under the power of eminent domain. It calls for judges and others to apply to regulations the very strongest constitutional presumption that they uphold these principles.

Notwithstanding these insights and suggestions, the review does not uncover any assured means of better achieving a rule of law. An attitude of restraint cannot be achieved simply by passing laws. It is also arguably far too complicated a matter to be thought up and put into practice by design.

Section 6 ends with a review of natural rights theories about the issues of constitutionality and liberty. It concludes that natural rights theories can bolster support for the rule of law, but they can also be used to undermine the rule of law.

Section 7, Regulatory Reform Options, discusses options for constraining government regulation under the headings of democracy, the separation of powers and takings.

Options for reform under the heading of democracy include binding referenda, reform of campaign financing, terms limits and reform of voting systems. Binding protest referenda may curb the excesses that occur when parliamentarians are not reflecting voter preferences. The interests of parliamentarians and political parties may diverge from those of the mass of the voters on many matters. These include the number of members of parliament (MPs), the type of voting system, election campaign funding and free air time, privileges for factional interests, parliamentary remuneration in all its forms, the size of Cabinet and the issue of term limits for (list) MPs.

The biggest concern with binding referenda is that a populist politician or faction may be able to manipulate an outcome that undermines the rule of law and the common law rights of minorities. It may be safer to make initiative referenda non-binding given the risks of populist excesses.

Options for reform under the heading of the separation of powers include issues relating to the independence of the judiciary and the possibility of a second chamber. The examination of these options is introductory. Hayek's proposal for a specific form of second chamber is outlined. While the discussion supports the proposition that this option is worthy of a deeper examination, it is by no means unequivocally supportive. Bicameral systems impose costs and could reduce accountability.

The discussion of the judiciary points in favour of retaining the Privy Council as a means of preserving the separation of powers. It considers the desirability of moving further towards a written constitution, or of retreating towards greater reliance on an unwritten constitution and the common law. The discussion is open-ended, but presents some arguments that point in favour of reliance on an unwritten constitution. Options for curtailing undue enthusiasm amongst the judiciary for making law, as distinct from applying it, include recall and confirmation ballots.

In contrast to these limited and exploratory discussions, the issue of compensation for regulatory takings is discussed in detail. It is the major focus of section 7.

It is widely accepted that governments should be able to exercise the power of eminent domain in order to allow transactions to occur that individuals in the community would have undertaken voluntarily but for problems of high transaction costs. This power provides an alternative to the common law as a means of addressing high transaction cost situations such as those that can arise from monopoly and hold out.

The power to take without compensation is similar to the power to tax arbitrarily. Both powers constitute a threat to the rule of law. Because the exercise of the power of eminent domain lends itself to abuse, it is highly desirable that its use be limited. Both history and principled reasoning suggest that its use should be limited to overcoming:

- public good (high transaction cost) problems where the loss of human welfare would be material and widely distributed in its absence; or
- bilateral monopoly (hold-out) problems where the public benefit is similarly high but where one or more individuals could otherwise extract the entire surplus from a necessary project, or thwart it entirely for unworthy reasons.

In both cases we suggest that recourse to this power be constrained by a high threshold in the form of a test that its use is necessary for the achievement of an essential public benefit. One concept for assessing this public benefit is the sum of producer and consumer surplus. A requirement for a public right of access could be part of the public benefit test. (This would not be a right to subsidised or preferential access.)

The transaction cost logic for the exercise of the power of eminent domain provides no case for departing from the mutually beneficial feature of unforced exchanges. Transactions that would be undertaken voluntarily can normally be presumed to be mutually beneficial to those who are parties to them. The normal test of mutual benefit is whether the buyer is prepared to meet the seller's price. This is 'the market's' cost-benefit test.

Under the same logic, those who wish the government to step in to force an exchange for their benefit should compensate those whose rights are taken. Not only should there be full compensation when rights to property are taken but, in principle, the compensation should be funded by those who will effectively obtain rights as a result of the forced exchange. It is their willingness to pay this compensation that establishes that the benefits from the exchange exceed the costs and ensures that all can be made at least as well off as if the exchange did not occur.

In order to reduce the potential for opportunism and wasteful lobbying over the distribution of any surplus, the report favours the concept of a proportional sharing in the gains between the parties to the forced exchange. This logic establishes a case for compensation to be *higher* than the level necessary to make those relinquishing rights no worse off than if the transaction did not take place.

Where those losing property rights share in the benefits generated from the new use of the relinquished rights, the need for cash compensation is reduced proportionately. In the extreme when the group that loses the rights is also the group that obtains all the benefits, all the compensation takes the form of reciprocal benefits and costs.

The test as to whom has been harmed by a government regulation or tax is to ask who would have had cause for action under existing law if the Crown had been a private party to the exchange. This benchmark is that which would have applied had high transaction costs not prevented the transactions from occurring voluntarily. Violations of existing legal rights, notably the common law of contract, property or tort, would constitute a cause for action.

In contrast, regulations that simply better enforce existing rights cause no harm to legal rights. These regulations reflect the exercise of 'police power'.

Compensation or restitution may be most applicable in the case of a taking of property. In the case of a violation of the law of contract and tort the normal remedy would be payment of damages and the cessation of the injurious activity unless the consent of the plaintiff is obtained. The preferred remedy for a regulation that would permanently impair a right to personal autonomy is to rescind the offensive regulation, and pay damages if required.

High transaction costs may make it uneconomic, or even impossible, for beneficiaries to pay compensation in some cases. While, on balance, the report favours taxpayer funding of compensation where this is practicable, there is a heightened risk that the power of eminent domain will be abused when those who lobby for a taking can escape the full costs. Issues arise in relation to consent, conformity to sound tax principles and the protection of minority rights. These concerns highlight the importance of setting a high threshold for recourse to this power.

Regulatory takings can often occur in the form of requiring a permit before an activity can be legally undertaken. This restriction on economic freedom can easily escalate if the issuer of the permit has the ability to make its issuance conditional on compliance with predatory or unconstitutional demands. Permit requirements and any attached conditions can be seen as analogous to the private remedy of injunctive relief for a pending harm. The need here is for similar disciplines to be applied to the imposition of such conditions as apply to the granting of private injunctions under the common law.

The report also draws attention to the scope for uncompensated takings to occur when rights are transferred within the public sector and from the public sector to the private sector. Such takings should not escape principled scrutiny.

Opponents of compensation often express the view that it would be fiscally prohibitive. This objection appears to be based on fiscal illusion. An uncompensated taking is a tax regardless of whether it is treated as such in the public accounts. As a tax, the real issue is whether it conforms to sound tax and constitutional principles.

In contrast, some proponents of deregulation might resist the concept of compensation for regulatory takings out of the fear that it could impede a programme of deregulation. However, if deregulation is genuinely cost-benefit justified, it should satisfy both sound tax principles and the requirement that, in principle, all parties to the forced exchange can be made better off. Deregulation does not necessarily remove a common law right. Sometimes it may remove a conferred privilege for which consideration had not been paid. Where no consideration has been paid there may be no right.

Notwithstanding all these limitations and complexities, the report concludes that establishing the principle of compensation for regulatory takings would have a potentially material and beneficial affect on regulatory behaviour. The rush to legislate first and resolve problems later would be made more fiscally irresponsible. Those clamouring for regulation would be more likely to be confronted with the possibility that they would be asked to share in the costs of compensation. It seems plausible that such a discipline could induce a greater sense of constitutionality and respect for existing legal rights.

Section 8, Design Options for the Proposed Regulatory Constraints, considers how the constitutional principles that emerged from the earlier sections might be converted into a process for testing existing and proposed regulations. An illustrative schema would screen a regulation by subjecting it to up to seven tests based on these principles.

Such an approach could be used in a major one-off review of regulations. It could also be built into the design of a reform intended to institutionalise the principled scrutiny of proposed regulations in the future.

One approach for achieving the latter goal would be a Regulatory Responsibility Act. Section 8 considers this option in some detail. The conflict between the provisions in such an Act and conflicting non-discrimination provisions in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993 would need to be addressed.

The report suggests that a Regulatory Responsibility Act could include a requirement for the executive to table in the House of Representatives regulatory strategy statements at regular intervals. In addition, it proposes that each regulatory proposal be supported by a regulatory analysis statement. This statement would address the issues of the necessity for recourse to the power of eminent domain, consent to the taking, compensation, proportionality of the distribution of benefits, options for funding compensation from beneficiaries, and related matters. This approach differs materially from the current regulatory impact statement approach that makes cost-benefit analysis its centrepiece. The proposed legislation also considers options for improving accountability for compliance through certification and certificates of responsibility.

Section 8 also considers more limited options for improving regulatory processes through amendments to standing orders or to the *Cabinet Office Manual*.

The report does not claim that the benefits from a Regulatory Responsibility Act would exceed the costs. There are risks that the initiative could fail because of the opposition to regulatory reform from groups wishing to defend their privileges. Modifications to the proposed legislation could see it aggravating rather than alleviating the problem of regulatory excesses.

The report concludes that a determined one-off review of regulations by a government that is genuinely determined to weed out excesses has the greatest likelihood of success. It considers that process reforms of the type just discussed could help (re)build an attitude of legality, but probably not on their own.

1 Introduction

If governments were perfect all regulations would enhance human welfare and there would be no need for this report. Unfortunately, governments are not perfect. As a result, some laws and regulations may reduce welfare.

This study is motivated by the widespread concern with the extent of costly and ill-conceived regulations in New Zealand. Section 2, Evidence of the Need for Regulatory Reform, documents these concerns. The hopes and aspirations of too many law-abiding citizens are being thwarted by laws that they cannot reasonably be expected to understand. Some people have been destroyed financially and emotionally. Too many regulations reward bullies, cheats, competitors or unworthy opportunists. Some perhaps unduly benefit the rich.

Our purpose is to find well-designed measures that could assist New Zealand governments to address these regulatory problems. Regulatory reform, properly conceived, is about finding the best set of regulations, avoiding the extremes of too little or too much regulation. Too little regulation would undermine private law and fail to complement it where it would be desirable to do so.

Regulation and private rules ideally exist to promote the interests of all members of a society. In part, the task of distinguishing between good and bad regulations involves asking whether society has made the right choice between regulation and private rules. Removing regulatory excesses should help restore respect for the law and allow the police and courts to focus more on protecting citizens against fraud, violence, trespass, burglary and theft.

The issue we address concerns human nature, institutions and incentives rather than villains and victims. For example, the owners of businesses should not be seen simplistically as the innocent victims of regulatory excesses imposed by politically powerful anti-business forces. To the contrary, individual businesses (or, more accurately, their owners and managers) can be as keen as any other citizen to lobby for regulations that might benefit them at the expense of someone else.

Our objective is to seek reforms that would allow New Zealanders to enjoy a higher level of welfare, whether they choose to exercise this through greater leisure or higher material living standards. It is not to maximise economic output, as measured by some indicator such as national income per capita. It would be offensive in itself to seek to increase national production or economic growth by introducing policies that violate fundamental and widely held rules of a moral or ethical nature.[1]

The focus on the welfare of the representative citizen precludes the view that this is an issue of business versus the citizen. The representative citizen is a consumer and a producer and effectively has an ownership interest in business both directly and indirectly. The representative citizen can only prosper if there is a vigorous and dynamic business sector. As conceived, regulatory reform is neither pro-business nor anti-business.

[1] An example would be the introduction of a mandatory 60-hour working week, which might well increase national output but not overall welfare.

Nor is regulatory reform about favouring big businesses at the expense of small businesses. To the contrary, we argue that regulatory burdens hit small businesses and private individuals the hardest, financially and emotionally.

In any case, business is a means, not an end. The end is the greater welfare of the population. Regulations should not create privileges for businesses at the expense of the common citizen. Corporate welfare that takes this form is undesirable on our yardstick. Regulations that are anti-competitive or lend themselves to anti-competitive purposes are a form of corporate welfare. Having made these points, all businesses benefit from sound laws, properly enforced.

Our objective also rules out the goal of *minimising* the burden of regulations on businesses. The welfare of citizens demands that businesses and citizens alike comply with sound regulations, even if the costs of complying are not trivial. Governments should, and do, have the power to tax and regulate so as to allow transactions to occur that individuals in the community would have undertaken voluntarily, but for problems of high transaction costs.

Our framework provides principles for testing the quality of any regulation, but leaves open the issue of where the line should be drawn in debatable cases. It accommodates a role for the state in respect of curbing monopoly and providing a welfare safety net, but cautions against regulations that take from the poor for the benefit of the already well off.

Our fundamental approach to evaluating candidates for regulatory reform is *consequentialist*. We ask if the reform would be likely to help the representative individual to obtain a higher level of welfare from scarce resources in a way that is not at the expense of others, such as a political minority. In answering this question we find the concept of economic freedom is a useful guide.

We seek reform principles that would be likely to weed out inefficient or unconstitutional regulations while preserving efficient regulations based on an assessment of their likely consequences for human welfare. Regulations, whose costs were likely to exceed their benefits markedly would be weeded out.

Being directed at principles, this study does not seek to determine precisely which regulations should be disposed of, modified, or retained. However, the discussion of these principles inevitably identifies particular areas in which problems of excess and poor design create a *prima facie* case for early attention, as the discussion of corporate welfare indicates.

It is implausible that regulatory excesses could persist without the continuing support of some politically powerful constituencies. Regulatory reform aimed at weeding out excesses is therefore fundamentally threatening to entrenched special interests. It will be inevitably controversial.

Our general approach in this study is to identify principles for reform that would appear to be widely acceptable to contending factions, leaving the more controversial issues to public debate and further analysis.

Section 2 motivates the case for reform by putting forward evidence and opinions that regulatory excesses exist in New Zealand. It also puts New Zealand's regulatory experience into an international context.

Section 3, What is Regulatory Reform?, examines the relationship between regulation and two broad aspects of human welfare – liberty and prosperity. It also defines key concepts.

Section 4, Various Reform Initiatives and Experiences, moves the discussion from symptoms to treatment difficulties – it reviews some reform options and experiences in New Zealand and internationally. Regulatory excesses appear to be entrenched.

Section 5, Why Reform is so Difficult – Public Choice Theory, uses the economic theory of regulation to explore the underlying problem – what factors tend to sustain an excess of regulation? The analysis raises constitutional issues.

Section 6, Constitutional Aspects of Regulation, explores the constitutional issue of limits on the abuse of state power in the form of poor quality regulations. Some ideas for guiding regulatory reform emerge.

Section 7, Regulatory Reform Options, analyses in greater detail the reform ideas that emerged from the analyses in sections 5 and 6.

Section 8, Design Options for the Proposed Regulatory Constraints, uses these analyses to suggest some specific options for constraining regulations, including the option of a Regulatory Responsibility Act.

2 Evidence of the Need for Regulatory Reform

2.1 Introduction

This section provides an overview of the extent of regulation in New Zealand and overseas and the costs and benefits of that regulation.

Section 2.2 provides detailed evidence and arguments in support of the proposition that an excess of regulation exists in New Zealand.

Section 2.3 puts the extent of regulation in New Zealand into an international context.

Section 2.4 summarises the main points made in this section.

2.2 Symptoms of regulatory excess in New Zealand

2.2.1 Introduction

In the following subsections we aim to make a plausible case that New Zealand suffers from avoidable and undesirable regulatory excesses.

In sections 2.2.2 to 2.2.5 we use a two-step approach. First, we identify many examples of worrying outcomes that have been sufficiently material to attract media attention. Second, we provide a commentary that explores the possibility of a *prima facie* case that these outcomes may be due apparently to avoidable flaws in the underlying legislation.

The second step is important because examples of bad outcomes from regulations do nothing by themselves to establish that there is a better way. Perfection is commonly impossible. The best attainable rule or regulation may produce a small but irreducible incidence of uncomfortable outcomes.[2]

We provide many examples, since any particular example may not prove robust under closer scrutiny. Our interest is in the general point rather than in the full facts of any specific case.[3]

We make no attempt to document all cases of likely regulatory excesses as our purpose here is purely motivational. In particular, we limit the illustrative material to cases of regulatory costs and excesses as they affect businesses. This topic is large enough by itself and its selective nature does not affect the generic analysis in the later sections.

For the record, we make no presumption that any excesses affecting businesses are worse for welfare than are other excesses. Regulations abound outside the commercial sphere of our lives. Consider for example, those relating to access to social welfare, accident insurance for accidents outside the workplace, child custody and drug abuse.

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[2] Hence the saying 'hard cases make bad law'.

[3] A cautionary point here is that many of the examples are taken from newspaper reports. As such they will not be complete and may be unreliable in any particular case.

Newspapers commonly document significant problems in these areas that reflect badly on the quality of regulations and the administrative processes that result from them.[4]

We draw our illustrations from regulations that primarily impinge on:

- taxation;
- employment;
- land use and sea use;[5] and
- safety.

Section 2.2.6 provides other evidence of the existence of excess regulation in New Zealand.

2.2.2 Tax regulations

Symptoms of excess

With central government spending targeted at 35 percent of gross domestic product (GDP), tax regulations are inevitably intrusive and troublesome. The greatest economic costs of taxes arise from the many ways in which they distort behaviour. Section 3.7 provides estimates of the deadweight costs of taxation.

Greater compliance burdens in recent years have come from new taxes such as the goods and services tax (GST) and fringe benefit tax, complex accrual tax arrangements and the additional administrative responsibilities arising from the deduction of student loans, child support payments and debt repayment deductions ordered by district courts from wages[6] and the imposition of resident withholding tax on interest. The penalty regime that penalises businesses for failing to forecast income accurately adds to these burdens.

The costs to businesses of complying with the tax code alone are significant from a national perspective. In 1999 an expert committee endorsed an estimate of $1.8 billion a year (approaching 2 percent of GDP) for annual tax compliance costs.[7] It has been reported that the cost of complying with depreciation regimes for capital items of low value can easily exceed the capital cost of those items.[8]

Tax regulations are far too intricate for any single business or tax adviser to hope to comprehend fully. Small businesses as a whole cannot be realistically expected to comprehend the laws even with the benefit of legal advice that they could not afford. According to an Organisation for Economic Cooperation and Development (OECD)

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4 For example, the editorial, 'Punished for caring', in *The Dominion* of 14 February, 2001, refers to a "travesty both of justice and of common sense" that saw a grandmother convicted on four counts of abduction for rescuing her four granddaughters from a gang atmosphere of violence and neglect after authorities failed to respond adequately to her repeated calls for something to be done.

5 Much environmental regulation comes into this category.

6 *National Business Review,* 'Burdens on Business: The High Cost of Compliance – The Coalface Laments: Enough is Enough', 30 October, 1998, p 34.

7 *National Business Review*, 26 February, 1999.

8 See, for example, *National Business Review, op cit*, 30 October, 1998, p 34.

survey of adult literacy, over 40 percent of adults in New Zealand do not have the level of literacy required to cope with daily adult life.

Nor can taxpayers rely on getting accurate advice from the Inland Revenue Department (IRD). The training and retention of skilled staff is often a problem in government agencies. In 1997, the *New Zealand Herald* reported that according to the IRD's annual report only 67 percent of advice given by it over the telephone was technically correct, with a higher score for written advice.[9]

Brent Gilchrist, managing director of consultancy firm Gilchrist Taxation, was reported in *The Dominion* of 7 February, 2001, as saying that the IRD has threatened to fine, or even jail, taxpayers for not providing documents it already possesses. He says that the IRD denies taxpayers the opportunity to contest the accuracy of information about the taxpayer that it holds on its files.[10]

In 1997, a spokesperson for a business information service expressed the view that "most small businesses had no idea of the significant risks they now faced [under the tax regime]. But actions they took now could bring huge penalties down the track".[11]

Widely publicised cases allege that the IRD has been able to present a business with an erroneous and apparently arbitrary tax demand, with the flexibility to add penalties and interest that quickly or slowly bankrupt that business. This has happened without any readily enforceable obligation for the IRD to furnish the taxpayer with a proper basis for that assessment.

A notable case that led to a parliamentary select committee inquiry in 1999 occurred a few years ago. In this case Christchurch businessman, David Henderson, has publicly accused the IRD of bankrupting his firm by assessing it liable to pay GST for $1 million after he had submitted a claim form for a refund of $60,000.[12] He alleges that the IRD did not provide him with a calculation showing how its assessment was derived. Years later the department rescinded the $1 million assessment and paid the $60,000 refund.

According to *The Independent*, the chair of the select committee inquiry commented that:

> The cases were harrowing. There was a common theme of an individual up against a monolith.[13]

The Henderson case alone signalled clearly to all businesses, or at least to all small and medium-sized businesses, that they can be put into bankruptcy at any time at the discretion of the IRD. In fact, evidence before a parliamentary committee of inquiry established that this was not an isolated case. Many taxpayers have been emotionally

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9 *New Zealand Herald*, 22 October, 1997.

10 Brent Gilchrist, 'Taxing Times Still Loom for the IRD', *The Dominion*, 7 February, 2001.

11 *Sunday Star-Times*, 26 October, 1997.

12 This is perhaps the most publicised and investigated case. David Henderson published a book presenting the facts as he saw them. See, *Be Very Afraid: One Man's Stand Against the IRD*, David Henderson, Alistair Taylor IRD Press, Auckland, 1999. (This is not the same person as the David Henderson cited in other references in this report.)

13 Deborah Diaz, 'Has Parliament's select committee really de-fanged the fiscal fiend?', *The Independent*, 14 March, 2001, pp 6–7.

shattered and financially ruined by IRD actions that appear to be unconscionable. The parliamentary inquiry established an appalling number of cases of apparently honest taxpayers being financially and emotionally ruined, to the point of suicide, along with evidence of a predatory culture within IRD.[14] In one particularly excruciating case, a man committed suicide after an IRD employee allegedly threatened to confiscate his tools of trade, depriving him of the means of livelihood for which he was trained. The IRD is in the difficult and inconclusive position of being unable to prove that its employee did not make this threat.

In a recent decision the Court of Appeal has limited the degree to which taxpayers bear the burden of proof in disputes with the IRD. The case involved a dispute between Abattis Properties and IRD over whether the latter should have to prove that it issued a taxpayer a GST assessment before taking action against the company. According to Brent Gilchrist, Abattis first knew of a GST assessment for $388,000 (which included more than $200,000 in late payment penalties) when IRD attempted to put the company into liquidation for not paying. Abattis could obviously not hope to prove that IRD had never mailed the GST assessment it failed to receive. The Court of Appeal determined that, in certain situations, the onus is on the IRD to prove that it complied with statutory procedure.[15]

Commentary

Care should be taken in interpreting any particular case because government agencies have limited abilities to defend themselves. This is in part because of privacy issues in relation to private citizen's affairs. Nevertheless, the reality of taxpayer vulnerability to IRD power cannot be denied.

Article 20 of the Magna Carta states that:

> For a trivial offence, a free man shall be fined only in proportion to the degree of his offence, and for a serious offence correspondingly, but not so heavily so as to deprive him of his livelihood. In the same way, a merchant shall be spared his merchandise, and a husbandman the implements of his husbandry, if they fall upon the mercy of a royal court. None of these fines shall be imposed except by the assessment on oath of reputable men of the neighbourhood.

Clearly, the power of IRD must be limited if gross abuses are to be avoided.

Although progress has been made in simplifying the tax regime from time to time, it has been uneven. In part this is because of offsetting factors such as the need to protect the tax base with complex new taxes, such as the fringe benefit tax and the accrual tax legislation.

A one-sided penalties regime and the delegation of great authority to the IRD compound these problems. The penalties regime exposes taxpayers to the risk of severe penalties if their forecasts of their future income turn out to be too low. On the other hand, they do not get commensurate benefits if their forecast turns out to be too

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[14] *The Free Radical* has documented many of these cases (from the viewpoint of the taxpayer only) in many issues. See in particular issues 34 and 35 in 1999.

[15] Brent Gilchrist, 'For once, the onus of proof is on IRD', *The Dominion*, 7 March, 2001.

high. Officials have to exercise judgment about the severity of the penalty; that is, they have some discretionary power.

Recent evidence of a change in culture of Inland Revenue (under new management) was provided when it apologised in front of a parliamentary committee to the Willis family. According to a tax expert at Ernst & Young, the family is estimated to have lost $1 million, had a business providing 400 jobs destroyed, and incurred health problems in a 14-year battle with IRD.[16] The case is notable in that the couple has been awarded compensation of $550,000.

These cases point clearly to problems in the process for judicial review of IRD actions. The processes at the time do not appear to have been sufficiently timely or effective. It also appears that individual taxpayers may not have been made fully aware of their appeal rights.

No doubt the complexity of the tax laws makes judicial review, or a successful review using political processes, difficult in some cases. Able politicians and senior bureaucrats must be aware of the potential for the IRD to use its powers to destroy the lives of particular taxpayers in order to make an example of them. But, like the general public, they might find it difficult to determine whether an aggrieved taxpayer is being honest.

However, governments also see a need to preserve those powers in order to strengthen the IRD's arm against those who seek improperly to avoid or evade tax and ensure they do not derive a benefit at the expense of more law-abiding taxpayers.

The fact that the taxpayer is forced to deal with the IRD on an ongoing basis may be another factor. Inland Revenue has the discretion to determine whether to subject a taxpayer to an intensive audit. This discretion could be used to punish particular taxpayers who cause difficulties for the IRD.[17] This raises a question about the transparency and objectivity of audit selection processes.

Presumably in a partial response to such concerns, on 1 October, 1996 the IRD put into effect a new disputes resolution process.[18] This process requires it, *inter alia*, to provide the facts and legal issues that underlie its assessment. It provides for time limitations and a conference between the parties. Taxpayers can appeal to an adjudication unit within IRD for administrative review and adjudication. A taxpayer can challenge the outcome by filing proceedings with the Taxation Review Authority (a unit within the Department of Courts) or with the High Court.

There is some evidence of a decline in the number of disputes as public and political attention has been directed at these complaints. The annual number of proceedings filed with the Taxation Review Authority ranged between 50 and 69 in the three years to 2000. This is down appreciably from the range of 99–132 in 1995 to 1997, which is itself markedly down on the range of 195–255 during 1991 to 1994.

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16 Jo Doolan, 'Willis case shows one rule for taxpayers and another for the taxman', *The Independent*, 8 February, 2001.

17 See, for example, *The Free Radical*, April/May 1999, p 7.

18 Inland Revenue Department Tax Information Bulletin: Volume Eight, No 3, August 1996. A copy is currently obtainable at http://www.ird.govt.nz/tib/vol08/03/tib8-03.pdf.

The parliamentary select committee's report on its inquiry into IRD administration was released late in 1999. It made 27 recommendations. Inland Revenue has progressively implemented a number of them. They include the recent release of a taxpayers' charter and an improved complaints management service. Accountants have reported that IRD's performance has improved.[19]

While this looks encouraging, ongoing difficulties can be expected. Complex tax laws, staff training problems (given the problems government departments commonly experience with retaining trained staff) and problems of incentives promise to conspire with the wide-ranging powers delegated to IRD.

Changes in tax rules with retrospective effect are another sign of an excessively onerous tax system. In May 2001 the government reportedly rejected IRD advice (and accepted the Treasury's advice) in retrospectively blocking up to $200 million in GST refunds being claimed by inbound tour operators.[20]

In conclusion, a fundamental problem is that high government expenditure requires an intrusive tax system. Government has to defend aggressively the tax base, even if it has been defined aggressively. Otherwise it may not get the revenue it requires. The rule of law is undermined.

2.2.3 The regulation of employment

The first symptom of excess: volume of legislation and high unemployment

The first symptom of regulatory excess is the sheer volume and detail of employment-related legislation.

Legislation impinging on employment includes the: Privacy Act 1993; Human Rights Act 1993; Fair Trading Act 1986, Immigration Act 1987; Holidays Act 1981; Anzac Day Act 1966; Waitangi Day Act 1976; Parental Leave and Employment Protection Act 1987; Smoke-free Environments Act 1990; Wages Protection Act 1983; Child Support Act 1991; Volunteers Employment Protection Act 1973; Civil Defence Act 1983; Transport Act 1962; District Courts Act 1947; Time Act 1974; Shop Trading Hours Act Repeal Act 1990; Equal Pay Act 1972; Health and Safety in Employment Act 1992; Industry Training Act 1992; Sale of Liquor Act 1989, New Zealand Bill of Rights Act 1990[21] and more recently the Hazardous Substances and New Organisms Act 1996 (HSNO), the Accident Insurance Act 1998 and its Amendment Acts of 1999 and 2000, the Accident Insurance (Transitional Provisions) Act 2000, Protected Disclosures Act 2000 and the Employment Relations Act 2000. We make no case that all these Acts are unsound.

The dates of these Acts reflect the frequency with which parliament passes new legislation and modifies existing legislation – and expects employers to keep up. Fourteen of these Acts were passed in the 1990s and another six were passed in the 1980s. Collectively this is more than two-thirds of the total.

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19 Diaz, *op cit*, p 6.

20 Craig Howie, 'Cullen rejected IRD advice and took Treasury's to block refunds', *The Dominion*, 15 June, 2001.

21 Susan Jepson, an employment relations consultant is reported to have compiled this list of legislation in 'An Employer' Test: Do You Know Your Legal Obligations?', *National Business Review*, 30 October, 1998, p 34.

Furthermore, arguably at least 11 of these Acts imposed significantly new burdens and represent relatively new directions for regulation. These comprise the Accident Insurance legislation in 2000, Privacy, Human Rights, Immigration, Parental Leave and Employment Protection, Smoke-free Environments, Child Support, Employment Relations, Health and Safety in Employment, Protected Disclosures and New Zealand Bill of Rights Acts. Even the Acts that materially deregulated businesses (such as the Shop Trading Hours Act Repeal Act 1990 and portions of the Employment Contracts Act 1991) would have imposed transitional costs on businesses by changing the business environment.

The Department of Labour has published a pamphlet 'Guidelines for Employers and Employees' that brings together the basic information from the many laws that deal with the workplace. The March 1999 edition comprised 64 pages and explained that it should not be used as a substitute for legislation or for legal or other expert advice.

Moreover, proposals for adding to this regulation appear continually. Currently the government is contemplating imposing a requirement of paid parental leave whereas current law provides for a year's unpaid parental leave for maternity care.

Last, but not least, New Zealand's much increased rate of unemployment since the early 1970s is a sign of an overly rigid labour market in the face of economic change. It represents a failure to adjust to changing circumstances.[22]

Commentary

Existing and proposed policies for parental leave oblige all employers, including the 84 percent of businesses who employ fewer than five employees, to keep a position open for a person taking leave for up to 12 months. This must hurt small businesses disproportionately. As a recent editorial in *The Independent* pointed out, the effect must be to reduce employers' incentives to hire women and to train the ones who are hired. As with all such outcome-based central planning legislation, employers and employees are denied freedom of contract in these respects and therefore the ability to pursue outcomes of their own choosing.

It is simply not credible that small businesses in general can afford either the time or the money in gaining expert advice necessary for understanding the full import of the regulations governing employment. No amount of expert advice can determine how the courts might apply a vague newly legislated requirement – like 'good faith bargaining'. Regulation of such unnecessary complexity tends to bring the law into disrepute.

Clearly the barrage of legislation overriding the common law cumulatively amounts to a major vote of no confidence in the efficacy of the common law, and perhaps also on the competence of adults to sell their own labour. The existence of the common law of contract raises a question about the need for a material role for the state in this area. Employment contracts are simply one of many contracts adults negotiate for themselves in life. Parties to an employment contract could assign terms and conditions including safety risks and responsibilities between themselves as they pleased. (Contracts with minors are customarily a special case.) The question is why the common law of contract should not suffice in governing employment contracts as it

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[22] Sufficiently generous and accessible unemployment benefits could see a lot of unemployment beneficiaries even if the labour market was otherwise regulated only by private rules.

does, or could, for other contracts. What is the comparative advantage of the state in over-turning the common law of contract in relation to employment?[23]

In addition, ideas and paternalism surely play a role, at least in influencing public opinion. The Marxist idea that employers exploit employees leads easily to the fallacious notion that employers' profits are higher if wages are lower, regardless of the intensity of product market competition. Low wages may be seen to reflect employer exploitation rather than the effects of low productivity and supply and demand.

Paternalistic legislation naturally assumes that workers are not as competent as the legislature to determine what is in their best interests. In contrast, generic common law could define personal freedoms of autonomy and contract without the need to distinguish between the role of an employer and an employee.

More symptoms of excess – personal grievance cases

Although it restored many contractual freedoms and advocated freedom of contract in its very title, the Employment Contracts Act 1991 also removed an existing right for many employers and employees to agree to employment contracts on an at-will basis. Instead it imposed on them a new constraint in the form of an unjustifiable dismissal clause. The ability to contract out of this provision by mutual agreement was explicitly denied.

This infringement on freedom of contract, in conjunction with an activist Employment Court, has created an environment that has so encouraged opportunistic personal grievances cases that the term 'taking a PG' has since entered common parlance.[24]

Such employment legislation has allowed businesses to be harassed when they dismiss an employee, even in a case of employee theft. Deborah Coddington has documented the case of a small business that fought an award of $4,500 in favour of such a dismissed employee for years before winning the case in the Employment Court. But the toll led Jayne Roughan and Steve Murphy to sell the business.[25]

In another case, a disagreement over whether a single job interview had resulted in an author verbally agreeing to employ a researcher for work worth $50.41 led to a $14,000 cost to the author, despite no agreement being signed and no work being done.[26]

In March 2001, the Employment Tribunal awarded a former harbour pilot $121,000, perhaps four year's income for the average family. The pilot told the tribunal that he resented being told as a '*fait accompli*' that his employment under a two-year contract would be taken over by another company. The Port of Gisborne wished to contract out

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[23] Richard Epstein addresses this issue for the New Zealand Business Roundtable in *Restoring Sanctity of Contract in Employment Relationships*, Wellington, 1999.

[24] A number of New Zealand Business Roundtable publications comment in detail on the problems with employment law. Examples include: *A Study of the Labour/Employment Court*, 1992, Colin Howard, *Interpretation of the Employment Contracts Act 1991*, 1995, Richard Epstein, *Employment Law: Courts and Contracts*, 1996, Bernard Robertson, *The Status and Jurisdiction of the New Zealand Employment Court*, 1996, Charles Baird, *The Employment Contracts Act and Unjustifiable Dismissal: The economics of an unjust employment tax*, 1996, and Richard Epstein (1999), *Restoring Sanctity of Contract in Employment Relationships*, *op cit*.

[25] Deborah Coddington, 'Pizza Plunder', Labour laws destroy a fledgling business, *The Free Radical,* 31, July/August 1998.

[26] Deborah Coddington, 'Labour Pains', *The Free Radical,* 25, June/July 1997, pp 14–15.

of the management of those services. It told the tribunal it had guaranteed work and income for the remaining term of the contract.[27]

In April 2001, the Employment Court awarded $50,000 to the estate of an employee who committed suicide after resigning. The Court reportedly decided on the balance of probabilities that the resignation was an unjustifiable constructive dismissal and that there was a causative link between that dismissal and the suicide. Employers now fear that they may be liable to pay for a tearful employee's disappointment.[28]

Commentary

Small employers are all too likely to be unaware of the detailed procedures that the Employment Court will hold them to account for observing even in the most egregious cases of misbehaviour by the employee. Yet, the employer has no assurance of success even if these procedures are observed.

As a result, employers may find it commercially expedient to pay out on opportunistic personal grievance claims rather than litigate them. All their honest work colleagues then see the opportunistic and unscrupulous rewarded. The social fabric corrodes and the law is brought into disrepute. Indeed, the burden is likely to fall ultimately on honest workers because such legislation raises the cost of hiring labour generally, thereby reducing the wage rates that can be sustained in New Zealand.

Symptoms of excess: the Employment Relations Act 2000

The Employment Relations Act 2000 creates privileges for unions by reducing the freedom of contract between employees and employers. Only unions may negotiate a collective contract – formerly any bargaining agent could do so. The Act relies on the novel and ill-defined concept of 'good faith bargaining'. Since no-one knows what this really means, no employer can be sure what good faith bargaining entails.[29] Once again the effect is to reduce certainty in the application of the law.

Since the passing of the Employment Relations Act 2000 there has been a determined effort by one waterfront union to thwart the common law rights of members of another union to work for the employer who prefers to hire them. In another recent dispute government veterinarians held up production of meat exports as part of their claim for higher wage rates.

There may be room for debate about what role the new legislation is playing in relation to these disputes. The Hon Richard Prebble, a lawyer by training, has argued that the civil unrest has been a direct result of the Employment Relations Act 2000 "where there is no procedure for employers to obtain court injunctions against unions seeking to prevent New Zealanders from carrying out their lawful activities".[30]

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27 *The Dominion*, 'Sacked harbour pilot awarded $121,000', 21 March, 2001.

28 Jock Anderson, 'Bosses fight suicide payout', *National Business Review*, 12 April, 2001.

29 In the first relevant case the Employment Court considered under the Employment Relations Act 2000, *Baguley v Coutts Cars Limited*, the Court set a new standard of fair dealing in redundancy situations, awarding a car groomer $10,000 plus three months lost wages. See Peter Cullen, 'Landmark case sets job relations on a new course', *The Dominion*, 11 April, 2001.

30 Hon Richard Prebble, press release, 'Coalition to Blame for Civil Unrest on Wharves', 24 January, 2001. See also R Prebble, letter, 19 February, 2001.

Commentary

The law reduces the freedom of contract of workers by limiting the range of contracts that can be offered to them. Employees cannot contract out of this legislation in offering their labour.

One of the Act's sponsoring ministers defended these limitations in the presence of one of the authors of this report. The minister did so on the basis that the legislation sought to maximise freedom of contract while protecting employees from exploitation by employers. The minister provided no evidence of exploitation by any firm in any industry when questioned. Similarly, the minister had no answer to another questioner's observation that there was unquestionably a sellers' market for computer analysts, so the notion that the computer industry was exploiting analysts was simply absurd.

The Employment Relations Act 2000 thereby undermines the principle of freedom of contract that one of its proponents asserts in its defence. The case illustrates the general point made earlier about how freedom can be simultaneously espoused and curtailed.

Symptoms of excess – cases arising from restrictions on freedom of speech and association

Far from safeguarding pre-existing common law rights, the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993 impose far-reaching restrictions on freedom of contract, association and speech in the workplace.

The following cases illustrate the problems that have resulted:

- An employer was denied the right to advertise for a *Christian* mechanic.
- A *middle-aged woman* who owned a bookshop was told she could not advertise for an assistant of the same sex and age.[31]
- A major investment banking firm was told it could not advertise for a *junior* or *senior* research analyst. It was told that advertising for an analyst with an *intermediate* level of competence would have been acceptable.[32]
- The Human Rights Commission took a Wellington hairdresser to task for offering a lower rate to pensioner male customers because they take less time.[33]
- The Human Rights Commission reportedly warned a golf club in Nelson not to hold its annual married couples tournament because to do so would be discriminatory.[34]
- In 1994 the Human Rights Commission reportedly advised that superannuation schemes paying pensions to surviving spouses would be discriminating against

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31 *New Zealand Herald*, 21 March, 1994.

32 Personal experience of one of the authors. To the Human Rights Commission the terms 'junior' and 'senior' indicated age discrimination and a determination not to hire on merit regardless of the competitive nature of the industry. Why 'intermediate' was regarded differently is not clear and presumably could never be made clear.

33 *The Dominion*, 16 August, 1996.

34 *The Dominion*, 16 August, 1996 and 7 September, 1996.

single people.[35] In 1996 the Commission also declared that almost a quarter of superannuation schemes could violate the Human Rights Act 1993 in relation to benefits for spouses.[36]

- In 1994 the *Evening Post* reported that the Human Rights Commission had ruled that when Wellington bus company Stagecoach bought 80 buses it had discriminated against disabled people by not buying buses accessible to wheelchairs.[37] In 1994 the Commission took an action designed to stop Stagecoach from accepting 26 new buses on the grounds that they were insufficiently accessible to wheelchair users.[38] Yet other organisations assist wheelchair users to afford taxis and mini-cabs. When the company subsequently spent $500,000 experimenting with modified buses it found that only three wheelchair-bound passengers chose to use them.[39]

- In 1994, the Broadcasting Standards Authority reportedly advised that television viewers might have to be warned, in order to avoid breach of the Human Rights Act 1993, that they might find a programme offensive if it included heterosexual kissing.[40]

- Thomas Cook reportedly withdrew an advertisement in 1995 depicting a black (New York) taxi driver after a complaint to the Advertising Standards Council that it was 'blatantly racist' because it portrayed the taxi driver in an aggressive manner. Presumably there would have been no grounds for complaint if it had been a white taxi driver.[41]

- A public library on Auckland's North Shore reportedly removed a Halloween display in 1995 on receiving a complaint that it was offensive to Christians.[42]

- In 1996 the owners of a proposed bar decided to change its name from Buddha Bar to the Souk Bar when told that the former name was culturally insensitive but that the Office of the Race Relations Conciliator would approve the latter.[43]

Other legislation affecting advertising similarly reflects highly expanded concepts of what constitutes a harm relative to conventional common law standards. For example, in 1994 a North Island company, Kiwi Blue, that was exporting water from the North Island using a picture of Mount Cook (in the South Island) on its label was the subject of a complaint from a local government agency, Tourism Coromandel, that this was misleading advertising that breached the Fair Trading Act 1986.

Prescriptive employment and human rights legislation can interact with prescriptive safety legislation (see below) to make the employment of drug-impaired youth almost prohibitive. In January 2001, MP Dr Muriel Newman cited the case of a forestry contractor in a high unemployment area who, under his contract to the parent

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35 *AEA Bulletin*, 13 May, 1994.

36 *Evening Post*, 2 September, 1996.

37 *The Dominion*, 5 December, 1994.

38 *New Zealand Herald*, 31 May, 1995.

39 *Evening Post*, 22 April, 1997.

40 *The Dominion*, 23 November, 1994.

41 *New Zealand Herald*, 26 October, 1995.

42 *Sunday Star-Times*, 5 November, 1995.

43 *New Zealand Herald*, 22 June, 1996.

company, would be financially liable to the tune of perhaps $10,000 for a rehabilitation programme for any young person he hired who turned out to have a drug problem.[44]

Commentary

These episodes illustrate the problems that can arise when governments legislate so as to override the common law in governing interactions between individuals.

The essence of the problem is that such legislation can severely impair freedom in the name of freedom. One device is to propose a novel and contradictory freedom. The effect may be to expand greatly on the displace common law definition of a hard or a duty. It may also be to relax, or even eliminate, the common law test of an interested party. Where legislation allows any opportunistic or malicious stranger to object to an arrangement, freedom of contract is eliminated in that activity. The remainder of this section illustrates these points.

Sections 14 and 17 of New Zealand Bill of Rights Act 1990 grandly provide for apparently open-ended freedoms of expression and of association respectively. In contrast, the common law minutely permits a considerable degree of freedom in these respects by the device of limiting the common law duties to others in relation to such matters as libel and nuisance. Such limits curb harms to non-consenting parties and the constraints are reciprocal. It is also taken as given in common law that individuals are free to consent to limit their freedom of speech (for example, by signing confidentiality agreements) and of association (for example, by signing a non-competition clause or an exclusive contract).

Section 19(1) of the New Zealand Bill of Rights Act 1990 asserts the conflicting right to freedom from discrimination on the ground of colour, race, ethnic or national origins, sex, marital status or religious or ethical belief. This appears to expand radically the common law definition of a harm.

Discrimination is not defined in this legislation.[45] This leaves its interpretation in the hands of the political, bureaucratic and judicial elite of the day. A sufficiently liberal interpretation that encompassed anything that caused offence to political correctness, as determined by the elite, could largely negate sections 14 and 17. The Act does not provide that the prohibited forms of discrimination can occur in the event of mutual consent, that is, it does not provide for freedom of contract in these respects.

The prohibitions on discrimination are carried into the Human Rights Act 1993 with a particular focus on employment situations. Freedom of speech is particularly impaired in recruiting situations, and on termination.[46]

The contradictory elements are heightened by section 19(2) of the New Zealand Bill of Rights Act 1990. This section makes it clear that parliament actually favours

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[44] Dr Muriel Newman, 'The Real Cost of Drug Usage', 10 January, 2001, weekly column.

[45] The potentially draconian nature of section 19(1) is marginally reduced by other contradictory sections, such as sections 15, 20 and 28 that provide for freedom of religion, the rights of minorities and security in non-enumerated rights and freedoms.

[46] A booklet by the Human Rights Commission, *Pre-Employment Guidelines*, takes 17 pages to set out indicative guidelines to private employers as to what questions they might or might not ask when conducting job interviews. In economic terms the list seems likely to impede markedly the ability of employers and employees to establish their mutual compatibility. It notably limits freedom of speech, contract and association in employment.

discrimination on all the above grounds – as long as it is in 'good faith' and is in favour of 'disadvantaged' groups.

The Act also fails to define the terms 'good faith' or 'disadvantaged'. Are men disadvantaged if on average they have lower life expectancies and spend more of those shorter lives away from their families or are women disadvantaged if on average they earn less, spend more and live longer? Providing no guidance on these matters, the New Zealand Bill of Rights Act 1990 again leaves these judgments in the hands of a political, bureaucratic and judicial elite.

These two Acts in combination deny a general freedom of association in private employment – where the incentives to hire on merit are the strongest and the increase in social cohesion achieved by allowing freedom of association may be greatest. At the same time they sanction a potentially invidious and divisive right of discrimination in the public sector – where the private incentives to hire on merit are weakest. In short, these Acts moved New Zealand far away from common law rights that are blind in relation to age, gender or race.

These issues have been analysed in detail by Professor Richard Epstein, University of Chicago Law School, for the New Zealand Business Roundtable.[47] These publications should be referred to for a fuller analysis.

In short, the New Zealand Bill of Rights Act 1990 illustrates how moves towards a written constitution can undermine liberty and institutional quality. It has provided an instrument that interest groups could have used to undermine the constitutional concept of equality under the law. The grandly stated freedoms embody much woolliness.[48] They also enhance the opportunities for the judiciary to create new interpretations and remedies, as the Baigent case mentioned in section 6.3 demonstrates. These new rights and remedies may be novel and unpredictable In addition, it reduces the legitimacy of judicial decision making by expecting the judges to act both as the guardians of human rights and parliamentary sovereignty.[49]

A final point of some significance is that the government was given until 31 December, 1999 to comply with the full requirements of the Human Rights Act 1993. In 1999 the government had that deadline extended to 31 December, 2001. In contrast, the private sector was obliged to comply without delay.

2.2.4 Land use regulation

Symptoms of excess

In *Situation and Outlook, September 2000* the Ministry of Agriculture identified many regulatory concerns in relation to the outlook for agriculture. These included: Accident Compensation Corporation (ACC) reforms, a possible lack of availability of veterinary

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47 Refer for example to Richard Epstein, *Human Rights and Anti-Discrimination Legislation*, 1996, and *Age Discrimination and Employment Law*, New Zealand Business Roundtable, Wellington, 1999.

48 DF Dugdale, 'Common Sense About the Bill of Rights: A Criticism of Geoffrey Palmer's Super-law', *New Zealand Law Journal*, April 1986, pp 127–128. (Note that the version finally passed avoided some of Dugdale's criticisms.)

49 See section 5 in Andrew S Butler, 'The Bill of Rights Debate: Why the New Zealand Bill of Rights Act 1990 is a Bad Model for Britain', *The Oxford Journal of Legal Studies*, Vol 17, Summer 1997, pp 323–345.

medicines and farm chemicals (because the costs of complying with New Zealand's legislation for hazardous products could be greater than the effort was worth for the international companies that own these products), biosecurity, biotechnology (biogenetic material), Employment Relations Act 2000 (meat work strikes), possible ratification by New Zealand of the Kyoto Protocol, negative attitudes towards farming and research funding for agriculture, excessive costs of development, in part arising from frivolous environmental objectives, and legislative threats to existing land users as lifestyle block dwellers bring themselves to the nuisances of smell and odour problems.

Other irritants arise from safety regulation (see next section), new gun registration laws, the Animal Welfare Act 1999, employment legislation of which the compliance costs arguably make employing day-to-day casual farm labour uneconomic, new liquor licence requirements for the local golf club, and rules prohibiting farm-killed meat packs for local fund raising purposes.[50]

The Resource Management Act 1991 (RMA) is at the core of environmental legislation in New Zealand as it affects private sector activities. Related legislation includes the Hazardous Substances and New Organisms Act 1996 (see section 2.2.5 below), the Historic Places Act 1993, the provisions relating to sustainable forest management plans and the logging of native trees in various Forest Acts, including the Forest Amendment Act 1993, the similar sustainability provisions in the Fisheries Act 1996, and the Biosecurity Act 1993.

Section 85 of the RMA creates a presumption that no compensation be paid in respect of controls on land. It provides that plans can be challenged if they would make land "incapable of reasonable use" and provides that such a provision could be overturned if in addition the burden would be "unfair and unreasonable". It also provides that land acquired for heritage protection purposes is a public work as defined in the Public Works Act 1981. The Act provides for inverse condemnation where a heritage order means that the land use is no longer reasonable.

The provisions in the RMA are more restrictive in relation to compensation for the regulation of land than the Town and Country Planning Act 1977 that it replaced. The Town and Country Planning Act 1977 provided for compensation for certain restrictions to land use. They related to action under or resulting from an operative district planning scheme where the land use did not detract from the amenities of the neighbourhood, cause demand for uneconomic infrastructure expenditure, or uneconomic subdivision or ribbon development. Where the owner was deprived of the right to change an existing use, compensation could be payable as long as the new use was 'suitable' for the relevant land or building.[51] Excluded from the compensation provisions were regulations relating to the relationship of buildings to land, number of buildings or their appearance.

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50 Roger Higginson, farmer, 'Rural life ring-fenced by bureaucracy', *Evening Standard*, 25 January, 2001.

51 Ryan, K, 'Should the RMA Include a Takings Regime?', *New Zealand Journal of Environmental Law*, Vol 2, 1998, p 78.

The following examples illustrate some of the problems that have occurred in practice with this legislation:[52]

- In 1994, *The Dominion* reported that some councils were using the RMA to stop farmers from planting trees while others were stopping them from harvesting mature trees without a resource consent. Yet others were demanding that farmers plant buffer zones of different trees.[53]

- In the same article *The Dominion* reported that foreign investors wanting to buy rural land for afforestation were being deterred by New Zealand's land legislation.[54]

- A Waikato district plan in 1994 reportedly required farm woolsheds to be painted in natural tones and subject to an application for a resource consent requiring a deposit of $990, photographs of the site and a farmer's description of the woolshed environment.[55]

- Also in 1994 a white-water rafting operation in the Rotorua region was reported to be in jeopardy because of a local tribe's fear that it was abusing "the river's spirituality".[56]

- In 1995 a $9,000 fine was imposed by an Auckland Court on a developer who destroyed a 120-year-old oak tree (oak trees are not natives of New Zealand). Awards of costs and a replanting requirement added another $10,000 burden.[57]

- Getting permission to remove a front-yard pine tree took a Mr Hildritch three years and gave his family a huge amount of stress.[58]

- In 1996 the Department of Conservation refused to permit some coastal residents to shore up their properties with boulders to protect them from erosion from the sea. The penalties for a breach are up to two years in jail and $200,000 in fines.[59] According to the same source a citizen had to pay $500 for a resource consent to work from home.

- Competitors are using the RMA as an anti-competitive weapon.[60] In 1996, the *New Zealand Herald* reported a case in which wealthier competitors may have attempted to force a newcomer with limited resources out of the market.[61] In 1997 journalist Deborah Coddington documented a case involving medical practitioners. It took a general practitioner three years and cost her around

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52 Regular publications with a legal regulatory orientation such as the highly professional *The Capital Letter* and the passionately libertarian *The Free Radical* are a useful source of ongoing developments and case law on regulatory issues.

53 *The Dominion*, 29 July, 1994.

54 *The Dominion*, 29 July, 1994.

55 *The Dominion*, 6 July, 1994.

56 *New Zealand Herald*, 23 March, 1994.

57 *New Zealand Herald*, 4 May, 1995.

58 *The Free Radical*, 36, June/July 1999, p 37.

59 The TV1 60 Minutes documentary, 21 July, 1996, as reported in *The Free Radical*, October/November 1996, p 11.

60 Shane Cave, 'Businesses abuse resource act to obstruct rivals', *National Business Review*, 25 September, 1998. Refer also to Ernst & Young, 'Key Results of the Ernst & Young Study on the Impact of the RMA', commissioned by the Ministry of Commerce, December 1997.

61 *New Zealand Herald*, 27 May, 1996.

$100,000 to get a consent to use her villa in Parnell, Auckland, as a medical practice.[62]

- Whereas New Zealand North Island farming owes its existence to the hard work of colonists in clearing native bush, in 1996 a couple were reportedly fined $80,000 for clearing native bush from a section in the Waitakere Ranges in the North Island.[63]

- The local council told a boy scout group in Wellington that it would have to apply for a resource consent, a building permit and an exemption from the Reserves Act 1977 for a tree hut because the council deemed it to be 'structurally unsound'.[64]

- Maori can be given special standing as objectors to development.[65] According to a newspaper report in 1998, a Transit New Zealand consultant was paying $80 an hour to local iwi to ward off mischievous spirits.[66] In similar vein, the *New Zealand Herald* reported in 1997 that an iwi was asking $50 an hour for 'document perusal' and $300 a day for 'cultural consultation' from a Northland farmer who wanted to develop a property that the iwi said may contain a unlocated sacred site. The farmer said the iwi offered to locate it for a fee.[67]

- The *New Zealand Herald* reported in January 1998 that a survey of US companies operating in New Zealand found that New Zealand is missing out on millions of dollars of foreign investment because of cumbersome RMA compliance procedures.[68]

- According to *Rural News* in 1998, farmer Dan Riddiford was still battling for a consent to operate a coastal aquaculture activity in the Wairarapa after "nearly four years, expenditure of many thousands of tax and ratepayer dollars, untold court sittings, and countless hours of consulting councillors, lawyers, barristers, judges and local body officers.[69]

- Steve Applegath was fined $10,000 for breaches of the RMA in respect of his attempt to create a duck pond in a soggy portion of his five-acre block in Auckland's North Shore. He was applying for consents but the North Shore City Council reportedly claimed it had never received a letter from his engineer on one aspect.[70]

- Bryan Jackson purchased an old Post Office building in Devonport, Auckland in 1991 but did not manage to open it as a museum until 1995 because of a litany of bureaucratic rulings by the local council, the legality of which were questioned in

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62 Deborah Coddington, 'Recovering from RMA Syndrome', *The Free Radical*, 27, October/November 1997, pp 2–4.

63 *The Sunday News*, 14 April, 1996. A large portion of New Zealand is locked up in national parks in any case.

64 *New Zealand Herald*, 20 September, 1995.

65 Section 8 of the RMA requires all to take into account the principles of the Treaty of Waitangi.

66 *North Shore Times*, 19 May, 1998.

67 *New Zealand Herald*, 21 June, 1997. Other examples are provided on p 9 in the December 1999/ February 2000 issue of *The Free Radical.*

68 *New Zealand Herald*, 15 January, 1998.

69 *Rural News*, March 1998.

70 Deborah Coddington, 'Of Dictators and Duckponds', *The Free Radical*, 33, November/December 1998 p 16–17.

1993 by the ombudsman. Two years later he put the property on the market alleging ill health from the stress.[71]

- In 1998, Federated Farmers stated that it was spending $700,000 a year helping members cope with RMA costs. It estimated that local councils were spending $100–300 million a year on planning processes. It referred to the cost of compliance to farmers as 'crippling'.[72]

- *Straight Furrow* reported in 1998 that a Banks Peninsula farmer had reason to believe that his entire farm could be made unworkable because it contained one rimu tree. The local district plan recommended that the tree be protected, along with an area of the surrounding pasture that comprised the entire working area of the farm.[73]

- The *Franklin County News* reported in 1998 that the Franklin District Council planned to make routine inspections of consent holders and charge them $200 a visit in order to cover the costs. For example, a chicken farmer with a consent to farm 200 birds would be routinely checked to ensure compliance.[74]

- In an editorial in February 2001, *The Dominion* attacked the local district council in the Wairarapa for seeking to force two new businesses in Greytown to pay $495 each for applications for resource consents for shopfront signs that might violate the district plan by rising above the roof line. In one case the offending height was only 10 centimetres. Meanwhile, longer-standing businesses endured no such requirement because their signs pre-dated the district plan. Reflecting a widely held viewpoint on this legislation the editorial described the case as a "silly saga [that] shows yet again the lunacy which the Resource Management Act can inspire in local bureaucracies".[75]

- *The Press* reported in July 2000 that a Greta Valley (North Canterbury) farmer and conservationist had never seen his local community so torn apart. This was over decisions by the Hurunui District Council to use a district plan to remove significant private property rights over designated "significant natural areas". This was to be done without compensation. The newspaper attributed to him the view that the process was penalising 99 percent of farmers in an effort to control 1 percent and that it was unworkable and unenforceable.[76]

- According to the *Business Herald* in March 1999, Charta Group in Auckland took 18 months to get a resource consent for a parking building offering 341 car parking spaces in Auckland because the local authorities favour public transport. This was despite the fact that one of these authorities was itself applying for a resource consent for the Britomart project that would create 2,500 parking spaces

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71 Deborah Coddington, 'Life of Bryan', *The Free Radical*, 28, December 1997/January 1998, pp 2–4.

72 'Legislation used red tape to strangle the country: The Resource Management Act is destroying key production sectors, writes Federated Farmers leader Malcolm Bailey', *National Business Review*, 20 November, 1998. Refer also to the July 1998 submission by Federated Farmers to the Commerce Select Committee's Inquiry into Compliance Costs.

73 *Straight Furrow*, May 1998.

74 *Franklin County News,* 2 June, 1998.

75 'KO'd by the style police', *The Dominion*, 15 February, 2001.

76 'Farmers liken mayor to Mugabe', *The Press*, 2 July, 2000.

and the company's claim that the site could accommodate 300 apartments that would have been allowed 600 parking spaces under the same district plan.[77]

- In March 2001, the *National Business Review* reported that opportunistic objectors for whom time was not a problem were effectively blackmailing property developers. One article explained how an objector could justifiably hope to be paid to go away when an objection could delay a project for 18 months or more.[78] In another article on the same page the head of property for AMP Henderson Global Investors was reported to say that abuse of RMA processes was "rife and developers were starting to vote with their feet and take projects overseas".[79]

- *The Press* reported in January 2001 that the Tasman District Council obtained an application to designate a privately owned orchard for recreation purposes because it wanted to take the land to extend some existing council-owned playing fields.[80]

- The *National Business Review* reported in January 2001 that Olivine New Zealand shifted a $500 million development project to Perth, Australia after spending $5–6 million over five years in an unsuccessful attempt to gain approval for the plant in Mangere, Auckland.[81]

- The *New Zealand Herald* reported in May 2001 that after a five-year battle costing $2 million to get a consent for $100 million canal development in Whitianga consent was denied because the plan did not comply with legislation that was passed after the plan was prepared. The local mayor commented that:

  > It's another slap in the face for local democracy, the RMA, and the Environment Court. The RMA is now the province of barristers and solicitors.[82]

- In April 2001, *The Dominion* reported that Japanese timber firm, Juken, that had injected $400 million into New Zealand had become wary about investing further citing difficulties with New Zealand's workforce and its laws, particularly the RMA. The article stated that the deputy prime minister conceded that the delays under RMA were a concern.[83]

- In 5 June, 2001, *Straight Furrow* reported that a Waimakariri irrigation scheme that took one year to construct required 16 consents during a nine-year planning stage that cost, at $1 million, 13 percent of the total scheme cost.[84]

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77 *Business Herald*, 'Fringe parking building wins council approval', 31 March, 1999.

78 Campbell McIlroy, 'Beginner's guide to developer's blackmail', *National Business Review*, 2 March, 2001, p 17.

79 Campbell McIlroy, 'Developers fear no end in sight to resource management abuse', *National Business Review*, 2 March, 2001, p 17.

80 'Orchard steps up fight to stay', *The Press*, 11 January, 2001.

81 Campbell McIlroy, 'Wave goodbye to $500 million project as locals miss out', *National Business Review*, 26 January, 2001.

82 Anne Gibson and Kevin Taylor, 'Whitianga devastated by veto on waterways', *New Zealand Herald*, 11 May, 2001.

83 *The Dominion*, 'Streamlining call on resource consents', 18 April, 2001.

84 Murray Taggart, 'RMA hinders growth and development in Canterbury', *Straight Furrow*, 5 June, 2001.

The same problems bedevil attempts to adjust road capacity to changing traffic needs. The chair of Transit New Zealand recently lamented that:

> … it is frustrating to watch projects, often those which have strong local community support, become bogged down in prolonged consultation, and numerous hearings and appeals. Without such delays, the planning and building of roading projects still takes years to achieve. With them the benefits to road users can be substantially deferred. As well, the associated expense in participating in those processes chews through the money that would be better invested in the roading network and safety initiatives.[85]

Separate legislation apparently allows property owners essentially to have their property rights confiscated without compensation by the Historic Places Trust. In one notable case a John White purchased a longstanding sheep and cattle farm in 1989 in Northland on the basis that it was capable of carrying 10,000 stock units with projected earnings of around $200,000 per annum. The Historic Places Trust subsequently thwarted all his plans to develop and manage the property on the grounds that some or all of it were of archaeological, cultural and spiritual value. Yet in October 1993, the Department of Conservation found that the property did not carry archaeological evidence. John White reportedly estimates that the saga cost him over a million dollars.[86]

The Forests Amendment Act 1993 similarly allows the state to take private property rights without compensation, in this case in respect of fauna and flora. The case of Trevor and Heather Schroeder who farm 1,100 acres of sheep and beef near Taumaranui in the North Island and have title to 300 acres of native bush illustrates the problem. Following the passage of this legislation they found that if they wished to continue to harvest this bush sustainably they would have to spend $50,000 to prepare a sustainable management plan. Furthermore, there was no guarantee that it would be approved, particularly since no interested party test was applied to screen out possibly frivolous, opportunistic or malicious objectors. Trevor Schroeder was reportedly told he faced a fine of up to $250,000 if he milled a dead totara tree that had been lying in one of his paddocks for around 30 years. Apparently it was deemed to be of national significance.[87]

Intrusive regulation and state ownership also heavily curtail mining activity in New Zealand. According to the executive director of the New Zealand Minerals Industry Association, government red tape is to blame for the low level of exploration activity in New Zealand. The Department of Conservation owns much of New Zealand's land and one-third of it is locked up for environmental reasons. To gain access to the remainder, approval has to be sought from three ministers, Conservation, Energy and the Environment, each of whom has the power of veto.[88]

Commentary

All the Acts listed above were passed in the 1990s. This was when New Zealand was being variously celebrated and vilified for being a bastion of free market reforms.

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[85] 'Chairman's Report', *Transit New Zealand Annual Report*, Wellington, 1999–2000, p 5.

[86] Deborah Coddington, 'Historic Places Travesty', *The Free Radical*, 24, April/May 1997, pp 2–5.

[87] Deborah Coddington, 'Logging Off', *The Free Radical*, 41, May/June 2000, pp 4–5.

[88] *Otago Daily Times*, 'Cut red tape: mining lobby', 26 February, 2000.

Major problems and concerns surround the RMA.[89] It aimed to consolidate earlier legislation, but it also conferred great powers by way of delegated discretions to local authorities. Like much of the legislation of an environmental and safety (see next section) nature, it relies heavily on fuzzy terms (such as sustainable management, 'incapable of reasonable use', 'unfair and unreasonable burdens' 'intrinsic values' and kaitiakitanga).[90] Overriding the common law, it adopts a central planning approach that focuses on taking private property rights without compensation in order to achieve specific outcomes that reflect the dominant political interests of the day. Much of the other legislation that is cited in this and the next sections is similarly prescriptive in relation to outcomes.

Bad legislation creates the opportunity for bad outcomes but what happens in practice depends on how that legislation is applied by diverse local authorities. Here is what one well-respected advocate of the legislation's design observed on that issue:

> During my six years sabbatical leave from Parliament between 1990–1996, I was the Executive Director of the NZ Forest Owners Association where daily I was embarrassed by the appalling implementation of this legislation that I had so passionately supported and nurtured. I had totally underestimated the evils of perverse planning … .
>
> So what has gone wrong? In a nutshell, my impression is that the planning profession, supported by compliant and ineffective local body representatives, has participated in the wholesale slaughter of the RMA. Legislation that should have revolutionised local government in this country has instead spawned interminable waves of regulation that are at best a perverted version of the regulation arising under the old Town & Country Planning Act.[91]

In the *National Business Review* column referred to in footnote 91, former Environment Court judge, Peter Skelton, argues that exotic forestry development is rightly subject to specific scrutiny under the RMA because of "external effects that are difficult to internalise". In support of this (contentious) public good argument he cites visual effects, water catchment issues, and roading and harvesting requirements. However, road and harvesting costs are not obviously difficult to internalise and visual effects and water catchment issues could apparently be addressed by voluntary action and the common law – those who want to apply land to a different use would purchase those rights. This is not to argue that there are no public good issues in relation to water catchment problems, but it raises the question of the degree to which the RMA confuses public good issues with non-public good issues and thereby uses a gram of a public good argument to justify a tonne of anti-development activism. Water catchment issues have always required specific consideration and are unrelated to

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89 Refer, for example, to 'The Resource Management Act 1991 – The Transition and Business', *New Zealand Business Roundtable*, Wellington, 1994, and Bret Birdsong, 'Adjudicating Sustainability: New Zealand's Environment Court and the Resource Management Act', October 1998 (mimeograph). For an opposing view, see associate professor of law and former judge Peter Skelton's defence of the RMA in 'Developers' fears of RMA are "unfounded and ill-informed"', *National Business Review*, 25 May, 2001.

90 See for example, Jerry Taylor, 'Sustainable Development: Common Sense or Nonsense on Stilts?', *The Freeman*, September 1998; Peter Cresswell, 'A Pig of a Problem', *The Free Radical*, March/April 2000, 40, pp 4–5; and Richard Epstein, *Principles for a Free Society: Reconciling Individual Liberty with the Common Good*, Perseus Books, Reading, Massachusetts, 1998, pp 98–102.

91 Ken Shirley, 'RMA and Forestry', address to the Resource Management Law Association of New Zealand, 6th Annual Conference, Rotorua, 25 September, 1998, pp 1–9.

issues of visual effects or any failure to apply user pays in roading – or to the wider purpose of the RMA to impose outcomes rather than provide an improved basis for exchange.

In contrast to the whole approach of the RMA, a common law approach would focus on determining who had the property right, leaving outcomes to be determined subsequently by mutual negotiation between interested parties. These negotiations would allow benefits and costs to be weighed, a discipline that is woefully neglected under the current politicised approach.

Under common law approaches to environmental issues, a party or parties who believed they were to be harmed or had been harmed by an unrelated party would take a tort action against that party. That action might be a pre-emptive injunction or a claim for compensation for harms suffered.[92] For example, a property owner who feared property damage or risk to person as a result of wash from a fast ferry could apply to the court for an injunction against the ferry operator. The court would ensure that a number of tests applied to the action.

First, the plaintiff would have to establish a potential harm in the form of a personal interest. That could not take the form of a disembodied harm to a non-sentient being like 'the environment'. Nor would an interested party be one whose interest was solely vicarious – for example, if it took the form of self-professed 'fellow suffering' in the fears of the person whose actual life and property was at risk.

Second, the plaintiff would have to establish that the named defendant's actions were indeed culpable in terms of that harm, beyond reasonable doubt.

In addition, the plaintiff would have to prove that the action did not violate the *defendant's* legitimate property rights.

Once any such action had removed any uncertainty about the allocation of existing property rights, interested parties would be free to transact to their mutual advantage for the cessation or continuance of the offending practice. For example, if the fast ferry operator was found not to have the right to put property owners at risk, it might choose to desist or seek to contract with the interested property owners for the right to expose their properties to its wash compensating them for the costs of protective structures in the process.

The common law approach just described reduces the risk of hold up and opportunistic court actions, particularly where plaintiffs bear their own costs and may also be liable for the defendant's costs if the action is without merit. Of course, the common law is less effective in these respects if a court's decisions are unsound.

Public good (transaction cost) issues arise between fast ferries and small recreational (fishing) boats where there is no room for both to operate normally. In such cases, regulation may assist.

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[92] Refer, for example, to Roger E Meiners and Bruce Yandle, 'The Common Law: How it Protects the Environment', *PERC Policy Series*, Political Economy Research Centre, PS–14, May 1998 and David Schoenbrod, 'Putting the "Law" Back into Environment Law', *Regulation*, 17, Vol 22, No 1, 1999, pp 17–23.

In a similar vein, under a private property rights system those who wanted special physical features of private property to be preserved, such as a historic building, a copse of native timber, or endangered species, or an archaeological site would achieve their outcome by transacting with the existing owner. Where those with an interest in doing this lacked the resources individually, like-minded individuals could well set up a non-profit organisation for pooling funds on their behalf.

By preserving freedom in the exercise of legitimate property rights, the common law system preserves the important principle of full compensation (through voluntary exchange) for any reallocation of property rights.

Defenders of the RMA make the point that most applications for resource consents are processed without costly delays. (While it is true that some delays relate in part to the funding of the Environment Court, the reality of limited resources implies a general need to avoid intrusive and meddlesome legislation.) However, this argument does nothing to justify putting so many to the trouble of obtaining consents in the first place or imposing the costly delays that do occur. Nor would the absence of costly delays justify this legislation if it simply reflected the departure of developers and entrepreneurs to regimes with better-designed laws. Serious grounds for concern deserve serious consideration.

Key points of departure between New Zealand's legislation and the common law approach include:

- A reversal of the burden of proof. Whereas under the common law a plaintiff would have to apply for an injunction in order to stop a property owner's action, under the RMA a property owner cannot act without a prior consent from a central planning agency.
- A desire to impose outcomes – such as 'sustainable development' – rather than to overcome transaction cost problems, leaving outcomes to be determined by decentralised cost-benefit considerations.[93]
- The replacement of the principle of sanctity of existing legitimate property rights independent of political power by the concept of the primacy of district plans based on political power and influence. By politicising property rights such legislation arguably undermines their legitimacy.
- The extension of the concept of harm to encompass harms to 'the environment' of which the magnitudes, or even existence, are unprovable and cannot be compared, even in principle, with harms and costs to humans.[94]
- The virtual elimination of the interested party test. Widespread powers to object to the issuing of a resource consent are indiscriminately conferred on all, be they competitors, single interest fanatics, the malicious and opportunistic.
- Resistance to the concept of compensation for the loss of legitimately owned property rights.

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[93] For example, Warwick Heal, 'Sensible businesses don't have RMA hassles', *National Business Review*, 8 June, 2001, argues that the RMA enables development to occur 'in an appropriate way given proper environmental considerations' and is necessary to prevent the unwise use of precious finite resources. The common law makes no presumptions about the wisdom of use.

[94] Environmental 'harms' occur naturally.

- Resistance to the concept that those who object selfishly, maliciously or opportunistically to a proposed use for private property should carry any risk of having to bear the costs that they seek to impose on the rightful owner.[95]
- Reduced ability to transact in property rights once a determination has been made.
- The introduction of terms and concepts of which the meaning and utility are at best unclear.

The allocation of a widespread ability to object to the granting of a resource consent has three important adverse implications for welfare compared with a common law approach. First, it provides competitors with a means for undesirably raising a new entrant's costs. Second, it opens the way for opportunistic behaviour based on hold-up. Third, by raising transaction costs it makes it less likely that a welfare-enhancing reallocation of property rights can occur prior to, or subsequent to, the consent determination.

As is well known amongst economists who have studied private property rights systems, uncertainty about the allocation of property rights and limits on the ability to exchange property rights freely can be expected to raise tensions in the community and reduce welfare compared with a well-functioning common law system.[96] A ban on milling native trees can be expected to create a black market in milled trees and the neglect of tree management practices. Regulations that give too many people the ability to stop the exploitation of an asset can be expected to cause a 'tragedy of the anti-commons' depending on the circumstances.[97]

None of this is to argue against the efficiency of regulation in those public good situations that are not handled well by common law remedies. For example, in cases of non-point source pollution, common law solutions may not work well if the victim cannot establish, to a court's satisfaction, who caused the common law harm. Water regulation is another example. Water regulation pre-dates the RMA.

In effect, the project of introducing the RMA as an umbrella statute has served to extend regulation to all sorts of activities for which it is ill suited. This is a common theme with umbrella environmental legislation. The need is to restrict regulations to those public good situations that are not handled as well by common law remedies.

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[95] In December 2000, the government announced an environmental legal aid scheme that compels taxpayers to fund up to $20,000 to environmental groups that contest resource consents. Press release, 'Environmental Legal Aid Shows Anti-Business Agenda', Gerry Eckhoff, MP, 21 December, 2000.

[96] In the *Sunday Star-Times*, 26 February, 1995, the president of Federated Farmers reportedly expressed the view that the RMA would induce neighbours to combine against neighbours and work on conjecture and hearsay. Lawyers and consultants who do not live in the community would make money out of the misery.

[97] James Buchanan and Yong Yoon, 'Symmetric Tragedies: Commons and Anticommons', *Journal of Law and Economics*, Vol XLIII, April 2000, pp 1–13.

2.2.5 Safety regulation

Symptoms of excess

Major legislative instruments for the regulation of risk in relation to commercial activity in New Zealand include the Health and Safety in Employment Act 1992, fire service, labour market and accident compensation legislation, product safety and consumer safety legislation (including the Animal Products Act 1999) and the Hazardous Substances and New Organisms Act 1996 (HSNO).

The regulation of health and safety in the workplace is highly intrusive. The prominent law-publishing firm, CCH New Zealand, publishes a Safety and Health handbook for businesses, an ACC audit handbook, a workplace training kit and a number of health and safety audit guides.

Ample grounds exist for concern about the efficacy of much of this legislation. According to *The Independent*, the current minister of agriculture expressed his opinion that the food safety assurance system "is completely stuffed" and stated that:[98]

> If you go and buy food ready to eat in most main streets of New Zealand, you had better have a good supply of toilet paper on hand, because the chances of picking up food-poisoning organisms are higher here than in almost any other developed country.

According to *The Dominion*, professors John Scott and Des Gorman of the Auckland medical school told a parliamentary select committee in April 2001 that the system under which pilots were given medical clearance to fly was "stuffed". Professor Scott reported that more than half the files they reviewed were flawed and that they had trouble finding any files that were adequate as medical documents.[99]

In the health sector there is evidence of dissatisfaction with some outcomes under government control. Two former health ministers are currently being sued for allegedly failing to implement timely blood bank tests for hepatitis C. In an unrelated case, *The Dominion* reported in April 2001 that two women's groups, Misread Cervical Smear Support Group and Women's Health Action, were pushing for cervical smears to be analysed by an independent agency. This followed a committee of inquiry report that criticised the authorities for systemic failures involving no system of quality assurance for laboratories, a poorly designed management structure, no central register and a failure to evaluate and monitor information.[100]

Small businesses comprise 99 percent of all organisations. Surveys indicate that many of them do not know how much safety is enough. They also lack the time, money, skill and awareness necessary to be able to deal with the issues. These issues include the bureaucratic need to formalise workplace health and safety practices.[101] Industries targeted by the regulators such as agriculture, forestry and hazardous substances may be dense in small businesses.

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98 Bob Edlin, editorial, 'Why not apply export standards to the food we eat?', *The Independent*, 11 April, 2001, p 8.

99 Hannah Lawrence, 'Medical system for pilots flawed, say professors', *The Dominion*, 12 April, 2001.

100 Christine Langdon, 'Take screening from ministry – women', *The Dominion*, 12 April, 2001.

101 'Safety regime too tough for small business', *National Business Review*, 10 February, 1999, p 19.

Prosecutions under the Health and Safety in Employment Act 1992 have reportedly made many farmers fearful that they could be liable if farm visitors, or even the children of farm labourers, were injured or killed.[102] An amendment to the Act in 1998 reduced these fears but did not eliminate them. The belief exists that farmers can be made bankrupt if someone else does not take care on their property.[103] Farmers may now fear that if mushroom gatherers trespass on their property and one breaks an ankle the minimum fine for the farmer could be $10,000.[104] Moreover, proposals in a discussion paper in 2001 promise to reinvigorate these fears according to Federated Farmers.[105]

Firms that fail to take "all practicable steps" to ensure the safety of employees could face fines of up to $100,000 a year or be jailed for up to a year. A Christian youth camp was fined $30,000 after a child was hurt by a slide.[106]

The Building Act 1991 provides for fines of up to $200,000 and up to $20,000 a day for a continuing offence. A building contractor was fined $7,500 when a tile struck a visitor to the site. The Fair Trading Act 1986 provides for fines of up to $100,000.

The Department of Labour unsuccessfully prosecuted Keith and Margaret Berryman under the Health and Safety in Employment Act 1992 after a beekeeper plunged to his death in 1994 off a bridge on Crown land leading to their farm. They lost their farm and their health has suffered. While in opposition, the current prime minister reportedly told them that, in her view, the original charges should never have been laid. The Berrymans are still waiting, at age 66 and 72, for an official response to their claim for compensation.[107]

Hirepool, a firm that hires out more than 14,000 items and 550 categories of equipment, has had to increase its health and safety manual from 17 pages at about the time the Health and Safety in Employment legislation was passed to 109 pages. Hirepool is required to give clear, comprehensive training and instruction to every equipment user, so that they might safely complete any job with that equipment. Hirepool does hundreds of thousands of transactions a year. The legislation requires firms like Hirepool to minimise or eliminate accidents when it cannot hope to anticipate, let alone control, all the events that could result in accidents.

According to its chief executive, Hirepool's branch representatives attend bimonthly health and safety meetings. They do regular hazard identification, hazard notification and analysis. They have internal occupational safety and health (OSH) audits, two independent external audits annually and an OSH induction process for every trainee. All employees attend an approved NZ Safety training course, and there are health and safety reports. The Occupational Safety and Health Service of the Department of

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102 *Sunday Star-Times,* 6 November, 1994.

103 Roger Higginson, 'Rural life ring-fenced by bureaucracy', *Evening Standard*, 25 January, 2001. See also *Sunday Star-Times*, 6 November, 1994.

104 *Barrier Bulletin*, May 1998.

105 Gavin Forrest, 'Health and safety at work scrutinised', *Straight Furrow*, 13 March, 2001, p 27.

106 A recent article reports a view that the likelihood of being prosecuted is less than one in a 1,000 and argues, that in reality, the Act has turned out to be a 'paper tiger'. See Rebecca Macfie, 'Health and Safety in Employment Act scares bosses while failing to cure ills of workplace', *The Independent*, 7 March, 2001, pp 16–17. Bad legislation can easily be ineffectual overall and tyrannous in particular cases.

107 Jon Morgan, 'Couple 'heartily sick' of waiting for response', *The Dominion*, 28 March, 2001.

Labour has presented the firm with an award for the excellence of its efforts. But Hirepool still cannot hope to comply with the requirement to minimise or eliminate accidents.

The chief executive of Hirepool comments that the list of convictions under the health and safety legislation is "literally a 'who's who" of large publicly listed companies" and asks how small companies can be expected to comply if the largest companies cannot. He comments that anecdotal evidence suggests that OSH compliance by small businesses is woeful; it is the large companies that bear the brunt of the prosecutions.[108]

A Hamilton man with a successful homekill meat plant on his farm in October 1977 battled officials for two years to get his plant licensed so it could expand. However, he could get no clarity as to where the safety requirements started or stopped. He felt they were rising all the time. In the end, consultants' fees and lost income totalled $500,000 and he was reportedly forced to sell his farm.[109]

In an unrelated example, the president of the Nursery and Garden Industry Association has expressed the view that the Environmental Risk Management Authority (ERMA) was imposing barriers to imported new plant varieties that are "almost draconian". In his view, ERMA's fees and charges and its fears of introducing new weeds mean that a plant would probably now not be imported if it is not already in New Zealand or little is known about it.[110]

In 1999, Wellington drainage contractor David Spencer Limited was fined $25,000 for failing to keep an employee safe. (The employee died in a collapsed trench.) In 2000, David Spencer was fined a further $20,000 for manslaughter and given 80 hours of community service. His counsel told the Court of Appeal that three engineers, an occupational safety and health inspector and a man with 35 years' experience had visited the site before the accident but none had noticed the danger.

The Employers and Manufacturers Association (Northern) is seriously concerned about the implications of HSNO. In May 2001 it observed that, for most businesses, the fees to be charged (from 2 July, 2001) for importing or manufacturing a new substance will start at $2,000 per application for low-risk substances and $5,000 for higher-risk substances. It stated that anyone can request a hearing on any approved substance and these will cost from between $9,000 and $15,000 a day.[111]

In August 2001, research company Diatranz reported that it was quitting clinical trials in New Zealand on a diabetes treatment based on transplanting cells from young piglets into humans. The director-general of health reportedly confirmed that the Diatranz application had been rejected on safety and 'precautionary principle' grounds. The company's medical director asserted that the United States, Sweden and Switzerland would permit such trials. He stated that the company was already doing research overseas in one country, was applying to do another trial in Italy, and would

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108 Mike Buczkowski, 'Absurdities of OSH regulation', *The Independent*, 16 March, 1999.

109 Melissa Moxon, 'Battle with bureaucrats costing plenty', *New Zealand Herald*, 10 November, 1999.

110 Graeme Kennedy, 'Draconian laws are stunting gardening growth', *National Business Review*, 14 May, 1999.

111 Gilbert Peterson, media release, 14 May, 2001, 'Business alarm rising at fees and compliance of new environmental law'.

look at moving the rest of its research overseas. He expressed concerns about New Zealand's future if officials were too risk averse.[112]

Commentary

New Zealand's Health and Safety in Employment Act 1992 proscribes outcomes that must be achieved regardless of cost. Section 5 states that the Act's principal object is to provide for the prevention of harm to employees at work.

Section 6 of the Act imposes a duty on employers to ensure the safety of employees. It also states that:

> Every employer shall take all practicable steps to ensure the safety of employees while at work; and in particular shall take all practicable steps to—
>
> (a) Provide and maintain for employees a safe working environment; and
>
> (b) Provide and maintain for employees while they are at work facilities for their safety and health; and
>
> (c) Ensure that plant used by any employee at work is so arranged, designed, made, and maintained that it is safe for the employee to use; and
>
> (d) Ensure that while at work employees are not exposed to hazards arising out of the arrangement, disposal, manipulation, organisation, processing, storage, transport, working, or use of things—
>
> (i) In their place of work; or
>
> (ii) Near their place of work and under the employer's control; and
>
> (e) Develop procedures for dealing with emergencies that may arise while employees are at work.

The requirement that employers shall take 'all practicable steps' to ensure safety is so ill-defined and open ended as to be potentially ruinous for businesses when the potential fines are taken into account. No 'safe harbour' is provided that would provide employers and employees with a level of confidence that they had complied with this requirement. Critically, there is no scope for employers and employees to opt out of this legislation by mutual agreement.

Section 53 of the Act imposes strict liability, removing from David Spencer and others the defence of non-negligence. The other issue in the David Spencer case is double jeopardy.

The requirement for safety as an absolute is naïve, utopian and unachievable. Safety is desirable, but not if it means giving up an active life, and not if the costs of achieving greater safety exceed the benefits. Any legislation focusing on human welfare would be expected to seek to balance the marginal cost of achieving a greater level of safety with the marginal benefit. A sound case would also have to be made for denying freedom of contract in relation to the assignment of risk in the workplace.

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[112] Lindsay Birnie, 'Research firm gives up on NZ', *The Dominion*, 8 August, 2001.

Other recent safety-related legislation is similarly prescriptive.[113] For example, the purpose of HSNO is stated as follows:

> The purpose of this Act is to protect the environment, and the health and safety of people and communities, by preventing or managing the adverse effects of hazardous substances and new organisms.

The concept of protecting the environment is fundamentally different from the concept of protecting human welfare or private property rights. It implies that the objective is to promote anti-human rather than pro-human welfare.

Utopian and prescriptive legislation typically compromises with pragmatic realities by delegating discretions to those applying it. These discretions act as a safety valve because they can allow politically influential groups to achieve their goals without creating outcomes that are so indefensible that they bring down the entire legislative framework. Proponents of such legislation may see the processes for hearing appeals and permitting exceptions or adjusting standards as allowing a balancing of costs and benefits. Unfortunately, the incentives under these processes are commonly to balance political and bureaucratic costs and benefits rather than economic costs and benefits or the value of individual liberty.

Currently the advocates of this central planning approach are proposing that the Health and Safety in Employment Act 1992 be made more draconian. Under these proposals, the maximum fines and prison sentences would be greatly increased. Employees – including members of trade unions – could issue notices forcing allegedly dangerous work to stop immediately, and private prosecutions could be initiated.[114]

The alleged ineffectuality of the existing health and safety legislation is used to justify such proposals. According to journalist Rebecca Macfie there has been "no discernible downward trend in industrial fatalities" since the introduction of the original legislation. She also reports that New Zealand's workplace fatality record is worse than that in Australia and the United States. However, the article gives no consideration to research findings that suggest that much safety regulation appears to increase mortality. Furthermore, an excess of regulation in general will increase mortality by reducing wealth.[115]

Regulation of prices can also adversely affect safety. For example, the regulation of public hospitals in New Zealand does not ensure that public hospitals will be particularly safe. To the contrary, because the government deliberately under-prices public hospital services, it has to ration both quality and quantity by non-price means. This may compromise safety.

Safety can also be compromised by other goals, often of an absolute nature, that government agencies pursue. For example, Cassandra Hewitt-Reid has argued that the pursuit of cultural safety in the training of nurses has been putting the safety of patients at risk.[116] In a related vein, a plausible case exists that fears of being accused of

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113 For a critical commentary on the HSNO legislation in a property right context, see Paul Harrison, 'Facing the ERMA Hurdle', *The Free Radical*, 39, December 1999/February 2000.

114 See Macfie, *op cit*, and *Discussion Paper on the Health and Safety in Employment Act 1992*, Department of Labour, Wellington, 2000.

115 See Macfie *op cit* and Robert Hahn, Randall Lutter and Kip Viscusi, *Do Federal Regulations Reduce Mortality?*, AEI/Brookings Joint Centre for Regulatory Studies, Washington DC, 2000.

116 Cassandra Hewitt-Reid, 'Cultural Safety is Dangerous', *The Free Radical*, 36, June/July 1999, pp 12–13.

being racist or culturally insensitive have made government agencies reluctant to expose the reality of domestic violence, particularly in relation to child abuse.[117]

In contrast, under a common law approach, case law would establish what constituted a harm and penalties for causing a harm other than by mutual consent. This process would allow risk to be contracted for between consenting parties. Workers could trade a riskier workplace for higher wages, or a safer workplace for lower wages. Consumers could buy a riskier product at a lower price. These trade-offs are inescapable – they cannot be removed by regulation. Diverse risk preferences could be accommodated.

Again, we make no claims that New Zealand stands apart from many other countries in its regulation of health and safety. New Zealand is simply reflecting overseas trends with much of this 'no-risk' legislation.[118]

2.2.6 Other opinions and evidence on the quality of regulation

It is implausible that any marked excess of regulation could exist in New Zealand without attracting comment from independent and reputable observers. This section documents a number of supporting opinions on this matter. Other supportive evidence comes from trends in legislative activity and sporadic government Acknowledgments of the problem in the form of attempted palliatives.

Sir Geoffrey Palmer and Matthew Palmer eloquently reflected on the pressures voters put on governments to regulate as follows:

> New Zealanders tend to exhibit an innocent and misplaced faith in the efficacy of legislation. We also undervalue the importance to the community of good law flowing from good law-making procedures. We seem to be addicted to passing legislation for the sake of it, and to believe that legislation can cure our innermost ills. This superfluity of legislation is in part a response to political demands. The government must be seen to be reacting; if it passes a law it can be said to be doing something. In response to other pressures, legislation is passed for which there is no legal need. As a respected New Zealand judge, Sir Alexander Turner, wrote in 1980: 'The belief is widely held, that there is no human situation which is so bad that legislation properly designed will effectively be able to cure it'.[119]

The relentless pressures to regulate are manifest daily in the media. Businesses notoriously lobby for protection from competition, subsidies, tax privileges and for regulations that will raise competitors' costs or undermine a supplier's property rights. Consumer and environmental groups commonly lobby for benefits at the expense of the existing owners of property rights. Regulators lobby for greater powers. Lobbyists

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[117] The current head of Women's Refuge gained widespread publicity recently for drawing attention to this problem. Also, the Commissioner for Children revealed recently that he succumbed to political pressures at ministerial level to play down the issue in a public report on the death of James Whakaruru. See also, Felicity Goodyear-Smith, 'Child Sex Abuse and PCs', *The Free Radical*, November 1994, pp 7–9

[118] For articles and references to criticisms of existing legislation in New Zealand and elsewhere, refer to: New Zealand Business Roundtable, *Regulating for Occupational Health and Safety*, 1988 and *Accident Compensation: Options for Reform, op cit*, pp 132–137.

[119] Palmer, G and Palmer, M, *Bridled Power: New Zealand Government Under MMP*, Oxford University Press, Auckland, 3rd edition, 1997, p 150.

habitually use the media to whip up public opinion. The media are compliant because it is their job to attract an audience. Horrific crimes, breaking stories about real or fancied risks, for example in relation to road safety, food or product safety or the environment, constantly put pressure on governments to 'be seen to be doing something' about whichever unfortunate event or alarmist story underlies the headlines of the day.

To what extent do parliaments succumb to such pressures?

In 1908 the entire body of public Acts was published in five volumes comprising 4,221 pages and, at a quick count, 208 Acts.[120] Based on the 16 volume, 14,105 page 1908–1957 reprint and consolidation, at the end of 1957 there were, at a quick count, 413 Acts in force.

Each year the government publishes a complete list of the Acts, ordinances and statutory regulations in force. The list for 1997, published in 1998, comprises 311 pages.[121] Excluding amendments to statutes and ordinances, it appears that over 1,100 public general Acts were in force on 1 January, 1998, or about to come into force.[122] In addition, there were a similar number of local Acts in force (again, excluding amending Acts) and nearly 200 private Acts.[123] Based on a sample drawn from the 120-page list, over 2,000 statutory regulations were in force, not including regulations amending those regulations.[124]

In 1978 the New Zealand Statute Book comprised more than 60 volumes at an average of 800 pages per volume.[125] The body of all local and private Acts published since 1978 and of all general public Acts still in effect at January 1998 is contained with much duplication and redundancies in 89 volumes comprising 32 volumes in the Reprinted Statutes series and 57 volumes in the annual Statute series.[126]

The great volume of intrusive regulation requires endless amendments and modifications to reflect changing circumstances, new enthusiasms and the correction of earlier errors. For the past 20 years around 4,000 pages of statutes and legislation have been passed on average each year (split almost equally). There is no strong trend in the number of statutes passed in the last two decades, but there does appear to be an upwards trend in the number of regulations.

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120 According to Bruno Leoni in 'The Law and Politics' published in *Freedom and the Law*, expanded 3rd edition, Liberty Fund, Indianapolis, 1961, p 201, only 50 statutes relating to private relationships among citizens are recorded in more than 1,000 years of Roman legislation.

121 *1997 Tables of New Zealand Acts and Ordinances and Statutory Regulations in Force*, New Zealand Government, Wellington, 1998. This list includes amending Acts.

122 Some Acts, such as the Finance, Local Legislation, Maori Purposes and Reserves and Other Land Disposals Acts have multiple appearances, depending on the year in which each was enacted. But, for the multiple appearances of these Acts, the total would be approaching 900.

123 Local and private Acts are, respectively, Acts that relate to a particular locality and Acts that relate to a particular person, group or corporation.

124 We have been told by a Hong Kong official that there are no more than 1,000 regulations affecting businesses in total in Hong Kong, but have no documentation to support this number.

125 Hon Sir Kenneth Keith, quoted in Palmer and Palmer, *op cit*, pp 149–150.

126 Estimated, based on the information provided in Volume 37 of the Reprinted Statutes. There may be considerable duplication within the reprinted series and between this series and the annual volumes. In addition, some statutes in both series will have been repealed.

During the decade to 1998, 1,409 new Acts and 3,789 new regulations were passed. More regulations were passed in 1998, at 467, than in any previous year. In any year some regulations repeal in whole or part regulations passed in the same year and in earlier years. As an indication of this level of activity, during the period of intense deregulation from 1984–1988, between 6 percent and 11 percent of the regulations passed in that year were revoked or expired. A much larger number of regulations passed in earlier years would be revoked by the regulations passed in any one year.

In 1788, James Madison commented on such orgies of regulation as follows:

> What indeed are all the repealing, explaining, and amending laws, which fill and disgrace our voluminous codes, but so many monuments of our deficient wisdom; so many impeachments exhibited by each succeeding against each preceding session; so many admonitions for the people of the value of those aids which may be expected from a well-constituted senate?[127]

The then executive director of the Federation of Commercial Fishermen was reported in 1996 as saying that the Fisheries Bill included more that 4,000 regulations and small owner-operators could not be expected to know them all.[128]

Such trends do not reveal the uneven nature of the progress of the legislative juggernaut. The traffic has not been all one way. Strong ministers of finance can achieve significant deregulation, at least in the economic sphere, from time to time. The obligations on lower-income taxpayers to furnish a tax return have been substantially reduced. In addition, the arrangement obliging the IRD to give a self-binding ruling on proposed tax arrangements has the potential to improve information flows and reduce business uncertainty about the tax implications of proposed financial arrangements. Furthermore, compliance costs are not the only issue. Many of the tax reforms have reduced distortions in remuneration structures and savings and investment decisions.

Section 4 of this report comments on New Zealand's experience with deregulation.

But episodes of deregulation should not be allowed to obscure the story of the apparently inexorable advance in other dimensions. Even during the limited period of deregulation, there was a substantial increase in administrative and social regulation.

A prominent and colourful New Zealand businessman, Sir Robert Jones, drew attention several years ago to the escalating intrusions of regulation into the minutiae of New Zealanders' lives during a period of significant deregulation:

> The great myth of contemporary New Zealand is that over the past fifteen years we have undergone a massive de-regulatory process. Nothing could be further from the truth. What in fact has happened is that the state has removed itself from ownership and therefore direct authority of the larger commercial enterprises; of aviation, insurance, banking, rail, shipping and so on.
>
> But having abandoned these activities to the private sector it then through the relevant bureaucracies substituted a previous management process with a regulatory process. This rule-writing fervour has been contagious and has led to an orgy of social engineering type regulations, all of which are doomed to

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127 James Madison, *The Federalist Papers*, Paper No 62, The Penguin Group, New York, 1961, p 379–380.

128 *New Zealand Herald*, 26 April, 1996.

> failure. The volume of New Zealand regulations and in my view, regulatory excess, can easily be illustrated by measuring the size of a set of law books in 1984 with the size today. Metaphorically speaking, a dictionary has been replaced by a set of encyclopaedias. More telling, personal responsibility has been replaced by an enormously costly set of rules covering every contingency, in many cases for all practical purposes totally unnecessary. This is particularly true of safety rules.[129]

Access to regulations has been another problem. New Zealand's laws and regulations have long not been readily accessible to most people.[130] The only way of obtaining an authoritative printed version of New Zealand's laws is to get access to annual statutes that have been kept up-to-date by manually installed amendments. It seems safe to say that, although all citizens are expected to observe the obligations imposed on them by law, the public at large simply have to rely on their common sense and habitual behaviour, until something goes wrong.

The government has conceded that public access to legislation needs to be improved. This is slowly occurring. Electronic access to statutes is now available.[131]

Access is only one of many problems. Better access cannot solve the problem that many regulations use vague and ill-defined terms of which the meaning may take years to be tested in the courts.[132] Regulations also delegate much arbitrary discretion to regulators, and are sometimes so breathtaking in their scope as to create serious doubts as to the degree to which they will be enforced.[133] In the absence of a well-developed body of case law, professional advisers may be unable to assist materially with such interpretative problems. Again, businesses, individuals and their advisers effectively fly blind.

Susan Bambury, a partner in law firm Heaney & Co, has made the point that even best-practice employers could be financially crippled by fines from harms that result from inadvertence or ignorance.[134] Expressed differently, fines under the Building Act 1991, Fair Trading Act 1986, Resource Management Act 1991 and Health and Safety in Employment Act 1992 can be imposed on a strict liability basis that denies any defence of negligence. For example, a business advertising that the goods it was selling were made in China when it believes this to be true would be in breach if they were actually made in Taiwan. In similar vein, a business could be financially crippled because it was unaware that it would be held responsible for the non-compliance of a builder it hired who failed, for whatever reason, to obtain a resource consent.

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129 Sir Robert Jones, 'Some thoughts on Standards, Bylaws, Laws and other Regulations', *Standards*, publication of Standards New Zealand, June/July 1999, p 5.

130 Palmer and Palmer, *op cit*, p 166.

131 Refer, for example, to *Government Response to the Report of the Regulations Review Committee on Investigation into Access to Regulations*, http//www.knowledge-basket.co.nz/gpprint/govres.html.

132 Lack of clarity and unresolved disagreements about the underlying problem can commonly be patched over by imprecision and ambiguity in legislation. Imprecise and troublesome concepts enshrined in recent legislation include: 'cultural and spiritual values', 'heritage value', 'historic site', 'archaeological significance', 'intrinsic value', 'sustainable development', 'price sensitive', 'dominance', 'purpose', 'reasonable' and 'energy efficient'. Such vague terms convey great potential powers on those who can decide how they are to be applied.

133 For example, the Historic Places Act 1993 makes it an offence to modify knowingly any archaeological site without a permit and defines such sites to include any place in New Zealand that was associated with human activity before 1900. The fine can be up to $40,000.

134 Susan Bambury, 'Laudable aims, serious results', *The Independent*, 14 March, 2001, p 21.

The regulatory juggernaut has continued despite professed concerns about it at the highest parliamentary level. It has become *de rigueur* for governments to state that they are in favour of easing the burden of regulations on small businesses. For example, prime minister Jenny Shipley was quoted in 1998 as saying: "We have to improve the delivery services of government. The private sector is groaning under costs that the government is imposing". (This was in the context of a discussion on reducing the number of government departments from 40 to 15 in the next five years.) In similar vein, the current Labour/Alliance government has set up a Business Compliance Costs Panel to look into the issue.[135] More than 500 businesses have confirmed that compliance costs are a significant problem. One business adviser is reported to have estimated conservatively that compliance costs would erode the net profit of a small business by 10 percent each year.[136] However, these exercises usually focus on symptoms of excesses, such as the costs associated with form filling and time delays. Relative to the total economic costs of regulations, these are the tip of the iceberg. Few could find grounds for optimism from compliance cost reduction initiatives given the records of past governments. To the contrary, the drive for ever more prescriptive safety and environmental regulation seems relentless.

In 1998, the government attempted to improve the quality of regulatory advice by administrative means. A Cabinet Minute in that year instructed ministers to attach a Regulatory Impact Statement to regulatory proposals that the minister was taking to Cabinet for its approval. These statements are widely used internationally (see section 4.3.2) in order to impose more discipline on the regulatory process.

Populist concern that the quality of regulatory analysis is lacking is evident in the following editorial comment on research by Simon Chapple, a Department of Labour analyst, that called into question the basis of policies that presumed income gaps were race-based rather than class-based:

> Mr Chapple's research does more than question sacred cows: successive government policies, it seems, have been based on emotion and propaganda rather than solid evidence and research.[137]

In respect of commercial activity, regulations affecting taxes and employment have a pervasive effect. Land-based regulations impact particularly on farming, mining and land development. Sea-based regulations can affect sea transport, but currently the major sea-specific concerns arise in relation to the regulation of fishing. Conservation and environmental regulations can affect both land- and sea-based activities. Safety regulation affects businesses differentially. Some particular concerns have arisen in relation to farming. Businesses servicing nationalised industries, such as health, education, water and much of electricity generation and distribution, may also have to cope with onerous regulations that are specific to those industries.

The scale of regulation and its dynamic nature are daunting indeed. This problem could conceivably be overcome by sufficient expenditures on professional advisers – if individuals and businesses could afford them. Yet the strong and recurring message amongst those who have studied the ability of small businesses to comply is that they cannot possibly hope to deal with the complexities of the regulatory environment. They fly blind.

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135 *MG Business*, 22 June, 1998.

136 Craig Howie, 'Small businesses denounce red tape', *The Dominion*, 16 April, 2001.

137 *The Dominion*, 'Getting the Policy Right', 27 September, 2000.

Those that are unlucky enough to be caught could well be destroyed emotionally and financially. On the other hand, large businesses must either keep out of New Zealand or genuinely attempt to comply, even if the costs are potentially vast. Penalties that are scaled for larger companies may be simply terminal for smaller companies.[138]

A risk audit and advisory firm reported in 1997 that "the new generation of managers" is often unaware of the full extent of the legislation that affects their business. For example, they might be aware of only five or 10 pieces of legislation. However, the firm reports that a medium-sized company would have no difficulty identifying at least 40 statutes that have a significant impact on its business. The most common statutes, in that they stretch across all sectors, include the Health Safety and Employment Act 1992, the Employment Contracts Act 1991, the Commerce Act 1986, the Fair Trading Act 1986, and the Companies Act 1993.[139]

A 1996 booklet produced by a legal firm for the Retail and Wholesale Merchants Association identified 33 pieces of legislation with which merchants need to comply. The list was not exhaustive.[140]

Telecom New Zealand's solicitors reportedly advised it that 160 pieces of legislation affected the company. Telecom produces a compliance manual and processes for its managers. The manual reportedly includes four-page summaries of 30 Acts that the company considers every manager should be aware of.

A business compliance manual produced by CCH New Zealand in order to assist businesses to comply with the law lists 25 Acts, includes a diskette containing 25 forms to help businesses with their 'daily business requirements', and comprises over 160 pages.

Food and safety legislation has also been under attack from industry for "serious inconsistencies" and unnecessary costs and confusion. A joint submission in 1999 from industries representing many sectors estimated that the burden of complying with the current law was between 1 and 2 percent of turnover, many hundreds of million dollars annually.

In 1994 the *Sunday Star-Times* summed up this point of view as follows:

> Ninety percent of small businesses are failing to comply with the welter of complex new laws enacted with medium-sized and big business in mind. In some cases the new laws are putting the survival of small enterprises at risk.[141]

This sort of situation brings the law into disrepute. Hayek made the point in *The Road to Serfdom* that prescriptive law carried to excess must be either enforced to a draconian degree or be ineffectual because the authorities lack the will to adopt the required totalitarian measures to enforce it.

Finally, we come to the issue of evidence in relation to the quality of this regulation.

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138 Such a concern was attributed in *The Dominion*, 8 December, 1994, to the chair of the Air Conditioning Companies Association.

139 *The Dominion*, 1 September, 1997, p 24.

140 Anthony Davis, 'Business seen as government's unpaid public servant', the *Corporate Manager*, monthly publication of The Chartered Institute of Corporate Management New Zealand, 30 September, 1998, p 29.

141 *Sunday Star-Times*, 2 October, 1994.

In 1995, the New Zealand Law Commission starkly stated in its annual report that:

> The Commission has serious concerns about the quality of some legislation. Much of the advice which it gives to departments and other agencies relates to the formulation of legislative proposals. The legislation itself is then observed at the select committee stage. Six issues recur.
>
> First, *inadequate problem definition.* Framing the problem too narrowly or too broadly, or wrongly identifying it, results in policies and legislation which are inappropriate and ineffective.
>
> Secondly, *an assumption that legislation is needed when it may not be.* This may be the result of inadequate and delayed legal advice.
>
> Thirdly, a *failure of the legislation to give effect to the intended policy.* This is often a reflection of the first problem and the next.
>
> Fourthly, *premature introduction of legislation.* This is a growing problem in the Commission's view. It leaves large and complex issues to be grappled with by select committees. Resolving those issues takes time and resources which are more profitably used at the drafting and policy development stages. Underprepared legislation also compromises the public submissions process, especially when the need for further development is acknowledged at the time of its introduction.
>
> Fifthly, *a failure to comply with accepted constitutional principle.* One example is the use of open-textured drafting. This could be a legitimate choice (for example, to leave the development of the law in certain areas to the courts), but there must as well be proper and comprehensive policy development before the legislation is introduced.
>
> Sixthly, *a failure to draft law which is as understandable and accessible as possible.* Improvements can be observed, but much legislation could be written more plainly, with major advantages to those affected by it.[142]

Of course parliament is commonly aware that the legislation it is passing will prove to be troublesome in practice. However, there is always the option of passing later amending legislation that responds to revealed anomalies and difficulties while hopefully preserving the thrust of the original. But for this option, more care would have to be taken at the outset. Ultimately, however, the problem is systemic. Intrusive regulation commonly requires the delegation of interpretative powers in order to preserve a degree of common sense in the application of the regulations. However, such powers can be used for different purposes.

A significant problem in respect of the last of the Law Commission's points is that much legislation delegates significant discretion in the use of the Crown's coercive power to the executive. The executive may be able to delegate those powers further to other arms of government, the bureaucracies, regulatory agencies or even the judiciary.[143]

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142 New Zealand Law Commission, *Annual Report 1995*, Report 33, Wellington, 1995, pp 14–15.

143 For example, parliament left it to the judiciary to interpret what was meant by the term 'principles of the Treaty of Waitangi'.

Delegating law-making powers to the judiciary may compromise the independence of the judiciary in relation to the check of judicial review that would otherwise apply to the exercise of delegated powers.

The effect of such delegations, in the view of parliament's Regulations Review Committee, has been to delegate undesirably too much power to coerce or tax far from the direct scrutiny of parliament. The reports of this committee further testify to the existence of bad regulations.[144]

Another problem arises because all too much legislation is self-contradictory. In section 2.2.3 we commented on the self-contradictory nature of the Employment Contracts Act 1991 that purported to provide for freedom of contract while denying it in respect of dismissals. In the same section we noted the self-contradictory nature of the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993 in relation to freedom of association.[145]

The 'home invasion' legislation passed in 1999 in response to public agitation following widespread media publicity given to a particularly horrific, unprovoked home invasion and murder illustrates the difficulties that arise from self-contradictory legislation motivated by the passions of the day. The 1999 amending legislation created a conflict between section 4(2) of the Criminal Justice Act 1985 that sought to protect against legislation with retrospective effect and section 80 that sought to achieve retrospectivity. This contradiction split the Court of Appeal when it was confronted with the issue in *R v PORA*, 2000.[146]

A further example is provided by the tension between successive governments' drive to legislate both for privacy and for forced disclosure 'in the public interest'.[147] Thus the Privacy Act 1993 is being used to justify withholding information about patients with mental disorders who pose a risk to unwitting flatmates, public service bonuses in particular cases, or hospital patients being cared for at the taxpayers' expense.[148] At the same time, the state forces private companies to disclose senior executive salaries rather than allow this to be a matter for free private contracting. It also forces companies to provide commercial secrets without charge to those who could potentially use them against that company's interests – such as trade unions and competitors.[149] Meanwhile, the state is demonstrably failing to protect the public from

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144 See for example, Brent Edwards, 'Concern at regulatory powers', *Evening Post*, 29 January, 1999 and Sir Geoffrey Palmer, 'Deficiencies in New Zealand Delegated Legislation', *Victoria University of Wellington Law Review*, 1999, 29, pp 1–47.

145 A further internal contradiction arises in that the governments of the day actually wanted the state to discriminate 'positively' in respect of 'disadvantaged' groups, and provided for this 'reverse discrimination' in the legislation.

146 See Jack Hodder, *The Capital Letter*, 23 January, 2001, p 1.

147 In discussing University of Manchester philosopher Hillel Steiner's concept of 'compossible' rights (see below), Tom Palmer of the Cato Institute asks how we are to know who should be legally or morally entitled to do what if my right to privacy conflicts with your right to know. Tom Palmer, book review in the *Cato Journal*, Vol 15, No 2–3, on Hillel Steiner's *An Essay on Rights*, Blackwell Publishers, Oxford, United Kingdom, 1994.

148 Frank Haden, 'Privacy abuse a public nuisance', *Sunday Star-Times*, 28 January, 2001. See also the editorial in *The Dominion*, 26 April, 2001, 'Idiocy of Privacy Act'.

149 Section 32(1)(e) of the Employment Relations Act 2000 entitles unions to information that relates to wage bargaining. Section 34 provides a limited safeguard, partly in the form of recourse to an 'independent' reviewer. However, it also gives the union the right of veto over the appointment of the reviewer. Disclosure requirements for antitrust reasons, such as those under the Kiwi share arrangement in telecommunications, also have this potential for misuse.

the disclosure of highly sensitive information that it holds.[150] Tellingly, parliament's enthusiasm for forced disclosure in the private sector does not extend to what *The Dominion* referred to as "the wall of secrecy surrounding the Parliamentary Services Commission" in commenting on MPs' perks in the form of air points.[151] A number of New Zealand Business Roundtable publications have analysed in some detail the issue of when it is desirable to legislate for disclosure.[152]

The Fair Trading Act 1986 provides another example of how parliamentarians can set themselves above the rules they set for others. Section 9 of this Act states that "No person shall, in trade, engage in conduct that is misleading or deceptive, or is likely to mislead or deceive". The Act defines 'trade' so as to exclude political representatives and their parties. Yet, to cite just one example, in 1997 the political party New Zealand First allowed National to form a governing coalition with it after campaigning in 1996 on the basis that a vote for New Zealand First was the only way of keeping National out of power.

Some regulations directly or indirectly create or protect monopoly positions. Occupational licensing regulations can easily have the effect of erecting entry barriers against competitors. So can industry-specific regulation. The regulations giving various primary producer boards a 'single seller' role in purchasing and marketing products also illustrate this genre. Other examples include the statutory monopoly enjoyed by the ACC, minimum wages that protect those with jobs from competition from the least skilled without jobs and the prohibitions on free contracting between employees and employers that are designed to create privileged positions for trade unions. This drive is at odds with other pro-competition legislation.

Defenders of regulations that appear to be inefficient might sometimes justify them on the basis that they transfer wealth from those on higher incomes to those on low incomes. However, economists have long pointed to government policies that appear to favour the relatively well off or the relatively undeserving. For example:

- high tariffs on children's clothing and footwear affect large, low-income households disproportionately;
- Europe's common agriculture policy subsidises farmers heavily, some of whom are wealthy, while raising food prices markedly for all, including low-income households;

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150 *The Dominion*, 'Informer tells court of gang infiltration', 27 March, 2001, reports on revelations to the High Court that the Mongrel Mob gang had infiltrated the Ministry of Justice and its access to the police computer. The *National Business Review*, 'Undercover probe exposes corrupt Winz bureaucrats', 2 March, 2001, reports that an undercover investigation revealed widespread corruption in the welfare agency with staff routinely selling private confidential data to debt collectors for as little as $10 a time.

151 *The Dominion*, 'MP's perks up in the air', 28 March, 2001, p 12.

152 See for example, Richard Epstein, *The Concealment, Use and Disclosure of Information*, New Zealand Business Roundtable, Wellington, 1996, and George Benston, *Voluntary vs Mandated Disclosure*, New Zealand Business Roundtable, Wellington, 1997.

- some established tenants in state houses paying below market rentals are much better off than some in private rentals;[153]
- state lotteries commonly sell tickets primarily to lower-income groups and distribute the proceeds in part to activities patronised by the relatively well off;
- minimum wages may raise the wages of students in well-off households and deprive an unskilled worker in a low-income household of a job;
- tax breaks for film productions may benefit well-off foreign investors at the expense of locals;
- universal state pensions favour those with long life expectancies relative to those with short life expectancies. For example, some low-income ethnic groups are prone to diabetes, lung cancer and other illnesses that shorten life expectancies;
- funding universal state pensions for millionaires arguably reduces the funding available for ailments, such as glue ear, that are prevalent in low-income households and that can adversely affect children's learning abilities;
- subsidies for legal aid may benefit malicious or delinquent litigants at the expense of more virtuous defendants. Section 2.2.1 of this report cites an instance of grandparents being impoverished by state-funded legal action taken by delinquent parents;
- regulations can favour the opportunistic relative to the virtuous. For example, over 47,000 people shared in $100 million paid by New Zealand's state accident compensation monopoly on sexual abuse claims. False claims arising from so-called repressive memory therapy sessions were allegedly rife and rarely tested in the early 1990s;[154]
- redundancy legislation can result in enormous sums being paid to managers on high salaries while much smaller payments are made to staff on lower salaries;[155]
- subsidies for tertiary education overwhelmingly favour higher-income households,[156] meanwhile over 40 percent of adults in New Zealand are believed to lack the level of adult literacy deemed necessary to cope with normal daily life; and
- occupational regulation may reduce the ability of low-income people to obtain cheaper substitutes for expensive services, while raising the income of those in well-paid professions.

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153 *The Dominion*, 'Tenants earn $1,000 a week', 21 March, 2001. In addition, some state houses have a market value of more than $500,000, which indicates that the objective is not to provide decent, basic accommodation at least cost to the taxpayer. The same outlay could provide basic housing to more people.

154 Opinions expressed by Dr Felicity Goodyear-Smith as reported by Leah Haines, 'Sex abuse: 47,000 get compo of $100m', *The Dominion*, 14 March, 2001.

155 Large redundancy payments to the chair and chief executive of Brierley Investments Limited brought the private sector into disrepute in the popular media. Yet the Brierley board was advised that it was required by law to make those payments.

156 Theresa Gardner, 'Fewer poor, more rich going on to university', *Weekend Herald*, 18/19 September, 1999 reports that a University of Auckland study found that only 8 percent of students enrolled at university in 1997 were from schools ranked decile 1 to 3, the bottom rungs of the scale of 1 to 10 used to rank schools.

While some regulations may transfer wealth in favour of those in need, such a list may motivate the question as to whether this transfer was really by design or as a by-product of a less laudable goal. It may be no easy matter to hold a government to sound equity criteria when it is implementing redistributive policies through regulations.

Finally, there is the vexing issue of the proper enforcement of (negative) human rights. The time police put into enforcing drug laws, and poor quality regulations is not available for enforcing the law protecting personal autonomy and property. The police must allocate scarce resources across a broad front. In March 1998, a former newspaper editor documented a number of cases concerning basic assaults to persons and damage or theft of property that police were not regarding as a priority. The editor asserted that the police and politicians had effectively abdicated their responsibility to protect the common person from lawbreakers.[157] A front-page article in the *Evening Post* on 10 April, 2001 provided unintended supporting evidence of the reality of these trade-offs. In the article the police reported that solving burglaries in Wellington had been a key focus in the year, targeting repeat offenders. Reported burglaries were lower than in the previous year and the number of burglaries solved had been lifted by 6 percent to 45.7 percent as against 41.4 percent nationwide. Meanwhile there was a lift in reported sex crimes, violence and hard-drug use.[158] Also in April 2001, licensed motor vehicle dealers were taking out full-page advertisements in major newspapers. These advertisements stated that the laws against illegal trading in cars were not being enforced. They also alleged that a police district commander had advised that complaints under the Motor Vehicle Dealers Act 1975 had low priority and were unlikely to be investigated.[159] In May 2001, *The Dominion* reported in an article about a decision by the police to turn down an offer of $5 million worth of free equipment designed to detect and recover stolen cars because a police spokesperson said that stolen car recovery was not a priority.[160] The police had earlier advised in April 2001 that they could no longer afford to give full protection to employees of Mainland Stevedoring against four months of disruption caused by the rival Waterfront Workers Union. An *Evening Post* editorial asserted the union had "indulged in a campaign of bullying and intimidation of a style not seen in New Zealand since the early 1980s …".[161]

We bring the main points in this section together later in section 2.4.

2.3 New Zealand in an international context

This section summarises some available evidence on the aggregate costs and benefits of regulation. As is so often the case, the bulk of the research applies to the United States. The fact that New Zealand and the United States are rated similarly for regulation in the rankings of economic freedom (see below) makes the comparison more relevant.

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157 Karl du Fresne, 'New meaning to the word 'copout'', *The Evening Post*, 11 March, 1998.

158 *Evening Post*, 'Burglars feel heat as police close in', 10 April, 2001.

159 See, for example, the *Evening Post,* 10 April, 2001, p 12.

160 *The Dominion*, 16 May, 2001, 'Free anti-car theft system spurned'.

161 *Evening Post,* 'Game, set and match to Mainland', 10 April, 2001.

2.3.1 New Zealand's international ranking for regulation

Section 2.2 focused on symptoms of regulatory excess in New Zealand. It did not attempt to balance the picture. This section provides some balance using cross-country comparisons.

New Zealand ranks relatively highly in international comparisons of the degree of freedom from regulation. For example, according to the Heritage Foundation/*Wall Street Journal 2001 Index of Economic Freedom*, New Zealand scored 2 for freedom from regulation. A score of 1 represents the highest level of freedom and a 5 the lowest level. Eighteen other countries received a score of 2. They included Canada, Japan, Taiwan, the United Kingdom and the United States, but not Australia, France, Germany, or Italy. Only three countries out of 155 received a score of 1 for regulation – Hong Kong, Singapore and the Bahamas.

Some indication of where New Zealand might stand in a more finely graduated analysis is indicated by a recent detailed review by the OECD of economic and administrative regulations of product markets in 21 OECD countries. This study put New Zealand in fifth freest position overall, with the United Kingdom first followed by Ireland, Australia and the United States in that order. New Zealand achieved the position despite being eighth for both economic regulation and administrative regulation. Some countries ranked higher than New Zealand in one dimension but not both. Canada ranked more highly than New Zealand in both dimensions but came out lower than New Zealand overall, apparently because of its relatively high level of regulation of foreign operators.[162]

A relatively high ranking for New Zealand is consistent with information of a more fragmented and anecdotal nature. A Harvard University cross-country study examined the costs and delays imposed on start-up companies by regulations. It found that a new company can be operating in New Zealand after 17 days, compared with an average for all countries studied of 63 days. In Australia, it should only take three days, but legal set-up costs were reportedly more than five times greater than in New Zealand.[163] Following the economic reforms in New Zealand from 1984 to 1992 and prior to the rulings in the mid-1990s of the Employment Court and subsequently the Employment Relations Act 2000, labour market regulation was arguably less of a barrier to employment in New Zealand than in Australia. It is also not difficult to open a bank account in New Zealand, rent accommodation (there is no rent control on private dwellings), get basic utilities connected and complete an annual personal income tax return. According to the OECD, New Zealand's securities market regulations also appear to add less to the cost of raising funds than those of other countries.[164]

For a time, according to the OECD, New Zealand particularly stood out for the quality of its tax structure. Broad-based taxes with relatively few exemptions, exceptions and anomalies reduced the complexity of the system compared with many other countries.

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[162] See chapter vii, 'Cross Country Patterns of product market regulation', pp 179–190 in the *OECD Economic Outlook*, December 1999.

[163] The study, by Simeon Djankov, Rafael La Porta, Florencio Lopez de Silanes and Andrei Shleiffer, is reported in 'Open to Enterprise', *Competition and Regulation Times*, Institute for the Study of Competition and Regulation, March 2001, Issue 4, p 12.

[164] The OECD commented at p 132 in *Economic Surveys 1997–1998, New Zealand*, that: 'Overall New Zealand's securities regulation seems to be well regarded internationally'.

Goods and services tax was levied on a very broad base at a single rate. The elimination of a tax rationale for remunerating employees in part through company cars, home mortgages or superannuation and the like allowed companies to simplify greatly employee remuneration schemes. Capital gains taxes in the form of accrual taxation and taxes on trading profits and investments in certain international investments of a tax haven nature were also less intrusive in New Zealand than in some other countries.

Some of these advantages are likely to persist. Others are being eroded or eliminated as other countries become freer or as New Zealand moves in the opposite direction (for example, in respect of tax and labour market and securities market regulation).

Should New Zealand be satisfied with a score of 2 for regulation? Section 2.3.2 below considers this question.

2.3.2 Detailed estimates of the costs and benefits of regulation

A score of 2 for regulation (see section 2.3.1) is a relative, not an absolute, measure of perceived regulatory burdens. It does not indicate an absence of regulatory excesses.

To the contrary, many countries with this score have been very concerned in recent years about the growing burden of regulations on their citizens. This is not to argue that the trend has been all in one direction. Significant reductions in economic regulations have occurred in some countries and industries. However, almost universally there has been substantial growth in health, safety, environmental, 'human rights' and paternalistic regulation (protecting people from their own folly, for example, in respect of securities regulation and consumer protection regulation).

The costs of regulation are multi-dimensional. The most easily assessed costs of regulation are the budgetary expenses of regulators who administer the regulations (administrative costs). To these must be added the costs to those who are being regulated of satisfying regulatory agencies that they are complying with those regulations (compliance costs). Given the technical legal distinctions that commonly accompany 'command and control' regulations, these costs could include legal and accounting costs.

Regulations may also force firms to incur additional capital expenses, perhaps in the form of safer plant and equipment or more complex reporting systems. They may also have to hire more staff. Such costs and burdens are relatively easy to observe.

Regulations also may have many hidden costs. This is because they commonly alter behaviour in undesired and unintended ways. Regulations can reduce allocative, productive and dynamic economic efficiency. An import quota, for example, may have all three effects. First, it will tend to misallocate resources, favouring the protected activity at the expense of activities that would add more to national output. Second, with less competition, firms are less likely to keep costs to a minimum. Third, over time they will be under less pressure to innovate, invest in new technology and adopt best practices. Such losses in economic efficiency typically represent the largest costs of regulations.

The costs of regulations, and indeed their overall impact, may be heavily determined by the way an agency translates statutory goals into operating rules. The agency's

attitudes may swing with changes in key personnel, the general climate of public opinion and a new government.

In similar vein, the costs of a failure to regulate (that is, the costs of greater reliance on market incentives and common law) may vary with changes in the attitude of the courts towards penalties.

Incentives generated by court decisions in many instances dwarf those incentives created by regulatory processes. Court awards in asbestos cases have all but eliminated that industry in the United States.

Viscusi, Vernon and Harrington comment that liability costs have led the pharmaceutical industry largely to abandon research on contraceptive devices, and have resulted in the removal of diving boards from motel swimming pools in the United States. They conclude:

> To understand the role of the government within the context of this type of regulation, one must assess not only how the regulatory agencies function but what doctrines govern the behaviour of the courts.[165]

The literature on regulation is rich in stories of the inefficiencies that result from the unintended and undesired effects of regulation. Often these can be foreseen, but often they are not, because government advisers lack information.

Regulations may destroy jobs by raising the cost of labour, reducing total output and leading industries to relocate overseas. One study has estimated the total job losses from regulations in the United States to be at least 3 million.[166]

Regulations will also directly cost lives. A lot of drugs that are available in Europe only become available in the United States many years later because of the prolonged drug approval processes in that country. The delays cause avoidable pain, suffering and death.[167]

Bad regulations can also reduce national output. Research in the United States suggests that lower national productivity resulting from federal regulatory activity from 1963 to 1993 had reduced GDP in 1993 by 17 percent compared with what it might have been. This loss is in addition to compliance costs and federal spending on regulation.[168]

Less output means less wealth and lower material living standards. A number of studies find that life expectancy and health standards depend on material living standards. Estimates show that for every reduction in national wealth in the range of $2–$6 million, one additional premature death will occur. The benefits and costs of social regulation have been scrutinised by a number of researchers. One study concluded that 60,000 lives in the United States are lost every year due to the

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165 Viscusi, Kip, John Vernon and Joseph Harrington Jr, *Economics of Regulation and Antitrust*, MIT Press, Cambridge, Massachusetts, 2nd edition, 1998, pp 9–10.

166 Yilmaz, Yesim, 'Private Regulation: A Real Alternative for Regulatory Reform', *Policy Analysis*, 20 April, 1998.

167 Yilmaz, *Policy Analysis*, *op cit*.

168 Research by Richard Vedder as reported by Keating, R, '49 and Holding', *The Freeman*, November 1998, p 685.

command-and-control regulations that waste money in eliminating risks that are negligible while failing to protect the public from others that are much more serious.[169]

Estimates of regulatory costs in New Zealand.

There has been no comprehensive study of the costs of regulation undertaken in New Zealand. In a press release dated 18 August, 1999, the minister of commerce noted no data for New Zealand were available but immediately stated that overseas studies put the costs of regulations at between 4 and 10 percent of gross domestic product.

As mentioned above, the annual costs to businesses of complying with the tax code alone have been put at around 2 percent of gross domestic product.

In 1997, KPMG reviewed compliance costs in New Zealand for the Ministry of Commerce. Their report included the following findings:

- tax compliance was mentioned as a problem by nearly every surveyed organisation;
- occupational health and safety legislation was consistently seen to be costly;
- compliance with Statistics New Zealand requirements was costly;
- accident compensation legislation was mentioned by many, but not all;
- manufacturing firms were most concerned about the occupational health and safety and resource management legislation;
- general practitioners were concerned about proliferating consumer and information legislation;
- the Building Act 1991 and associated property maintenance legislation was reported to be "very costly". One major insurance firm stated that it was withdrawing from investment in the physical property market as a result; and
- the resource management legislation and the Commodity Levies Act 1990 were notable burdens in the private sector.[170]

A study of 73 businesses in 1997 by Ernst & Young for the Ministry of Commerce found that the cost of complying with environmental regulation was around 5 percent of business costs for half of 28 surveyed businesses that were able to provide estimates. The other half estimated the cost to be less than 1 percent of business costs. In the network industries, compliance costs were around 10–15 percent of project costs. Outside these industries, amongst firms that could estimate these costs, the ratio was commonly lower, at 1–5 percent of project costs. The study found that the impact of the RMA varies markedly depending on the nature of the activity, the business's own processes and the operation of the particular local authority. More than half of the businesses surveyed considered that the resource consent process went well.[171]

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169 Antonelli, A, 'Regulation: Demanding Accountability and Common Sense' in Butler, SM and Holmes, KR, (eds), *Issues '98: the Candidate's Briefing Book*, The Heritage Foundation, Washington DC, 1998, p 11 (on-line copy).

170 KPMG, *Ministry of Commerce: Review of Compliance Costs of Regulations*, 25 August, 1997.

171 Ernst & Young, *op cit*.

Surveys of the RMA compliance costs to an existing business cannot capture the deterrence effect of the costs to new businesses that need to get through the RMA in order to exist at all. In 1998, *The Independent* cited an Employers' Federation opinion that the RMA is one of the most significant deterrents to the initiation and growth of new business.[172]

In 1998, the Commerce Committee of the House of Representatives reported on its findings from an inquiry into business compliance costs.[173] The committee made several recommendations mainly focused on streamlining government department reporting requirements.

In 1998, an inquiry for Local Government New Zealand into the costs of regulations involving local government identified the following main concerns:

- widely varying approaches to fees and charges for cost recovery under section 26 of the RMA;
- a perception of varying mindsets towards the regulations across local authorities, variable response rates and competencies;
- concerns about a lack of accountability, a lack of reliable comparative information on local government performance, a lack of effective monitoring by central government; and
- a general perception that compliance costs are too high.

The following paragraphs summarise more fragmentary evidence on regulatory costs.

The costs of complying with land use regulation are of significant concern to farmers. The major longstanding piece of legislation here is the RMA. We commented earlier on the $700,000 a year that Federated Farmers spends on helping its members make submissions, or appeal against decisions. It reports that in more extreme cases farmers may have to spend thousands of dollars for approval to go ahead with minor land development projects and that there have been bankruptcies caused by local government delays. While for most farmers the out-of-pocket costs are not major, there is evidence of deep-seated concern about the inconvenience and uncertainties associated with the RMA legislation and the processes it has set in train.[174]

According to the Employer's Federation, a medium-sized business can expect to complete 168 forms a year for government agencies. A member of parliament recently asserted that "it is not uncommon to find small business owners spending up to 10 percent of their working time fulfilling these requirements".[175]

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172 Graeme Speden, 'Upton's RMA initiative cops flowers and flak', *The Independent*, 30 September, 1998.

173 New Zealand House of Representatives, *Inquiry into Compliance Costs for Business: Final Report of the Commerce Committee*, 1998.

174 Roger Wilkinson and Peter Jarvis from Landcare Research and Tony van der Lem from MAF Policy, 'New Zealand Farmers' Costs of Compliance with Legislation', paper presented to the Annual Conference of the New Zealand Agricultural and Resource Economics Society, Blenheim, 3–4 July 1998.

175 Richard Prebble, 'Death by 1000 compliance cuts', *The Chamber*, Wellington Regional Chamber of Commerce, November 1999.

For the median small business, the major compliance costs are borne as external expenses. For example, the article just referred to estimated that small businesses spend around $600 million a year on external advisers and consultants. With over 250,000 businesses registered in New Zealand,[176] this would be only around $2,400 per business. A significant portion of that amount could be due to accounting costs that might be required regardless of regulatory impositions. Of course, for the small number of firms that get caught up in disputes concerning dismissals, safety or tax, the external costs could be terminal.

The risk and audit firm, referred to above, commented that some consultants are charging between $18,000 and $25,000 for compliance-based checklists. This provides a more anecdotal indicator of the scale of potential costs of larger firms

Any firm requiring consents from a government agency can expect to incur considerable costs. Legal opinions are likely to be costly. A law firm recently commented that legal firms' total fees from work related to the Commerce Act 1986 alone could be in the order of $50 million a year. An application for clearance for a business acquisition would cost between $5,000 and $20,000 depending on its complexity. Obtaining an authorisation for a price fixing arrangement that was not entirely straightforward could cost well over $50,000.[177] Fines for breaches of the Commerce Act 1986 can be as high as $500,000 for individuals. For companies, the fines for restrictive trade practices can be up to the greater of $10 million or three times the commercial gain or, if this gain cannot be assessed, 10 percent of the turnover of the firm and all its interconnected bodies corporate. If the interconnected entities include a multinational parent company this could be a very large sum indeed. The law firm stressed that the costs associated with complying with the Commerce Act 1986 were likely to be far lower than those associated with "any form of direct industry regulation".

In June 1999, New Zealand's major food producers made a joint submission to the deputy prime minister and the food and fibre minister. The submission stated that the existing framework for food safety was confused, costly and seriously inconsistent and estimated that the burden of complying with it was 1–2 percent of turnover, amounting to some hundreds of millions of dollars for the export sector alone.

Estimates of regulatory costs in the United States.

In the United States the costs of economic regulation – such as antitrust regulation and the regulation of the labour market, transportation and utilities sectors – dominated other forms of regulation from the late 1970s until the early 1980s when the Carter and Reagan administrations initiated the first major deregulatory moves.[178] The costs of social regulation were relatively small until the wave of health, safety and environmental regulation in the 1970s.

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176 The *New Zealand Official Yearbook 1998* estimates the number of economically significant enterprises in 1997 as 264,365, p 385.

177 Letter from Chapman Tripp to the Consumers' Institute, 8 July, 1999.

178 See the discussion of the development of regulation in Viscusi, *et al*, *op cit*, p 6.

Considerable efforts have been made to estimate the overall costs (and benefits) of federal regulations in the United States.[179]

Estimation is difficult because regulatory costs are not accounted for in the budgetary process. While agencies are supposed to estimate costs and benefits of regulation, these vary in quality and often underestimate the cost or overestimate the expected benefits.

In the United States, the most visible cost of regulations – the annual cost of running regulatory agencies – stands at around US$17 billion.[180] This cost is dwarfed by the total direct costs of the order of US$500–$700 billion (see table below). According to the Competitive Enterprise Institute these costs are larger than Canada's entire economy and are the equivalent of a hidden tax of US$7,500 a year for the typical two-earner family.[181]

The following table summarises movements in the cost of federal regulations during the last two decades.[182] This research suggests that the total costs of complying with federal regulations stand at around 9 percent of US gross domestic product. This is more than 40 percent of the entire federal budget. The cost to the typical family was US$6,875 in 1997, 19 percent of its after-tax budget of US$36,423. The estimated total compliance costs of US$688 billion in 1997 (in 1995 dollars) exceed 1996 personal income tax payments of US$631 billion and 1995 corporate profits of $601 billion.

Table 2.1: Direct costs of complying with US federal regulations in 1995 dollars (US$bn)

	1977	1987	1997
Social	**79**	**125**	**240**
Environmental	47	93	180
Other social	32	32	60
Economic	**337**	**258**	**223**
Efficiency loss	149	90	79
Transfer	288	168	144
Paperwork	**138**	**174**	**225**
Total	**641**	**557**	**688**

Source: Thomas Hopkins (see footnote 183 below for details).

On these estimates, the total cost of social regulation in the United States was broadly comparable with the total cost of economic and administrative regulation. The

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179 Important contributors to these estimates include Robert Hahn, director of the AEI-Brookings Joint Centre for Regulatory Studies, John Hird, director of the Center for Public Policy and Administration, University of Massachusetts, Thomas Hopkins from the Rochester Institute of Technology, the Environmental Protection Agency and the US Office of Management and Budget.

180 Douglass, C, Orlando, M and Warren, M, 'Regulatory Changes and Trends: An Analysis of the 1998 Budget of the United States Government', *Policy Brief*, No 182, Center for the Study of American Business, 1997, quoted in Antonelli, *op cit*, p 1 of on-line copy.

181 Kemp, Jack, 'Economic Mischief', *Washington Times*, 22 November, 2000.

182 Based on annual estimates prepared by Hopkins as reported by Crews, Clyde W, *Ten Thousand Commandments: A Policymaker's Snapshot of the Federal Regulatory State*, 1998 edition, Competitive Enterprise Institute, Regulatory Reform Project, Washington DC, January 1998, pp 1–46.

combined total cost of regulation in the United States has risen in the last 20 years despite a reduction of about a third in the estimated costs of economic regulation.

In 1977, entry and price controls accounted for 67 percent of the total costs of regulation; environmental and risk reduction for 12 percent; and paperwork for 21 percent. In 1995, entry and price controls had fallen to 34 percent of the total costs; environmental and risk reduction had increased to 33 percent and paperwork to 33 percent of the total regulatory costs.[183]

Estimated total costs fell by US$84 billion in the decade to 1987 only to rise by US$131 billion to 1997. The full data set (not shown above) shows that the total estimated costs of complying with federal regulations reached their lowest point in 1988 (at US$549 billion).

The marked reduction in the cost of economic regulations during this period coincides with the wave of deregulation that started with the elimination of the Civil Aeronautics Board in 1978. Thereafter, deregulation, featuring greater reliance on competition and less on rate of return regulation, applied to trucking, rail transport, stockbroking, long-distance telephone and, to a lesser extent, banking. Stephen Breyer and Paul MacAvoy suggest that deregulation was relatively uncontroversial in these industries because of the thinness of the economic case for regulation and the presence of competitive pressures. They postulate that the rationale for intervention in relation to health, safety and the environment is stronger and the market alternatives less obviously superior.[184]

The estimate of the United States Office of Management and Budget (OMB) of around $200 billion per annum for the costs of social regulation in 1997 is similar to that of Hopkins.[185] However, its total estimated cost of US$279 billion is less than 40 percent of that estimated by Hopkins. This is primarily because the OMB elected not to include tax paperwork and transfer payments. The latter are the value of price increases to consumers resulting from government interventions.[186] These constitute transfers rather than opportunity costs.

Economists debate the proportion of transfer costs that should be regarded as a deadweight loss to society because of the resources devoted to rent-seeking activities. Estimates of the size of transfer costs are important to any understanding of the effect of regulations and to any analysis of whether the regulations represent an efficient or equitable means of transferring income.

Estimates of the benefits from regulations in the United States

Researchers in the United States have also made the most thorough attempts to quantify the benefits of regulation. In 1997, the OMB estimated that the quantifiable costs and benefits of US regulations were as follows:[187]

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183 Hopkins, TD, *Regulatory Costs in Perspective*, Center for the Study of American Business, Washington University, St Louis, Minnesota, 1996, quoted in Antonelli, *op cit*, p 1.

184 Stephen Breyer and Paul MacAvoy, 'Regulation and Deregulation', in *The New Palgrave: A Dictionary of Economics*, Volume IV, Macmillan Press, London, Stockton Press, New York, 1998, pp 128–134.

185 This is unlikely to be a coincidence since Hahn reports that the OMB and Hopkins both used his earlier estimates. (See Hahn (2000), *op cit*, pp 204 and 205).

186 Refer, for example, to 'Regulatory Costs and Benefits', *Executive Alert*, National Center for Policy Analysis, May/June 1998, p 7.

187 The data cited herein are taken from Hahn (2000), *op cit*, p 204.

Table 2.2: Estimated costs and benefits of federal regulations in 1997 (US Office of Management and Budget) (US$bn)

Type of regulation	Costs	Benefits	Net benefits
Environmental	144	162	18
Other social	54	136	82
Economic	71	Not estimated	na
Paperwork	10	Not estimated	na
Total	**279**	**na**	**na**

Estimates of benefits must be regarded as particularly tentative. Other things being equal, agencies whose staffing levels depend on the continuance of regulations may be likely to overestimate their benefits. According to Hahn, the OMB's report took "each agency's regulatory assessment as gospel, offering no additional analysis or insight based on its own detailed knowledge of individual regulations".[188]

It is not hard to find research that strongly questions whether much regulation does, in fact, produce the alleged benefits. For example, Breyer and MacAvoy report in relation to industrial and road accidents and pollution that:

> Analysts, however, have been unable to find significant reductions in the unhealthful conditions which were to be dealt with by the new regulatory activities.[189]

As a specific illustration, the regulations requiring drivers to wear seat belts or cars to be fitted with air bags were expected to reduce injuries and deaths. However, empirical studies indicate that drivers compensate for their increased safety by driving more dangerously (since the safety benefits from added care are diminished). The result is that injuries and deaths suffered by third parties (passengers, pedestrians and other road users) increase while injuries and deaths of car drivers decreased by less than expected.[190]

It is clear that environmental regulation has had detectable effects in some specific locations. However, Breyer and MacAvoy cite several research papers in support of the finding that pollutants were often being reduced anyway. This was because it was profitable to use new technologies to conserve inputs that had previously been discharged as wastes. Overall they conclude that:

> On the whole, the health and safety regulatory systems have most likely increased prices and reduced GNP in the regulated industries. Also, there are indications that because of drawing attention to equipment and away from behavior, the control system has not brought about improvements in health, safety and environmental quality that could have followed from use of other regulatory methods. In other words, these regulatory agencies have been generating substantial cost effects, but one cannot be certain they have brought about the benefits intended in the enabling legislation.

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188 Hahn (2000), *op cit*, p 207.

189 Breyer and MacAvoy, *op cit*, p 132.

190 Viscusi *et al*, *op cit*, pp 761–764.

In section 5 we canvass the many reasons why regulation that ostensibly serves such noble ends can have such disappointing outcomes. Often regulation can be protectionism in disguise. New Zealanders are well aware of the alacrity with which nations can leap to impose import bans on agricultural products on the slightest pretext, and even spread misinformation about the risks. There also obvious conflicts of interest if insulation manufacturers and glass merchants sit on bodies promulgating standards for energy efficiency in relation to insulation and double glazing.

Breyer and MacAvoy do not assert that the costs of every social regulation exceed its benefits. They make it clear that they are sympathetic to the case for continuing economic and social regulation in particular cases. However, they express the view that more attention could be paid to less restrictive or burdensome forms of regulation such as tradeable pollution permits.

As reported by Hahn, the OMB, notwithstanding its passive approach to the estimation of benefits, concluded that there is "insufficient evidence to recommend eliminating any specific regulatory programs". Hahn strongly disagrees with this conclusion, listing several major groups of regulations that he believes should be looked at with a view to their elimination. He also analysed the OMB's data on costs and benefits at a disaggregated level and commented that:

> Research suggests that more than half of the federal government's regulations would fail a strict benefit-cost test using the government's own numbers. (Hahn 1998). There is ample research suggesting that regulation could be significantly improved, so that we could save more lives with fewer resources (Morral, 1986, Viscusi, 1996). One study found that a reallocation of mandated expenditures toward those regulations with the highest payoff to society could save as many as 60,000 lives a year at no additional cost (Tengs and Graham, 1996).[191]

Other countries

Similar trends in the costs and benefits of regulation can be found in other countries.

The UK government established a system of compliance cost assessment in 1986. The assessments are carried out when a new piece of legislation or regulation with a cost to business is being considered. The total cost of complying with taxation has been estimated at approximately 1.5 percent of GDP. Together with government administrative costs, compliance costs amounted to around 4 percent of tax revenue.[192] The compliance costs of regulations in the United Kingdom have been estimated very approximately at around £43 billion or over 6 percent of GDP.[193]

Compliance costs are just one element of the costs of regulation – the costs of distorting market processes are more significant but extremely difficult to calculate. Compared with an unregulated market there are effects on prices, profitability, investment and growth. Regulation may affect the size distribution of firms across the economy. In a 1993 United Kingdom Institute of Directors survey, 23 percent of directors stated that regulation had restricted the ability of their businesses to develop new products and

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191 Hahn (2000), *op cit*, p 201.

192 Cedric Sandford's 1989 study is quoted in Smedley, I, 'Beyond Regulation: An Analysis of Regulation and the Alternatives', *Economic Affairs*, 1994, p 36.

193 Smedley, *Economic Affairs*, *op cit*, p 37.

enter new markets. Forty-two percent stated that regulation had restricted their firm's ability to expand output and employment.[194]

In Europe, the administrative burdens of regulations on businesses amount to 3 to 4 percent of GDP. Small enterprises are typically affected disproportionately, as indicated by statistics in respect of France, Canada and the Netherlands.[195] In New Zealand there is no doubt that the burdens of administrative regulation fall disproportionately on the self-employed and small and medium-size businesses.[196] This is a particular concern because small and medium-size businesses provide between 40 and 80 percent of all jobs (depending on the country) and much innovation.[197]

In Canada, very small firms spend 8 percent of revenues complying with government paperwork, while larger firms spend 2 percent. Small firms in the Netherlands spend six times as much per employee on government paper work as large firms.[198] Research in the United States estimates regulatory costs per employee to be 86 percent higher for firms with fewer than 20 employees than for those with more than 500 employees.

Over two hundred years ago James Madison anticipated this situation in the following terms:

> It will be of little avail to the people that the laws are made by men of their own choice, if the laws be so voluminous that they cannot be read, or so incoherent that they cannot be understood; if they be repealed or revised before they are promulgated, or undergo such incessant changes that no man who knows what the law is today can say what it will be tomorrow.[199]

In summing up the total picture today, the OECD observed that:

> The volume and complexity of laws, rules, paperwork, and administrative formalities now reach an all-time high in OECD countries, overwhelming the ability of regulators in implementing the total load, the private sector in complying, and elected officials in monitoring action. Too often, legislators issue laws as symbolic public action, rather than as practical solutions to real problems. Regulatory inflation erodes the effectiveness of all regulations, disproportionately hurts SMEs [ie Small and Medium Enterprises], and expands scope for misuse of administrative discretion and corruption.[200]

Deregulation should have the potential to provide significant benefits if an excess of regulation exists. Section 4 discusses the international experience with regulatory reform.

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194 Smedley, *Economic Affairs*, *op cit*, p 37.

195 Palmer and Palmer, *op cit*, p 17.

196 See, for example, Commerce Committee, *Inquiry into Compliance Costs of Business: Final Report of the Commerce Committee*, November 1998. See also 'Managers in the Firing Line for Legal Compliance Issues', *The Dominion*, 17 September, 1997.

197 OECD, 'Regulatory Reform, *OECD Policy Brief*, No 4, Paris, 1998, p 7.

198 Keating, *op cit*, p 685, citing research by Thomas Hopkins.

199 Madison, *op cit*, p 381.

200 OECD, *The OECD Report on Regulatory Reform: Synthesis*, Paris, 1997a, p 14.

2.4 Summary observations

We summarise our main observations from this section as follows.

- Regulatory excesses arise in good part from incessant populist pressures on governments to 'do something' about the problems of the moment.
- The evidence that parliaments respond to these pressures is undeniable.
- The quality of regulation too often fails objective tests, as do regulatory processes.
- Poorly drafted, ill-considered and even self-contradictory regulations have been pushed through, often hastily, in response to populist pressures.
- There is a tendency for legislation to prescribe outcomes that are to be achieved regardless of costs or personal preferences, rather than to define transferable rights so as to improve the balancing of costs and benefits while allowing individuals to pursue diverse outcomes.
- Denial of freedom of contract is a common feature of such legislation.
- There is a pattern of resistance to compensation for regulations that are allegedly imposed for the common good, particularly in the environmental area.
- Laws that are too complex to understand for those who are subject to them undermine the rule of law. They impair commerce and human welfare by leaving many in doubt as to what is legal. They bring the law into disrepute.
- Small businesses in New Zealand cannot be expected to understand or comply with the barrage of regulation that affects them.
- There is ample evidence that tax and other regulations are financially and emotionally ruining the lives of otherwise law-abiding people running farms and small businesses.
- There can be no doubt that the hopes and aspirations of much greater numbers are being thwarted.
- At the same time, and not inconsistently, it seems likely that the laws are also being applied unevenly between small and large businesses by authorities who lack the will or resources to be as totalitarian as their role requires.
- Laws applied to the private sector may not apply to politicians.
- The compliance costs for large businesses are now so onerous as to deter investment in New Zealand to a degree that may be significant.
- Excessive powers of coercion are being delegated too far from the scrutiny of parliament, to the concern of the parliament's regulations review committee.
- Some regulations appear to create monopoly situations rather than alleviate them.
- Other regulations can be exploited for anti-competitive purposes.

- Some regulations allow unscrupulous people to extort money from businesses simply because of the time and cost it would otherwise take to resist their demands.
- Opportunistic and unscrupulous people can also hope to obtain settlements for dubious claims in personal grievance cases and accident compensation the size of which must offend decent people.
- Some regulations transfer wealth from the less well off to the better off, rather than the reverse.
- New Zealand does not appear to stand out from the wealthy industrialised countries in many of these respects.
- New Zealand's ongoing decline relative to other nations suggests that it should be more, rather than less, concerned about these regulatory problems.

3 What is Regulatory Reform About?

3.1 Introduction

Section 1 explained that our objective was to seek reforms that would improve the welfare of New Zealanders by removing regulatory excesses. Section 2 motivated this task. This section examines the relationship between regulation and two broad aspects of human welfare – liberty and prosperity.

Section 3.2 defines regulation, regulatory reform and the concept of economic liberalisation.

Section 3.3 explores the complex relationship between rules and liberty. Liberty is valued in its own right. Threats to liberty may assault human dignity and undermine democracy itself, independently of any effects on prosperity. Liberty can be impaired by bad rules or by the absence of sound well-enforced rules. Most would agree that laws are required to protect fundamental freedoms by imposing a duty on all to observe them. Except as self-defence, assault is wrong morally and legally. It is a much more difficult matter to determine how far the law should go in imposing a legal duty on people to take moral actions. However, much can be said about the characteristics of a set of legal rules that are necessary if they are to be capable of providing a coherent and civilised social ordering.

Section 3.4 examines in some depth the controversy between two contrasting versions of liberty – positive or welfare rights and negative or liberty rights. Fundamentally different views about the nature of liberty lead to different views about the set of regulations that would best protect liberty.

Section 3.5 focuses on one dimension of liberty – economic freedom – and relates it to economic prosperity. This is a consequentialist examination of regulations and liberty. In contrast, the discussions in section 3.3 and 3.4 are more ontological.

Section 3.6 serves to explain the comment made in section 1 that the task of distinguishing between good and bad regulations involves, in part, asking if society has made the right choice between regulations and private rules. The common law provides the basis for private rules and dominates regulations in governing the interactions between private citizens. While regulations may usefully complement the common law, bad regulations may also wrongly substitute for it.

Section 3.7 acknowledges for completeness that regulatory reform cannot be considered in isolation of its relationship to other policies that could also affect human welfare. In particular, it relates the problem of regulatory reform to the problem of excessive government spending and taxation. Any benefits from removing regulatory excesses will be reduced if the effect is to increase ill-advised government spending and taxation.

Section 3.8 makes some concluding comments.

3.2 Defining regulation and regulatory reform

3.2.1 Regulation

In this report, *regulation* refers to the diverse set of instruments that *governments* use to impose requirements on enterprises and citizens. Regulations include laws, formal and informal orders and subordinate rules issued by all levels of government, and rules issued by non-governmental or self-regulatory bodies to which governments have delegated regulatory powers.[201]

As defined, regulations do not include the common law – sometimes known as judge-made law. Nor do they include the private rules that are set by voluntary associations, including businesses. Except where stated explicitly to the contrary we use the term 'private rules' to refer to all laws and rules that are not regulations. As defined, private rules include the common law.

It is common internationally to divide regulations into three categories – economic, social and administrative:

- *economic regulations* intervene directly in market decisions such as pricing, competition, market entry, or exit;
- *social regulations* aim to protect public interests such as health, safety, the environment, and social cohesion; and
- *administrative regulations* impose requirements to comply with paperwork and administrative formalities – so-called 'red tape' – through which governments collect information and intervene in individual economic decisions.[202]

Some analyses of regulatory costs are based on this classification (see section 2). However, while its international use indicates it has some general utility, the demarcation between these categories is likely to be hard to maintain in many cases. This suggests that it does not provide a sound basis for the development of regulatory policies.

The above definition of regulation is economic rather than legal. Acts of parliament, regulations and by-laws are legally distinct categories. Acts of parliament are sometimes referred to as *primary legislation* and regulations and by-laws as *subordinate legislation*.

Regulations in the legal sense can be made if an Act of parliament contains empowering provisions. Regulations are made by the executive branch of government and not by parliament. Regulations can be brought in without warning and without parliamentary or public debate or the normal processes of political representation.

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[201] This definition is used by the OECD secretariat. See OECD, *The OECD Report on Regulatory Reform, Volume II: Thematic Studies*, Paris, 1997b, p 196.

[202] The OECD secretariat uses this classification in OECD (1997b), *op cit*, pp 195–196. So does the US Office of Management and Budget. (See, for example Hahn, R, 'Policy Watch: Government Analysis of the Benefits and Costs of Regulation', *Journal of Economic Perspectives*, Vol 12, No 3, 1998, p 203.) Viscusi *et al*, *op cit*, note that the dividing line between economic regulation and social regulation is unclear. The authors prefer to use the term 'health, safety and environmental' regulation for social regulation.

Examples in New Zealand of repressive Acts that conferred enormous discretionary regulatory powers on the executive are the Economic Stabilisation Act 1948 and the Public Safety Conservation Act 1932.

By-laws can only be made where an Act of parliament confers power on an organisation to make them. Local authorities make most by-laws. Their power to do so is conferred by the Local Government Act 1974.

To minimise the risk of confusion we shall, wherever possible, use the economic definition of what is meant by regulation. When it is necessary to make the distinction, we use the term 'subordinate' legislation to refer to regulations that derive their authority from Acts of parliament.

3.2.2 Regulatory reform

Regulatory reform refers to changes that improve regulatory quality – that is, which enhance the performance, cost-effectiveness, or legal quality of regulations and related government formalities. Reform can mean revision of a single regulation, the scrapping and rebuilding of an entire regulatory regime and its institutions, or improved processes for making regulations and managing reform.

Deregulation is a subset of regulatory reform and refers to the complete or partial elimination of regulation in a sector to improve economic performance.[203]

Most countries that are members of the OECD have implemented regulatory reform during the last two decades in the form of privatisation and deregulation. Such reforms are sometimes described as *economic liberalisation*.

As David Henderson has explained, economic liberalisation invokes a European sense of liberalism that can be traced back at least two-and-a-half centuries.[204] This doctrine sees the state as playing an important role in establishing and maintaining a framework for voluntary exchange and cooperation, while restricting the powers and functions of government so as to leave individuals with a very wide freedom to participate in such opportunities according to their inclination and abilities.

Many OECD countries have established specialised mechanisms for overseeing regulatory reform activities. The OECD notes that these mechanisms vary widely across countries:

- in some countries specialised bodies can participate directly in the development of new regulations and the review of existing regulations on the basis of mandatory quality standards.[205] This enables them to intervene at an early stage if regulatory proposals are of poor quality;

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[203] OECD (1997a), *op cit*, p 11.

[204] David Henderson, *The Changing Fortunes of Economic Liberalism: Yesterday, Today and Tomorrow*, Institute of Public Affairs, Melbourne and New Zealand Business Roundtable, Wellington, 1999.

[205] These include the Office of Regulation Review in the Australian Productivity Commission; the Office of Regulatory Affairs in Canada; the Working Group for Proposed Regulations in the Netherlands; the Deregulation Unit in the UK Cabinet Office; and the Office of Information and Regulatory Affairs in the US Executive Office of the President.

- in some other countries officials are empowered to act as advisers in setting the general framework for polices for regulatory reform and encouraging ministers to comply;[206] and

- others may be deeply involved in reviewing existing regulations and in setting priorities for action by the ministries.[207]

Reform of *economic* regulation aims to increase economic efficiency by reducing barriers to competition and innovation, often through deregulation and the use of efficiency-promoting regulation, and by improving regulatory frameworks for market functioning and prudential oversight.

Reform of *social* regulation aims to verify that regulation is needed, and to design regulatory and other instruments, such as market incentives and goal-based approaches, that are more flexible, simpler and more effective at lower cost.

Reform of *administrative* regulation aims to eliminate regulations that are no longer needed and streamline, simplify and make more transparent those that are needed.

3.3 Rules, regulations and liberty

There is a common misconception that regulatory reform is driven by a desire to achieve a state of liberty interpreted as the absence of all rules.[208] In fact, sound and well-enforced rules are essential to order, personal autonomy, security in legitimate possessions and civil society itself.[209]

The alternative to rules is anarchy, defined as a state of lawlessness, disorder and chaos. The critical importance of rules for a social ordering is easily illustrated by the road system. One simple rule – keep to the left (or right) – provides for order where chaos could otherwise prevail.

In short, where there is no law there is no freedom.[210] Liberty is not *licence*.[211] All liberty is limited by the *duty* to respect and preserve the like liberties of others. There is surely no need to labour the obvious point that, at the other extreme, rules can reduce or eliminate liberty.

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206 Examples include the Commission for Public Sector Reform in France, the Ministries of Economics and the Interior in Germany, and the Ministry of Finance in Sweden.

207 Examples include the ministerial-level Economic Deregulation Board in Mexico and Japan's Administrative Reform Committee, an advisory body to the prime minister.

208 Rousseau, whose ideas contributed greatly to the terror of the French Revolution according to Henry Maine in 1861, wrote in 1762 that man is born free, and everywhere is in chains.

209 Of course, good law is necessary but not sufficient for a successful society. Laws that are not well-enforced or that are not respected will not be successful. Moreover, good laws might not survive unless the general climate of opinion fosters an attitude of self-restraint and respect for the persons and property of others.

210 Sir William Blackstone attributed this saying to philosopher John Locke in Book 1, Chapter 1, of *Commentaries on the Laws of England* (1775). We note in passing that there is a philosophical sense in which only individuals who use reason to live justly, resisting base passions, are free to choose.

211 Randy Barnett, *The Structure of Liberty: Justice and the Rule of Law*, Clarendon Press, Oxford, New York, 1998, comments on John Locke's distinction between liberty and licence, p 2. Liberty refers to freedoms that people should have. Licence refers to freedoms that people should not have. Licence is closely connected to the idea of duty. People have a duty to respect the like freedoms of others. This duty may be moral or legal.

Liberty can be reduced directly, by prohibiting a course of action that would otherwise be available, or by constraining individuals by adding to their duties. Freedom of speech could be banned outright, or equivalently confined by suitably expanding the legal definition of libel. The latter could be defended as 'enhancing freedom from defamation'. Freedom to work can be reduced by a regulation that imposes a minimum wage. The imposed duty on employers might be 'justified' on the basis that it enhances freedom from exploitation. In similar vein, freedom of association can be banned explicitly in the workplace, or impaired by the creation of a contradictory 'right' – such as a right to freedom from discrimination. Alternatively, regulation could increase the liberty of ruling groups or political interests by reducing the freedoms of those with less political power. For example, recourse to such terms as 'worker rights' or 'employer rights' may indicate factionalism. As all these examples may illustrate, it is extraordinarily easy in common discourse to seek to curtail one liberty in the name of another. In the words of Thomas Jefferson:

> It is in the natural course of things for liberty to give and government to advance.

It is more accurate to speak of the freedom to act than of the *right* to act. One's freedom to act arises from the duty of others to respect that freedom. One person's duty (for example, not to trespass) is another person's right to be free from that interference. Assertions about rights are assertions about duties or constraints. They are essentially assertions of a conclusive finding. Whether, in fact, these findings should be regarded as conclusive obviously depends on the quality of the reasons put forward in their support. We discuss the concept of natural rights briefly below and more fully in section 6.4.6. We discuss the issue of positive or welfare rights in section 3.4.

If regulatory reform is to enhance human welfare by enhancing liberty, it must be concerned with bringing about a better balance between freedom and constraint. Constraints arise from voluntary contracting and, where there are no contracts, from other components of the common law and regulations.

The common law is the dominant source of rules governing interactions between individuals. It will prevail in the absence of regulations. Later sections explore the issue of the relative efficacy of judge-made law and regulations.

Other regulations govern the relationship between citizens and the government – for example, those that require free elections within a defined period, prohibit arbitrary arrest and detention and ensure a fair trial.[212]

There is a large literature that debates the controversial issue of the proper balance between liberty and duty. It invokes issues of ethics, morality, natural law, positive law, natural rights and utilitarianism.[213] We cannot hope to do justice to this literature in this report. All we aim to do here is to draw some relevant aspects and sources to the attention of the interested reader as they arise.

As interpreted by Boston University School of Law professor Randy Barnett, a natural law approach to ethics attempts to infer the implications of the givens of human nature and the state of the world for the rules for behaviour that would need to be adopted if humans desire to achieve some goal. In contrast, a natural rights analysis aims to use

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[212] Friedrich A Hayek, *The Constitution of Liberty*, University of Chicago Press, Chicago, 1960, p 11.

[213] Barnett discusses the relationship between natural rights and utilitarianism, *op cit*, pp 23–24.

the same methodology to identify the liberty or space within which individuals should be free to make their own choices.[214] Barnett defines justice in terms of particular natural rights – to property, freedom of contract, self-defence and restitution, and uses this "classical liberal conception of justice" to evaluate existing laws.

Liberty is the freedom to act subject to the duty to comply with rules that protect the like freedoms of others. The classical liberal approach considers that the government's prime role and obligation must be to protect individual life, liberty and property of all citizens. Epstein sums this up as a 'first do no harm' principle for government action. Jaffa sees such a focus for government as the "greatest of all practical applications of the golden rule: 'Do unto others as you would have them do unto you' ". John Stuart Mill's famous nineteenth century essay *On Liberty*, illustrates an imperfect attempt to adopt this approach.

Mill proposed "one very simple principle" for judging the degree to which society could coerce any individual member:

> That principle is, that the sole end for which mankind are warranted, individually or collectively, in interfering with the liberty of action of any of their number is self-protection. That the only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others. His own good, either physical or moral, is not a sufficient warrant. He cannot rightfully be compelled to do or forbear because it will be better for him to do so, because it will make him happier, because, in the opinion of others, to do so would be wise or even right. These are good reasons for remonstrating with him, or reasoning with him, or persuading him, or entreating him, but not for compelling him or visiting him with any evil in case he do otherwise. To justify that, the conduct from which it is desired to deter him must be calculated to produce evil to someone else. The only part of the conduct of anyone for which he is amenable to society is that which concerns others. In the part which merely concerns himself, his independence is, of right, absolute. Over himself, over his own body and mind, the individual is sovereign.[215]

Yet the experience of the last 150 years has demonstrated that this principle lacks application as long as the benchmark for what constitutes a harm to others can be widely defined. Consider, for example, the implications of expanding the definition of a harm to encompass the act of denying to confer a benefit on a stranger. None could avoid harming others. Passivity would fail those who could have been helped by a positive action. Yet to help some is to harm those that could have been helped instead. In the extreme, this would describe a state of anarchy. No individual would have a right even to their own person.

Richard Epstein identified two important cracks in Mill's "intuitive edifice" in chapter four of *Principles for a Free Society: Reconciling Individual Liberty with the Common Good*.[216] First, Mill failed to consider which harms are best dealt with by legal processes (under common law) rather than by government action. Second, Mill did not deal

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[214] Barnett sums this up as follows "In short, natural law ethics purports to instruct us on how to exercise the liberty that is defined and protected by natural rights", *op cit*, p 15.

[215] John Stuart Mill, *On Liberty*, p 13.

[216] Richard Epstein (1998), *Principles for a Free Society: Reconciling Individual Liberty with the Common Good*, *op cit*.

satisfactorily with the need to determine why some harms are unacceptable while others are permitted (such as those suffered by less successful competitors).

The first was a major flaw because it prevented Mill from establishing where the role for the common law ended and the role for government action might begin. By not discussing explicitly the issue of public goods and taxation, Mill also failed to establish when government action would be desirable in respect of public goods.[217] Finally, Mill did not provide a theory that could set a limit on what actions constitute an actionable harm to others.[218]

Friedrich Hayek, one of the major contributors to these issues in the twentieth century, defines liberty or freedom as the absence of coercion, or, at least, the minimisation of coercion.[219] He defines coercion as occurring when one or more persons are obliged to serve as a means for some other person's ends, rather than being permitted to serve their own ends. Coercion implies both the threat of inflicting harm and the intention thereby to bring about unwilling conduct. A coercive exchange is likely to leave the victim worse off than if the 'offer' or demand that led to that exchange had never occurred. In the absence of such coercion the basic presumption is that it makes all parties to the exchange better off. Self-defence is not coercion when it is not aggression. Liberty and coercion are opposites, as is peace to war.

While useful, such a formulation leaves open the scope of the definition of coercion. Hayek discusses this at length. Economics professor Murray Rothbard has strongly attacked Hayek's discussion for entertaining too broad a definition of coercion.[220] Again, coercion would lose any useful meaning if it were defined so as to encompass failing to confer a benefit.

David Kelly argues that the definition of coercion needs to be limited so as to describe only situations in which our capacity to act independently is reduced by some positive action by someone else that forces us to comply with their will rather than our own. Blackmail and other offers or demands that are backed by credible threats of illicit aggression for failure to comply illustrate coercion under this definition. Otherwise a different word would have to be invented to fill the need to distinguish these situations from others.[221]

The confusion about definitions both obscures and reflects deep differences about where the balance between liberty and duty should be found. Liberal individualistic ideas clash with collectivist ideas that put less emphasis on the sanctity of the individual relative to the role of a group. The liberal concept of civil society and civil associations clashes with the concept of the corporate state. Decentralised concepts of social ordering clash with statist concepts. Section 3.4 focuses on a particularly

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217 Lon Fuller, *The Morality of Law*, Yale University Press, Yale, 1969, also comments on this aspect on p 169.

218 Leoni, *op cit*, pp 15–16, has suggested that Mill's 'self-protection' principle is only actually applicable if its scope is 'reduced to' the Confucian principle "do not do unto others what you would not wish others to do unto you".

219 In this report we generally follow Hayek in using freedom and liberty interchangeably. Leoni observes that 'liberty' is the Latin counterpart of freedom, not a word with a different meaning (*op cit*, p 48). However, we note that Steiner (*op cit*, p 60) distinguishes between pure freedom (or negative liberty) – the ability to act at all – from liberty defined as an ability to act without defying a duty.

220 Murray Rothbard, *The Ethics of Liberty*, New York University Press, New York, 1978, pp 219–229.

221 David Kelley, *A Life of One's Own: Individual Rights and the Welfare State*, Cato Institute, Washington DC, 1998, pp 70–71.

controversial illustrative issue – the extent to which the state should legislate so as to compel all to fund positive or welfare rights. Obviously there is a big difference between morally exhorting all individuals to do good and making them legally liable to do good in a particular manner.

Any attempt to remove regulatory excesses undoubtedly represents a step towards a more liberal approach to policy. Those who put the collective before the individual may agree with removing particular excesses, but oppose a trend towards economic liberalisation, laissez-faire, or a liberal conception of justice.

Some citizens may prefer to live in an open, dynamic, entrepreneurial, prosperous and heterogeneous community with a residual state safety net. Others may prefer an expanded safety net, a quieter life and/or a less populated environment – a 'New Zealand, the life-style choice' ethos. Many variations and other preferences are likely to exist and can be accommodated to some degree by migration and regional differences. Such accommodations may be more difficult in other dimensions. For example, different preferences may have very different implications for national policies towards such things as tourism, immigration and foreign ownership.

Clearly there are ample grounds for reasoned debate as to where the balance between liberty and constraint might be struck for any legal system. Governments cannot remain aloof from such questions. A government policy programme must either endorse observed and prospective outcomes or seek to shape them in a different direction. Whatever the choice, unanimity cannot be expected. Tyler Cowen makes the point that:

> Preferred policies, including laissez-faire, must ultimately be judged not only on traditional efficiency grounds, but also as a program for favouring one set of preferences over another. While we cannot eliminate the arbitrariness in policy evaluation, we should at least be more explicit about the subjective nature of the underlying values we choose to promote.[222]

Theories as to where the limits should be set can be grounded in ethical or moral principles or could be based on more-or-less pragmatic comparisons on the desirability of the outcomes that are likely to result from particular choices.

Our preferred approach to such conflicts is *consequentialist*. It asks which approach is likely to best serve the welfare of the representative individual (rather than benefit one group at the expense of another). This approach might lead to questions like: "Under which conception of the role of government are more people likely to starve?", or "Under which conception are there more likely to be bridges under which the poor can shelter or find bread to steal?".

What we suggest is that where a community is deeply divided between conflicting ideological positions, it might be possible to bring the contending factions closer together by putting the ideologies into the background and focusing the conversation on the implications of the contending policies for likely outcomes.

Utilitarian approaches are strongly consequentialist. As explained in section 6.4.6, some natural right theories also use consequentialist reasoning.

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[222] See Tyler Cowen, 'The Scope and Limits of Preferences Sovereignty', *Economics and Philosophy*, 9, 1993, p 267.

In his book *Principles for a Free Society: Reconciling Individual Liberty with the Common Good*, Epstein uses a consequentialist utilitarian approach to justify a comprehensive set of efficient rules that allows for voluntary and forced exchanges. These rules are explicitly derived from efficiency considerations. For example, Epstein argues that whereas force and fraud clearly impede wealth-creating activities, competition stimulates innovation and wealth creation. Therefore efficient rules prohibit force and fraud but permit competitive entry. This is consistent with the common law definitions of a harm.

Epstein concludes that the application of this approach will lead to similar conclusions to those of Mill about the proper limits to the use of the power of eminent domain. Force and fraud are prohibited. The close scrutiny arising under common law in relation to monopoly and restraints on trade is indicated. For the rest, Epstein suggests that the principle of freedom of action (of speech, religion, contract and association) should remain as strong and as vibrant as Mill would have it.[223]

The contrast is with a *deontological* approach. A deontological approach is derived from the branch of ethics dealing with duty, moral obligation and moral commitment. It may postulate human obligations from reason or see them as residing primarily in certain specific rules of conduct. Such rules may be derived from moral reasoning, 'nature', or god. For example, most would regard slavery as an evil that must be banned regardless of the validity of any alleged harmful consequences from such a ban. Liberty or justice might be defended on deontological grounds even if the outcomes failed to pass a consequentialist test.

When it comes to passing regulations on the basis of either consequentialist or deontological reasoning, consideration needs to be given to the importance of limited knowledge and interest group pressure. Hayek, Barnett and others have stressed the importance of limited knowledge. There is a case for the state to be cautious in overturning rules that have stood the test of time, even if their rationale is obscure. The greater the concern about such problems the greater the case for reliance on the decentralised processes permitted by the common law and other private adjudication processes. In this report we suggest that considerable reliance should be put on common law determinations of what constitutes a harm when considering whether there is a case for compensation for regulatory takings.

In favouring a consequentialist approach we are not disagreeing with all deontological propositions. We are not opposed to banning evils. To the contrary, specified coercive harms to others are banned under common law and rightly so if the rule of law is to prevail.

Also, importantly, deontological reasoning can throw useful non-ideological light on the attributes of any legal system worthy of the name. Fuller's classic book on the morality of law is more deontological than consequentialist. It focuses on the implications for a sound legal system of the distinction between the moralities of duty and of aspiration. The distinction between them is found at the boundary below which a person is condemned for failing to perform a duty but can expect no praise for success, and above which would be admired for success and at worst pitied for a failure to succeed. Laws can impose penalties for failing to perform a duty, but laws cannot compel someone to achieve their potential.

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[223] Richard Epstein (1998), *Principles for a Free Society: Reconciling Individual Liberty with the Common Good*, *op cit*, p 103.

Fuller sees the morality of duty as laying down the basic rules that are necessary for an ordered society. He states that:

> It is the morality of the Old Testament and the Ten Commandments. It speaks in terms of "thou shalt not", and, less frequently, of "thou shalt". It does not condemn men for failing to embrace opportunities for the fullest realization of their powers. Instead it condemns them for failing to respect the basic requirements of social living.[224]

There would surely be near universal agreement about the soundness of laws that protect individuals against fraud, force, assault and libel, ensure a fair trial and deny governments the ability to fine, arrest, or detain people arbitrarily. Nor can there be much disagreement that laws should aim to satisfy common sense tests relating to their design and application Such laws can be regarded as providing the foundation stones for a sound legal system.

Fuller observes that deciding where the pressure of duty falls off and the challenge of excellence begins is one of the most difficult tasks of social philosophy. If the morality of duty is extended too far in the direction of attempting to make aspirations a duty, "the iron hand of imposed obligation may stifle experiment, inspiration, and spontaneity". On the other hand, if the morality of aspiration is expanded too far at the expense of duty "we may end with the poet tossing his wife into the river in the belief – perhaps quite justified – that he will be able to write better poetry in her absence".[225]

In stressing the importance for a legal system of establishing the invisible pointer that divides the morality of aspiration from the morality of duty, Fuller drew a parallel with the problem in economics of finding the right balance between the security in property rights and contract that forms the basis for the economics of exchange and the need for some flexibility in order to make other social goals achievable.

Fuller postulates eight principles or desiderata for testing the 'inner morality' of any legal system. These comprise (not in Fuller's order):

- failing to achieve a rule at all, thereby leaving every issue to be decided on an *ad hoc* basis;
- retroactive legislation;
- failing to make rules understandable;
- enacting contradictory rules;
- requiring conduct beyond the powers of the affected party;
- failure to administer the rules as announced;
- changing the rules so frequently that actions cannot be aligned with them; and
- failing to make the rules available to those who are expected to comply.[226]

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224 Fuller, *op cit*, p 6.

225 Fuller, *op cit*, p 28.

226 Fuller, *op cit*, p 39.

Fuller comments that a total failure in any one of these eight dimensions would result in something that could not properly be called a legal system at all. Instead, nothing would be left on which to ground a citizen's duty to observe the rules. The citizen would face a more difficult predicament when there was no total failure in any of the eight dimensions but rather a general and drastic deterioration in legality with tyrannous effects.[227]

Fuller suggests that these principles could be seen as relating to a natural law concerning procedures and institutions rather than to a natural law of substantive ends. Every failure is an affront to the dignity of human beings as responsible agents. To illustrate the last point, to punish someone for violating a law that cannot be understood is to affront their dignity.[228]

In similar vein, University of Manchester philosopher Hillel Steiner uses the concept of compossible rights to analyse the coherence of legal rules. 'Compossible' means being able to coexist or coincide. Steiner suggests that a set of rights must be jointly performable if the rights are compossible. Where a set or rights is not compossible a particular action either is unrealisable or (what comes to the same thing) must be modified to be realisable. Such rules do not permit a social ordering to emerge spontaneously.

As already discussed, when a harm is defined to incorporate the failure to confer a benefit, no individual can act without harming someone. No autonomous social ordering is possible with such a rule.

Here Fuller's principles serve notice that there is a risk that markedly attempts to disturb the balance of the law at the expense of its internal morality, that will undermine the integrity of the entire structure, just as might the removal of some foundation stones from a building in order to add more floors.

3.4 Positive or welfare rights and redistribution

The debate over the proper limits to the state's role in redistributing income and wealth obviously reflects different views about the proper use of the state's coercive powers. Perhaps less obviously, it also highlights the difficulties in debating these issues that arise from opposing concepts of rights and freedoms.

The case for state redistribution may invoke the concepts of positive rights, welfare rights and positive freedoms. Welfare rights are a claim on the production of someone else. To claim a right to be free from hunger, for example, is to claim a right to the production of others. So is the claim to a right to legal representation at below cost.[229] The 'right' to freedom from want is an example of a positive freedom.

Welfare rights mesh easily with the concepts of social insurance and a state safety net. Social insurance differs from private insurance in that participation is mandatory and premiums are not actuarially based, even in principle.

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227 Section 6.4.2 examines New Zealand's laws in relation to Fuller's principles.

228 Fuller, *op cit*, pp 96, 102, 162, 184.

229 Section 35 of New Zealand's Bill of Rights Act 1990 provides for free legal assistance and free assistance with a court interpreter.

Prescriptive labour market, safety and environmental duties that cannot be contracted out of may be defended as ensuring positive rights. So might regulations designed to create legal rights to a 'living wage', a safe workplace or an 'unspoilt' landscape.

Liberty rights focus on process. They define the domain for freedom of action, as distinct from the concept of freedom to command resources owned or produced by others. With liberty rights, the duty to avoid infringing the like rights of others implies no duty to serve others or to lay a claim to the goods and services provided by others. The self-denial is mutual and the benefits are reciprocal. None can escape personal responsibility for a failure to self-provide or for causing a legal harm to others.

Liberty rights stand good against all mankind, not just against those operating within a given state. Under a system of liberty rights, all have a moral and legal duty to respect the legitimate legal rights of others.[230] None would be legally compelled without their specific consent to provide positively for an unrelated person's material welfare.

Under a system of liberty rights, outcomes result from the decisions individuals make when they exercise their permitted freedoms of action. Of course, those who are slaves to their impulses are unable to benefit from such freedom. Self-discipline or self-government is necessary for liberty. Sam Gregg refers to this as the third form of liberty.[231]

A liberty right only prohibits an outcome in the absence of mutual agreement. In conjunction with freedom of exchange and of contract it is permissive between consenting parties. While a system of liberty rights would prohibit assault without consent, it would permit consenting participants to box each other.[232] No such freedom of contract and exchange may be permitted with a welfare right.

In fact, even in the absence of mutual agreement liberty rights can permit diverse outcomes. The 'no trespass' rule, for example, holds good against all humanity. Yet any individual can make their property part of the commons simply by permitting all to access it. In contrast, a rule that gave each and every citizen a 'positive right' to every other citizen's property would prevent a 'no trespass' option from emerging anywhere, simply because of transaction costs.

A liberty right confers a freedom of action that is likely to be enhanced by the absence of others (since there are fewer who might get in one's way and be harmed). The liberty rights of a Robinson Crusoe stranded alone on a desert island would be secure. In contrast, the welfare rights of the same Robinson Crusoe would be violated, except for those he satisfied out of his own exertions.

Under a system of liberty rights, the counterpart to 'social insurance' is private insurance. Unlike the case of social insurance, the recipient of a payment under a private insurance policy owes no debt to society because the payment results from a contractual, voluntary risk-sharing arrangement. The recipient paid a premium, along with everyone else in the pool, that would, in principle, have reflected an actuarial

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230 See, for example, the discussions in Barnett, *op cit*, p 67, David Kelly, *op cit*, pp 65–90, and *The Economist*, 'Liberty, Equality, Humility', 11 September, 1999, particularly page 18, and the special survey section with the same title, p 36.

231 Sam Gregg, The Limits of Politics, CIS lectures, Centre for Independent Studies, 31 January, 2000 at http//:www.cis.org.au/CISlectures/310101sgregg.htm.

232 Sir Isaiah Berlin's 1958 essay 'Two Concepts of Liberty' provided a seminal discussion of these issues.

assessment of the risks associated with their participation in the pool. No issue of benevolence arises.

In contrast, welfare rights are commonly an entitlement to make a claim on others without any obligation or responsibility to reciprocate. Their fulfilment requires coercion. Those being coerced are serving as a means to someone else's end. None can contract out of the duty, no matter how undeserving the recipient.

Without such tests, welfare and liberty rights are easily confused. A call for a right to freedom from want or hunger can appear to be of the same nature as a call for the right to freedom from interference. It also strikes a more immediate, practical and humanitarian concern.

Advocates of welfare rights commonly see a gain in human dignity and freedom from their forced supply that outweighs any loss of freedom of action viewed from a liberal perspective. For example, journalist Chris Trotter has asserted that the rights to life, liberty and property are incompatible with 'universal' liberty.[233] He asked rhetorically "How could a starving man be free?". Anatole France vividly represented this point of view in 1894 when he scoffed at the "majestic equality of the law" of a liberal system "which forbids the rich as well as the poor to sleep under bridges, to beg in the streets, and to steal bread".

Underlying such observations are the notions that the range of alternatives available to individuals is a measure of their freedom or, that poverty results from liberty. Under the former conception, the (positive) freedom of people is reduced if they are unable to run a four-minute mile, an offer of marriage is declined, or illness reduces a person's capacity to work.[234] Here the concept of the freedom to choose amongst the available alternatives is confused with the range of those opportunities. Other words, such as 'power', 'ability' and 'opportunities' already exist to describe the range of opportunities available to any individual. Furthermore, to broaden the definition of freedom in this manner would broaden its antonym, 'coercion', to anything that reduces an individual's opportunity set. It would then have no meaning other than causality. Trotter's rhetoric argues that if people are made less secure in life, liberty and property they will achieve greater 'universal' liberty and there will be less starvation. The last part of this is a consequentialist proposition.

The second notion embodies the possibility that desperate poverty can be reduced by reducing liberty, at least for the rich. A consequentialist utilitarian might indeed accept a reduction in individual liberty if it genuinely resulted in a reduction in poverty. Such an inquiry would properly lead to a discussion of the general causes of poverty and prosperity. Extremely large government has certainly been a disaster in these respects.[235] Section 2.5 explores the more general relationship between liberty and prosperity. Nor is the experience with big government encouraging.[236] The inquiry

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233 Chris Trotter, *The Independent*, 5 April, 2000.

234 These examples and the arguments in this paragraph are due to Kelley, *op cit*, pp 68–70.

235 A survey by *The Economist* of the twentieth century reports research that assessed that governments killed 170 million civilians while another 37 million persons were killed in war. Arguably the most definitive study of the evils resulting from communism is *The Black Book of Communism: Crimes, Terror, Repression* by Stéphane Courtois *et al*, translated Jonathan Murphy, Mark Kramer (ed), Harvard University Press, Cambridge, Massachusetts, 1999.

236 Winton Bates addresses this question in an extensive discussion in *How Much Government: The Effects of High Government Spending on Economic Performance*, New Zealand Business Roundtable, Wellington, 2001.

would also consider the problems of lack of knowledge and interest group behaviour that could confound government poverty programmes. It would worry that departures from "the majestic equality of the law" could see laws that create privileges for those with political power rather than for the poor. (Section 5 discusses public choice issues.)

To some extent ontological arguments run in parallel with consequentialist discussions. From the perspective of Fuller's discussion of the morality of the law (see section 3.3) welfare rights can be interpreted as the use of the law to convert a moral obligation into a legal duty. Under a liberal conception of justice, all might have a moral responsibility to strive to be virtuous, avoid being a burden on others and to care for others. However, the law would not attempt to deprive any person of the freedom to determine how best to respond to the moral imperative to care for others.

Under Mill's concept, for example, we could exhort others to behave morally, but we could not use the power of the state to compel them to do so. Under this liberal concept, a donor deserves our admiration for benevolent behaviour and the recipient's gratitude.

In contrast, under a system of welfare rights, donors deserve no thanks because the recipients are merely getting their dues. Forced exchanges deprive donors of the ability to tailor assistance to the facts of the case. Cash is king; compassion is optional. Nor can individual donors impose conditionality in terms of self-improvement or reciprocating moral behaviour from recipients.

The morality of depriving individuals of the legal freedom to make a moral choice can be debated. From a consequentialist perspective, forced exchanges may impair civil society by denying an outlet for compassion and diminishing responsibility. They may also impair the self-respect and self-reliance of the recipients.

In terms of Fuller's taxonomy (see section 3.3), legislation entrenching welfare rights converts a moral aspirational obligation (to be compassionate and duly benevolent to those in need) into a legal duty to provide a specific and materialistic form of assistance. But to do so breaks the human links in the form of charity, compassion, benevolence and reciprocity between the donor and the recipient. This may change the responses of both the donor and the recipient in unfortunate ways. Advocates of welfare rights may acknowledge that a system of positive rights does impose such costs, but argue that they are outweighed by gains from the alleviation of poverty. This is a consequentialist argument.[237]

Another moral problem arises in assessing whether the recipient is in fact more deserving than the donor or, particularly given the widespread grinding poverty in the world, other potential recipients. The ethical problems arising from using income as a measure of welfare were discussed at length by Cathy Buchanan and Peter Hartley in *Equity as a Social Goal*.[238]

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[237] For a critical discussion of this proposition, see Kelley, *op cit*, pp 115–116.

[238] Cathy Buchanan and Peter Hartley, *Equity as a Social Goal*, New Zealand Business Roundtable, Wellington, 2000, particularly at p 121.

Some theories of morality might insist that none should eat if even one person in the world is starving.[239] Again, such theories do not establish that it is wise for the state to attempt to force people to act morally. As a practical matter, anyone who attempts to enforce a rule that demands that all starve if even one is starving is clearly going to be overthrown before all do starve.

A moral case for forced redistribution might arise where current outcomes result from illegitimate past actions. A moral difficulty arises here where the redistribution takes place at the expense of innocent parties.

A theory of legitimacy in property rights would surely insist that the final distribution is legitimate if the initial distribution were legitimate, along with the intervening transactions. Moreover, it seems unlikely that theories of distributive justice going back to Aristotle would sanction the forced redistribution of justly acquired property. Rather, Aristotle saw distributive justice as the principle of assigning common grounds or honour according to merit. Similarly, Nozick held the view that the complete principle of distributive justice would say simply that a distribution is just if everyone is entitled to the holdings they possess under the distribution.[240]

A system of welfare rights does not permit a social ordering to occur spontaneously. What is to be done when one person's 'right' can only be satisfied at the expense of the 'right' of someone else? Any dollar spent on 'free' medicine could have been spent instead on 'free' education.

Perhaps more subtly, a system of welfare rights must tend to undermine the foundations of Fuller's morality of duty. This is because the state's role in redistributing income conflicts with its responsibility to provide security in person and property. Frederic Bastiat forcefully made this point over 150 years ago. He argued that when the law departs from its role of protecting each individual against coercion from others:

> … it has acted in direct opposition to its own purpose. The law has been used to destroy its own objective: It has been applied to annihilating the justice it was supposed to maintain; to limiting and destroying rights which its real purpose was to respect. The law has placed the collective force at the disposal of the unscrupulous who wish, without risk, to exploit the person, liberty and property of others. It has converted plunder into a right, in order to collect plunder. And it has converted lawful defense into a crime, in order to punish lawful defense.[241]

In sharply drawing the battle lines between the conflicting visions about the role of the state Bastiat made a point that is still troublesome. It concerns where to draw the line once the state has accepted a redistributive role:

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239 Nagel suggests that Scanlon's theory of morality would not reach this conclusion, p 3. See Thomas Nagel's review of TM Scanlon, *What We Owe to Each Other*, Harvard University Press, Cambridge, Massachusetts, 2000, in *London Review of Books*, Vol 21, No 3, 4 February, 1999, at http://www.lrb.co.uk/v21/n03/nage2103.htm.

240 R Nozick, *Distributive Justice: The Entitlement Theory*, Basic Books, New York, 1979.

241 Frederic Bastiat, *The Law*. This monograph was first published in June 1850. The citation is from a translation by Dean Russell published in 1998 by the Foundation for Economic Education, Irvington-on-Hudson, New York, p 4–5.

> As long as it is admitted that the law may be diverted from its true purpose – that it may violate property instead of protecting it – then everyone will want to participate in making the law, either to protect himself against plunder or to use it for plunder.[242]

The debate over what rights to regulate goes to the heart of the relationship between the individual and the state. Gregg summed up these rights issues as follows:

> It may well be that one of the challenges for this forthcoming century will be for us to realise that safeguarding what we call human rights is far too important a task to be entrusted to professional human rights activists. Ideas do have consequences, for good or for evil. But they are not the toys of intellectuals. It follows that if rights become modern Trojan horses that help to turn politics from a process of reasoned deliberation and decision-making into what amounts to nothing less than, to paraphrase Clausewitz, war by other means, then we will have no one but ourselves to blame. The number of people who suffered and died through the abuse of state-power in the 20th century defies the imagination. Yet we also know that the utopian impulse remains deeply ingrained in the human condition. The free society has only the most fragile of defences against the desire of some to try and build heaven-on-earth through politics: these protections include such humble institutions as the rule of law, not to mention the ever-evolving but delicate tapestry which we know as the common law. To see these safeguards of our liberty undermined in the name of rights, both real and imagined, would surely be the cruelest paradox of all.[243]

Like many other countries, New Zealand has since moved far in the direction that Bastiat so vigorously opposed. The substantial regulatory apparatus required by the welfare state invites regulatory abuses and excesses. *The Economist* observed in 1999 that it is easy to see the moral case against attempts by the state to force people to do what is deemed to be in their best interests. However, the practical case is that it presumes a knowledge and certainty that is not and cannot be possessed.[244]

The issue New Zealand faces is where to draw or redraw the balance. This is not a question as to which economic theory can make a decisive contribution. The issue of achieving a transition from a welfare state to a more compassionate society based on civil association was discussed extensively by David Green.[245] Civil society does of course impose a moral duty on the well off to be compassionate. By and large these challenges still lie ahead for New Zealand.

A public policy adviser has no comparative advantage in determining how much potential output should be sacrificed in order to redistribute income. However, economists can hope to identify policies that will enable particular objectives to be pursued or sacrificed at least cost.

Reflecting such considerations, economists do suggest that governments would do better to target any redistributive policies towards the alleviation of poverty or to the redress of grievances rather than to achieving greater equality in the distribution of

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242 Bastiat, *op cit*, p 14.

243 Sam Gregg, *op cit*, p 6.

244 *The Economist*, 11 September, 1999, *op cit*, special survey section, p 36.

245 David Green, *From Welfare State to Civil Society*, New Zealand Business Roundtable, Wellington, 1996.

income.[246] The large deadweight costs of taxes and spending programmes argue against the churning of spending and taxes associated with middle class welfare.[247] Flaws in the use of measured current income as an indicator of welfare add to the case for targeting redistributive policies at the alleviation of poverty rather at achieving income equality. Finally, redistribution from the poor to the relatively well off seems offensive on equity grounds.

3.5 Regulation, economic freedom and prosperity

The domain for liberty is broad. Economic liberalisation describes regulatory reforms directed at increasing the domain for economic freedom.

Milton Friedman usefully distinguishes between three freedoms: human freedom, political freedom and economic freedom.[248]

Human freedoms are based in part on the duty of the rest of the world to desist from violating one's person and space. Slavery indicates a lack of human freedom for the slave. Arbitrary arrest and detention violate human freedom. All have a property in their rights to personal autonomy.[249]

Democracy is an important political freedom.

Economic freedom is about freedom of action and exchange and security in person and in rightfully owned possessions. William Beach and Gerald O'Driscoll define economic freedom as:

> … the absence of government coercion or constraint on the production, distribution, or consumption of goods and services beyond the extent necessary for citizens to protect and maintain liberty itself.[250]

Such a state requires self-restraint by individuals and governments so as to preserve the like freedoms of other individuals. It requires a legal system that defends individuals against violence, fraud and theft. It requires a system that secures individuals against arbitrary and oppressive government yet allows governments to raise the funds necessary to preserve law and order.

Richard Epstein has pointed out that the Beach and O'Driscoll definition fails to establish clearly the relationship between economic freedom and government provision of public goods.[251] The provision of other goods held in common, such as the public road network, is not obviously covered by the authors' definition. It is important to provide for taxation subject to the consent of those being taxed, or their

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246 Feldstein, Martin, 'Reducing Poverty, Not Inequality', *The Public Interest*, No 137, Fall, 1999, pp 33–41.

247 See James Cox, *Middle Class Welfare*, New Zealand Business Roundtable, Wellington, 2001, for a discussion of the magnitude of middle class welfare in New Zealand and the issues that arise.

248 Milton Friedman, Economic Freedom, Human Freedom, Political Freedom, The Smith Centre, Inaugural Lecture, 1 November, 1991. Related concepts arise in Blackstone's concept of the 'absolute rights of individuals' – see section 6.3.

249 Steiner refers to the 'important conceptual truth' in this Lockean view, *op cit*, p 93.

250 O'Driscoll, Gerald P, Holmes, Kim R, and Kirkpatrick, Melanie, *2000 Index of Economic Freedom*, Heritage Foundation and *Wall Street Journal*, November 1999, p 71.

251 Personal communication, 21 March, 2000.

representatives, for the provision of public goods such as national defence and the enforcement of sound laws. We return to this point in section 3.7 below.

With this caveat, a high level of economic freedom implies a correspondingly limited role for government. The higher the level of government spending, the more taxes must appropriate private property, in good part in the form of labour income. Similarly, the greater the volume of intrusive regulation, the smaller is the domain for individual freedom of action.

Individuals are less likely to improve their skills, work hard, save or invest if others can simply expropriate the benefits through violence, theft, fraud, corruption, regulation or taxation. Securing economic freedom requires avoiding lawless anarchy at one extreme and totalitarian government at the other. In between these extremes there is a balanced role for government that allows a country's citizens enough economic freedom to generate the wealth on which prosperity, security, longevity and health depend. Exactly where this balance lies is a matter for sound research and reasoned debate.

Economic freedom cannot exist without private property. Without private property, voluntary exchanges between individuals would be drastically limited. Moreover, if people are not free to sell their own labour they are not free. If they are not free to possess the fruits of their labour, they may be little better than slaves. Consent is critical in relation to principled taxation.

Private property protects people from uninvited and undesired intrusions, yet allows them to come together for mutually beneficial exchanges. It allows people to be free, subject to respect for the rights of others and secure in the mutual nature of that protection.

This requirement for mutual self-constraint makes private property, in the words of James Q Wilson, "a powerful antidote to unfettered selfishness".[252] Private property necessitates allegiance to rules such as 'keep your hands to yourself' (assault cases) and 'do not trespass' (privacy cases) the observance of which is critical to a civil society.

The institution of private property is also critical for the existence of political and individual freedoms. Leon Trotsky reportedly observed earlier last century that where there is no private property none can eat except at the pleasure of those controlling the coercive powers of the state.[253] The Legislative Advisory Committee *LAC Guidelines* cite Cross on the view that "the protection of property is generally regarded as one of the fundamental values of a liberal society".[254]

Since the fall of communism there has been little dispute about the proposition that prosperity depends on the existence of private property. A more finely graded question concerns the degree to which an increase in economic freedom will lead to greater prosperity.

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252 As reported on p 10 in Tom Bethell, *The Noblest Triumph: Property and Prosperity through the Ages*, St Martin's Press, New York, 1998.

253 Bethell, *op cit*, p 9.

254 Legislative Advisory Committee, *LAC Guidelines: Guidelines on Process and Content of Legislation*, 2001 edition, May 2001, New Zealand Government, p 51.

Tom Bethell has recently traced the history of private property in relation to prosperity across civilisations and cultures and its links to traditional concepts of justice and liberty.[255] He argues that the critical importance of private property was taken for granted by classical economists prior to the mid-nineteenth century to such a degree that its importance was largely overlooked when it was attacked by Karl Marx, Robert Owen and other socialists.

Bethell suggests that the apparent material economic successes of socialism until late in the twentieth century further contributed to a prolonged lack of interest in the subject by economists. The depth of this lack of interest is indicated by Armen Alchian's lament, as late as 1981, that articles in 1958 and the early 1960s by economists such as himself and Ronald Coase were regarded as having created a 'new field' in economics called 'property rights'.[256]

Private property rights are typically calibrated rather than absolute. As discussed here in this section (3.5) and section 7, such rights must accommodate the pressing interests of others in cases of private necessity and public use. Regulations could serve to impair or enhance security in property rights, depending on their nature.

A system of private property rights does not ensure a high degree of economic freedom by itself. Regulations that create monopolies reduce economic freedom by limiting competition. New Zealand's 50-year experience with import licensing illustrates this type of regulation.

So, a high degree of economic freedom requires a system of well-defined and secure property rights that allows competitive entry. It is market competition, in conjunction with the profit motive and private property, that induces self-interested producers to seek to identify, and serve, the interests of consumers.

Adam Smith postulated over two hundred years ago that, as if guided by an invisible hand, market competition and the pursuit of self-interest (profit) produce unintended benefits for the wider public. Smith also succinctly highlighted the importance of a high degree of individual liberty and economic freedom for prosperity:

> Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes and a tolerable administration of justice; all the rest being brought about by the natural course of things.[257]

Adam Smith inferred the benefits of a system of private property, voluntary exchange and market competition independently of modern day mathematical theorising.

Last century mathematical economists rigorously explored the circumstances under which markets could be expected to allow society to squeeze the maximum conceivable benefits (in terms of goods, services and leisure) from available resources. Under limited conditions, including perfect competition, a market economy would lead to an outcome in which no one could be made better off without making someone worse off. Economists call allocations that have this property Pareto efficient

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255 Bethell, *op cit*.

256 Bethell, *op cit*, pp 310–313.

257 Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, 1776, republished 1976, Edwin Cannon, (ed), University of Chicago Press, Chicago, p xl.

allocations.[258] Pareto theory does not provide a basis for choosing between alternative Pareto efficient allocations.

The theorem provides a formal basis for explaining the enormous potential power of decentralised processes for using scarce resources to meet human wants. This is a major achievement. Samuelson and Nordhaus comment on this finding as follows:

> This is truly an astounding statement about the power of competition to produce beneficial results. It means that, given the resources and technology of society, even the most skilled planner cannot come along with a computer or an ingenious reorganization scheme and find a solution superior to the competitive marketplace; no reorganization can make everyone better off.[259]

Intuitively, it is the voluntary nature of market exchanges that fosters Pareto efficiency. Each and every party to a voluntary exchange can refuse to participate. As long as there is no coercion or fraud, no participant can be worse off (*ex ante*) as a result of the exchange.[260]

Of course, the same finding could be turned around and expressed as a finding that established that a market economy could not be expected to produce a Pareto efficient allocation when transaction costs are positive, as is almost always the case. In these circumstances the case for the market economy must be established by a real world comparison of alternatives – the so-called comparative institutional approach – rather than by mathematical proofs based on armchair theorising. This was Adam Smith's approach.

More recent history similarly demonstrates that market economies work better than centrally planned economies in practice. The collapse of central planning in Eastern Europe during the last decade demonstrates that market economies provide the surest route to economic health. China's recent history tells the same tale. History and theory broadly align. Of course, the collapse of any one regime will not guarantee a successful transition to a better regime.

For all these reasons, a high level of human, political and economic freedom should result in a high level of well-being for the fortunate citizens. But there is an important caveat: can such a combination be achieved and sustained? History and contemporary cases demonstrate that countries can, and do, slip from democracy into totalitarian or anarchistic regimes.

Milton Friedman pointed out that political and economic freedoms are not necessarily mutually reinforcing. Political majorities can vote to reduce economic freedom for shortsighted or self-serving reasons.

Nor is political freedom necessary for prosperity. Hong Kong under British rule was the exception that establishes this point. Its political freedoms were limited, but it

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[258] People can be made worse off as a result of chance or the actions of others without violating Pareto efficiency. Pareto efficiency is an *ex ante* concept that permits lawful harms such as competitive harms.

[259] Samuelson, PA and Nordhaus, WD, *Economics*, 16th edition, McGraw-Hill, Irwin, New York, 1998, p 266.

[260] The institution of private property is a prerequisite for decentralised voluntary exchange.

enjoyed a high level of economic freedom and prosperity. Friedman suggests that the former may have permitted the latter.

A more general way of making the point is that democracy may be constitutional, respecting the liberties and property of minorities, or it may be predatory towards minorities. Where a democracy is predatory it will undermine civil society and ultimately put itself at risk. As we note in section 6, the problem is to achieve constitutional democracy, avoiding majoritarian excesses.

Neither of these points affects Friedman's conclusion that a high level of economic freedom is necessary for prosperity. He finds no cases to the contrary in the history of nations.

This leads us to the question raised earlier as to how progressive is the relationship between economic freedom and prosperity. Should a material increase in economic freedom increase prosperity or do such increases make no difference beyond some threshold level? Answering this question requires some quantification of economic freedom.

Economic freedom is not inherently quantifiable. Yet quantitative research requires a quantified measure.

Only in recent years have a number of researchers tackled the demanding task of creating measures of the degree of economic freedom across countries and through time.[261] This was necessary before researchers could explore statistically the robustness of the expected relationship between prosperity and economic freedom.

The task was demanding because measures of economic freedom must take account of both the amount of regulation and of government spending (and therefore taxes), that is, of the overall intrusiveness of the government. Furthermore, as just explained, the relationship between the size of government and economic freedom is not monotonic – beyond some point, smaller or less intrusive government could mean less liberty.

Nevertheless, a number of researchers have produced quantitative measures or rankings of levels of economic freedom across countries and through time in recent years. For example, after a major research effort involving 11 institutes, some of the world's top economists and six conferences during the 1986–1993 period, three authors under the auspices of Florida State University were able to publish quantitative analyses of the relationship between economic freedom and living standards.[262]

Their work provided, in the words of *The Economist*,[263] "the best attempt yet to define and measure economic freedom". It also provided what *The Economist* accepted as "powerful evidence" in support of what it called the liberals' case that "the demise of

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261 For a survey of these measures, see Hanke, Steve H and Walters, Stephen JK, 'Economic Freedom, Prosperity, and Equality: A Survey', *Cato Journal*, Vol 17, No 2, Fall, 1997, pp 117–146.

262 Gwartney, J, Lawson, R and Block, W, *Economic Freedom of the World, 1975–1995,* Fraser Institute, Cato Institute, and the Institute of Economic Affairs, Vancouver BC, 1995.

263 *The Economist*, 'Economic Freedom: Of Liberty and Prosperity', 13 January, 1996, pp 19–21.

socialism and of old, state-led, import substitution models of development will bring faster, more sustained growth to countries that keep their economies free".[264]

The Economist further commented that:

> … the conclusion from this research into 102 countries over 20 years could scarcely be more emphatic: the more economic freedom a country had in that period, the more economic growth it achieved and the richer its citizens became.

More recently, Gwartney and Lawson reported, using 1997 data, that the top fifth of the countries in terms of economic freedom had an average GDP per capita of US$18,142 whereas the bottom fifth had an average of only US$1,538.[265]

Higher levels of economic freedom also tend to be associated with better non-monetary measures of well-being such as improved infant mortality, life expectancy, literacy and safer drinking water. Nor does the reduced poverty from economic well-being appear to be associated with greater income inequality, as measured by the spread between the highest and the lowest income brackets. On the other hand, it does appear to be strongly associated with an increase in the size of the middle class.[266]

New Zealand also ranks very highly for economic freedom. For example, it ranked fourth in the world for economic freedom in the *2001 Index of Economic Freedom* published by the Heritage Foundation and the *Wall Street Journal*. This high ranking is relatively recent. Prior to the economic deregulation that occurred between 1984 and 1987 New Zealand was relatively highly regulated.

New Zealand's current high ranking for economic freedom is apparently at odds with the trend in decline during the last half-century in New Zealand's international ranking for per capita gross domestic product. Clearly any measure of economic freedom is imperfect and it is likely to take time for institutions and individuals to respond to changes in economic freedom. It takes time for institutions to respond and for investment responses to have a material impact on overall levels of human and physical capital, and thereby on national productivity. The length of time will depend on expectations of the sustainability of those changes. Meanwhile other factors, such as changes in the external terms of trade, government spending and tax policies, other government regulations, climate events and migration can complicate interpretations of trends.

We comment on evidence from the gains from deregulation and privatisation in New Zealand in section 4.2. For the purposes of the current argument, we suggest that the decline in relative living standards in New Zealand should motivate consideration of the contribution of regulatory excesses documented in section 2.

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[264] Questions can be raised about the accuracy of any broad measures of freedom. See, for example, Henderson, D, 'Measuring Economic Freedom and Assessing its Benefits', *Agenda*, Vol 4, No 2, 1997. More research can be expected on this question.

[265] James Gwartney and Robert Lawson, 'Economic Freedom of the World: 1998/99, Interim Report', 6 November, 1998, as reported by the National Center for Policy Analysis, *Executive Alert*, March/April 1999, p 7.

[266] See, for example, 'Economic Freedom and Social Welfare' in James Gwartney, and Robert Lawson, with Samida, Dexter, *Economic Freedom of the World 2000 Annual Report*, Fraser Institute, Canada, 1999, pp 16–17 and Hanke and Walters, *op cit*, pp 140–142.

3.6 Regulation and the common law

The common law provides the foundation for order and freedom in English legal systems. The common law of England is largely a Norman creation. Scholars have readily traced the influence of principles drawn from Roman law on the common law.[267] The law has evolved from the body of customary law that the common law courts of England have administered since the Middle Ages.

The common law stands in contrast to statute law, rules developed by separate acts of equity, and the legal system derived from civil law that dominates in continental Europe and elsewhere. Parliament abolished the system of competing, separate common law and equity courts in England in 1873. However, separate courts of chancery or equity still exist in some states of the United States and in some commonwealth nations.

Distinguishing features of the common law system include trial by jury, unbiased judges who preside over an adversarial contest between a defendant and a plaintiff or prosecutor who are on equal footing. In criminal cases the defendant is presumed innocent unless proven guilty beyond reasonable doubt. In civil cases guilt is based on a balance of probabilities. Individuals wanting access to justice can readily obtain it for valid purposes through a system of writs. Civil rights are protected by the jury system because the judge cannot determine guilt. The focus is on ensuring a fair trial (that is, on process) rather than on determining guilt or innocence. For example, the accused has the right of silence.

This type of legal system also exists in the United States and in many members of the (ex-British) commonwealth of nations, such as Australia and Canada as well as New Zealand.

The common law underpins the system of voluntary exchange based on private property rights and individual liberties. *Inter alia*, common law generally makes it illegal to harm others by causing injury to their persons or physical damage to their property. Common law obligations are reciprocal across individuals, although they do not, of course, affect all equally. The prohibition of the law on fraud, libel, coercion, theft, trespass and assault are not specific as to position, person, gender, age, ethnicity, status, location or time.

The common law of property, contract and tort largely provides for personal autonomy and security in possessions and exchange.[268] When soundly enforced and widely regarded as legitimate, it secures for all individuals a high measure of freedom to pursue goals of their own choosing. As foreshadowed in section 3.3, a system of private property rights allows individuals to stay apart (secure in the law from trespass) and to come together for exchange. Contract law protects against coercive contracts while allowing other contracts to be enforceable under the law. Tort actions protect against damage to person and property, for example, those arising from libel, fraud, assault and various forms of negligence or fault.

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[267] See, for example, the review by Russell Kirk, *The Roots of American Order*, 3rd edition, Regnery Gateway Publishing, Washington DC, 1992, pp 188–189.

[268] The Legislative Authority Committee, *LAC Guidelines: Guidelines on Process and Content of Legislation*, *op cit*, p 45, note that the scope of the common law also includes 'equity', almost the whole of judicial review, and much of the law by which statute law is interpreted by the courts.

Common law processes that clarify disputes between contracting parties over the allocation of rights are not prescriptive with respect to outcomes as long as subsequent freedom of contract is preserved. In contrast, regulations commonly prescribe outcomes.

Tort processes are particularly applicable to harms resulting from interactions between strangers. This is important because the argument that voluntary exchange is Pareto efficient is obviously potentially weakened if the parties to the exchange are benefiting at the expense of someone else. For example, a downstream user of water might be able to take a successful action against an identifiable upstream polluter.[269] Common law processes provide *ex ante* and *ex post* remedies for harms between contracting parties and between strangers.[270] Such remedies potentially correct such externalities. They thereby greatly weaken the case in elementary economics textbooks for government intervention whenever there is an 'externality'.

It has also long been accepted under English common law (and statute law) that violations of private property rights, without the prior consent of the owner, were legally justifiable in some cases of dire necessity. However, this ability to trespass *in extremis* without prosecution did not avoid liability for compensation.[271]

The availability of common law actions also stands behind the enforceability of much rule-making in the form of private regulations and self-regulation.[272] Private standards, certificates and warrants of performance can only exist where the property right and reputation of the certifying agency is protected from fraudulent claims.

Common law processes allow disputes between contracting parties and strangers to be resolved based on the facts particular to the dispute and case law precedents. Often the resolution may simply take the form of determining who is in the right. Such determinations subsequently make it easier for the parties to the dispute to negotiate to reallocate that right should they so desire.

The common law can achieve assent in good part because it is not imposed 'from above' by a ruling elite. To the contrary, it derives its acceptance by appeal to ancient rights and customs and decisions by jury. Its system of writs, court procedures and national enforcement protected the lowly individual from oppression by powerful individuals. Statute law is dwarfed in comparison, being referred to by one New Zealand expert as "an archipelago within the ocean of the common law".[273]

In principle a writ can be taken out against the highest member of society as readily as against any other individual. The poorest in the land can have their day in court against the most powerful. This 'equality under the law' conflicts with the unattainable and utopian goals of equality of opportunity and equality of outcome. In

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269 See, for example, *Carmichael v City of Texarkana*, 94 F 561 (WD Ark, 1899) and *Whalen v Union Bag & Paper Co*, 208 NY 1 (Ct Ap, NY 1913).

270 Injunctive relief is an *ex ante* remedy. Restitution or compensation is an *ex post* remedy. Exemplary damages may impose penalties that exceed the damage caused to the victim.

271 Richard Epstein footnotes "the classical tort cases" establishing this liability on p 110 in, *Takings: Private Property and the Power of Eminent Domain*, Harvard University Press, Cambridge, Massachusetts, 1985. See also his discussion in *Simple Rules for a Complex World*, Harvard University Press, Cambridge, Massachusetts, 1995, p 114.

272 See, for example, Yilmaz, *Policy Analysis*, *op cit*.

273 Baragwanath, D, 'The Function of the High Court Judges Today and Judicial Appointments', address to the New Zealand Bar Association Conference, Christchurch, August 1998.

section 3.4 we considered Anatole France's attack on the "majestic equality under the law".

The vast apparatus of the common law governs the interactions between private citizens. Encroachments by legislation on the common law as it relates to interactions between private citizens are very common, as the material in section 2 illustrates. Bruno Leoni has posited that legislation in matters of private law is fundamentally incompatible with political freedom and is not really compatible with free markets.[274]

Kirk recently commented on the trend for statute law to displace the common law as follows:

> In the twentieth century, the common law of England, of the United States, and indeed of every country that has adapted English common law to its needs, steadily gives ground before the advance of statutory law. Some legislators scarcely seem aware that the common law still exists, and they succeed in enacting statutes which deal in less satisfactory fashion with subjects already adequately covered by common law.[275]

Leoni has insisted that it is impossible to over-emphasise the importance for preserving individual freedom against the power of government of the ancient distinction between governmental power and the judicial function that was stressed in the Middle Ages by Bracton. He argued that centralised law-making in matters of private law is fundamentally incompatible with the freedom of exchange that is necessary if political freedom is to be sustained.[276] Leoni also commented on the importance of impartial judges who seek to discover what the law is and apply it to the facts of the case as distinct from judges who seek to create new law. We discuss the latter issues under the heading of judicial failure in section 5.2.5. Putting these two notions together, Leoni observed that:

> Unfortunately, today the overwhelming power of parliaments and of governments tends to obliterate the distinction between the legislative or executive power, on the one hand, and the judicial power on the other, which has been considered one of the glories of the English constitution since the times of Montesquieu. This distinction, however, is based on an idea that people at present seem to have lost sight of: *Law-making is much more of a theoretical process than an act of will, and as a theoretical process it cannot be the result of decisions issued by power groups at the expense of dissenting minorities.*
>
> If the basic importance of this idea is realized again in our time, the judicial function will recover its true significance and legislative assemblies or quasi-legislative committees will lose their hold on the man in the street.[277]

We discuss in much greater detail the issue of the separation of powers in section 6.3.

Of course, concerns about the displacement of the common law by regulation should not be read as denying that regulation can also usefully complement the common law. Richard Epstein has explained at length why common law processes and voluntary

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274 Leoni, *op cit*, p 89–90.

275 Kirk, *op cit*, p 192.

276 Leoni, *op cit*, p 89–90.

277 Leoni, *op cit*, p 186.

exchange may be less efficient than regulations in some generic instances.[278] Issues of hold out, necessity, property held in common and public goods, create a potential role for regulation to complement private rules rather than substitute for them. For example, in cases of non-point source pollution the victim may be unable to bring a successful common law action. Regulations governing the importation of pests not already present in New Zealand may also illustrate this type of situation. So may regulations governing the spread of communicable diseases, including any outbreak of foot and mouth disease in New Zealand. More generally, laws relating to major emergencies, including major civil unrest and war, may be efficient.

3.7 Regulatory reform and government spending

Regulation and expenditure can be substitutes. Either can be used to redistribute income or wealth in favour of a politically influential group.

The benefits from regulatory reform must depend in part on the quality of government spending responses. Benefits will be reduced if the effect is to increase wasteful spending. Conversely, the benefits from a measure that imposes greater fiscal discipline are likely to be reduced if the effect is to increase wasteful forms of regulation.

High taxes clearly reduce economic freedom. They are, therefore, likely to reduce prosperity. Leoni states that, even when the Romans taxed a conquered people for the subsequent use of the conquered land, the tax never went, as a rule, over 10 percent of the income of those who had to pay it.[279] In a review of taxation across civilisations, Charles Adams concluded that much of the history of civilisation can be interpreted as a story of the inability of rulers to adhere to modest tax systems. Their civilisations declined and their subjects ultimately revolted.[280] Clearly, limits on taxes and spending are desirable. Adams asserts that separating the power to tax from the power to spend is critical. However, he does not establish that this option deserves such an emphasis – either historically or in this century.

An excess of regulation is likely to go hand-in-hand with excessive government spending and taxes for obvious reasons. There is supporting evidence that lower taxes and spending would increase prosperity in many countries. Research by two International Monetary Fund (IMF) economists found that the countries with the lowest increase in public spending since 1960 appeared to be more efficient, more innovative, enjoy a lower level of unemployment, and have much smaller 'black' economies.[281] They also concluded that rising public spending since 1960 had delivered few social benefits and, in some cases, had harmed economic performance. They suggested that state spending should be reduced to the proportion of GDP that prevailed in the 1960s. (In New Zealand central government non-finance current spending was around 21 percent of GDP in the 1960s. Today, Crown non-finance

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278 Richard Epstein (1995), *Simple Rules for a Complex World*, *op cit*.

279 Leoni, *op cit*, p 211.

280 Adams, Charles, *For Good and Evil: The Impact of Taxes on the Course of Civilisation*, Madison Books, Lanham, Maryland, 1993.

281 Tanzi, V and Schuknecht, L, *The Growth of Government and Reform of the State in Industrial Countries*, International Monetary Fund working paper, Fiscal Affairs Department, Washington DC, WP/95/130, 1995, and *Public Spending in the 20th Century: A Global Perspective*, Cambridge University Press, Cambridge, United Kingdom, 2000.

current spending is around 28 percent of GDP on a system of national accounts (SNA) basis.)

Gwartney, Holcombe and Lawson recently explored the relationship between the share of government spending and economic growth in some depth using statistics for the OECD region, supplemented by a data set covering 60 countries around the world.[282] The authors' regressions indicated that government spending has now reached such high levels in many countries that a decrease of 10 percent in government expenditures as a share of GDP would increase the rate of growth of GDP by about 1 percent. The authors could find no evidence that government spending of the order of 15–20 percent of GDP would be too small to maximise economic growth. Perhaps, more relevantly, they found that the core functions of government (the protection of persons and property and the provision of a limited range of public goods) could be provided with expenditure of less than 15 percent of GDP.

The deadweight costs of raising taxes independently support the case for smaller government. Taxes used to raise revenue typically distort resource allocation by limiting incentives to work and invest and by increasing incentives to consume income in non-taxable form. These costs are often referred to as the 'deadweight loss' of taxation. The deadweight 'cost' of taxation is difficult to estimate with precision and depends on the detailed features of the tax system and the state of the economy in a given year. Most economists tend to place the deadweight costs between 15 and 50 percent, for most tax systems. New Zealand estimates of deadweight costs have ranged from 14 percent to 146 percent.[283] Raising taxes from the middle class and from high-income earners in order to fund health and educational services that are provided to the same group is not a free lunch.

In an extensive analysis for the New Zealand Business Roundtable, economist Winton Bates recently estimated that at current levels of expenditure, each additional dollar of government spending funded out of taxes cost the nation around $1.50. The implied deadweight costs of 50 cents in each dollar of taxes is due in part to the relatively high deadweight costs of taxes on capital income and to the distortions to behaviour introduced by government spending programmes.[284]

New Zealand's Fiscal Responsibility Act 1994 makes it harder for governments to satisfy partisan interests through government expenditure. In the remainder of this section we outline the nature of this legislation.

The Fiscal Responsibility Act 1994 requires the executive to report to parliament at regular intervals on the government's fiscal strategy. The Act requires the executive to report on the compliance of this strategy with specified principles. It heightens accountability by requiring certain documents to be personally certified by the

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[282] Gwartney, J, Holcombe, R and Lawson, R, 'The Scope of Government and the Wealth of Nations', *Cato Journal*, Vol 18, No 2, 1998, pp 163–190.

[283] A study by Diewert, WE and Lawrence, DA, *The Marginal Costs of Taxation in New Zealand*, prepared for the New Zealand Business Roundtable by Swan Consultants (Canberra) Pty Ltd, 1994, finds that the marginal excess burden with labour taxation was then 18 percent and the marginal excess burden with consumption taxation was 14 percent (administration and compliance costs are additional). A second report, by McKeown, PC and Woodfield, AE, 'The Welfare Costs of Taxation in New Zealand Following Major Tax Reforms', *New Zealand Economic Papers*, 29(1), 1995, pp 41–62, finds rates of deadweight loss ranging from 24 to 146 percent, depending on assumptions about labour supply elasticity.

[284] Bates, *op cit*, p 56.

treasurer and the secretary to the Treasury and by imposing transparency requirements.

There are two key elements to the fiscal responsibility legislation. The first is a set of principles of fiscal responsibility. The second is a requirement for a transparent assessment of the government's fiscal policies against the principles.

The Act establishes the following five principles of responsible fiscal management:

- reducing Crown debt to prudent levels;
- running balanced budgets over the medium-to-long term;
- achieving Crown net worth to provide a buffer against adverse future events;
- prudently managing the risks facing the Crown; and
- pursuing policies consistent with a reasonable degree of predictability in future tax rates.

The Act allows the government to depart temporarily from the principles of fiscal responsibility. When it does so, it must justify the departure and outline how it intends returning to policies consistent with responsible fiscal management.

The Fiscal Responsibility Act 1994 commits the government to fiscal openness. It requires the government to publish regular statements of its short-term and long-term fiscal intentions. The reports are to be published at specified times and minimum disclosure requirements are set out in the Act. All fiscal policy reports required under the Act are referred to a parliamentary select committee responsible for the review of financial management. The committee is required to report back to the house on its review of the government's statements. The committee can call for submissions, examine the minister of finance and obtain independent assessments of the reports.

Overall, the Act has had a positive effect in respect of all five principles. It has focused attention on achieving and sustaining fiscal surpluses on the basis of generally accepted accounting principles (GAAP). This has lead to significant reductions in net public debt and increases in Crown net worth. A lot of attention has been placed on fiscal risks and prudent fiscal management, although it is harder to speculate on what might have happened otherwise. The Act has ensured that there are no major fiscal 'surprises' for an incoming government – and, thereby, made it harder for an incoming government to depart from the fiscal policies for which it had campaigned. The information disclosed by the government has also allowed closer monitoring of the government's fiscal performance.

One weakness of the Act is that it focuses attention on the government's operating balance and debt with less of a focus on expenditure and particularly the quality of expenditure. The level of government spending has increased substantially since the 1990–1993 period of fiscal discipline. At the same time, the quality of government spending has arguably deteriorated.[285] The Fiscal Responsibility Act 1994 has provided no constraint on these trends.

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[285] Refer, for example, to the New Zealand Manufacturers Federation's criticisms of the quality of the $5 billion package of increased spending by the coalition government on taking office in 1996.

If the Act had put greater emphasis on expenditure control it is plausible that governments would have pursued their objectives to a greater degree using regulations. Uncompensated regulatory takings are a form of selective taxation, regardless of their accounting treatment. Similarly, regulations that allow user charges to be used as taxes to fund gross revenue might reduce recorded taxes and appropriated spending in the Crown's accounts, depending on consolidation provisions.

Businesses and other groups took a close interest in the budget policy statements prepared in the early years of the Act. Many groups made submissions on these statements to the finance and expenditure committee. However, few now bother to do so because it has become apparent that such input has had little, if any, impact on government policy. In turn, the select committee process has had little effect on the government's fiscal approach, with the government-dominated committee generally endorsing government policy.

The Act may have had the measure of success that it has because of strong, if largely inchoate, public support for the notion that fiscal surpluses and reductions in net debt are a good thing. The pursuit of those goals does not necessarily make it harder for powerful interest groups to sustain low-quality spending programmes. Hence, the Act may not attract the strong opposition of such groups.

In contrast, measures to improve the quality of spending programmes and the quality of government regulations are likely to arouse the opposition of interest groups that benefit disproportionately from low-quality spending programmes and regulations. Therefore, we cannot conclude very much from the experience to date with this Act about the likely success of any Regulatory Responsibility Act.

3.8 Concluding comments

To be successful, regulatory reform must preserve sound regulations while eliminating excessive, unnecessary or undesirable regulations. Depending on which regulations are being discussed, there is room for much common ground and for much disagreement as to which regulations should be preserved and which should go.

Many relatively uncontested principles for sound regulations have been established in the course of human history. These particularly relate to those that govern interactions between the state and the individual. They include procedural requirements such as *habeas corpus*, a fair trial and proper burdens of proof. Regulations directed at interactions between individuals are a more controversial issue. The common law is the dominant form of such law. Regulations that override it are particularly suspect.

Economists generally consider that there may be a *prima facie* case for government action where private arrangements and the common law can be expected to encounter public good problems.

As discussed in a later section, longstanding precedents also motivate, a *prima facie* case for regulation in respect of hold-out situations in relation to public works. The argument for intervention in significant cases of monopoly is also widely accepted but is arguably more controversial, given the frequency with which antitrust laws are used by competitors for anti-competitive purposes. Regulations that attack low prices and create or protect an existing monopoly are harder to defend.

A *prima facie* case for regulations also arises in relation to individuals, such as minors and the mentally incapacitated, who are not in a position to take responsibility for their own welfare.

Such a set of regulations, in conjunction with a judge-made body of law that preserves liberal principles of personal autonomy and freedom of contract and exchange, would result in a very high level of economic freedom.

Governments can usefully contribute to economic efficiency by:

- underpinning common law processes for protecting personal autonomy, private property and contractual freedoms;
- regulating wisely so as to complement or supplement common law; and
- taking action to secure the provision of a limited number of public goods.[286]

The case for regulations (including taxes) that are designed to provide a safety net for those who would otherwise be destitute is also commonly (but not universally) accepted.

Much greater controversy is likely to surround the issues of the role of the state both in respect of redistribution beyond the point of a residual safety net and in respect of the range of public goods in which government intervention is justified. This should cause no surprise. Reasonable people could be expected to differ about these things even in the absence of significant differences in values. As always, governments must find a balance, hopefully based around a consensus that is informed by reasoned discussion and principles, including a concern to protect minorities from predatory majorities.

Notwithstanding areas of sharp disagreement, there are also likely to be significant categories of regulations that give rise to widespread concerns. Suspect regulations that, from the point of view of economic freedom, might come into this category include regulations that:

- primarily transfer wealth to those who are already relatively well off;
- are anti-competitive in intent or in practice;
- create unnecessary uncertainty as to the allocation of property rights;
- reduce the freedom of contract or the enforceability of contracts;
- lack universal application; or
- attempt to dictate outcomes (one-size-fits-all) rather than allow individuals to pursue diverse outcomes.

Economic freedom is an important yardstick for evaluating regulations for consequentialist reasons. Economic freedom is closely associated with prosperity.

Perhaps the most important conclusion in this section is that regulations that displace the common law should be subject to particular scrutiny. The common law provides

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[286] Samuelson and Nordhaus, *op cit*, p 285, list four potential roles for government. However, two of them, 'stabilizing the economy through macroeconomic policies' and 'conducting international economic policy', arguably fall under their first category of 'improving economic efficiency'.

the foundation for law and order in English systems. It underpins the system of voluntary exchange based on security of rights to self and property and freedom of contract and exchange. When administered by an independent judiciary it protects the individual from centralised power.

Regulations should be regarded as particularly suspect when they impose duties that cannot be reassigned by contract between consenting parties. Regulations creating positive rights, welfare rights or positive freedoms that either deny freedom of contract or make it impracticable, fall into this category.

4 Various Reform Initiatives and Experiences

4.1 Introduction

This chapter reviews regulatory initiatives in recent decades amongst a number of OECD countries, including New Zealand.

The OECD has usefully surveyed attempts at regulatory reform amongst its member countries.[287] It reports that there has been a significant increase in regulatory reform activity in recent years, but the pace and depth of reform differs considerably from country to country.

Section 4.2 reviews findings on the results of the wave of privatisations and deregulation in OECD countries during the last two decades.

Section 4.3 reviews the experience with procedural or administrative reforms based on increasing the quality of existing regulatory processes or procedures without necessarily changing the role of existing institutions. These reforms include the advent of regulatory impact statements and codes of good regulatory practice. Greater reliance on cost-benefit analysis is another option that is discussed in this section.

Section 4.4 reviews some options and experience to date with the creation of new bodies.

Section 4.5 reviews some reform options and experiences that relate to sunset provisions and *ad hoc* reviews, and staged repeal.

Section 4.6 explores self-regulation and the option of allowing individuals to opt out of regulations of a command and control nature.

Section 4.7 explores the option of a regulatory budget.

Section 4.8 draws some conclusions.

4.2 Privatisation and *ad hoc* deregulation

In recent years governments many countries have deregulated, replacing statutory monopolies with competitive markets. Often privatisation has accompanied these reforms. Industries in which major productivity increases and price reductions have resulted include road transport, airlines, electricity, financial services, professional services and telecommunications. Non-European countries, other than the United States, which have undertaken such reforms include New Zealand, Australia, Japan, Mexico and Korea.

[287] See, for example, OECD (1997a), *op cit*, pp 3–57.

New Zealand reduced much economic regulation during the 1984–1992 period.[288] Notable reductions in economic regulation included the abolition of:

- all legislation relating to centralised wage fixing;
- virtually all subsidies for agriculture;
- interest rate, price and rent controls;
- foreign exchange controls;
- import licensing; and
- all non-trivial restrictions on entry into banking.

In addition there were significant privatisations subject in some cases to a 'light-handed' regulatory environment in respect of antitrust issues.

The achievements attracted worldwide attention. There is ample evidence (see below) of significant efficiency gains in the sectors that were deregulated relative to other sectors. In evaluating these reforms the latest OECD report on New Zealand commented that "the comprehensive economic reforms have seen potential output improve appreciably in the 1990s compared with the 1980s", referring to a growth in potential output of 2.3 percent a year compared with 1.4 percent.[289]

Episodes of deregulation are remarkable. Mancur Olsen suggested that the public is most likely to support fundamental changes as a response to a crisis.

David Henderson has reviewed the widespread initiatives around the world in the last two decades to reduce the role of the state by making national economies less regulated and international trade and private capital flows freer.[290] He suggested that 1978 was the year of transition to greater freedom. This was when member countries of the OECD resolved to take steps to free their oil markets.

Notable early deregulatory initiatives included airlines and road freight deregulation in the United States, the suspension of foreign exchange controls in the United Kingdom in 1979 and major reforms in China associated with Deng Xiaoping.[291]

Most countries seem to have been affected. By 1995, Henderson's analysis suggests that 77 out of 114 countries had moved in a more liberal direction (that is, had increased economic freedom) on balance.[292]

The United Kingdom was one of the first to privatise state businesses and remained a leading practitioner of privatisation. According to World Bank data, 88 countries sold

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288 See, for example, Evans, L, Grimes, A and Wilkinson, B with Teece, D, 'Economic Reform in New Zealand 1984–95: The Pursuit of Efficiency', *Journal of Economic Literature*, Vol XXXIV, December 1996, pp 1865–1902 and David Henderson, *Economic Reform: New Zealand in an International Perspective*, New Zealand Business Roundtable, Wellington, 1996.

289 OECD, *Economic Survey: New Zealand*, Paris, December 2000, p 63.

290 Henderson (1999), *op cit*, *The Changing Fortunes of Economic Liberalism: Yesterday, Today and Tomorrow*.

291 Henderson (1999), *op cit*, *The Changing Fortunes of Economic Liberalism: Yesterday, Today and Tomorrow*, p 15.

292 Henderson (1999), *op cit*, *The Changing Fortunes of Economic Liberalism: Yesterday, Today and Tomorrow*, elaborates on these terms on pp 3–5.

US$135 billion of assets in 3,801 transactions of more than US$50,000 in 1988–95. Sales in Latin America and the Caribbean accounted for 46 percent of the total proceeds followed by East Asia with 25 percent.

D'Souza and Megginson recently reviewed the pre- and post-privatisation operating experience of 85 companies from 28 industrialised countries that were privatised between 1990 and 1996.[293] Combined with results from two previous directly comparable studies, they report that their findings "strongly suggest" that privatisation yields significant performance improvements.[294] Ownership matters.

The gains in the United States from the deregulation of particular industries further motivate the case for more active assessments of the costs and benefits of existing regulations. Focusing solely on economic deregulation in five industries in the United States, Winston concluded that:

> The evidence to date suggests that since deregulation, each industry has substantially improved its productivity and reduced its real operating costs from 25 percent to 75 percent.[295]

and that:

> Consumers have turned out to be the primary beneficiaries of deregulation. The evidence to date suggests that since deregulation, each industry has significantly improved its service quality and reduced its real average prices from 30 percent to 75 percent.[296]

Annual consumer benefits in the United States from deregulation of the railroad, natural gas, long distance telecommunications, airlines and trucking industries have been estimated at around US$53 million.[297]

Lewis Evans recently reviewed the empirical record on privatisation internationally and in New Zealand.[298] Along with many other researchers he makes the important point that the benefits from privatisation will depend on the quality of the ongoing regulatory environment as it affects the privatised firm. He draws the general conclusion that private ownership in conjunction with a 'light-handed' regulatory regime will increase efficiency. He and Boles de Boer have analysed the efficiency gains achieved by Telecom New Zealand from corporatisation and subsequent privatisation in particular detail. They found total factor productivity gains of 9.5

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293 For an earlier review see *The Public Benefit of Private Ownership: The Case for Privatisation,* New Zealand Business Roundtable, 1992.

294 Juliet D'Souza and William Megginson, 'The Financial and Operating Performance of Privatized Firms During the 1990s', *Journal of Finance*, August 1999. See also William Megginson and Jeffrey Netter, 'From State to Market: A Survey of Empirical Studies on Privatization', *Journal of Economic Literature*, Vol XXXIX, No 2, June 2001, pp 321–389.

295 Refer to page 98 in Winston, C, 'US Industry Adjustment to Economic Deregulation', *Journal of Economic Perspectives*, Vol 12, No 3, Summer 1998, p 98.

296 Winston, *op cit*, p 100.

297 Crandall, R and Ellig, J, *Economic Deregulation and Customer Choice: Lessons for the Electric Industry*, Center for Market Processes, Fairfax, Virginia, 1997, pp 3–7. Quoted in *The New Palgrave: A Dictionary of Economics*, Volume IV, Macmillan Press, London, Stockton Press, New York, 1998, pp 9–10.

298 Evans, Lewis, *The Theory and Practice of Privatisation*, New Zealand Institute for the Study of Competition and Regulation, draft, Wellington, 1998, pp 1–39.

percent per annum between 1987 and 1993 and assert that the productivity gains since privatisation were at least as large as the gains resulting from commercialisation alone.

Witold Henisz has also analysed the New Zealand experience with privatisation from an international perspective. Observing that "the benefits of privatization have been well chronicled in numerous qualitative and quantitative empirical works", his article focuses on the issue of the appropriate regulatory framework for privatised industries. He suggests that light-handed regulation is particularly appropriate in countries that have relatively independent judiciaries and relatively few constraints on executive authority.[299]

The OECD also reports that strong competition "is not inconsistent with a good safety record", citing US airline and trucking deregulation and the deregulation of dentists, optometrists, pharmacists, physicians and veterinarians. The OECD also identifies many examples in which deregulation has led to a cleaner environment.[300]

The OECD cites some evidence that public sector ownership of commercial enterprises in an industry tends to be associated with regulations that inhibit private entry and competition in those industries.[301]

Reflecting on evidence to date of the benefits from deregulation, the OECD assesses that:

> More heavily regulated countries, which include some European countries and Japan, can expect increased gross domestic product (GDP) to the order of 3 to 6 percent, after ambitious reform programmes. Additional gains can be expected from market-opening reforms.[302]

4.3 Reforms to regulatory processes

4.3.1 Introduction

By the early 1980s most OECD countries had begun to consider how to reform regulatory processes so as to reduce regulatory costs on businesses. This approach is sometimes referred to as administrative reform.

The drive for regulatory reform reflects the growth in regulation in recent decades amongst the OECD countries. Notable areas of increased regulation include health, safety, environmental, 'human rights' regulation and paternalistic regulation that attempts to protect people from their own folly (for example, in respect of securities regulation and consumer protection regulation). This growth mirrors the growth in government expenditure in relation to GDP since the 1950s.

The OECD secretariat has actively promoted the case for reform. It has promulgated generic guidelines and policy recommendations for regulatory reform. In 1990 a Public Management Service was created within the OECD. Its brief was to work on

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299 Henisz, Witold, 'The Institutions and Governance of Economic Reform: Theoretical extensions and applications', *Public Management*, Vol 1, Issue 3, 1999, pp 349–371.

300 OECD (1997a), *op cit*, p 28.

301 *OECD Economic Outlook*, OECD, December 1999, pp 187–188.

302 OECD (1998), *op cit*, p 3.

regulatory management and reform. It reports on developments amongst OECD member countries.

In 1995, the OECD found that most member countries had established a clear regulatory reform policy. Thirteen out of 14 countries studied had established some form of a specialised unit to oversee regulatory reform. However, the degree of commitment to reform varied widely across countries. According to an Australian publication, Australia, Canada, the United States and the United Kingdom are the countries with the greatest perceived commitment to reform.[303] Appendix A to this report provides more details on these experiences.

The OECD also reports that many countries have attempted reforms that apply across the economy and to a broader range of policy areas, involving many thousands of existing and proposed regulations at multiple layers of government. It argues that comprehensive reform works better than piecemeal reform, citing New Zealand's agricultural reforms of the mid-1980s.[304]

It also reports that reform of social and administrative regulations is an increasingly high priority in OECD countries. Reform efforts in these areas aim to:

- screen out regulations that are outdated or ineffective;
- streamline and simplify others;
- make greater use of market incentives and more flexible regulatory approaches; and
- increase discipline in regulatory processes.

Process reforms in the United States in the 1980s have not sustained the pace of regulatory reform in that country in the late 1970s. Roger Noll, non-resident senior fellow at the Brookings Institution has studied the economic and political sources of this slowdown. He argues *inter alia* that some major reasons why economists are less successful when they advise structured and procedural changes to regulation (as distinct from its elimination) is that political leaders view structure and process as a means to advantage allies and disadvantage foes rather than as a means of improving performance.[305]

New Zealand, while not a leading practitioner of this approach, did undertake some initiatives that fall into the administrative reform category in the late 1990s.

Encouraged by John Luxton as minister of commerce in 1997 and 1998, the Ministry of Commerce put considerable thought into options for improving regulatory outcomes in New Zealand.[306] As part of their inquiries, officials studied the following three distinct approaches to regulatory reform:

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303 *Regulatory Efficiency Legislation*, Report of the Parliament of Victoria Law Reform Committee, October 1997.

304 OECD (1997a), *op cit*, p 32.

305 Noll, Roger, 'The Economics and Politics of the Slowdown in Regulatory Reform', *Brookings Discussion Papers in Domestic Economics*, Brookings Institution, Washington DC, 1996.

306 See 'Regulatory Management: Achieving Intended Results with Minimum Compliance Costs', in *Newsletter*, Institute of Policy Studies, Victoria University of Wellington, No 51, August 1997, pp 4–11 for an overview of the New Zealand approach to the problem at this time.

- setting clear standards for policy advice and action by having the executive arm of government require that regulatory proposals conform to a code of good regulatory practice and are prepared in accordance with a generic policy development process;
- strengthening compliance with such standards and communication of the intent of regulations by an executive requirement that they be accompanied by a Regulatory Impact Statement (RIS); and
- constraining the executive's ability to bring forward poor quality or unnecessary regulations by having parliament legislate for a Regulatory Responsibility Act that might contain principles for sound regulations.

As a result of this work, Cabinet adopted, in 1998, a requirement that regulatory proposals be accompanied by a Regulatory Impact Statement (CO 98 (5)).

Although the Ministry of Commerce explored the possibility of a Regulatory Responsibility Act that would complement the Fiscal Responsibility Act 1994, the government did not advance this option. The ministry has developed a code of good regulatory practice but Cabinet has not imposed such a requirement.

4.3.2 Regulatory impact analysis

Regulation is often made without much understanding of its costs and benefits or its impact on employment, competition and innovation. This is, in part, due to the lack of analytical skills and resources in regulatory agencies, lack of adequate information and lack of incentive to look beyond an immediate problem being addressed. A lack of understanding of the full consequences of regulation may result in adoption of regulation that is more costly or less effective than an alternative course of action. Improving the assessment of such impacts prior to introducing regulation is proposed as an option for improving the quality of regulation.

The governments in most OECD countries have imposed a regulatory impact analysis (RIA) requirement. The RIA is a decision tool to (a) examine systematically and consistently selected potential impacts arising from government action and (b) communicate the information to decision makers.

In New Zealand the requirement for RIA is contained in Cabinet Office Circular CO 98(5). The circular applies to all policy proposals submitted to Cabinet that result in government Bills or statutory regulations. It requires each such proposal to be accompanied by a RIS, unless an exemption applies.

The stated objective of this requirement is to "improve the quality of regulation-making and to ensure that regulatory proposals are cost-effective and justified". The RIS replaced an earlier requirement that proposals for regulatory action include an assessment of the compliance costs of the proposal.

The Cabinet Office Circular requires the following information to be contained in a regulatory impact statement:

- a statement of the nature and magnitude of the problem and the need for government action ...

- a statement of the public policy objective(s) ...
- a statement of feasible options (regulatory and/or non-regulatory) that may constitute viable means for achieving desired objective(s) ...
- a statement of the net benefit of the proposal, including the total regulatory costs (administrative, compliance, and economic costs) and benefits (including non-quantifiable benefits) of the proposal, and other feasible options ...
- a statement of the consultative programme undertaken.

Regulatory impact analysis attempts to overcome some of the pressures of interest groups by requiring a wider analysis of the costs and benefits of regulation against alternative ways of achieving policy objectives. Regulatory impact statements can be linked to improved transparency and public consultation.

The analytical methods used in a RIA include the assessment of important impacts, fiscal costs, compliance costs, or formal cost-benefit analysis.

There is evidence from a number of countries that the RIA requirement has made a difference to the quality of regulation, with some costly regulations being abandoned on the basis of regulatory analysis.

The RIA is limited in its ability to capture the dynamic costs of regulation – the costs in terms of lost productivity, lost opportunities, lost innovation and lost growth.

There is also evidence of non-compliance with regulatory analysis requirements, or perfunctory efforts being made to meet such requirements.

A study assessing the quality of RIAs in the United States found evidence that "strongly suggest[s]" that government agencies generally failed to comply with President Clinton's Executive Order 12866 or with the cost-benefit guidelines issued by the US Office of Management and Budget. Agencies quantified net benefits for only 27 percent of the rules studied and quantified costs and benefits of alternatives in only 31 percent of the roles studied.[307]

The OECD reports that most OECD countries and the European Commission have implemented RIAs. It notes:

> … there is a broad consensus that, properly done, RIAs can be effective in helping to produce the most effective, least cost instruments, though they require additional resources. An evaluation of 15 RIAs in the United States found that they cost about $10 million to conduct but resulted in revisions to regulations with estimated net benefits of about $10 billion, or a benefit to cost ratio of about 1,000 to 1. The Canadian Business Impact Test has been judged effective particularly in assessing SME (small enterprises) impacts. But RIA is very hard to do properly. More work is needed to strengthen the methods, procedures and practice of RIA and to strengthen regulatory management to support its timely and effective use.[308]

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307 Hahn, RW, Burnett, JK, Chan, Yee-Ho I, Maeler EA and Moyle PR, 'Assessing the Quality of Regulatory Impact Analyses', AEI/Brookings Working Paper, 00–01, January 2000.

308 OECD (1997a), *op cit*, p 41.

The experience in New Zealand confirms that a requirement for a RIS can be readily by-passed by ministers and departments keen to introduce regulations for whatever reason. Without strong government commitment to ensuring high-quality RISs, government departments make little effort to undertake full analysis.

The Labour-led government elected in 1999 made it clear that it intended to implement the policies that it took to the electorate regardless of any contrary professional assessments of where the national interest lay, or the extent to which a majority of voters had failed to support its programme. The RIS for the Employment Relations Bill in 2000 failed to identify any symptom of any problem, let alone provide an assessment of the underlying cause of the symptom. Instead, it declared the problem to be that: "[c]urrent legislation is contrary to Government policy on employment relationships". The statement failed to identify, let alone analyse, any alternative courses of action. This did not stop it from asserting positive net benefits against an undeclared alternative. The section that required a statement as to who had been consulted provided instead a list of government agencies that had "been advised of this regulatory impact statement and related Cabinet paper". Subsequently, major additional regulations for the electricity industry were put to Cabinet without the benefit of any RIS whatsoever. The pretext for the omission was that the proposals had already had a full airing in the form of public consultation.

In New Zealand, no obvious sanctions apply where a RIS is not up to standard and the responsible minister takes no action. Signs of lack of professionalism can creep in at several levels:

- the problem may be stated so narrowly as to exclude broader and more satisfactory solutions;
- the policy objective may be stated so narrowly as to exclude better alternative courses of action;
- relevant alternatives, such as privatisation or reliance on the evolution of common law, may be ignored; and
- some real resource costs or benefits may be overlooked entirely, yet redistributions of income may be regarded as if they were real resource costs or benefits.

The minister responsible for an agency that produces an unprofessional RIS may be content if the RIS reaches a preferred conclusion. In other circumstances the agency is less likely to get away with it.

In March 2001, Tasman Economics reviewed the effectiveness of the RIS regime in New Zealand for the Ministry of Economic Development and the Treasury.[309] The review found that "many regulatory impact statements were far too brief, given the importance and complexity of the issues being addressed and were of poor quality". It did not say whether any were satisfactory overall. It made a number of recommendations for improving the design of the regime and compliance with its requirements.

We take up the issue of possible solutions to these types of problems in section 7 and section 8.

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[309] John Wallace, 'Regulatory Impact Statements', Tasman Economics, mimeograph, March 2001.

4.3.3 Code of good regulatory practice

Another option that has been proposed is to require the proponents of regulation to conform to a code of good regulatory practice.

The OECD checklist for regulatory decision making includes the following principles in the form of questions:

- is the problem correctly defined?
- is government action justified?
- is regulation the best form of government action?
- is there a legal basis for regulation?
- what is the appropriate level (or levels) of government for this action?
- do the benefits of regulation justify the costs?
- is the distribution of effects across society transparent?
- is the regulation clear, consistent, comprehensible and accessible to users?
- have all interested parties had the opportunity to present their views?
- how will compliance be achieved?[310]

Checklists can help achieve common standards for regulatory development. They provide information on how the government will exert its regulatory powers and they can act as management tools for the government's regulatory actions.

Regulatory quality standards reverse the burden of proof, placing the onus on the agents proposing the regulation to justify its implementation.

In New Zealand, the Ministry of Commerce developed a code of good regulatory practice. It sets out a number of requirements for good regulation under the headings of efficiency, effectiveness, transparency, clarity and equity.

There are no formal requirements for compliance with the code of good regulatory practice. Cabinet has not endorsed the code or made it a requirement that must be followed by those promoting regulations. In any case ensuring compliance with such a code can be difficult.

However, the Treasury and the Inland Revenue Department have developed, and attempt to apply, a 'Generic Tax Policy Process'. This process is designed to produce better and more effective tax policies.[311] Regulations that are intended to redistribute income have the characteristic of a tax. Arguably, it is desirable to establish that implicit taxes conform to sound tax policy principles.

There is room for substantial debate over what principles should be incorporated into a code of good regulatory practice. Some of the requirements of the Ministry of

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[310] OECD (1997b), *op cit*, p 208.

[311] See, for example, pp 7–8 in the Department of Inland Revenue's *Briefing for Incoming Minister*, November 1999.

Commerce, such as minimising the fiscal impact of regulations and the impact on competition, are questionable because optimal regulation does not necessarily imply minimal fiscal impact or minimum adverse impact on competition. Other requirements, such as compatibility with international standards, are unnecessary and potentially undesirable given the poor-quality, rent-seeking nature of much offshore regulation.

4.3.4 Greater use of cost-benefit analysis

Cost-benefit analysis provides a formal process for analysing the impact of regulation. As such, it provides an obvious tool for improving the quality of regulation. Cost-benefit analysis may well have been most widely applied in the United States. But even in the United States there are obvious grounds for concern. In section 2.3.2 we noted the degree to which a control agency in the United States relied on the cost-benefit analyses of regulations that were supplied by the agency advocating their adoption.

Unhappily, independent, professional cost-benefit analyses appear to be the exception rather than the rule with government interventions. *The Economist* recently lamented that all too many government interventions last century were justified by little more than the observation that markets 'fail' in the sense that they do not conform to the perfectly competitive model:

> Such thinking is profoundly misguided. In a sense market failure is pervasive. Competition is 'imperfect', production and exchange involve externalities, the future is uncertain; for all these reasons, markets fail to allocate resources precisely as they would in the textbook world of basic economics. By the same test, there is much to be said for central planning. But this century's most important economic lesson is that, except in textbooks, government failure is broader, more damaging in economic terms and much more threatening to individual liberty than market failure.[312]

The lesson to be drawn is that market failure should be seen as a necessary, but not sufficient, condition for government action. The administrative costs of action and the risks of government failure (public choice risks) must also be considered.

Greater attempts to ensure that decision makers are informed by professionally sound evaluations of the costs and benefits of the regulations they are considering can only be applauded. It is no surprise that cost-benefit analysis often forms the cornerstone of many proposed reform processes – including RIA.

A competent cost-benefit analysis should help identify who is likely to gain from a regulation and who loses. It should be able to provide some guide as to the materiality of those changes in value. This could motivate an examination of why those who are benefiting should not be expected to make the same payment for the property rights being transferred as they would have expected to pay under a system of voluntary exchange. Finally, such an analysis might help assess whether any wealth transfers implicit in the regulation are likely to be in accord with, or offend, widely accepted notions of equity.

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[312] *The Economist*, 11 June, 1994, p 9.

Despite the undoubted potential utility of a cost-benefit analysis, there are severe limits to how far any such requirement can be expected to limit excess regulation. The experience in the United States demonstrates that Congress readily passes many regulations that fail even a cost-benefit analysis conducted by the agency proposing the regulation.

Public choice theory (see section 5) provides reasons why this result should be no surprise. But, even putting public choice theory to one side, there are sound reasons for regarding cost-benefit analysis as a useful tool or sieve rather than as a decisive test for distinguishing between good and bad regulations. The remainder of this section outlines some of these reasons.

For a start, it may not be possible to quantify important costs, benefits or risks with satisfactory precision. In these cases the assessment may be essentially a judgment call. Where it is particularly difficult to quantify costs and benefits in terms of outcomes, a more logical approach is to assess the likely costs and benefits of the regulations in terms of the strengths and weaknesses of the institutional and incentive structures they create.

Another potential problem arises because cost-benefit analysis works with dollar valuations of costs and benefits that may not represent accurately the change in the utility or welfare of the individuals concerned. An additional dollar may increase welfare more the lower the wealth of the recipient. More worryingly it may be worth more to the spendthrift than to the non-materialistic hermit or devotee of simple living.[313] Market prices may provide a poorer measure of gains and losses the greater the likely effect of a regulation on those prices. Disequilibrium prices provide a poor guide to underlying values. In addition, resources should not involve positive or negative externalities, and market participants should be relatively well informed. Adding the dollar values of costs and benefits across diverse individuals is problematic for these reasons.

A different problem arises because cost-benefit analysis has two ways of measuring the benefits of a policy change, and the choice of measure matters. One method is willingness to pay (how much an individual would pay for a change); the other is willingness to be paid (how much an individual would have to be paid to maintain the same level of well-being as that prevailing before the policy change). Unfortunately, there are often wide discrepancies between willingness to pay and willingness to be paid estimates. Individuals appear to attach much greater value to the property they already own than to any potential additions to their endowment.

It is not possible to know which evaluation should be used – even if an impartial observer conducts the analysis. The existence of the discrepancy makes cost-benefit analysis susceptible to manipulation by an agency pushing a particular agenda. Most of the time it is not possible to obtain a pure estimate of the value of a policy change to an individual because the preferences expressed will depend on the context of the choice, the baseline of the choice and various other factors.

When costs and benefits accrue in the future, they are typically discounted for time. The application of discount rates creates further ambiguities for cost-benefit analysis, especially for policies with long-reaching implications such as environmental policy.

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[313] Cathy Buchanan and Peter Hartley discuss the fragile case for assuming that total welfare is increased by redistribution to someone on a lower income in *Equity as a Social Goal*, *op cit*, p 121.

One approach estimates discount rates using the real rate of return on private capital. Another method estimates the social rate of time preference using the real rate of return on the near riskless obligations of the government. The discount rates calculated by this second method are generally lower than the first. A third approach argues that a zero discount rate should be used for inter-generational issues. While this method has a logic, many would find that it is not compelling. Weighting the utility of much more numerous future generations equally with the utility of a current generation could produce the discomfiting result that the present generation should impoverish itself in the interests of making wealthier future generations even more wealthy. A different criterion might suggest that each generation aim to pass on to the next generation an inheritance that was at least as good as the one it inherited itself.

The issue of the appropriate discount rate to use has not been settled in the academic literature.[314] In practice, governments typically apply a variety of discount rates without insisting on consistency. The choice of discount rate has a significant effect on the evaluation of costs and benefits when the time horizon is long.

The valuation of human life provides one of the most difficult issues in cost-benefit theory, or indeed in any public policy assessment. The valuation of life features prominently in cost-benefit studies. Cost-benefit analysis usually obtains values for life through examining what individuals are prepared to pay to lower the risks of death (for example, expenditure on safety equipment). A variety of critics question the appropriateness of this procedure and the accuracy of the data created.

A more fundamental criticism is whether economic analysis can value life at all, even in principle. Cases of certain death pose fundamental difficulties for cost-benefit analysis. One's life has no finite monetary value. Concerns as to the ability of cost-benefit analysis to handle cases of certain death, extend to its ability to handle stochastic cases of death – since one could question why it should matter whether we know the exact identity of the individual who will die. This does not suggest that individual lives have infinite value relative to other social goals but, rather, that cost-benefit analysis, which relies on dollar valuations, cannot limit the value of human life in a meaningful manner.

A further difficulty arises with 'non-use' or existence values. Some individuals may value the existence of the blue whale or an environmental reserve even if they are unlikely to benefit directly from these in any way. Non-use values create practical problems for cost-benefit analysis. In the absence of measured or estimated market demands, there is no easy way of measuring non-use values. In practice, cost-benefit analysis must rely on questionnaire and survey experience. These are unreliable for a number of well-known reasons.

Some of these liabilities on cost-benefit analysis serve to highlight the virtues of voluntary exchange. Such exchanges induce individuals to quantify their preferences. Resources are allocated to their highest value uses, be they preserving or destructive of things that are more precious to some than to others. Voluntary exchange economises on the need to centralise information – the information problems that confound cost-benefit analyses also undermine the basis of confidence in government-imposed outcomes, including central planning. Even an unequivocal positive net benefit from a

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[314] For a recent summary of studies of personal discount rates see Warner JT and Pleeter S, 'The Personal Discount Rate: Evidence from Military Downsizing Programs', *American Economic Review*, Vol 91, No 1, March 2000, p 33–53.

proposed change does not justify the imposition of that rule on non-consenting adults. It is not illegal to spend one's own money unwisely, as judged by some cost-benefit analysis.

Niskanen's view is that the net benefit standard does not provide a sufficient basis for the redistribution of income, the taking of private property for a public benefit, or for restricting the activities of individuals and firms that bear the full cost of their actions.[315] Barnett makes a more general argument that the problems of lack of information and interest group politics that make cost-benefit analyses problematic also affect 'public policy analysis' generally. He concludes that law-making should be informed by considerations of justice rather than solely by public policy analysis.[316]

Niskanen also makes the point that judicial review provides no protection against bad analysis because the courts will not accept the role of evaluating scientific and economic studies. Richard Epstein has independently argued in another context that it is desirable that judges focus on applying the law – determining if an action was legal – rather than allowing their decisions to be affected by explicit references to cost-benefit analysis.[317]

Of course, none of these objections to cost-benefit analysis establish the existence of a superior approach to decision making where government is determined to impose an outcome. The usefulness of cost-benefit analysis depends only on whether superior alternatives are available in practice. Because resource scarcity limits what can be spent in saving human life, all regulatory decisions that relate to resource scarcity effectively put a price on human life. A cost-benefit assessment that demonstrates, for example, that extra resources put into immediate on-site treatment in automobile accidents can save far more lives per dollar than subsequent hospital care can usefully inform public expenditure decisions. Cost-benefit analysis can provide useful information to policy makers. There is a wide class of decisions for which cost-benefit analysis does give the right answer.

Nevertheless, cost-benefit analysis cannot claim a mantle of pure scientific objectivity and efficiency, and its more ambitious interpretations are subject to the limitations discussed above. The practical application of cost-benefit analysis involves significant and controversial value judgments. A stand-alone paper available from the authors of this report contains a fuller discussion.

4.3.5 Parliamentary scrutiny

Currently parliament controls legislative proposals through its standing orders. A Bill cannot proceed on being introduced to the House of Representatives (the House) unless it survives the speaker's scrutiny for its compliance with standing order 256. This scrutiny is essentially perfunctory.

A potentially much more powerful check is applied before a motion is permitted in the House that the Bill be read a first time. Under standing order 260, before such a motion is put, the attorney-general must report to the House on any provisions that appear to

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315 Niskanen, WA, 'Regulatory Reform: No Silver Bullet', *Cato Handbook for Congress*, Cato Institute, 26 February, 1997.

316 Barnett, *op cit*, pp 322–325.

317 Epstein (1995), *Simple Rules for a Complex World*, *op cit*, pp 97 and 103.

be inconsistent with any of the rights and duties contained in the New Zealand Bill of Rights Act 1990.

After being debated for the first time, a Bill can be referred to the select committee preferred by the House for detailed consultation and scrutiny. This process may take six months or more. The powers and processes of select committees are also controlled by standing orders.

In the second reading, the House debates the select committee's report and votes on its recommended amendments. If the amended Bill is to proceed, the House then debates it in committee, clause by clause. After this process the amended Bill may be passed by the full House on its third reading. It may then pass to the governor-general for the Royal Assent.

This process constrains government, members', local, and private Bills alike, although the process governing each type can differ in the details.

The constraints apply to both process and content. Their very provision no doubt influences the drafting of Bills before they reach their first reading.

These standing orders fall short of dictating to the House what decision it will take in respect of any conflicts between the content of a Bill and the New Zealand Bill of Rights Act 1990. Obviously, it would be possible to design supra-majority arrangements that might apply in such instances. However, section 4 of the New Zealand Bill of Rights Act 1990 denies that its provisions override conflicting provisions in any other enactment. Hence, parliament has yet to demonstrate a willingness to accord the content of this Act superior status.

Nevertheless, it should surely be possible, in principle, to strengthen existing constraints in terms of process and content. For example, the New Zealand Bill of Rights Act 1990 could be amended in order to acknowledge the right to private property and freedom of contract. More specific regulatory principles and constraints could be embodied in a Regulatory Responsibility Act that was given special status through a standing order analogous to standing order 260. Provision could also be made in standing orders for Regulatory Impact Statements to be required for bills. Standing orders already give select committees the power to call for reports.

Parliament has a mechanism for scrutinising subordinate legislation. Standing orders 195–197 provide for the House to appoint a Regulations Review Committee that must examine all subordinate legislation for compliance with specified requirements.[318] The committee must receive complaints from the public and must decide whether to draw any departures from the specified requirements to the special attention of the House. Parliamentary committees have powers to send, and call, for persons, papers and records under standing orders 203 and 204.

Further weight is given to the recommendations of the Regulations Review Committee via the Regulations (Disallowance) Act 1989. Under this Act, non-conforming regulations can be struck out. The default option is for any notice of motion to the House for the disallowance of any regulations, or any provisions in any regulations, by any member of parliament who is also a member of this committee to take effect after

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[318] For a useful overview of the Regulations Review Committee's work and responsibilities see Hunt, J, 'The Regulations Review Committee', *New Zealand Law Journal*, November 1999, pp 403–408.

the twenty-first following sitting day. This Act also requires all regulations, as defined by the Act, to be laid before the House not later than the sixteenth sitting day following the day on which they are made.

This provision has been exercised only three times in the 10-year history of the Act. Palmer reported in 1999 that the committee has been much more willing to draw problems to the special attention of the House than it has been to trigger the disciplines made available in this Act. He speculates that this reluctance may reflect the reluctance of a government to receive a setback in the House, even under the Mixed Member Proportional (MMP) electoral system.[319]

Palmer also notes that, while the check of judicial review is available, "the contribution of the courts in New Zealand to checking the use of the regulation-making power in recent years has not been great". Courts have been happy to review regulations to determine if they are *ultra vires* in terms of the primary legislation, but have resisted ruling them out on the grounds that their restrictions are unreasonable.[320] He suggests that it would be desirable on constitutional grounds if the courts were more willing to apply an unreasonableness test to regulations.

Nevertheless, following the passing of these measures, members of the committee, and others, have noted a strong growth in the number of rules made by administrative bodies. Parliament's Regulations Review Committee expressed alarm in early 1999 at the power parliament has delegated to bureaucrats to make subordinate laws in forms such as rules, codes of practice, instructions, standards, notices, orders and regulations.[321] These measures can take effect merely on the approval of the delegated minister. By the end of 1998, 47 laws reportedly authorised departments and agencies to impose rules and regulations without reference to Cabinet or parliament.

Unlike other regulations, such 'deemed regulations' do not need to be approved first by Cabinet and then by the executive and gazetted. Because they are not printed in the Statutory Regulations series, they can proceed unnoticed. Areas in which deemed regulations can be passed include drivers' licenses, civil aviation, drug testing in prisons and legal services.

Palmer posits a cause and effect relationship:

> When Parliamentary checks and other measures have been implemented to discourage Government by regulation the phenomenon simply meta-morphoses into new forms and takes on new characteristics.[322]

The Regulations Review Committee has made a number of recommendations designed to tighten up on this tendency.[323] It remains to be seen what the results will be.

Even so, it is difficult to resist the conclusion that this agency has proven to date to be unable to make a real impact on the steady stream of proliferating regulations in New

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319 Palmer (1999), *Victoria University of Wellington Law Review*, *op cit*, pp 1–47.

320 Palmer (1999), *Victoria University of Wellington Law Review*, *op cit*, p 11. He notes that the courts have felt no constraint in ruling that local authority by-laws are unreasonable and therefore invalid.

321 *Evening Post*, 'Concern at Regulatory Powers', 29 January, 1999.

322 Palmer (1999), *Victoria University of Wellington Law Review*, *op cit*, p 17.

323 New Zealand Government, *Regulations Review Committee Inquiry into Instruments Deemed to be Regulations*, I16R, 1999.

Zealand. Legislators will not enforce the watchdog powers of an agency unless they can reap political capital in doing so. The question is, therefore, how regulatory reform can increase public support for superior regulatory policies.

We return to these ideas in section 8.

4.4 Agency reforms

The initiatives described in section 4.3 relate primarily to new legislation and regulation. This leaves existing regulation outside the review process. One option to rectify this is to establish an independent agency responsible for reviewing existing legislation. The agency could also have a role in examining new regulations when they are introduced.

We consider in more detail the options of a separate agency devoted to monitoring regulators (a 'regulatory watchdog' agency), an independent monitoring institution (an independent watchdog) and monitoring through an ombudsman system in a separate paper.

4.4.1 Regulatory watchdog agency

One proposal calls for parliament to create a separate agency to monitor regulatory behaviour. In a New Zealand context, this agency would be commissioned by parliament and given an explicit charge to study and evaluate new legislation. The Regulations Review Committee is of this genre.

Under some forms of this proposal, the watchdog agency would have no independent powers but would report back to parliament when it found undesirable regulations. Under more powerful forms of the proposal, the agency would have independent powers to strike down undesirable regulations.

The watchdog agency would be commissioned by parliament, and would be accountable to parliament, but would not require parliamentary approval for each individual action. Under some versions of the plan, a senior Cabinet minister would head this agency, with perhaps a new Cabinet post created for that responsibility.

What economists call 'path-dependence' may provide another reason why a monitoring agency may improve outcomes. To some extent, citizens may accept and come to approve of a political development if they perceive it as permanent.[324] The existence of a watchdog agency provides a signal of the government's commitment to regulatory reform and may, over time, make regulatory reform more 'fashionable'. Again, the relevant mechanism is through public opinion and parliamentary rewards, rather than through the operations of the watchdog agency per se. While there is no guarantee that public opinion and parliamentary emphasis will shift in this fashion, it does seem that such shifts are a necessary prerequisite for reform. Strategies of regulatory reform that do not achieve such shifts are likely to fail or backfire.

Watchdog proposals have never been implemented in pure or strong form, but the most serious attempts in this direction are found in the United States. In the United

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[324] Kuran, T, *Private Truths, Public Lies*, Harvard University Press, Cambridge, Massachusetts, 1995.

States, the Office of Information and Regulatory Affairs (OIRA), part of the Office of Management and Budget informs the president on the burdens of regulation. More significantly, OIRA submits major regulations to a cost-benefit test and recommends rejection for those regulations that fail.

The results of the experience in the United States with watchdog agencies and regulatory reform have not been encouraging. The Reagan regulatory reform programme failed to mobilise public opinion in part because the regulatory reforms had no political support base and they were purely procedural in nature.

In the United Kingdom, the Regulatory Impact Unit (formerly the Better Regulation Unit) advises the government on regulatory matters. The unit is inside the Cabinet Office but it contains a task force that is independent of the government. Again procedural attempts at regulatory reform seem to have done little to reduce the costs of regulatory excesses.

As noted in section 4.3.5, the effectiveness of New Zealand's Regulations Review Committee is not encouraging in relation to the scale of the problem. Regulatory reform is most likely to succeed, not through procedural innovations, but rather by raising public awareness about the underlying problem. A watchdog agency can have impact simply by making its goals public and, therefore, more visible. In other words, the watchdog agency may serve as a focal point for regulatory reform sentiment. The new publicity and information may, to some extent, shift the underlying political equilibrium and encourage parliament to support regulatory reform.

In February 1987, the government set up, by the device of a Cabinet Minute, an Economic Development Commission (EDC) as part of Vote: Treasury in order to assist it with regulatory reform issues. It was staffed by experienced professionals from the private and public sectors. The government intended to ask parliament to legislate for its creation as a regulatory watchdog, but this did not eventuate. The EDC had an annual budget of around $1 million and reported directly to three of the most senior members of Cabinet (the deputy prime minister, the minister of finance and the minister of trade and industry). During its brief tenure the EDC worked on generic reforms to regulatory processes, the issue of state-owned enterprise monitoring, and specific regulations – for example, opposing and proposing alternatives to the further regulation of insider trading, company takeovers, the imposition of a novel statutory management regime and material aspects of the RMA, and advocating the deregulation of primary product producer boards.

The EDC was disbanded without notable controversy in 1989. Core government agencies were thought, in many cases, to be working on the same issues, although, with the exception of the Treasury with which the EDC was closely associated, not necessarily with the same expertise and orientation towards liberalisation. The work on more fundamental change may have been too inconclusive or too difficult to progress and the reform momentum was largely lost within the government in 1989. The experience supports the view that it is difficult for a specialist monitoring agency to endure outside the control departments that must continue to advise their minister on the same regulatory issues. It also supports the view that, while significant progress can be made in respect of specific regulatory regimes, generic sustainable reform of fundamental process is a much greater challenge.

Also in the 1980s the government created a Legislation Advisory Committee to assist it to assess the public law impacts of proposed laws and regulations. Currently it is a

ministerial committee that is established by the minister of justice. It draws on senior legal experts from academia and the private sector. It works independently of the government. It produces guidelines on the process and content of legislation and scrutinises particular legislation when asked to do so. Section 5.28 of the *Cabinet Office Manual* requires drafting instructions for Bills to comply with these guidelines. No doubt the committee has assisted the government to avoid some legislative excesses, but it has clearly not made a discernible impact on the climate of public opinion or the onslaught or regulation.

4.4.2 An independent watchdog agency

A different approach to regulatory reform would create an *independent* watchdog agency that is not directly accountable to parliament. An independent agency, with the ability to strike down regulations of other agencies, would change the balance of regulatory influence. Individual regulatory agencies would lose power at the expense of this super-agency.

Regulatory power would become more centralised and more subject to external non-agency manipulation; such manipulation, of course, could produce either desirable or undesirable results.

The Reagan administration tried to set up its own independent study agency when it commissioned the Grace Commission in the early 1980s. Although appointed by Reagan, the Grace Commission was fully independent and was funded by the private sector.

The commission produced 47 different reports and issued 2,478 concrete recommendations. It concluded that over US$400 billion could be saved without raising taxes or cutting any substantive services. Since that report was issued, however, there has been virtually no implementation of the recommendations. The central problem was simply that the commission had no base of political support and no means to pursue reform by working within the government.[325]

4.4.3 A regulatory ombudsman

Numerous countries have successfully used independent monitors of government power. Often these monitors are called ombudsmen. A look at the ombudsman system illustrates when independent monitors are likely to succeed and what limitations they face.

Most ombudsman systems are characterised by the following four properties. The Ombudsman:

- is an independent and non-partisan officer of the legislature;
- supervises the administration of the law;
- deals with specific complaints from the public about bad or unjust administration; and

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[325] On the Grace Commission, see Savoie, Donald J, *Thatcher Reagan Mulroney: In Search of a New Bureaucracy*, University of Pittsburgh, Pittsburgh, 1994, ch 5.

- has the power to investigate and publicise, but not overturn decisions or exercise independent legal force.[326]

Ombudsman systems vary in their details. The original and strongest system is found in Sweden, where the ombudsman dates from 1809. The Swedish ombudsman is non-partisan (typically all parties agree on the appointment) and has considerable independence from the legislature. The ombudsman's office responds to external complaints or initiates investigations of its own. The Swedish ombudsman relies heavily on publicity, personal credibility, and use of the press, rather than direct force of law.[327]

Most observers agree that the ombudsman has had a strong influence on the operation of the Swedish government. The cases handled by ombudsmen include citizens who cannot receive appropriate information from the government, citizens who face delayed decisions, violations of civil liberties, problems in tracking down lost cheques, and so on.[328] The ombudsman system started to spread beyond Scandinavia in the early 1960s and by 1983 was used in almost every country in Western Europe.[329]

The New Zealand ombudsman system started in 1962, under the title of Parliamentary Commissioner. The New Zealand system is like the Scandinavian systems in that it is not completely subordinate to parliament. Nonetheless, the New Zealand ombudsman is less active than the Swedish counterpart. In New Zealand the Parliamentary Commissioner has been more likely to investigate issues raised by others rather than initiate an investigation itself.

Unlike the case in many countries, investigations by the New Zealand ombudsman can go beyond the question of the illegality of an administrative action, to consider whether it is unjust, oppressive, or just 'plain wrong'. The New Zealand ombudsman also has greater powers to examine and retrieve evidence than do the courts or other sources of administrative review. The ombudsman, however, cannot investigate matters that could be reviewed 'on their own merits' by a court or administrative tribunal, nor can the ombudsman bring a matter before a court.[330]

The New Zealand ombudsman has handled a variety of issues and complaints, including questions about benefit eligibility, lost benefit cheques, rights of legal appeal, poor bureaucratic service, and immigration queries.[331] The scope of the ombudsman's remit was extended to include hospital boards in 1968 and local authorities in 1975. In 1982, the ombudsman's role was extended to cover functions under the 1982 Official Information Act. This role was extended to local government in 1987 and to school

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326 Rowat, DC, *The Ombudsman Plan: Essays on the Worldwide Spread of an Idea*, revised 2nd edition, University Press of America, Lanham, Maryland, 1985, p 147.

327 The most comprehensive survey of ombudsman systems is Weeks, KM, *Ombudsmen Around the World: A Comparative Chart*, Institute of Governmental Studies, University of California, Berkeley, California, 1973. See Rowat, *op cit*, for a more recent treatment.

328 Rowat, *op cit*.

329 Seneviratne, M, *Ombudsmen in the Public Sector*, Open Court Press, Buckingham, United Kingdom, 1994.

330 Gellhorn, W, *Ombudsmen and Others: Citizens' Protectors in Nine Countries*, Harvard University Press, Cambridge, Massachusetts, 1966, pp 110, 125, 433–434; Sawer, G, 'The Ombudsman and Related Institutions in Australia and New Zealand', *The Annals of the American Academy of Political and Social Science*, 377, May 1968, pp 62–72; and Hill, LB, *The Model Ombudsman: Institutionalizing New Zealand's Democratic Experiment*, Princeton University Press, Princeton, New Jersey, 1976.

331 Hill, *op cit*, pp 94–95.

boards of trustees in 1994.[332] Other commissioners also have responsibility in various areas.[333]

A regulatory ombudsman would involve the creation of an independent office to monitor the quality of regulation and receive complaints. In the United States there has recently been created an ombudsman for helping small businesses deal with regulators.

In addition to the small business ombudsman, the United States has used an institution called the inspector general. The inspector general is an officer who works in a government agency, often, but not exclusively, in a regulatory agency. The inspectors general are appointed by the president but they are accountable to Congress as well. Most importantly, they are independent of the agency they work for. Typically their charge is to investigate fraud, waste and corruption. Unlike most ombudsmen, they do not usually receive direct complaints or appeals from the public.[334]

Unfortunately, such an ombudsman system is unlikely to decrease significantly the net regulatory burden. It would probably be politically unacceptable to allow businesses to complain about excess regulation without allowing citizens, consumers, and pro-regulation businesses to complain about a paucity of regulation. An ombudsman's office would be likely to serve both constituencies to a greater or lesser degree. So while the ombudsman's office would combat regulation in some areas it would promote more regulation in others.

If the public demands high (and excess) levels of regulation, the ombudsman system could serve this tendency. Assume, for instance, that the ombudsman fights for less regulation and the bureaucracy favours more regulation. The bureaucracy will make it more difficult for the ombudsman to investigate bad regulations. The bureaucracy may also behave strategically – issuing new and unneeded regulations, and then agreeing with the ombudsman to strike them down if the ombudsman will leave other regulations alone.

New Zealand does offer precedents for ombudsmen intervention into the regulatory process. However, the precedents do not support the proposition that the overall effects are likely to be significant. Prior to privatisation and deregulation, a number of Telecom subscribers complained about Telecom's standard terms of contract. These complaints were investigated.[335] In another example, the ombudsman investigated the regulations for walking the Milford Track and undertook action that eventually led to

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[332] McGee, D, *Parliamentary Procedure in New Zealand*, 2nd edition, Office of the House of Representatives, GP Publications, Wellington, 1994.

[333] The Health and Disability Commissioner Act 1994 established a commissioner with powers to investigate complaints against health care providers. The Privacy Act 1993 provides for the appointment of a privacy commissioner with the power to investigate privacy issues. The parliamentary commissioner for the environment has a wide-ranging role investigating the actions of public authorities to the extent they have an environmental impact. The police complaints authority was created by statute to investigate complaints alleging misconduct, neglect of duty or other practices of the police.

[334] The best and most comprehensive work on the inspector general institution is Light, Paul C, *Monitoring Government: Inspectors General and the Search for Accountability*, The Brookings Institution, Washington DC, 1993. There have, however, been recent proposals for the creation of an ombudsman to help small business deal with regulators.

[335] Seneviratne, *op cit*, p 49.

their reform and liberalisation.[336] The ombudsman has played a role in other regulatory areas as well, including the Accident Compensation Commission, hospital and education boards, the National Roads Board, the Soil Conservation and Rivers Control Council, the Water Allocation Council, and other agencies of a similar nature.[337]

One example of a New Zealand ombudsman intervention into the regulatory process ran as follows. A regulation had previously recognised foreign secondary schooling (for the purpose of awarding university scholarships) only if the student's parent had been transferred to New Zealand in the course of employment. An ombudsman investigated this regulation and found it unreasonable. The ombudsman recommended, successfully, that recognition instead be based on the quality of the education that had been received. In another case, the ombudsman recommended that individuals who give up their business during the course of a year be allowed to receive a refund for the remaining part of their yearly liquor licence fee.[338]

These experiences illustrate the flexibility of the ombudsman system at a relatively minor level. The essence of the ombudsman system is to bring publicity to bear on government. This tends to bring policy closer into line with public opinion. In the case of regulatory excesses this may be a mixed blessing.

4.4.4 Assessment

The primary problem with excess regulation is that parliament lacks the political will to combat excessive regulation – unless this is changed then procedural changes are likely to have limited impact.

The existence of a watchdog agency under the control of parliament provides a signal of the government's commitment to regulatory reform and may, over time, make regulatory reform more 'fashionable'. New Zealand's experience to date with parliament's Regulations Review Committee indicates that this innovation cannot be expected to stem the regulatory tide as things stand.

Nor does it obviously help to make the watchdog agency independent. The ombudsman system was motivated by the desire for an autonomous watchdog. But such autonomy can serve populist ends. If regulation is excessive because of public demand, a regulatory ombudsman could exacerbate these pressures. A regulatory ombudsman is unlikely to have the authority or the incentive to solve the problem of over-regulation.

In 1997, 14 out of the 29 OECD member countries had established management units with the express task of regulatory reform.[339] A few countries have established independent high-level commissions to identify and promote regulatory reform. The OECD draws the following conclusion:

> Considerable experience across the OECD has shown reform units are most effective if they are independent from regulators (not closely tied to specific regulatory missions), work under a clear regulatory policy endorsed at the

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336 Sawer, *op cit*, pp 70–71.

337 Hill, *op cit*, pp 92–94 and pp 218–231.

338 On these episodes, see Hill, *op cit*, pp 218, 223.

339 OECD (1997b), *op cit*, p 210.

> political level, horizontal (cut across government), expert (have information and capacity for independent judgment), and linked to existing centres of regulatory oversight authority (centres of government, finance ministries).[340]

An alternative approach to reform is to place less emphasis on achieving a steady reduction in excess regulation. It may be the case that meaningful regulatory reform comes only in 'big bangs' (see the next section on *ad hoc* reviews).

Experience suggests that regulatory reform is most likely to succeed, not through procedural innovations but rather by raising public awareness about the underlying problems. Regulatory oversight bodies can hope to reduce regulation by raising public awareness of the problem of regulatory burdens. Additional publicity and information may, to some extent, shift the underlying political equilibrium and encourage parliament to support regulatory reform.

When designing a regulatory reform proposal, we should consider its ability to support such 'big bang' deregulations at specific moments in time, even if it does not produce daily or immediate improvements. This point favours proposals that give the legislature added control over regulators, even if those controls do not produce any immediate benefits.

Having made that case, oversight bodies are not independent of politics and could incorporate biases that make them part of the problem rather than part of the solution. Much depends on how they are picked and their detailed incentives (for example, the political support they would enjoy if they did an excellent job). At worst, they may exacerbate the problem by giving an unsatisfactory regulatory environment the appearance of having withstood watchdog scrutiny.

These concerns might favour, instead, special purpose task forces with mechanisms likely to result in them self-destructing when the political impetus for meaningful reform is lost.

4.5 Sunset provisions and *ad hoc* reviews

4.5.1 Sunset provisions

Statues may become obsolescent for a number of reasons. Sometimes the problem or crisis that led to regulation is short term in nature, or ceases to be a problem – as was the case with the energy crisis in the 1970s. The statute might prove ineffective at achieving desired objectives or might create more problems than it solves. Regulation can also become obsolete in a rapidly changing world.

A sunset law is a statute or provision in a law that requires periodic review of the rationale for the continued existence of that particular law, administrative agency or other government function.[341] The sunset law could either provide that the statute lapses unless it is reviewed, or require that a review must be undertaken at a particular

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[340] OECD (1997b), *op cit*, p 212.

[341] McKinley, V, 'Sunrises without Sunsets: Can Sunset Laws Reduce Regulation?', *Regulation*, Vol 18, No 4, 1995, p 1.

time. It could specify the time to review, matters that should be considered and the agent responsible for conducting the review.

A select committee, department or an independent body could be responsible for reviewing statutes that reach their sunset period. Parliament would then repeal an Act found to be obsolete (unless it automatically lapsed).

Sunset options were extensively reviewed in the United States in the 1970s but a sunset review Act was never passed. Some administrative agencies have utilised sunsetting.[342]

In practice sunset clauses have proven to be of limited effectiveness, and only a weak tool for slowing down the growth in regulation. The Commodity Futures Trading Commission that was established in 1974 in the United States was subject to a four-yearly review. Despite serious criticisms of its functions and performance it has survived a number of sunset reviews, doubling its size since its creation.

A sunset arrangement may prevent review of an inadequate or inappropriate statute prior to its review date. The review date may signal to interest groups that it is time to marshal support for an Act. Substantial costs may be associated with the process of reporting and review.

4.5.2 *Ad hoc* reviews and staged repeal

Ad hoc reviews are limited in time and scope. They may be targeted at particular sectors (for example, building codes) or a range of rules with certain effects (for example, compliance costs).

Australia has actively pursued this approach in the 1990s. Its reviews are backed up by public consultation, regulatory impact statements and scrutiny by independent expert reform units.[343]

Staged repeal or 'automatic revocation' processes are systematic and comprehensive reviews of existing regulations. Regulations are grouped by age. The regulations in each age group are reviewed, starting with the oldest group. Meritorious regulations may be remade to make them up-to-date with current quality standards, others are repealed. Again, Australia has led the way in the OECD region.[344]

According to the president of Australia's National Competition Council, the South Korea government reacted to the recent Asian crises in part by requiring all national legislation to be reviewed over a one-year period with a goal of halving the raw number of regulations – and achieved that goal. The president states that many commentators attribute the return of South Korea's economy to strong growth during 1999 to the scope, content and credibility of the government's reform programme.[345]

Ad hoc approaches can be useful to exploit a political window of opportunity to upgrade or eliminate large numbers of regulation in a short period of time. *Ad hoc* reviews may be weakened by exemptions, lack of priority setting, fragmentation and

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342 McKinley, *op cit*, p 4.

343 See, for example, OECD (1997b), *op cit*, box 6 on p 40.

344 OECD (1997b), *op cit*, p 226.

345 Samuel, Graeme, 'We can't afford reform retreat,' *Australian Financial Review*, 21 June, 2000.

lack of depth of review. Results from many reviews have been disappointing, illustrating the need for good design, implementation, leadership and political will.[346]

4.6 Opt out and self-regulation

One regulatory reform option allows firms and customers to 'opt out' of a regulatory regime. This may or may not be subject to conditions. For example, those opting out may have to adopt another option, or clearly signal their lack of conformance with the regulatory regime.[347]

A related option would be simply to limit the scope of existing regulation. For example, a government could simply amend it to specify that it did not apply to private land, private individuals or private businesses.

Many options exist for private warranties or certification of product safety and credit risk or financial strength. Permitting firms and individuals to opt out of a regulatory regime permits consumers to indicate the value they put on products that comply with that regime as distinct from private alternatives. The information provided by consumer preferences revealed in this way can inform regulators, policy advisers and potential suppliers alike.

The New Zealand Stock Exchange successfully implemented a takeover code that permitted shareholders to vote to choose, company by company, which of three alternative sets of takeover rules will apply to their company. This delayed the adoption of the 'one-size-fits-all' regulation that is the norm in major sharemarkets. There was remarkably little dissension amongst shareholders; overwhelmingly they voted for the option recommended by each company's board. This did not prevent the media from giving great publicity to complaints from small and large shareholders who 'missed out' when control changed without all shareholders having an opportunity to sell at the same price.

Following a change of government in 1999, the populist pressures for one-size-fits-all regulation proved to be too strong. By early 2001, the prime minister, minister of finance and minister of economic development publicly justified regulation based on a mandatory bid and an equal price rule on the basis that without it New Zealand's equity market would be as lawless as the last frontier of the Wild West. This was the same justification that was used politically to justify the Securities Amendment Act 1988.

In New Zealand, it was drawn to the attention of politicians that the Swiss takeover code did permit shareholders to vote to opt out, but there was no evidence that this option was considered seriously. There was some evidence in shareholder voting on the options of the Stock Exchange that shareholders with small holdings were relaxed about voting for the option their boards recommended, with the few who did feel strongly retaining the ability to complain to the media afterwards. Perhaps the politicians decided that, in this situation, there were more votes in being seen to be responding to media pressure.

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346 OECD (1997b), *op cit*, p 226.

347 See for example, Yilmaz, *Policy Analysis*, *op cit*; Pasour, Jr, EC 'We Can Do Better than Government Inspection of Meat', *The Freeman*, May 1998, pp 290–295; and Charles Murray, *What it Means to be a Libertarian*, Broadway Books, New York, 1997.

The case for permitting firms and individuals to opt out of a regulatory regime should be explicitly considered as a matter of good regulatory practice when any regulations are being proposed. Otherwise, those proposing the regulation have failed to demonstrate that it is superior to alternatives that permit opting out.

The common failure of legislation to permit mature adults to agree to opt out suggests that its fundamental intention is to override individual choice rather than to allow individuals to pursue goals of their own choosing.

4.7 Regulatory budget

Regulation is often attractive to politicians as an alternative to direct spending. The costs are hidden and unaffected by spending constraints.

One option for improving transparency and allowing an assessment of the total costs of government intervention is to create a regulatory budget, parallel to the traditional spending budget.[348] The government could impose limits on the regulatory budget in the way that applies to government expenditure. Departments could be required to seek authority to 'spend' money through regulation. This could help force agencies to trade off different regulatory objectives and options. For example, an agency facing 'spending' limits could only propose a new regulation if it was prepared to repeal an existing one. An agency wanting to exceed its budget would have to obtain government approval. Each year the government could be required to publish its regulatory budget.

This might increase the transparency of the cost of government regulation and encourage questioning of the government's priorities. It may make it harder for governments to pass 'feel good' regulations without clearly signalling their costs. It is possible that such a process could, at least, spark a debate and better understanding of the cost of regulation. It could also facilitate a comparison between indirect spending via regulation with direct spending by government.

A regulatory budget might change the incentives of regulators. Regulations proposed by one agency, say to save lives, could be compared with life-saving regulations proposed by other agencies through the regulatory budgeting process. Each agency would have incentives to monitor other agencies and to expose weaknesses in their assessments of costs and benefits. A regulatory budget may discourage the substitution of regulation for direct spending and could create pressures to eliminate the least effective regulation.

There are a number of problems with the regulatory budget approach. The costs and benefits of regulations are difficult to measure – and agencies will have incentives to underestimate costs and overestimate benefits. An assessment of net benefits requires defining the benchmark costs and benefits in a no-regulation situation – obviously such a calculation will be difficult to make.

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[348] See, for example: Shanahan, John, 'Regulating the Regulators: Regulatory Process Reform in the 104th Congress', *Regulation*, Winter 1997, pp 27–32; Hughes, Samuel, 'Regulatory Budgeting', *Center for the Study of American Business*, Working Paper 160, June 1996; and Crews Jr, Clyde W, *Promise and Peril: Implementing a Regulatory Budget,* Competitive Enterprise Institute, Regulatory Reform Project, April 1996.

A regulatory budget would not solve the problem of poor-quality regulation. Just as there is poor-quality expenditure, government agencies could continue to promulgate poor-quality regulation to meet interest group pressures. The process would also involve substantial administrative costs.

Currently, we are unaware of any country that has successively implemented this approach. The practical difficulties look formidable. There appears to be a risk that implementation difficulties would absorb too much time and goodwill that could be put to better use in making an assault on regulations that are obviously causing disturbing outcomes and whose rationale is unclear if not decidedly dubious.

4.8 Concluding observations

The OECD has observed that:

> … the history of regulatory reform is not one of coherent government strategy, but rather of reactions to changing crises and opportunities across countries, industries and policies. Oil shocks in the 1970s, currency volatility and declining tariffs, growing awareness of environmental degradation, rapid regulatory inflation – these revealed the previously hidden costs of out-dated, rigid and expanding regulation.[349]

On the positive side, section 4.2 demonstrated that impressive gains are achievable from privatisation and deregulation. There is also no shortage of ideas for achieving regulatory reform should sufficient political will exist.

On the negative side, the material in subsequent sections demonstrated that achieving reform was a serious challenge. Governments often fail to adopt a coherent reform strategy even when the need is apparent. The OECD observed that:

> … in all these cases reform was delayed or blocked. Future use of regulation must be based on an understanding of why OECD countries have found themselves in need of reform, that is why governments have found it difficult to control the quality and quantity of regulation and to take corrective action.[350]

The OECD's explanation for regulatory excesses includes voter failure, partisan interest group behaviour, political decision making under majority rule and bureaucratic behaviour.

The OECD identified the following impediments to reform:

- the complexities and uncertainties surrounding reform proposals, policy fragmentation in government and inadequate policy and administrative resources in government;
- vested interests and a 'regulatory culture', with a lack of transparency being the key problem, aided by opaque processes and inadequate accountability;
- incentive problems within regulatory bureaucracies;

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[349] OECD (1997a), *op cit*, p14.

[350] OECD (1997a), *op cit*, p 14.

- inadequate government attention to reviewing past regulation as circumstances change; and
- the tendency of legislators to issue laws as 'symbolic public action', thereby contributing to paralysis as officials, regulators and the private sector get overwhelmed by the complexities.

The above problems are compounded if different layers of government also impose duplicative, conflicting or excessive regulations.

This list motivates the discussion of economic theories of regulation in section 5.

The OECD proposes the following seven rules for regulatory reform as a result of its review of cross-country experiences:[351]

1) adopt at the political level broad programmes of regulatory reform that establish clear objectives and frameworks for implementation. They need to create credible and effective mechanisms inside the government for managing the reform process;

2) review regulations systematically against sound principles to ensure that they meet their intended objectives efficiently. Regulatory impact statements are essential and sunset clauses should be used where appropriate;

3) ensure that regulations and regulatory processes are transparent, non-discriminatory and efficiently applied;

4) review and strengthen where necessary the scope, effectiveness and enforcement of competition policy;

5) reform economic regulations to stimulate competition;

6) eliminate unnecessary regulatory barriers to trade and investment; and

7) develop policies to achieve other objectives in ways that support reform.

However, it is difficult to believe that governments that have attempted to reform have failed because they and their advisers failed to consider the wisdom of such suggestions. What is surely required is a deeper analysis of why reform attempts have been so successfully blocked.

The next two sections explore the fundamental forces that could be creating regulatory excesses and frustrating attempts to reduce them.

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[351] OECD (1998), *op cit*, p 3. See OECD (1997a), *op cit*, pp 37–47.

5 Why Reform is so Difficult – Public Choice Theory

5.1 Introduction

This section uses the economic theory of regulation to analyse the fundamental problem of why regulatory reform is so difficult.

Section 5.2 provides an overview of the economic theory of regulation. Regulatory problems can arise because of voter failure, political failure, bureaucratic failure, or judicial activism, or any combination thereof.

Section 5.3 highlights the importance of ideas in driving voter behaviour.

Section 5.4 reviews solutions to regulatory excesses that are posited by public choice theories.

5.2 Economic theories of regulation

5.2.1 Introduction to theories of regulation

Theories of regulation attempt to explain the observed pattern of regulation. If all regulations promoted the welfare of the representative citizen, there would be no need for such a theory. Observed regulations would reflect a sound response to the gaps in the common law that we discussed in section 3.

The observed pattern of regulation does not accord with the pattern economists would expect to occur if governments passed regulations in order to fill gaps in the common law (that is, the pattern of regulation cannot be explained by 'market failure' arguments).[352] Nor can the incidence be credibly explained by a general desire to protect the public from the abuse of monopoly power, alleviate poverty or provide a safety net.

Governments have shown longstanding determination to maintain statutory privileges that put the public interest at risk. Examples include the statutory privileges enjoyed by trade unions, professional organisations, producer boards and government agencies. The fact that firms and industries commonly support more regulation and resist deregulation cannot be readily explained by a 'market failure' theory of regulation.

In addition, government user-pays policies frequently allow a statutory monopoly supplier to force payments from those who would never purchase those services under common law assignments of property rights were it not mandatory to do so. Mandatory ACC levies and border clearance charges are possible examples.

[352] See Viscusi *et al*, *op cit*, p 326.

Economists have had to develop a more complex theory of regulation to explain why industries often support regulation and why so many activities not subject to market failure are regulated.[353]

In 1971, George Stigler made the major breakthrough in the theory of regulation by providing a set of assumptions that generated predictions about which industries would be regulated and what form those regulations would take.[354] This theory built on the work of Mancur Olson on interest group behaviour.[355] Sam Peltzman made an early important contribution to the development of Stigler's ideas.[356]

The theory of *interest group behaviour* also illustrates the public choice approach. It proposes that regulation is supplied in response to the demands of interest groups that wish to maximise their own income, rather than national income. It postulates that a legislator or regulator seeking to maximise political support will provide benefits to interest groups in exchange for votes.

One idea here is that groups that can readily organise themselves (that is, incur low transaction costs in coordinating their efforts) may be able to obtain undue influence at the expense of a more distracted majority. If so, narrow concentrated interests may obtain privileges that benefit them at a greater overall cost spread over a much larger populace.

Capture theory suggests that *industries* support regulation that restricts market entry and raises prices and profits. Producer support for a monopoly over exports amply illustrates industry support for regulation.

The theory has significant explanatory power, but it is inconsistent with the observed cross-subsidies in many regulated industries (often favouring household customers or rural users rather than business customers) and with much anti-business regulation. The theory of capture by industry clearly provides an incomplete explanation of observed behaviour.

'Milker' theory offers a different explanation of regulation. Under this theory, as developed by Cornell University law professor Fred McChesney, political blackmail and extortion are inherent features of the modern regulatory process.[357] Political entrepreneurs use the threat of legislation and regulation to extract various forms of largesse from the targeted firms or industries in order to defeat the threat. American politicians are said to call such Bills variously 'milker' Bills 'cash cows' and 'juicer' Bills. Examples postulated by Thomas DiLorenzo include regulatory threats on the alcohol, tobacco, cable television, pharmaceutical and banking industries, and the current regulatory attack on Microsoft.

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353 For a useful overview of public choice theory see Tullock, Gordon, Seldon, Arthur and Brady, Gordon, *Government: Whose Obedient Servant? A Primer in Public Choice*, Institute of Economic Affairs, Readings 51, London, 2000.

354 Stigler, G, 'The Theory of Economic Regulation', *Bell Journal of Economics*, 2, 1971, pp 3–21.

355 Olson, M, *The Logic of Collective Action*, Harvard University Press, Cambridge, Massachusetts, 1965.

356 Peltzman, S, 'Towards a More General Theory of Regulation', *Journal of Law and Economics*, 1976, pp 211–240.

357 McChesney, F, *Money for Nothing: Politicians, Rent Extraction, and Political Extortion*, Harvard University Press, Cambridge, Massachusetts, 1997, pp 29–30, as cited by Thomas DiLorenzo, 'Regulatory Extortion', *Ideas on Liberty*, March 2000, pp 37–42.

Milking theory may combine with the natural incentive of a regulatory agency to expand its budget, clout and influence by taking on large firms. It provides an opposing explanation to capture theory for the regulation of industry. Both tendencies are pernicious.

A large literature explores and tests these theories. Public choice theories can be used to explain detailed regulatory decisions. The approach has been used to develop a detailed transaction cost, public choice theoretic explanation of the institutions that politicians choose to administer and control a policy being put in place. The credibility of political commitments, the ongoing level of political involvement and accountability, transparency, and vulnerability to interest group capture may vary systematically according to the choice of detailed institutional arrangements. The theory posits that politicians choose the arrangements that will maximise political support.[358]

Public choice theories of regulation provide several possible reasons for chronically unsatisfactory regulations. First, voters might fail to provide politicians with the incentives to adopt policies that would most increase the welfare of the population at large. These failures might reflect 'voter failure' or 'voting mechanism failure'. Issues of the quality of constitutional protection for minorities and constraints on the power to tax and redistribute wealth opportunistically arise here. Section 5.2.2 discusses these issues.

Second, politicians may fail to deliver the policies voters desire because political interests do not necessarily coincide with those of voters. 'Political failure' may arise if politicians can exploit voter ignorance and imperfect information to pursue policies that benefit themselves or favoured constituencies because the community at large is insufficiently aware of what is happening (see section 5.2.3). Greater policy transparency may help here.

Third, politicians may not be fully able to pursue welfare-enhancing policies because the public service may successfully impede the implementation of desired policies for self-serving reasons (see section 5.2.4).

For the avoidance of misunderstanding, public choice theory need not be interpreted as implying that voters, politicians and civil servants act ignorantly or ignobly all of the time. To the contrary, human history abounds with uplifting stories of public-spirited actions. But inspiring cases do not establish the general tendency.[359] Public choice theory reminds us that the public welfare is at risk when those who control the use of the full power of the state face a conflict between their personal interests and those of the community at large.

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[358] Horn, M, *The Political Economy of Public Administration: Institutional Choice in the Public Sector*, Cambridge University Press, New York, 1995.

[359] "History … is indeed little more that the register of the crimes, follies and misfortunes of mankind", according to historian Edward Gibbon in *The Decline and Fall of the Roman Empire* (1776), Penguin Classics, United States of America, 1985, ch 3, p 106. *The Oxford Dictionary of Quotations*, *op cit*, cites Voltaire expressing a similar view, p 716. Adam Smith (also in 1776) famously declared that we address ourselves not to the humanity of the butcher, the brewer or the baker for our evening meal, but to their self-love and we talk not of our necessities but of their advantages.

5.2.2 Voter opportunism and majority decision dilemmas

This section discusses the possibility that poor-quality regulations arise from a failure in our democratic arrangements rather than from a failure of politicians or bureaucrats. First, consider the (unrealistic) case in which all voters vote disinterestedly for policies that are likely to produce the greatest possible benefits for the public at large, regardless of their own personal interest. Even here, diverse voter preferences can create difficulties for democratic decision making under majority rule, as Arrow's well-known impossibility theorem demonstrates. Such problems are as intractable as the name of the theorem suggests. They provide one reason among many for limiting the size of government. This is because, in contrast, a system of private exchange allows diverse preferences to be met (for private, club and many, but not all, public goods) without the need for 'one-size-fits-all' majority decision making.

However, this problem is primarily only of academic interest for our purposes.[360] The very real regulatory excesses that are the concern of this report cannot be plausibly argued to result from voting problems of this type.

Next, consider the more realistic situation in which individuals will vote for policies that benefit themselves or a group or faction to which they belong, even at the expense of the overall public interest. Self-interested voting by individuals obviously increases the risks of policies that reduce national welfare. A majority of voters can impose their will on a minority by voting to expropriate their wealth or otherwise to impose constraints on them.

Even if most voters would oppose it in principle, governments may be driven to pursue welfare-reducing policies as long as: (1) parliament is constitutionally able to create privileges for favoured groups at the expense of the wider good; and (2) most groups want privileges for themselves but not for others. Majority opinion may represent the result of bargaining, as distinct from a genuine agreement on principles. Friedrich Hayek notes:

> What we call the will of the majority is thus really an artifact of the existing institutions, and particularly of the omnipotence of the sovereign legislature, which by the mechanics of the political process will be driven to do things that most of its members do not really want, simply because there are no formal limits to its powers.[361]

A different sort of voter failure can arise if concentrated interests lobby hard for benefits at the expense of a more disinterested, but much larger, majority. This is essentially a free-rider problem. Any subset of the majority could lobby to prevent the transfer, but the costs of doing so might exceed the private benefits. It is rational for most voters to remain ignorant about most public issues including the implications of any votes they are asked to cast, except where their self-interest is most affected. This is because it is costly to obtain detailed, accurate information and most voters will feel that any investment in that information will not affect the outcome.

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[360] Gordon Tullock holds a self-described minority view that these problems are not material in reality. See Tullock, G, *The New Palgrave: A Dictionary of Economics*, Eatwell, J, Milgate, M and Newman, P, (eds), Volume III, Macmillan Press, London, Stockton Press, New York, 1998, pp 1041–1042.

[361] Hayek, FA, 'Economic Freedom and Representative Government' in *Economic Freedom*, Masters in Modern Economics series, Institute of Economic Affairs, Basil Blackwell, Oxford, United Kingdom, 1991, pp 385–386.

Noting the interest group pressure for legislation that creates special privileges, such as the pressure for occupational licensing, Palmer and Palmer comment in a New Zealand context that:

> There are a good many things about which it is better not to legislate. Legislation gives the state its legitimate authority to exercise its coercive powers over citizens and should not be entered into lightly. The wholesale creation of new criminal offences in an effort to regulate behaviour often creates great problems in law enforcement and leads to community disrespect for the law. New Zealanders have failed to appreciate the limits on legal sanctions as a means of ordering society; moral purity cannot be brought about by legislation. Not only should we pass fewer laws, we should go through the statute book and see what can be cut out.[362]

Excessive criminalisation diverts law enforcement officers from the most needed areas – cases such as murder, theft and rape. It also risks reducing the moral and legal sanctions that apply to criminals.[363]

Groups of voters who hope to benefit disproportionately put politicians under incessant pressure to increase government spending or regulation, as any daily newspaper attests. Those who want dissenting or apathetic groups to be forced to conform to particular moral, religious, ethnic, cultural or environmental values or codes of behaviour also commonly pressure politicians to regulate accordingly.

On the other hand, politicians are also subject to pressure to reduce regulations and lower taxes in order to allow greater scope for individual freedom, self-reliance, human creativity and entrepreneurship and to allow the community to respond flexibly to changing circumstances. Often politicians can be pressured to spend and regulate more in one area by the same groups that are pressuring them to reduce taxes and regulations in total.

Politicians are obliged to respond to pressures from voters. How they respond depends on why they are in politics. It will also depend on what view they take about the role of government in relation to wealth creation and redistribution. But, most of all, it will depend on what they need to do to encourage votes, since they must first be elected as politicians.

Reflecting such pressures, legislation all too often serves in some degree two purposes – a professed non-partisan, national interest purpose and the real, partisan purpose. Regulatory reform should seek in the first instance to detect the most egregious cases where a national interest pretext is used to cover significant redistribution that offends conventional equity principles.

Commonly governments proclaim laudable aggregate objectives – such as the achievement of a high rate of growth in gross domestic product, reducing the rate of unemployment to 3 percent, 'building strong communities', 'closing the gaps', or reducing business compliance costs – yet fail to put in place any credible, consistent strategy for achieving these goals. Moreover, at the same time they may pursue a wide range of policies that are inconsistent with any given goal. For example, the same governments could well simultaneously raise taxes, increase state dependency through

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362 Palmer and Palmer, *op cit*, p 151.

363 We are grateful to Richard Epstein for these two points.

an expansion in the welfare system and corporate welfare, raise minimum wages, subsidise the legal costs of environmental groups that harass developers, and increase the power of union officials over workers and businesses. Such incoherence reflects the absence of any unifying strategy.

The marked balkanisation of the bureaucracy in New Zealand no doubt also reflects interest group pressures. Government agencies are typically structured so as to lend themselves to capture by special interest groups. Capture theory would predict that organised labour in nationalised industries should be able to dominate consumer interests. Public hospital services and education are two examples. Whereas the New Zealand Bill of Rights Act 1990 purports in its major clauses to provide for the self-contradictory freedoms of association and non-discrimination, in fact the public service is organised in a highly discriminatory manner. Agencies are organised on an advocacy basis in respect of age (youth and the aged), gender (women) and race (most notably Maori). Labour has its own agency. The environmentalists have many, the three main ones being the Ministry for the Environment, the Department of Conservation, and the Parliamentary Commissioner for the Environment. On an industry basis, there are agencies specific to agriculture, forestry, fishing, transport, commerce and many others.

5.2.3 Political failure

Politicians also face, as individuals, the problem that it is costly to understand detailed policies. Most of them are not sufficiently senior or well-placed to be able to affect a proposed policy in a major way. Politicians are aware that their constituents are ill-informed and that there may be a large gap between what their constituents *should* support (in their own best interests) and what they *will* support. These factors affect any politician's incentive to seek policies that would best promote the national interest.

Where politicians enjoy a secure majority, along with a degree of discretion, they may be able to implement policies primarily because they satisfy their own ideologies or other preferences. In 2000 in New Zealand, a senior member of the opposition suggested that a large increase in government spending on the arts would not have occurred but for the personal intervention of the prime minister.

Section 7.3 identifies a number of situations in which the interests of politicians may diverge from those of voters. It is costly for voters to monitor government actions and to evaluate the quality of those actions. Expert opinions can be obtained about the quality of any particular policy but they may be costly and be readily countered by other expert opinion. A potential free-rider problem arises in relation to monitoring costs because it is the public at large that benefits from better quality government, yet the costs of private monitoring could be much more concentrated.

In similar vein, it is costly for the legislature to monitor the executive fully. Where the legislature is not completely separated from the executive (as in New Zealand) it may be difficult for the legislature to control the executive. A fuller separation of powers should curb excesses, but it may also make it more difficult for politicians to respond to voter choices. Indeed, this is exactly what is intended by the separation of powers.

Such information costs make it easier for politicians to pursue their self-interest. However, this freedom is constrained by:

- their re-election prospects, as seen by important voting constituencies;
- constitutional conventions and the law;
- international opinion, as reflected, for example, in willingness to invest;
- budgetary pressures;
- the climate of ideas and opinions concerning desirable policies (church, academic and editorial opinions are relevant here); and
- the degree to which public opinion is accurately informed.

Some of these constraints also limit the extent of voter failure. The tighter these constraints the less politicians can implement policies that are opposed to the interests of a majority of voters.

5.2.4 Bureaucratic failure

Public choice theory also explores the conflict of interest that public service and government officials may face between their own interests and careers and those of politicians and voters at large.

The degree to which politicians can control senior public servants depends on tenure arrangements and appointment and termination processes. The state sector reforms in New Zealand have abolished the concept of tenure for public servants. This should make senior public servants more accountable to their ministers for their performance, but the control is imperfect.

Control is further reduced because senior public servants cannot perfectly control their subordinates. Senior public servants commonly have no accurate way of measuring the contribution of each individual to the organisation's goals. The problem is aggravated when government departments have vague and/or conflicting objectives. While most employees are presumably concerned to retain their jobs, gain promotion, and please their superiors, these factors attenuate control.

Tullock summarises the findings of public choice theory in these situations as follows:

> Whether an individual bureaucrat works hard or not, prepares himself or herself well or not, is largely a matter of individual choice. As a rough rule of thumb, those people who do work hard and prepare themselves well are those people who have their own idea of what government should do in their particular division and work hard at that. In a way they are hobbyists. It should be said, however, that their hobby is normally motivated by a desire on their part to maximise what they think is the public good. In other words, they are usually well-intentioned individuals who can be criticized only in that their idea of the public good may or may not coincide with that of their superiors. If it does not coincide, this does not prove that they are wrong and their superiors right, but it does mean that the government is not apt to follow a coordinated policy …
>
> Bureaucrats normally have several private motives. One is, of course, simply not to work too hard – a motive which does not seriously affect the hobbyist described above. Another is to expand the size of one's own department and

> in the process of so doing, being willing to go along with the expansion of all the rest. A third is to improve the 'perks' that accompany the particular position …[364]

As bureaucracies grow larger, the theory predicts that policies will tend to be developed lower in the organisation, and be less integrated. More individuals can be expected to coast.

None of this is to deny the importance of the ethic of impartiality and integrity that is embodied in the very name of the public service. However, public choice theory provides cogent reasons why self-interest and information problems put these qualities at risk.

As noted in section 5.2.2, many government agencies are organised on an interest group basis. Each sectional agency is likely to have parochial and open-ended objectives for the policies it advocates. Each has a strong incentive to call for additional regulations and spending in support of the interests that justify its existence, be it greater safety, more conservation, a cleaner environment, or greater benefits for women, children or Maori. Disappointing outcomes from existing programmes simply create a case for additional spending or regulation. It is failure in the public sector that often attracts more money whereas in the private sector it attracts less. In contrast, under a market failure approach the interest of government agencies would be to overcome a transaction cost impediment rather than to achieve a specific sectoral outcome.

Non-business interest groups will commonly prefer that businesses and land owners be made to pay for things that benefit the interest groups. Each such agency is no doubt aware that the regulations it may be advocating will harm business activity, and, ultimately, voters at large, but it is in its interests that this problem is eased at some other agencies' expense. This is a 'tragedy of the commons' situation, but it is also a problem of political majorities exploiting a minority.

It appears to be the norm for government spending and regulatory agencies to set themselves an overriding objective for their activities that presumes more is always better, that is, the marginal benefits always exceed the costs. Thus, the Ministry of Health has adopted the goal of increasing the health status of all New Zealanders. The Ministry of Education has the goal of raising the level of education in the community. The Ministry for the Environment's goal is to have a cleaner environment, and the Energy Efficiency and Conservation Authority has the goal of promoting the more efficient use of energy.

The common feature of these approaches is that they completely fail to identify any grounds for government intervention or to acknowledge any limits to the comparative advantage of government in these areas. The implicit presumption is that private spending will always lead to too little safety, too little spending on health, education and conservation, and that additional spending by the government is necessary to make good the deficiency. The spread of the unconstrained vision amongst the spending and regulatory arms of the public service is consistent with public choice theories of empire building and interest group capture.

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[364] Tullock, *op cit*, p 1043.

Of course, when politicians and bureaucracies embrace a vision based on limitless resources, voter disappointment and dissatisfaction is inevitable. Government spending on health is a good example of this process. The Ministry of Health's 1996 post-election briefing explained that government spending on health was designed to ensure that no-one was denied necessary health services because of lack of funding. No constraint was set on what was deemed to be necessary. The ministry's 1999 post-election briefing paper proposed the goal of achieving access to an "acceptable range" of services regardless of the ability to pay without providing any non-political basis for limiting what was "acceptable". However, because the government is limited by the amount of tax it can collect from individuals, it faces the same income constraint that would confront individuals pooling their funds through private insurance arrangements. Therefore governments have to constrain their spending on medical services because of lack of finance. Individuals find that the government, having taken their money, denies them access to needed services because it does not have enough to fund everything they demand at the subsidised prices. This is not what they were led to expect. No feasible increase in spending can overcome the fundamental problem. Respect for government can only diminish as a result.

In contrast, an approach that recognised resources were limited would be obliged to define a role for government that sought to complement, rather than override, private spending.

The growth in prescriptive health, safety and environmental regulation has greatly increased the power and influence of such organisations as the Department of Labour (occupational safety and health), the Ministry for the Environment and the Department of Conservation. The Ministry for the Environment's close involvement in the development of global warming policies gives rise to potential conflict of interest problems. The same policies create a potential conflict of interest for the government's scientific advisers.

The ministries of Health and Education both face a conflict of interest in advising on policies that would increase the role of the private sector in health and education. Health and education professionals employed by the state form clear special interest groups. Similar comments apply to state funded and provided social welfare policies.

Such theories can also explain the Energy Efficiency and Conservation Authority's support for making energy efficiency standards mandatory and for any resistance by Transfund to seeing its role disappear in the projected corporatisation of roads.

Payment of compensation for regulatory takings also raises the issue of conflicts of interest in the public service. The intense opposition of environmental groups to proposals that the Resource Management Act 1991 should, in principle, require compensation to be paid to land owners who are regulated in the general public interest under the Act suggests that such a provision could have real bite in this area. If so, capture theory and the theory of bureaucratic self-interest would predict that the Ministry for the Environment and the Department of Conservation would support environmentalist lobby groups on that issue.

Yet, the principle that money or property should not be extracted from a dissenting few for the benefit of many resounds across cultures, histories and generations – and is embodied in New Zealand's own Public Works Act 1981. Majorities cannot be permitted to exploit minorities if a democracy is to survive.

The major control departments – the Treasury, the Ministry of Economic Development and the State Services Commission – could take the initiative in monitoring the quality of the public policy analysis and advice in respect of regulations. Their failure to exercise more leadership in the areas canvassed in this report is a concern. To be fair, lack of political leadership will be part of the problem. This in turn points to voting issues.

One issue worthy of deeper consideration is what can be done if a government agency fails to provide work that meets professional standards. For example, a regulatory impact statement may demonstrably fail to comply with Cabinet Office requirements. Government agencies may fail to respond to professional criticisms of public discussion documents that relate to the basis of analysis and the absence of consideration of relevant alternatives. For example, the Ministry for the Environment may fail to respond to questions, say, as to whether the purpose of biosecurity legislation is to raise human welfare as distinct from sacrificing it in the interests of preserving 'intrinsic' values or protecting the environment; and, if the latter, what analytical basis does it use to determine the trade-offs?

In the absence of more decisive action by the State Services Commission on these issues, options for extending the scope of judicial review might be considered.

In the local government sector, conflicts of interest can arise where an agency is both a regulator of some activities and a subsidiser of competing activities. The Wellington Regional Council, for example, subsidises buses and trains and has an influence over the regional land transport strategy that establishes investment priorities. Its priorities consistently favour the increased use of buses and trains at the expense of cars. It is also strongly opposed to selling commercial assets.

5.2.5 Judicial failure

The common law is always evolving. Innovations that shift boundaries or require fresh determinations ensure this alone. Any legal determination of a dispute about property or contractual rights creates a precedent that can guide future determinations. Case law determinations delineate the rights and duties of citizens including property owners in an evolutionary manner. They can thereby affect incentives and the costs of transacting. The efficiency of exchange depends on the quality of the incentives and the level of transaction costs embodied in the laws of the land at any point in time.

The law can also change because of changing notions as to the role of the courts between individual judges and through time. Are judges to apply the law without fear or favour, or to administer justice as they see it in a particular case? Is the law to be applied to a particular case *discovered* through the application of painstaking impartial legal inquiry to the facts of a particular case, or is it something to be *created* by a judge as a matter of public policy? Does judicial review extend beyond 'manner and form' to legislative content?

Scholars have traced the subversive influence on the rule of law in the last century of the doctrine of legal positivism or legal realism.[365] Legal positivism rejects theories of

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[365] See, for example, Hayek, *The Constitution of Liberty*, *op cit*, pp 236–237, Walker, Geoffrey de Q, *The Rule of Law: Foundation of Constitutional Democracy*, Melbourne University Press, Melbourne, 1988, p 86 and ch 5, and Fuller, *op cit*, pp 106–118, 145–151.

ancient law, custom and natural law that posit a meta-law that can transcend the pronouncement of any current sovereign or parliament. Instead it posits that the law consists exclusively of deliberate commands of a human will.

Judges do not operate in a vacuum and, as with political agencies, may pursue their own objectives, or be affected by interest group pressures or changes in the prevailing wisdom concerning the sanctity of the law or the constitution. Judges are human and some may indulge in creating novel precedents and interpretations. Others might content themselves with applying existing law without fear or favour, whether it accommodates the dominant passions or prejudices of the day or not. Such judges would not seek to bend the law out of sympathy for a plaintiff or a defendant in a particular case. Nor would they seek to modify it in an attempt to promote (social) justice in general in response to clamour from populists or a state-dependent elite.

Unlike politicians, judges in New Zealand are not elected by voters to make social policy. If judges usurp the role of politicians in this respect they can expect to politicise the judiciary and undermine the separation of powers. The only enduring defence that judges have for the integrity of their decisions when under attack is their ability to establish that their judgment is in accord with the law. If their defence is essentially political, they have no authority as a non-elected body for resisting the authority of elected politicians.

Reflecting such debates, the evolution of the common law creates controversy. In any specific case, some may argue that judge-made law is failing to adjust adequately to changing circumstances, for example, to new technologies. Others may argue that it is over-adjusting to the latest populist fads, fashions or excesses. Nor are these views mutually incompatible.

The changes in the common law have been very significant during the last hundred years.[366] Thomas Sowell has discussed the issue of judicial positivism on the part of judges who see the law as an 'agent of change'. He postulates a tendency to reduce the burden of proof against those who are unpopular in the eyes of public opinion.

> The first field in which the burden of proof began to shift to the defendant or respondent was antitrust law. The most sweeping and dramatic shift was in civil rights law, which was followed by similar developments in environmental laws, tort liability, sexual harassment policies, and laws and policies applied to families.[367]

A major trend, at least in the United States, has been for courts to overturn defences based on the plaintiff's assumption of risk or contributory negligence or the defendant's non-negligence. Particularly in respect of workplace accidents, product safety and professional malpractice, the definition of a harm has widened and traditional defences have been undermined. The sanctity of contractual assignments of risk has also arguably been undermined by the trend for courts to apply tort rather than contract principles to the resolution of disputes. The third trend, already noted,

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366 See, for example, Michael I Krauss, 'Restoring the Boundary: Tort Law and the Right to Contract', *Policy Analysis*, 3 June, 1999, and Richard Epstein, *Torts*, Aspen Publishers, New York, 1999, pp xxviii.

367 Thomas Sowell, *The Quest for Cosmic Justice*, Free Press, New York, 1999, p 172. See also Thomas Sowell, *Is Reality Optional*?, Hoover Institution Press, Stanford, California, 1993, pp 144–154.

has been for statute law to replace contract law.[368] Such trends make the efficiency of the current legal rules governing voluntary exchanges an open question.

A majority in Australia's highest court recently provided what *The Capital Letter* described as "an unqualified endorsement of an academic lawyer's assertion that 'property … does not really exist: it is an illusion' ".[369]

In New Zealand similar concerns have been expressed.[370] Recently, Professor Peter Watt commented about "a judicial willingness to undertake a serious tinkering with contract law … in part at least the product of a perception of the judicial role that treats the judge's intuition for improvement in the law as sufficient to warrant change, rather than requiring strong evidence of a serious deficiency in the law".[371] Significantly, in a recent case involving Valentines Restaurant and some Wellington property developers, the Privy Council overturned Court of Appeal and High Court decisions on the grounds that they did not have adequate regard for what the contract actually specified.[372]

Amongst the local judiciary, there is clear evidence of a desire in some quarters to make public policy rather than simply to enforce the law and contracts. James Allan, law lecturer at the University of Otago, referred to the "all-too-common tendency of our courts ... to think the judicial nose for fairness and "social change" should trump clear statutes and long established precedents". In describing the *Lange v Atkinson* (1998*)* defamation case as a "striking example of judicial activism", he notes that it "ignores (or overrules) clearly established law in favour of what it thinks is right and just ...".[373]

During the twentieth century, the US Supreme Court has compromised with the rise of big government in that country by upholding constitutional safeguards for human freedom while allowing them to be undermined in respect of economic freedom.[374] As indicated below, there is evidence of the same compromise in New Zealand.

Judicial attitudes to the concentration of power can also change. In a recent exchange in *Commentary* magazine, Lino Gragalia, School of Law, University of Texas, expressed the view that the primary cause of the concentration of power at the federal level at the expense of state power in recent decades has been the US Supreme Court, not Congress. In reply, Gary Rosen shares Mr Gragalia's "frustration with the shameless overreaching of the federal judiciary".[375]

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368 For a defence of contract, see *The Fall and Rise of Freedom of Contract*, FH Buckley, (ed), Duke University Press, Durham, London, 1999.

369 *Yanner v Eaton*, HCA 7/10/99 as reported in *The Capital Letter*, 12 October, 1999, p 1.

370 Refer, for example, to Richard Epstein, *Economics and the Judges: The Case for Simple Rules and Boring Courts*, New Zealand Business Roundtable, Wellington, 1996, and to the discussion on capricious court cases in *Accident Compensation: Options for Reform*, *op cit*, pp 116–121. See also the discussion in this paper on the Bill of Rights Act 1990 and the Human Rights Act 1993.

371 As reported in *The Capital Letter*, 13 March, 2001.

372 Jenni McManus, 'Privy Council upholds sanctity of contract', *The Independent*, 4 April, 2001.

373 Allan, J, 'Judicial Activism Rides Again in Lange Decision', *National Business Review*, 26 June, 1998, p 19. Note also his critique of a paper by a Court of Appeal judge in 'The Invisible Hand in Justice Thomas's Philosophy of Law', *New Zealand Law Review*, 1999, pp 213–226.

374 Richard Epstein, *Principles for a Free Society*, New Zealand Business Roundtable, Wellington, 1999, p 23 and Lino Gragalia earlier in this section.

375 Letter to the editor, *Commentary*, November 1999.

A recent speech by US Supreme Court Justice Antonio Scalia attacked the concept of a 'living constitution' the meaning of which should be reinterpreted "to reflect changes in society".[376] In Scalia's view, only in the past 40 years, beginning with the ascendancy of Earl Warren, did judges see the constitution as an evolutionary document that could be interpreted differently with the passage of time.[377]

The point of constitutions is to entrench laws that fundamentally protect individuals from each other and from the arbitrary power of the state. A system of sound, stable institutional arrangements does not constrain changes in the use of property or the ability of communities to adapt to changing technologies and tastes. To the contrary, it provides a basis of legitimacy for the exchanges that allow those adjustments to take place. This is a virtue of rules that do not prescribe outcomes.

Scalia observed that a constitution was a legal document, "not an organism". It was there to protect the individual against the power wielded by a political majority, not to become the instrument of that majority. Political majorities could pass laws that reflected changes in the general climate of opinion. Judges should apply the law rather than continually revise their views of the constitution in response to their changing perception of the will of an elite or of the general will.

The current climate of opinion amongst some members of the New Zealand judiciary favouring the abolition of the ability to appeal to the Privy Council reinforces concerns about the possible trend to more insular, populist, judicial activism. James Allan has noted the risk that the judiciary would seek to impose, in effect, a written constitution by ruling that the Treaty of Waitangi is some sort of fundamental law.[378] More generally, he expresses concern about the evident willingness of our judiciary to ignore democratically elected legislatures in matters of social policy making.

Nothing in the material in section 6.3 that relates to New Zealand's judiciary provides any comfort on this point. For example, David Baragwanath, then High Court judge and president of the New Zealand Law Commission, notes that basic human rights are of greater moment than "mere" property and uses the right to education as an example of a basic right.[379] In another essay he appears to reject the proposition that indigenous people should not be treated differentially.[380]

Such concerns underlie the debate as to whether the evolution of the common law is less efficient than the evolution of statute law. To what *extent* are decisions by judges consistent with an efficiency standard? This is a controversial issue in the economics literature.

Gordon Tullock has argued that the common law is inefficient, even compared with Continental processes. He argues that the courts have failed to provide cost-effective resolution of disputes and they now administer a subjective, unresponsive, and

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376 Justice Scalia, speech to Marguette University, 14 March, 2001, as reported by Tom Kertscher, *Milwaukee Journal Sentinel*, 13 March, 2001. Epstein (1985) also discusses this issue in *Takings: Private Property and the Power of Eminent Domain*, *op cit*, p 24–25.

377 Presumably this does not deny the importance of Roosevelt's threat to stack the Supreme Court if it failed to find important elements of his 'New Deal' constitutional.

378 Allan, J, 'No Written Constitution for New Zealand', *Agenda*, Vol 5, No 4, 1998, pp 487–494.

379 Baragwanath, D, 'The Future of Administrative Law', mimeograph, April 1997, p 31. We criticise the concept of positive rights in section 3.

380 Baragwanath, D, 'The Treaty of Waitangi and the Constitution', mimeograph, March 1997, p 8.

essentially illegitimate legal system predicated more on the rule of men than on the rule of law.[381] In contrast, Richard Posner has been at the forefront of those arguing that the common law is efficient. Hayek argued that the common law was likely to be better than statute law.[382]

Inconsistencies between the actual common law and what might be considered desirable suggest that either the analysis is wrong or that the common law has evolved inefficiently. Such claims are easier to make than to prove or rebut. Judges commonly have to take hard decisions knowing that whatever they determine will displease at least one passionate group that could seek to exploit a media that is keen to sell copy. Trial by media may have heat without light. The degree of light can only be evaluated by a careful analysis of the quality of the arguments and an assessment of how far the inconsistent common law cases have stood the test of time. This is a job for experts.

The issue of what should be done about any worrisome trends is a debate about degree and persistence. The longer any feature of the common law has endured, the greater the presumption that it is efficient. There are grounds for arguing that the evolutionary nature of the common law should ensure that harmful interpretations of the law will be detected and weeded out in the fullness of time.

Where there is very strong evidence that the common law has evolved dysfunctionally, there may be a case for regulation to curb the excesses. For example, it is possible that the return of the right to sue for personal injury from accident in New Zealand would see excessive fines based on unprincipled assignments of liability (for example, the deepest pocket is made liable under any pretext). This concern may suggest a case for regulating for maximum awards for a transitional period. Similarly, there could be a concern that the case law in New Zealand in relation to unjustified dismissal cases has been seriously distorted by the passing of the Employment Contracts Act 1991 and subsequent legislation.

Yet, is it better for the legislature to act or to wait for later judges to correct the errors, if not on appeal then in subsequent decisions? The legislature should hesitate to act because such activism has many dangers. For a start, the legislature could be even more prone to succumb to populist pressures. Moreover, such activism taken to excess, could undermine the separation of powers (see section 6.3).

Leoni has discussed this issue in some detail.[383] He makes the point that the courts can only issue decisions if asked to do so by the parties concerned. The parties can, and often do, resolve any disputes independently of the courts. Furthermore, any court is bound by precedent and required to apply the law to the case at hand rather than to promulgate new law. Similarly, even a lower court judge, being bound by all precedents, has to decide whether or not a current decision on a particular case is bound by any given decision by a higher court or any other court. Final courts of appeal may have the greatest ability to attempt to impose new law, but even here it is clear that their power is more limited in important respects than that of a legislature. Another important point is that the common law crosses national borders. None can control a judge's mind in order to prevent precedents created elsewhere from affecting

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381 Gordon Tullock, 'The Case Against the Common Law', *Blackstone Commentaries*, No 1, The Locke Institute, Fairfax, Virginia, 1997.

382 Paul H Rubin, 'Judge Made Law', *Encyclopedia of Law and Economics*, 9200, Edward Elgar, Cheltenham, 1999, provides an overview and a bibliography.

383 Leoni, *op cit*, pp 179–186.

the judge's search to discuss the right law to apply to a particular case. Moreover, in New Zealand's case, recourse to the Privy Council is a significant constraint on Court of Appeal rulings.

Even judges who are clear that their role is to apply the law may find themselves in a difficult position when parliament passes a law that appears to be unconstitutional. When judges are faced with an apparent conflict between a statute and a fundamental constitutional principle or human freedom, the convention is that if it is possible to interpret the statute as not overriding fundamental constitutional principles they will interpret statute law on that presumption. We discuss the issue of the sovereignty of parliament and the independence of the judiciary in section 6.3.

Clearly the argument that the common law evolves imperfectly does not establish the superiority of legislation. Each has its place. A balanced approach would surely concentrate legislation on matters of public law (such as the Local Government Act 1974) largely leaving the common law of property, contract and tort to handle relationships between private citizens. The boundaries and overlaps are an important matter for debate. Academic debates about the relative efficiency of the common law should not obscure this wisdom.

It is important that judges administer the law as promulgated. This was one of Fuller's tests for the very existence of a legal system (see section 3.3). Otherwise people owning property or entering a contract have no certainty as to the basis for any judicial determination of their legal rights.

This conception of the role of the judiciary could be seen as conservative or activist, depending on one's viewpoint. It is conservative in that it implies a resistance to the concept of judicial activism as discussed to this point. It is activist in that it implies an active resistance to the subversion of the rule of law.

RB O'Hair has argued that what is needed "is not activist justice, or restrained justice, not radical justice, or conservative justice, but justice according to the law".[384] In similar vein, a US Supreme Court concerned to protect liberty should be much more activist than in the past in resisting the centralisation of power in the hands of the federal government in violation of written constitutional safeguards. In English law, judges might similarly preserve human and economic freedoms by interpreting statute law, wherever it is possible to do so, as not rebutting fundamental liberties.

5.2.6 The regulatory dynamic

Those who benefit from a regulation can be expected to support it. Once in place, those who make regulation-specific investments will add to the number of its supporters.

The benefits of existing regulations are seldom compared with their costs. As people find ways to circumvent the regulation and reveal its imperfections, its defenders will seek to extend its scope in order to 'close loopholes'.

Ill-founded regulations are unstable because of this regulatory dynamic. Those who hope to benefit will seek to extend their scope in order to correct 'anomalies'. Those

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[384] As cited on Walker, *op cit*, p 181.

opposed will argue that the regulation is inherently unsatisfactory and should be fundamentally reassessed. The two views are irreconcilable, but time favours the second group. Experience indicates that ill-founded regulations can last for decades (as in the cases of import licensing, tariffs and New Zealand's accident compensation arrangements).

5.3 The importance of ideas

Ideas can have a powerful influence on whether any group sees its objectives as moral and whether the passions of its members are aroused to protect those interests. Throughout time, different ideas have held sway, influencing the role of the state.

Churches have been, across the centuries, an important source of ideas and opinion as to what constitutes moral and ethical behaviour. The balance of opinion across church groups as to the causes of societal problems may also vary with, yet still reinforce or modify, the general climate of opinion. If nothing else, the massive changes last century in the incidence of divorce, abortion and children born out of wedlock illustrate the potential for ideas to change along with behaviour. A potent case has been made that the stance the church has taken on issues relating to economic freedom varies according to its structure and competitive nature.[385]

Developments in economic theory and political philosophy have influenced public opinion, thereby affecting governmental arrangements. In the seventeenth century Locke made a crucial contribution to establishing support for the rule of law and the case for limited government. His writings had a major influence on the framers of the US Constitution. However, as mentioned earlier, Locke failed to provide a full defence for the ownership of property.

Collectivist ideas have dominated the twentieth century. They are still widely supported, although not in the extreme forms of fascism and communism. Keynesian ideas have also been influential since the 1930s in supporting an ever-greater role for the state. These ideas emanated from the intellectual and academic communities but appeared to have peaked at the time of president Nixon's famous comment in 1970 that we are all Keynesians now. While now on the wane, they still retain much influence.

Section 3.4 contrasted the collectivist vision with the liberal vision in respect of the debate between liberal and welfare rights. As noted in this section, Green has depicted the debate as being between the concepts of civil association and corporate association.

Virginia Postrel has contrasted the impulses of some to embrace change (the dynamists) with the preferences of others for stability (the stasists).[386] Utopians embrace change, although they are not necessarily dynamists. Thomas Sowell has

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385 Paul Johnson, *A History of the American People*, Weidenfeld and Nicolson, London, 1997, p 1088.

386 Virginia Postrel, *The Future and its Enemies: The Growing Conflict over Creativity, Enterprise and Progress*, The Free Press, New York, 1998.

written extensively on the influence of utopian and unconstrained visions on public policies in the United States in recent decades.[387]

Many researchers have documented excesses in the drive to legislate for safety. The general public appears to be particularly susceptible to alarmist claims about remote risks, while under-appreciating more serious and familiar risks and being quite tolerant about risk in their private lives.[388]

A recent article in the *Los Angeles Times* asserted that, what it called, "America's panic over mad cow disease" was fuelled by misinformation, inexact science and alarmist media reports. It cited the chairman of the American Food and Drug Administration's specialist committee on spongy-brain diseases as saying:

> There are more suicides among farmers whose herds have been slaughtered in France than there are cases of BSE [mad cow disease].[389]

The citation from Palmer and Palmer in section 2.2.6 asserts the strength of the popular faith in the efficacy of legislation in New Zealand. Collectivist visions and ideas currently dominate many government communications and official discussion papers. They often assume that a process of consensus and consultation can reach common goals.

Under this view, 'New Zealand' is a single project.[390] The common goal is usually expressed as unconstrained aspirations. Its specifics depend on its main sponsor's interests, but it may take the form of a programme for better health, better education, safer roads, greater food safety, a cleaner environment, 'sustainable' development, more research and development, or for 'New Zealand' to join the 'knowledge and innovation society'.

No indication is given of how any one goal is to be traded off against its competitors. More is better on all fronts, or at least on the chosen front. Cost is not a consideration in the sense of comparing marginal benefit and marginal cost. Prosperity itself is commonly seen as something that happens by government design rather than as something that emerges spontaneously, like happiness, as a result of sound institutions and virtuous behaviour. The collectivists' aspirational rhetoric might pre-empt both rigorous public policy analysis and constitutional analysis if it succeeds in mobilising public support regardless. The evidence put forward in section 4.3.4 of the sorry state of regulatory analysis in official's documents in New Zealand is consistent with this possibility.

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387 See for example, the following books all by Thomas Sowell, *A Conflict of Visions: Ideological Origins of Political Struggles*, William Morrow and Company, New York, 1987; *Is Reality Optional?*, Hoover Institution Press, Stanford, California, 1993; *The Vision of the Anointed: Self-Congratulation as a Basis for Social Policy*, Basic Books, New York, 1995; *The Quest for Cosmic Justice*, The Free Press, New York, 1999.

388 For a text-book introduction to this topic, see the section 'Irrationality and Biases in Risk Perception' in *Economics of Regulation and Antitrust*, Viscusi *et al*, *op cit*, pp 661–663. For a more recent collection of essays, see *Safe Enough? Managing Risk and Regulation*, edited by Laura Jones, The Fraser Institute, Vancouver BC, 2000. See, in particular, the essay by Mark Neal, *Risk Aversion: The Rise of an Ideology*, pp 12–30.

389 Emily Green, staff reporter, 'Calming the Madness', *Los Angeles Times*, 5 March, 2001.

390 The notion that the community is a project with a common goal for outcomes is a central planning concept. Hayek discusses the conflict between individualism and collectivism and the relationship with central planning and the rule of law in chapters 3–7 of *The Road to Serfdom*.

5.4 Solutions to public choice difficulties

Tullock summarises the consensus view amongst public choice theorists about solutions to these public choice problems as follows:

- no one has any idea how to improve voters' information;
- no widespread support exists for any particular proposal to improve voting methods;
- most think that giving voters more opportunities to vote (for example, through referenda) would reduce problems of political and bureaucratic failure;
- many favour smaller electorates (providing a closer connection between individual voters and their representative);
- many would like to have at least one house of the legislature elected by proportional representation;
- there is general support for bicameral legislatures;
- the proposition that most legislation should require more than a simple majority is "seldom directly criticised, but not so widely approved". (The difficulty of repealing much legislation under this proposal concerns some);
- a uniform view is that bureaucracies should be brought under greater political control;
- competition (between departments and so on) should be encouraged; and
- more government activities should be competitively contracted out.[391]

Regulatory reform should not focus on reform of voting systems if their relationship to the quality of regulation is so indeterminate.

The items for reform in this list do not address the problem of an activist judiciary. Consideration needs to be given to the role of the courts in undermining contract, allowing an expansion in the definition of what constitutes a tort, and acquiescing to an enhanced role for government.

Would the agenda for reform that is implicit in this list have a major effect on the size of government if implemented? The proposals for bicameral legislatures and supra-majorities could have bite, but much would depend on the details.

Bicameral legislatures have not prevented the growth of big government in Australia, the United Kingdom or the United States. But, Hong Kong's limited recourse to regulation in conjunction with strict separation of the legislature from the executive branch of the government provides a possible exception.[392] Furthermore, while requiring a supra-majority vote for some proposals clearly could constrain a pure majority, getting such a proposal implemented requires overcoming majority resistance.

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391 Tullock, *op cit*, p 1045.

392 As noted earlier, Milton Friedman suggests that the high degree of economic and personal freedom in Hong Kong prior to the recent takeover by China may be partly due to the relatively low degree of political freedom.

A report for the New Zealand Business Roundtable in September 1992 recommended against a return to a bicameral structure for New Zealand. It observed that such a structure was better suited to larger, populous states and argued that specific constitutional concerns would be better addressed by other means, for example, greater recourse to referenda.[393]

A particular difficulty with any material constitutional change is the risk that the changes will be: (1) wrong-headed as a result of lack of expertise; and (2) captured by partisan groups. We suggest that any proposal for change should be required to overcome a strong presumption in favour of long-enduring features of any constitution. An attitude that a political majority of the day is entitled to change any feature of a constitution is highly undesirable.

Even if such reforms could have material net benefits, are they achievable? A fundamental constitutional dilemma lies at the heart of controlling the use of governmental powers to promote the interests of particular constituencies at the expense of the whole. Weingast notes:

> The fundamental political dilemma of an economic system … is this: A government strong enough to protect property rights and enforce contracts is also strong enough to confiscate the wealth of its citizens.[394]

The lack of ideas for addressing many problems of voter failure highlights the difficult nature of this issue. Problems of voter failure and the failure of coalitions to emerge that can enforce a rule of law appear to be almost intractable from a public policy perspective. This is because no political majority is likely to accept voluntarily a policy that will require it to exercise greater self-restraint in the general public interest.

It is difficult to avoid the conclusion that a change in sentiment amongst voters towards the efficacy of government intervention is highly desirable if regulatory reform is to be successful. The public choice theory of industry capture would predict that our nationalised education system is unlikely to teach students that there are a good many things about which it is better not to legislate.

If we turn the negative conclusions in this section on their head, we can generate a menu of possibilities for more hopeful developments:

- elite New Zealand opinion is likely to mirror changes in opinion elsewhere – there is evidence that big government is in retreat in many places, not just the old Iron Curtain countries;
- the evolution of the debate amongst judges as to whether they are there to apply the law or to modify it may evolve in the direction of the former;
- ending prescriptive government regulation of the curriculum in schools and allowing meaningful alternatives to union-captured schools should help raise literacy levels in due course and reduce any anti-business biases;

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393 Brook Cowen, Penelope, Cowen Tyler and Tabarrok, Alexander, *An Analysis of Proposals for Constitutional Change in New Zealand*, New Zealand Business Roundtable, Wellington, 1992.

394 Weingast, B, 'The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development', *Journal of Law, Economics and Organization*, 11(1), 1995, pp 1–31.

- policy changes that reduce the incidence of state dependency in New Zealand could increase the proportion of people who felt self-reliant and confident;
- changes in the balance of opinion amongst the major churches between the view that the individual must take responsibility for their own actions and the view that the community at large is responsible for the misfortunes of individuals; and
- an economic or political crisis that persuades the electorate that ever more government spending and regulation is not the answer.

The next section looks at constitutional issues identified in this section.

6 Constitutional Aspects of Regulation

6.1 Introduction

This section explores the constitutional aspects of regulation. Constitutionalism embodies the philosophy that all government powers should be limited. Some proposals designed to limit regulatory excesses may be constitutional in character.

Section 6.2 introduces constitutionalism and its origins.

Section 6.3 briefly comments on the importance of the separation of powers and an independent judiciary.

Section 6.4 examines the concept of the rule of law – a fundamental concept in all major constitutional theories.

Section 6.5 comments on the concepts of natural and fundamental rights.

Section 6.6 provides some concluding observations.

6.2 Constitutionalism and its origins

A constitution[395] is a body of doctrines and practices that form the fundamental organising framework of a political state. Constitutionalism is based on the view that members of a community can agree to be governed by a set of rules, or a constitution. 'Constitutional principles' are the principles underlying these shared rules.

The general idea of a constitution and of constitutionalism can be traced back to the ancient Greeks, especially Aristotle. Under good constitutions, as envisaged by Aristotle, rulers would rule in the interest of all. Under bad constitutions the rulers – which may be a democratic majority – would rule in their own interests alone, that is, despotically. Over two thousand years later Alexis de Tocqueville raised the possibility of a democracy based on paternalistic intrusive government that sapped a people of their independence, initiative and self worth.

Aristotle conceived of the state as a partnership of free people created for a good purpose. This purpose was for the common advantage of 'living well', conceived of as allowing a full and independent life, in accordance with excellence.

To Aristotle, the political good is justice, and justice is the pursuit of the common advantage. The law was conceived of as a covenant, a guarantor of one citizen's just claim against another. Rulers are as much subject to that covenant, and the law, as any other free person.

Governments that limit themselves to acting constitutionally accept that the power to rule is limited. For these limits to be effective, it must be possible to enforce them through established procedures. The implication is that those who are elected to

[395] For a useful discussion on this topic, see chapter II in Adam Mikkelsen, Money and the Constitution, doctoral thesis, University of Auckland, Auckland, 2000.

govern must abide by those rules. That is, they must themselves abide by the rule of law (see next section).

James Madison (writing as Publius in the Federalist Papers) also expressed the view that at the end of government, and of civil society, must be justice. He set out the problem of how to arrive at a government of laws and not of people when only people are available to rule in the following terms:

> If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself. A dependence on the people is, no doubt, the primary control on the government; but experience has taught mankind the necessity of auxiliary precautions.[396]

Legislative power is derived from the consent of the people under this conception. Those who exercise this power, the Crown, parliament and state agencies, have a fiduciary relationship with the community.

According to John Locke, the legislature would act against that trust:

> … when they endeavour to invade the property of the subject, and to make themselves, or any part of the community, masters or arbitrary disposers of the lives, liberties, or fortunes of the people.[397]

In 1649, John Bradshaw, the Puritan parliamentary prosecutor of King Charles I, invoked historical jurisprudence to argue that:

> This we learn: the end of having kings, or any other governors, is for enjoying the justice; that is the end. Now Sir, if so be the king will go contrary to the end of his government, Sir, he must understand that he is but an officer in trust, and he ought to discharge that trust; and they are to take order for the punishment of such an offending governor. That is not law of yesterday, Sir, but it is law of the old.[398]

Constitutionalism can be contrasted with the alternative concept of the state as the rule of one group over another. Once, that group might have been royalty, or a church, that claimed a divine right to rule. However, the English civil war demonstrated, according to Vile, that parliamentary power could be no less tyrannical.[399]

Currently constitutionalism can be contrasted with the view that a parliamentary majority has an unconstrained ability to exercise coercive power as long as it observes

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396 James Madison, *The Federalist Papers,* Paper No 51, The Penguin Group, New York, 1961, p 322.

397 Locke, footnote 68, p 129, as cited by Mikkelsen, *op cit*, p 21.

398 Ellis Sandoz, 'Foundations of American Liberty and Rule of Law', *Presidential Studies Quarterly*, 24/3, Summer 1994, pp 605–616.

399 MJC Vile, *Constitutionalism and the Separation of Powers*, 2nd edition, Liberty Fund, London, 1998, cited by Mikkelsen, *op cit*, p 33.

'manner and form' legal processes.[400] Under this alternative concept of the state, individual freedom would only exist at the pleasure of those controlling the legislature.

Constitutionalism is a philosophical concept rather than a concrete set of rules. Reflecting this, its rules cannot be precisely defined. Suri Ratnapala states that the most fundamental concepts of constitutionalism are:

- separation of powers;
- democracy; and
- the rule of law.[401]

Powers can be divided horizontally (for example, at a federal level) and vertically (across layers of federal, state and local government). The separation of powers is of fundamental importance in limiting the ability of any one group to control power for their own purposes. However, the check on the abuse of power is imperfect. Other checks are desirable. We discuss this issue further in section 6.3.

Democracy allows bad rulers to be overthrown without bloodshed. This is of fundamental importance. Yet, as Aristotle so acutely observed, democracy by itself does not protect minorities from the will of a populist majority. It is not enough for a constitutional order.

Aristotle noted that democracies that rest on force and are not directed at the common advantage have an element of despotism and deviate towards tyranny. The majority wish to be monarch. Where the people have authority over the laws, they may make war on the well off. This makes the democracy unstable. To make it unstable is to deny that government was created for a good purpose. To preserve a democracy, one should aim not for measures that will make it as democratic as possible, but for measures that promise to preserve it for the longest time.[402] Aristotle asserted that the outrageous behaviour of demagogues was the main cause of the overthrow of many democracies in Greek city-states.

> But the demagogues of today to court the favor of the peoples often use the law-courts to bring about confiscations of property. Hence those who are caring for the safety of the constitution must counteract this by enacting that nothing belonging to persons condemned at law should be confiscated and liable to be carried to the public treasury, but that their property shall be consecrated to the service of religion; for male-factors will be no less on their guard, as they will be punished just the same, while the mob will less often vote guilty against men on trial when it is not going to get anything out of it. Also they must always make the public trials that occur as few as possible, checking those who bring indictments at random by big penalties.

Demagogues attack the owners of property and thereby spur on the people to loot the rich. Aristotle suggested a number of safeguards. *Inter alia*, he suggested that:

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400 See sections 5.3 and 6.4.

401 Suri Ratnapala, *Welfare State or Constitutional State?*, Centre for Independent Studies, Sydney, 1990.

402 For example, appointment on merit often may be preferable to appointment by public elections. In New Zealand this is topical in respect of appointments to hospital boards.

- any confiscations of property imposed as punishment should become the property of the gods [that is, devoted to religious purposes] not of the public;
- large penalties should be imposed for frivolous prosecutions to prevent harassment of the rich; and
- public surpluses should not be distributed to the poor, for this practice stimulates demand.

In New Zealand the endless bitterness and strife that has followed government confiscations of Maori land during the nineteenth century amply demonstrates the wisdom of Aristotle's first point. Governments are not to be trusted when they confiscate the property of others.

Aristotle's second point surely resonates with those in New Zealand who have been harassed by malicious or opportunistic actions that are founded on ill-conceived legislation and may be funded by legal aid. Recent government funding for environmental groups that oppose development proposals promises to exacerbate these problems.[403]

We discuss the third of the concepts listed earlier by Ratnapala, the role of the rule of law, in section 6.4.

We end this section with a brief introduction to New Zealand's constitutional arrangements.

New Zealand's constitution reflects the country's origins as a Crown colony.[404] New Zealand is a constitutional monarchy, with a parliamentary system of government. It is a democratic state. The constitution is fragmented, reflecting its diverse foundations in prerogative powers, statute,[405] convention and judge-made customary and common law.

The Constitution Act 1986 is now the principal formal statement defining the institutions of governance – the queen as sovereign/head of state, executive, legislature, and judiciary – and the allocation (distribution and separation) of their powers. This Act abrogated the power of the United Kingdom parliament to make laws for New Zealand by request and consent of the New Zealand parliament.

The discretionary powers of the sovereign derive, however, from the position of the monarch as part of common law. Ministers, judges, and certain other statutory holders are appointed by the sovereign who can also summon and dissolve parliament and assent (or not) to Bills passed by the legislature. Ministerial powers derive from the common law powers of the Crown, and from statutes.

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403 The Ministry for the Environment's *Environment Update*, February–March 2001, describes this 'Environmental Legal Aid scheme'.

404 The New Zealand government's *Cabinet Office Manual*, Wellington, 1996, contains an essay by the Hon Sir Kenneth Keith on the constitution of New Zealand (see pp 3–8). The State Services Commission, *The Constitutional Setting*, Wellington, 1995, pp 1–12, also provides useful background on the sources of the New Zealand Constitution and its principles, conventions and practice.

405 State Services Commission, *op cit*, 1995, Appendix 1, lists 21 New Zealand statutes as embodying constitutional principles. Appendix 2 lists the Magna Carta 1297, the Habeas Corpus Acts of 1640, 1679 and 1816, Bill of Rights 1688, Act of Settlement 1700 and the Statute of Westminster 1931 as relevant English and United Kingdom statutes.

New Zealand's Imperial Laws Application Act 1988 confirms that such major English and United Kingdom statutes as Magna Carta 1297, the Bill of Rights 1688 and the Act of Settlement 1700 (that regulates succession to the throne) are part of the law of New Zealand. These statutes also regulate the relations between the state and the individual.

While 'in theory' many parts of New Zealand's constitution could be amended by legislation passed by a simple majority, law, convention and practice restrain that power.[406]

6.3 Separation of powers and the judiciary

In New Zealand, the power to use the coercive authority of the state is divided between the Crown (represented by the governor-general), the judiciary, central and local government, and the legislature and the executive.

Currently, parliament restrains the ability of the executive to make regulations by limiting the powers it delegates in primary legislation and by constraining the exercise of delegated power by the executive through parliamentary standing orders. (Constraints on the executive commonly limit the regulatory powers that can be delegated by the executive to administrative agencies.)

Reflecting its English origins, there is a separation of power between the legislature and the judiciary, but not between the legislature and the executive. An important aspect of the separation of powers is the exclusive right of the courts to declare what the law means. This includes their exclusive right to determine what a statute means.[407]

In the United States the absence of a monarchy makes a difference. Powers are separated vertically (federal versus state) and horizontally (the president and the executive, two congressional houses as the legislature, and the judiciary). James Madison made the case for separation as follows:

> But the great security against a gradual concentration of the several powers in the same department consists in giving to those who administer each department the necessary constitutional means and personal motives to resist encroachments of others. The provision for defense must in this, as in all other cases, be made commensurate to the danger of attack. Ambition must be made to counteract ambition.[408]

While an independent judiciary is critical to all constitutional arrangements, judge-made law (common law) plays a distinctive role amongst countries sharing the Anglo-Saxon traditions.

Conflicts between the legislature and the judiciary will always exist. Politicians may attempt to exert influence on the judiciary through legislation, judicial appointments and statements designed to affect populist opinion. Conversely, the judiciary cannot escape responsibility for responding adversely to regulations that appear to violate

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406 Refer to Hon Sir Kenneth Keith's introductory essay in the *Cabinet Office Manual*, *op cit*, p 8.

407 Legislative Advisory Committee, *LAC Guidelines: Guidelines on Process and Content of Legislation*, *op cit*, p 44.

408 James Madison, *The Federalist Papers*, Paper No 51, *op cit*.

either provisions in a written constitution or fundamental common law principles. Nor are the politicians necessarily always to blame for any conflicts. An undesirably activist judiciary could also be guilty of attempting to make public policy in competition with elected politicians.

In section 2 we reviewed the vast array of legislation affecting interactions between private citizens during the last half of the last century. In section 3.6 we noted that legislation that displaces the common law is likely to undermine economic (and political) freedom. Obviously such legislation is also particularly likely to put the judiciary in the difficult position of having to determine the interface between statute law and the common law when the statute law appears to conflict with deeply held common law principles.

This immediately leads to the important point that greater restraint by legislatures in respect of the common law would put the separation of powers less at risk (not that preserving this separation is necessarily a political objective).

When there is a conflict between statute law and key common law principles, judges have to address the issue of which must prevail. This raises the issue of the supremacy of parliament (which is not necessarily the same thing as the sovereignty of parliament) and the scope of judicial review of legislation.

The following paragraphs elaborate on the issues of judicial appointments and judicial review.

Judicial appointments

The independence of the judiciary is at risk when politicians can stack the highest court by appointing additional judges whose views accord with their own. Even a credible threat to exercise this power can suffice, as Franklin Roosevelt demonstrated in getting his 'New Deal' through the courts. A constitutional cap on the number of members of the Supreme Court would have provided stronger protection for the independence of the judiciary.[409]

New Zealand's highest court, the Privy Council in London, is independent of the will of whoever exercises political power in New Zealand in this respect. However, the legislature could remove this element of independence by abolishing the right of appeal to the Privy Council. Indeed, the current government appears to be determined to do so.[410]

Judicial review

There is no dispute that the courts in common law countries have the power to review (not of their own initiative) the actions of the executive to ensure that they are in accord with properly exercised legislative authority (that is, a 'manner and form' test). In New Zealand, the *Cabinet Office Manual* defines judicial review as:

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[409] For an encouraging research finding that governments in the United Kingdom appear to appoint soundly, see Eli Salzberger and Paul Fen, 'Judicial Independence: Some Evidence from the English Court of Appeal', *Journal of Law and Economics*, Vol XLII, October 1999, pp 831–847.

[410] See the editorial and the article by Jock Anderson, 'Secretive silks create Privy Council lobby' in *National Business Review*, 16 March, 2001 and the article by James Farmer QC on the editorial page one week later.

> … the review by a judge of the High Court of any exercise, or refusal to exercise a statutory power of decision in order to determine whether that decision or refusal is unauthorised or invalid.

The purpose of judicial review is to define principles of administration and to safeguard individual interests from unreasonable or illegal actions, or administrative actions taken without following proper procedures. Judicial reviews are more concerned with ensuring that proper decision processes have been followed rather than assessing their outcome.[411] The procedures for obtaining a review and the available remedies are set out in the Judicature Amendment Act 1972 [Part I] that forms part of the Judicature Act 1908.

Judicial review is no panacea. There is room for debate about how assertively the courts use this power to constrain government. Its quality and character can be expected to depend on the times. Constitutional scholar Edward Corwin commented on this in a US context as follows:

> Judicial review is, nevertheless, regarded here as taking on increasingly "the character of a species of arbitration between competing social interests rather than of adjudication in the strict sense of the term, namely, the determination of the rights of adverse parties under a settled, statable rule of law".[412]

Judicial review in this sense provides only a limited constitutional check on members of the executive, statutory officers and public servants.

Parliamentary supremacy or sovereignty

Much more contentious and more germane to this study is the issue of judicial scrutiny of the content of legislation. United Kingdom statutes and common law establish the supremacy of parliament in the making or unmaking of legislation, the gathering of revenue and the disposition of public money. This gives a government that enjoys a majority in parliament considerable power to legislate to achieve its objectives.

New Zealand's statutes of constitutional significance do not formally provide for the courts to rule that Acts passed by parliament are unconstitutional. This approach was explicitly considered, and rejected, in the debate preceding the adoption of the New Zealand Bill of Rights Act 1990. In New Zealand, the courts have always given effect to the will of parliament.

In passing in this context, we note that parliamentary supremacy is not necessarily total even disregarding the issue of judicial review and the political constraints of public opinion and mobile capital flows. International treaties with no withdrawal clauses can allow a current parliament to come close to binding future parliaments.[413] An example is the Abolition of the Death Penalty Act 1989 that implements the Second Optional Protocol of the United Nations International Covenant on Civil and Political

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411 For example, *Fitzgerald vs Muldoon, 1976, New Zealand Law Review*, 1976, pp 616–617 affirmed that changes to the law cannot be anticipated but can only be made by the authority of parliament.

412 Edward S Corwin, *The Constitution and What it Means Today*, Princeton University Press, Princeton, New Jersey, 12th edition, 1958.

413 Most treaties do have withdrawal clauses. Peace treaties, disarmament treaties and treaties containing a number of multilateral human rights instruments may well not have a withdrawal clause.

Rights that New Zealand ratified in 1990. This ratification severely constrained the electorate's ability to restore capital punishment should it ever wish to do so.

A related issue is the constitutional role accorded to the executive in respect of foreign relations and treaty-making powers. From 1965 until 1997 the executive was able to enter into international treaties without them being scrutinised and ratified by parliament. While only parliament can pass or withhold any legislation that is required in order to give effect to these treaties, concerns have arisen about the executive's ability to limit the flow of timely information to the public and parliament.[414] In 1997 an international treaty examination process was introduced in order to give parliament a greater role in considering treaty action, even if no implementing legislation is required.[415]

Putting the issue of international treaties to one side, the exercise of the state's coercive powers is also constrained by the conventions of the constitution that relate to perceptions of the legitimacy and fairness of government actions. The degree of consultation and informed consent are relevant to perceptions of legitimacy.

Relationships between the state and the individual are also governed by case law – decisions of the courts determining the extent of individual's rights when there appears to be a conflict between the common law and statute law. It is common law rather than statute law that protects the rule of law.

The reluctance of the judiciary to interpret legislation in a manner that would put it in conflict with fundamental common law principles is illustrated by the following observations by Lord Hoffman in *Ex parte Simms* [1999] All ER 400 at 412:

> Parliamentary sovereignty means that parliament can, if it chooses, legislate contrary to fundamental principles of human rights … The constraints on Parliament are ultimately political, not legal. But the principle of legality means that Parliament must squarely confront what it is doing and accept the political cost. Fundamental rights cannot be overridden by general or ambiguous words. This is because there is too great a risk that the full implications of their unqualified meaning may have passed unnoticed in the democratic process. In the absence of express language or necessary implication to the contrary, the courts therefore presume that even the most general words were intended to be subject to the basic rights of the individual. In this way the courts of the United Kingdom, though acknowledging the sovereignty of Parliament, apply principles of constitutionality little different from those which exist in countries where the power of the legislature is expressly limited by a constitutional document.[416]

When interpreting a statute, judges can and should apply a strong presumption that the parliament would not knowingly override fundamental common law principles. At the same time, judges must defer to the supremacy of parliamentary law. A common compromise is for the courts to interpret a statute that clearly overrides a fundamental common law right narrowly and to decline to interpret general or

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414 See, for example, Warren Berryman, 'The executive is selling our sovereignty – in secret', *The Independent*, 6 June, 1997, p 8.

415 For a recent detailed discussion of what the author describes as the "breathtaking" expanding scope of international law, see Mark Gobbi, 'Drafting Techniques for Implementing Treaties in New Zealand', *Statute Law Review*, Vol 21, No 2, 2000, pp 71–103.

416 See for example, the *LAC Guidelines: Guidelines on Process and Content of Legislation*, *op cit*, p 46.

ambiguous words as overriding such rights. The tension between these issues is inherent in the separation of powers.[417]'

The following example illustrates this point in a New Zealand context, albeit to an unclear degree. The RMA, section 85(1), provides that land shall be deemed not to be taken or injuriously affected because of any provision in a plan unless otherwise provided for in the Act. A provision in a plan can be challenged if it is likely to result in the interest in land being incapable of reasonable use and the restriction places an unfair and unreasonable burden on the owner. 'Reasonable use' is defined as use that has no significant environmental effects or effects on another person.

Relief is stated in the RMA to be limited to deleting an offending provision or rule, rather than the payment of compensation. However, in *Falkner & Ors v Gisborne District Council* (1995), justice Barker, while finding that the RMA had abrogated or modified common law rights, appeared to leave open the possibility that compensation might be payable. He commented that no intention to take away property without giving the legal right of compensation is to be imputed to the legislature unless that intention is expressed in clear and unequivocal terms. He declared that the "Act contains no such unequivocal intention".[418]

In the recent forestry-related takings case *Westco Lagan v Attorney-General* [2001] 1 NZLR 40 (HC), Justice McGechan observed in the High Court that:

> First, in principle, provided that Parliament proceeds according to mandatory law governing the procedure for the enactment of legislation ("manner and form") Parliament is Sovereign and can pass any legislation it sees fit. In particular, Parliament can enact laws expropriating property without compensation. In doing so, it can step right through existing laws and rights, obliterating remedies which otherwise would exist.[419]

Such timidity appears to stand in stark contrast to the staunchly expressed views of the great proponents of the common law in earlier centuries. For example, Sir William Blackstone's famous *Commentaries on the Laws of England* (1775) introduced the concept of 'the absolute rights of individuals' and defined it to mean those that are so in their primary and strictest sense. Later in the same chapter he defined the absolute rights of persons to comprise:

> … three principal or primary articles; the right of personal security, the right of personal liberty and the right of private property.

Blackstone defined personal security to be a person's legal and uninterrupted enjoyment of his life, his limbs, his body, his health and his reputation. Personal liberty was liberty of movement, without imprisonment or restraint unless by due

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417 The *LAC Guidelines: Guidelines on Process and Content of Legislation* note these issues and the risks of constitutional brinkmanship, *op cit*, p 46.

418 *Falkner v Gisborne District Council* (1995), NZRMA, p 479. See also *The Capital Letter*, 8 August, 1995, for other comments by the judge that are much less favourable in terms of liberty and economic freedom.

419 Paragraph 95 in *Westco Lagan Limited v Attorney-General* (first defendant) and The Clerk of the House of Representatives (second defendant), August 2000, CP142/00, reserved decision of McGechan J dismissing an application for an interim injunction restraining The Clerk from presenting a Bill including a no-compensation clause to the governor-general for assent if passed by the House of Representatives.

course of the law. He defined the right of private property to consist in the free use, enjoyment, and disposal of all acquisitions, without any control or diminution, save only by the laws of the land.

Blackstone was emphatic that judges were to apply the law and to resist staunchly the encroachment of the executive (in the form of the Crown) on the law.

> It were endless to enumerate all the affirmative acts of parliament wherein justice is directed to be done according to the law of the land: and what that law is, every subject knows; or may know if he pleases: for it depends not upon the arbitrary will of any judge; but is permanent, fixed, and unchangeable, unless by authority of parliament. I shall however just mention a few negative statutes, whereby abuses, perversions, or delays of justice, especially by the prerogative, are restrained. It is ordained by *magna carta*, that no freeman shall be outlawed, that is, put out of the protection and benefit of the laws, but according to the law of the land. By 2 Edw. III. c. 8. and II Ric. II. c. 10. it is enacted, that no commands or letters shall be sent under the great seal, or the little seal the signet, or privy seal, in disturbance of the law; or to disturb or delay common right: and, though such commandments should come, the judges shall not cease to do right. And by I W. & M. st. 2. c. 2. it is declared, that the pretended power of suspending, or dispensing with laws, or the execution of laws, by regal authority without consent of parliament, is illegal.[420]

In England, Sir Edward Coke asserted the ascendancy of the common law over the state on the basis of historical jurisprudence – Magna Carta and the 'ancient constitution'. He famously declared that "'sovereign power' is no parliamentary word", and "Magna Carta is such a fellow that he will have no sovereign". Coke stated the following dictum in Doctor Bonham's case:

> … when an act of parliament is against common right and reason, or repugnant, or impossible to be performed, the common law will controul it and adjudge such act to be void.[421]

Geoffrey de Q Walker has discussed the weaknesses in the doctrine of parliamentary sovereignty in some depth. Clearly the illegality of murder in human affairs could not be validly overturned by any legislation. A law that cannot be obeyed is void, and no law. Furthermore, the doctrine that Acts of parliament have the force of law is a common law principle and arguably not one that parliament could affect by statute. As such, it must surely be weighed with other common law principles in any particular case. Walker cites recent case law in which courts have found grounds for 'politely declining' to find that offensive 'outer clauses' in legislation have application in particular cases. In so doing, he suggests that they have in effect constructed "an entrenched common law doctrine of the separation of powers".[422]

Senior members of the judiciary in New Zealand have made it clear in recent years that they regard parliamentary power as potentially limited. High court judge and former president of the New Zealand Law Commission, Baragwanath J, discussed the issue explicitly in *Cooper v Attorney-General* 1996. He listed, without dissent, four cases in which Cooke J had warned by dicta that the judiciary reserved the right to declare that

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420 Blackstone, *op cit*.

421 As quoted by Ellis Sandoz, *Presidential Studies Quarterly*, *op cit*.

422 Walker, *op cit*, pp 144–161, and p 156 in particular.

some common law rights lie so 'deep' that even parliament could not override them. Both Baragwanath and Cooke clearly suggest that parliament might not be able to deny an individual access to the courts for the determination of their rights. Both explicitly accept that parliament has the right to remove by statute property rights that have been conferred by statute. However, their observations do not eliminate the possibility that courts could rule one day that property rights not conferred by statute, such as land rights, may not be removable by parliament, or perhaps could only be removed on payment of full compensation.

Baragwanath's judgment referred specifically to constitutional conventions and the Magna Carta, and expressed the coded warning that:

> … it is inconceivable that our Parliament would infringe the rule of law so as to destroy any right that is truly fundamental.[423]

The courts appear to be more willing to question the validity of the Crown's immunity from prosecution and to contemplate the possibility that they might one day rule that a parliamentary action is unconstitutional.

Baragwanath attributes this changed assertiveness in part to the passing of the New Zealand Bill of Rights Act 1990.[424] In particular, in *Simpson v Attorney-General* 1994 (known as Baigent's case), the Court of Appeal found that the police had illegally searched Mrs Baigent's house and were in breach of the New Zealand Bill of Rights Act 1990. More significantly, it determined that where such a right was breached there should be a remedy in the form of the right to claim damages for the breach, as a matter of public law rather than of tort.[425]

Baragwanath, in the same speech, makes it clear that the shift from the view that the King can do no wrong to the view that the roles of the state should be subordinate to promoting the interests of individual citizens "has considerable potential in current thinking about human rights".

Sir Geoffrey Palmer has also recently acknowledged the importance of a presumption by the courts that they will only recognise that property rights have been taken away if clear language is used.[426]

Even so, the implications of these developments for regulatory reform are far from clear. Judicial assertiveness could as easily be used to undermine the rule of law as to strengthen it.

Section 7.4.3 briefly considers reform possibilities.

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423 *Cooper v Attorney-General, New Zealand Law Review*, 1996, p 498.

424 Baragwanath, D, 'The Impact in New Zealand of Human Rights Legislation', address to Australasian Law Reform Agencies Conference, Melbourne, 16 September, 1997.

425 New Zealand Law Commission, *Crown Liability and Judicial Immunity: A Response to Baigent's case and Harvey v Derrick*, Report 37, Wellington 1997, p 4.

426 Sir Geoffrey Palmer, *'Westco Lagan v A-G'*, *New Zealand Law Journal*, May 2001, p 166.

6.4 The rule of law

6.4.1 The concept of the rule of law

Socrates said that laws should be clear and known in advance, that citizens should have an opportunity to criticise them and that there should be a means for having them changed.

Aristotle, arguing that no ruler can be a sound judge of his own cause, stated that:

> … the rule of law, it is argued is preferable to that of any individual … Therefore he who bids the law rule may be deemed to bid God and Reason alone rule, but he who bids the man rule adds an element of the beast; for desire is a wild beast and passion perverts the minds of rulers, even when they are the best of men. The law is reason unaffected by desire. … Hence it is evident that in seeking for justice men seek for the mean or neutral, for the law is the mean. Again, customary laws have more weight, and relate to more important matters, than written laws, and a man may be a safer ruler than the written law, but not safer than the customary law.[427]

Former University of Queensland law professor Geoffrey de Q Walker identifies at least three distinct senses in which the rule of law term is used. The rule of law is assumed to prevail when:

- a state of law and order prevails, as distinct from a state of anarchy;
- the legality of governmental actions is determinable by independent courts of law; or
- there are limits to the scope of legislative power.

The first sense is unexceptional for the purposes of this inquiry. However, it is of some importance in that regulations that violate legitimately held property rights are likely to undermine respect for the law and politicise the community. Burke expressed the concern as follows:

> People crushed by the law have no hopes but from power. If laws are their enemies, they will be enemies to laws; and those, who have much to hope and nothing to lose, will always be dangerous, more or less.[428]

The second sense relates to administrative law. This is relevant to our inquiry, but it does not get to the fundamental problem of policies that are legal but inefficient, if not tyrannical.

The third sense is fundamental to our inquiry. If the government is to be constrained from abusing its coercive powers it must be constrained in respect of the content of the legislation it can pass.

Rulers subject to the rule of law cannot use the coercive powers of the state arbitrarily to bolster their own position at the expense of the community at large. Unless those

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427 Aristotle, *Politics*, III, translation by Benjamin Jowet, http://eserver.org/philosphy/aristotle/politics.txt.

428 Edmund Burke, letter to Charles James Fox, 8 October, 1777, *The Oxford Dictionary of Quotations*, p 159.

who wield power conform to rules and laws that they cannot amend at will, their powers are unlimited and tyrannical.

The concept of a rule of law has a long antiquity, being well understood in Roman times. Under *jus civile*, the Roman civil law, Romans enjoyed a level of security in their property and protection against arbitrary power that was rare in the ancient world. Greek statesman Polybius spoke extremely highly of the sense of duty, honour and commitment to the law and strong social institutions that prevailed amongst Roman leaders around the time of the fall of Carthage.[429]

Walker describes the rule of law as a legal and constitutional doctrine that reconciles the need to constrain the use of governmental power with the need for flexibility.[430] He does not believe the concept can be defined precisely. Like the concepts of peace and freedom, its absence is more obvious than its presence.

The presence of the rule of law implies an attitude of restraint, respect by all individuals and groups of an obligation to comply with the law and the absence of arbitrary coercion by governments or any other groups.

Inevitably the doctrine expresses an ideal, something that imperfect societies must aspire to achieve rather than expect to attain perfectly. Hayek comments on its role as a guide or ideal as follows:

> It is a doctrine concerning what the law ought to be, concerning the general attributes that particular laws should possess. This is important because today the conception of the rule of law is sometimes confused with the requirement for mere legality in all government action. The rule of law presupposes complete legality, but this is not enough: if a law gave the government unlimited power to act as it pleases, all its actions would be legal, but it would certainly not be under the rule of law. The rule of law therefore, is also more than constitutionalism: it requires that all laws conform to certain principles.
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> From the fact that the rule of law is a limitation upon all legislation, it follows that it cannot itself be a law in the same sense as the laws passed by the legislator. Constitutional provisions may make the infringements of the rule of law more difficult. They may help to prevent inadvertent infringements by routine legislation. But the ultimate legislator can never limit his own powers by law, because he can always abrogate any law he has made. The rule of law is therefore not a rule of the law, but a rule concerning what the law ought to be, a meta-legal doctrine or political ideal. It will be effective only in so far as the legislator feels bound by it. In a democracy this means that it will not prevail unless it forms part of the moral tradition of the community, a common ideal shared and unquestionably accepted by the majority.[431]

Walker concurs with the view that the rule of law must limit the content of legislation to conform with certain principles. He explains that the rule of law doctrine:

> … must have something to say about the substantive content of the enactments that issue from the legislative arm of government. Otherwise, government will be able to simply alter and redefine the law in whatever way suits its purposes,

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429 See, for example, Kirk, *op cit*, pp 98–102.

430 See Walker, *op cit*, p 1.

431 Hayek, *The Constitution of Liberty*, *op cit*, pp 205–206.

with the state, as Kelsen said, in the position of a King Midas that is able to turn everything it touches into law.[432]

6.4.2 Implied constraints on the form and content of legislation

This leads to the question of what can be said about the nature of the constraints on the content of legislation that would be required by the rule of law.

One approach is to characterise the rule of law by exception. Section 3.3 sets out Fuller's eight 'routes to disaster' in making rules:

- failing to achieve a rule at all, thereby leaving every issue to be decided on an *ad hoc* basis;
- retroactive legislation;
- failing to make rules understandable;
- enacting contradictory rules;
- requiring conduct beyond the powers of the affected party;
- failure to administer the rules as announced;
- changing the rules so frequently that actions cannot be aligned with them; and
- failing to make the rules available to those who are expected to comply.[433]

Fuller comments that a total failure in any one of these eight dimensions would result in something that could not properly be called a legal system at all. Instead, nothing would be left on which to ground a citizen's duty to observe the rules. The citizen would face a more difficult predicament when there was no total failure in any of the eight dimensions but rather a general and drastic deterioration in legality with tyrannous effects, as in Germany under Hitler.

Multiple objectives facilitate rules of the first type. For example, the decision as to whether to deny an import licence on the basis of the need to promote domestic production and create employment or to grant it for the benefit of consumers is arbitrary if the regulator is instructed to serve all three objectives. Consent decisions under the RMA may well be made on an *ad hoc* basis for the same reason.

Cases of retrospective legislation in New Zealand were noted in sections 2.2.3 and 2.2.6 in relation to tax and home invasion legislation. Legislation that expropriates property without compensation and without proof of unlawful behaviour can also have this character. One example, the *Westco Lagan* case, was mentioned in section 6.3. Sir Geoffrey Palmer provides more examples in the paper cited in the same section.

It is all too common for laws in New Zealand to contain key terms whose legal meaning can only be guessed at prior to actual court rulings. Laws based on such fuzzy concepts as 'sustainability, 'good faith bargaining', 'intrinsic values', 'conduct likely to mislead or deceive', 'take all practicable steps', 'not abuse a dominant

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[432] Walker, *op cit*, p 4.

[433] Fuller, Lon, *The Morality of Law*, Yale University Press, New Haven, 1969, p 39.

position', 'comply with [unwritten] principles' of a treaty, or be 'fair or 'reasonable' abound. The difficulties that legal specialists face in drafting legislation based around such fuzzy concepts were charmingly summed up in the English pamphlet, The Preparation of Bills (1948) as follows:

> Nothing is more hampering to the Parliamentary Counsel, when the drafting stage is reached, than to be obliged to build what is usually a complex structure round 'sacred phrases' or forms of words which have become sacrosanct by reason of their having been agreed upon in Cabinet or in one of its committees. A still more serious objection to agreed form of words of this kind is that they often turn out to represent agreement upon words only, concealing the fact that no real compromise or decision has been reached between conflicting views upon some important question.

Contradictory legislation is also all too easy to find in New Zealand. The 'home invasion' legislation cited in section 2.2.6 provides one example. Human rights and bill of rights legislation that at once asserts freedom of association (and speech) and denies it in the workplace provides another example. Moreover, the drive for privacy that is evident in the Privacy Act 1993 is at odds with the drive to make disclosure mandatory, as is illustrated by the forced disclosure of ranges for senior executive salaries in the private sector.

Legislation (or court rulings) that extend the liability of employers or manufacturers far beyond the ability of those parties to control the behaviour of others illustrates Fuller's fifth category. A recent ruling making employers liable for the sexual behaviour of employees outside work hours and off-premises illustrates the relevance of this issue in New Zealand. So does a recent court case extending employer liability for employee suicides, allegedly for work-related stress. Even so, tort law developments in the United States, for example, in respect of tobacco and asbestos, are surely more pathological in this respect.

In respect of Fuller's sixth point, complaints that regulations are inadequately enforced are common. Often these complaints are opportunistic and self-serving, being made by those who would hope to benefit from the further regulation they may be advocating. Complaints about the inadequate enforcement of antitrust regulation by competitors of a dominant incumbent commonly fall into this category. At a more fundamental level, bad or draconian legislation may either have to be enforced with tyrannous consequences, or not enforced. The insider trading legislation passed in New Zealand in 1988 after the global sharemarket crash in 1987 arguably falls into this category. But this legislation itself, in the view of respected commercial lawyer Stephen Franks, arose in part because the longstanding commercial laws guarding against fraud and self-dealing were being inadequately enforced by the authorities and the commercial community, thereby bringing sound existing law into disrepute.

In respect of the seventh point above, section 2.2.6 highlighted the frequency of the amending Acts and the churning of regulations in New Zealand. Section 2.2.4 cited the particular case of a $100 million canal development that was stopped at one stage on the grounds that it did not comply with legislation that did not exist when the plan was prepared.

To illustrate the eighth point, section 2.2.6 cited the New Zealand Law Commission's view on the inaccessibility of too much of the law.

This illustrative discussion serves to motivate the concepts rather than to establish systemic fault. Failures in any or all of Fuller's eight dimensions do not prove in themselves that the legal system is defective. There is no attainable legal utopia in which all laws are perfect in all respects. Even if outrageous or merely gratuitous breaches are avoided, the stringency with which the eight desiderata should be applied, and the priority rankings in any case, depend on judgments about the best balance between competing considerations. One relevant factor will be the type of law under consideration. For example, a new statute creating a new crime retroactively is thoroughly objectionable.

Fuller concludes that, while it is easy to see that laws should be clearly expressed in general rules that are prospective in application and known to the citizen, finding the right balance in trading off these attributes where it is necessary to do so requires the skill of an expert law maker. Clearly, Fuller's criteria have implications for the content of legislation.

In similar vein, Adam Mikkelsen has argued that Dicey's conception of the rule of law also prescribes both the general content of legal rules and the limits to state power. In particular, Dicey asserts that a rule of law would exclude laws that allow a government to act arbitrarily, to enjoy prerogative power, or even to enjoy wide discretionary authority.[434]

Marshall similarly observed recently that:

> … the most obvious and undisputed convention of the British constitutional system is that Parliament does not use its unlimited sovereign power or legislate in an oppressive or tyrannical way.[435]

(Of course the value of this constraint depends on what is deemed to be oppressive or tyrannical taxation or regulation.)

Walker takes the opposite approach of exploring principles that might characterise the rule of law positively:

> The substantative law must be guided by the principle of 'normativism'. This notion means that the substantive law must possess characteristics of certainty, generality and equality. Certainty means, as Dr Raz explains, that all laws should be prospective, open and clear, and that they should be relatively stable …. The certainty principle condemns the enactment of excessively vague laws that delegate to administrators and judges the power to deal arbitrarily with the citizen ... Unless the law is specific in terms and general in application, and remains so over time, it ceases to be a system of norms and gives the government scope to become arbitrary in its behaviour. Citizens cannot orient their conduct by law if what is called law is simply a series of patternless exercises of state power.[436]

Mikkelsen concludes that the following three principles for the form and content of laws are fundamental if the rule of law is to exist:

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434 Mikkelsen, *op cit*, p 39.

435 Marshall, G, *Constitutional Conventions: The Rules and Forms of Political Accountability*, Clarendon Press, Oxford, New York, 1987.

436 Walker, *op cit*, p 42.

- rules of conduct must be general in application;
- general laws must be abstract; and
- rules of conduct must be equal in application.

He suggests that the importance of the first cannot be over-emphasised. General rules allow individuals to plan and predict conduct. The venerable common law prohibitions against trespass, assault, theft and slander are general in application.

Abstract rules define the legality of conduct, regardless of time, place or person – as in: 'Keep your hands to yourself'. It would be very hard for a person in power or a political majority to use such a rule to gain at the expense of a minority.

Walker expresses the third principle as follows:

> The equality [before the law] principle is the main basis for protecting the general interest against inroads by pressure groups and other special interests. It restrains, or should restrain, a legislature from enacting bills of attainder or other laws which unilaterally benefit or injure particular individuals or groups. This is particularly important in view of the current role of government as a dispenser of favours and redistributed wealth.[437]

A Bill of attainder is a legislative Act that singles out one or more persons and punishes them without the benefit of a trial. James Madison, in *The Federalist Papers*, No 66, commented that:

> Bills of attainder, ex post facto laws, and laws impairing the obligations of contract are contrary to the first principles of the social contract, and to every principle of sound legislation …

One source of constraint on those controlling sovereign power might be a strong sense of personal and civil rectitude and respect for the sanctity of well-established institutions. This form of 'unwritten constitution' is important in English jurisdictions. It also appears to have been very important at the height of the Roman empire.

As part of such a constraint, long-inherited values may be deemed to put some things beyond the power of governments to over-rule. These may include, for example, the presumption of innocence, the right to a fair, speedy and public trial and the presumption against retrospective legislation. Respect for the institution of common law, the largely decentralised law of judges, not of parliament, would also support a rule of law.

Hayek makes a separate case for rules of general application. His argument emphasises the need for general laws because law makers lack the information about facts and preferences necessary for success in respect of laws that attempt to prescribe outcomes. Hayek's analysis suggests that rules with the following characteristics might be deemed to accord with the rule of law:

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[437] Walker, *op cit*, p 25–26.

- government is bound by rules fixed and announced beforehand;
- no individual or body can use the coercive power of the state to discriminate against individual people;
- the rules determine the conditions under which available resources are to be used but leave decisions as to ends to individuals;
- it is impossible to know who will be assisted;
- the government is prevented from stultifying individual efforts by *ad hoc* action;
- no reference is made to time and place or particular people;
- the future actions of the state are made more predictable;
- other people's behaviour can be predicted more accurately;
- individuals can know precisely how far they are protected from others and from the state; and
- they are intended to be permanent and are not used to favour or harm particular people.

There is a striking overlap between Hayek's strictures and the earlier ones. The problem of constraining the abuse of sovereign power that arises from excessive paternalism and presumptions of knowledge about how best to satisfy diverse human needs is not unlike the problem of constraining the sovereign power to engage in predation.

Conversely, laws would not comply with the rule of law under Hayek's regime if they:

- direct the means of production to particular ends;
- attempt to provide for the actual needs of people as they arise;
- require the merits of diverse needs to be assessed; and
- make reference to what is 'fair' or 'reasonable'.

Clearly much of the legislation reviewed in section 2 would fail these tests. Laws promoting energy efficiency, sustainable development, safety and 'protecting' the environment all fall into the first category when citizens are denied the opportunity to contract out or opt out of these liabilities or harms. Welfare safety nets and even commercial insurance arrangements would appear, on the face of it, to fail the rule of law under the second or third bullet points. However, private insurance arrangements are voluntary and not the law. Difficulties arise when the state uses taxes derived from the population at large, some of whom are needy, and redistributes them on the basis of bureaucratic assessments of need.[438]

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[438] A well-known exchange on the constitutional aspects and informational difficulties that confront governments in deciding from whom to take and give is provided in *The Life of Colonel David Crockett*, compiled by Edward S Ellis, Porter and Coates, Philadelphia, 1884. It was recently republished in *Ideas on Liberty*, Foundation for Economic Freedom, No 7, July 2000. In section 2 we cited the case of state legal aid in New Zealand to delinquent parents who were using it to harass grandparents.

6.4.3 Two related constitutional constraints – taxation and eminent domain

Mikkelsen identifies two fundamental longstanding rules that directly limit the power of government. He suggests that these rules should be taken as an absolute constitutional presumption. Their breach should be regarded with utmost seriousness.

The rules comprise:

- the rule of compensation for takings under the power of 'eminent domain'; and
- the rule of 'no taxation without consent'.

There is a coherence between these rules. Consent lies at the heart of Aristotle's conception of democratic government as a partnership between free individuals whose prime purpose is to provide for justice between people. No one person can coerce another. Free individuals who come together to agree that powers of coercion have to be exercised by government could not be expected to agree that they would be used for predatory purposes rather than for mutual advantage.

When the government exercises the power of eminent domain or taxes in order to fund services that serve the common advantage, its purpose is to complete transactions that would have been conducted privately but for particular problems of hold out and public goods. Under voluntary exchange, compensation would be paid in the form of due consideration. The compensation clause mimics this property – this test of mutual benefit.

Similarly, the test as to whether the benefits to taxpayers from the provision of a public good exceed the costs is whether taxpayers will vote for the necessary level of taxes. If, as a body, they or their representatives fail to so vote, the implication is that the benefits fall short of the costs. This test mimics the test for the desirability of the supply of a private good: if consumers will not vote for its supply with their money, it will not be supplied.

Both the principles of consent and compensation accord with the common equity notion that 'those who benefit should pay'.

Blackstone summarises English law on this subject in 1775 in the following terms:

> So great moreover is the regard of the law for private property, that it will not authorize the least violation of it; no, not even for the general good of the whole community. If a new road, for instance, were to be made through the grounds of a private person, it might perhaps be extensively beneficial to the public; but the law permits no man, or set of men to do this without consent of the owner of the land. In vain may it be urged, that the good of the individual ought to yield to that of the community; for it would be dangerous to allow any private man, or even any public tribunal, to be the judge of this common good, and to decide whether it be expedient or no. Besides, the public good is in nothing more essentially interested, than in the protection of every individual's private rights, as modeled by the municipal law. In this, and similar cases the legislature alone can, and indeed frequently does, interpose, and compel the individual to acquiesce. But how does it interpose and compel? Not by absolutely stripping the subject of his property in an arbitrary manner; but by giving him a full indemnification and equivalent for the injury thereby sustained. The public is now considered as an individual, treating with an

> individual for an exchange. All that the legislature does is to oblige the owner to alienate his possessions for a reasonable price; and even this is an exertion of power, which the legislature indulges with caution, and which nothing but the legislature can perform.

In the United States, the Constitution provides several safeguards for the rights to one's own possessions.

The so-called '*takings clause*' in the Fifth Amendment provides that:

> … nor shall private property be taken without just compensation.

The government's power to take private property only for public use is known as the power of *eminent domain*. This 'takings clause' is also called the 'eminent domain' clause. The obligation to compensate ensures in principle that the state can only force exchanges on people if individuals are left with *rights* at least as valuable at the moment of the exchange as the *rights* they are being forced to relinquish.[439]

The *due process* clauses in the Fifth and Fourteenth amendments state:

> … nor shall any person … be deprived of … property without due process of the law.

While the due process clauses appear to be solely procedural, Meltz, Merriam and Frank state that the Supreme Court has long read a substantive component into them. This is that government Acts be non-arbitrary and sufficiently related to a legitimate government objective.

The Supreme Court's test of whether the government's objective is legitimate is whether it furthers the public health, safety, morals or welfare.[440] The government's power to take action to stop public nuisances – private actions that violate individual rights but for which individual action is too costly – is called the *police power*.[441] No compensation is due in relation to such government actions because they do not violate any common law rights.

A state can only protect the people against force and aggression if it has lawful police power. Police power allows the state to act on behalf of the many when the actions of someone breach any of the full range of common law wrongs – force and misrepresentation, deliberate or accidental, against other persons, including private nuisances. This power allows the state to regulate private conduct that would constitute a public nuisance. In particular, the state can step in to stop a wrong against many individuals, each of whom suffers a compensable harm that is so small that private enforcement is too costly.[442]

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439 Unrelated parties might be worse or better off in terms of the value of their ongoing rights. But as long as this simply reflects their exposure to an uninsured risk and violates none of their common law rights, no issue of compensation arises.

440 Robert Meltz, Dwight Merriam and Richard Frank, *The Takings Issue: Constitutional Limits on Land Use Control and Environmental Regulation*, Island Press, Washington, DC, 1999, p 16.

441 For a lengthy discussion of the term and the concept, see chapters 9 and 10 in Richard Epstein (1985), *Takings: Private Property and the Power of Eminent Domain*, *op cit*.

442 See Epstein (1985), *op cit*, p 112, for a reference to this definition of a public nuisance.

In short, a government taking is non-compensable if it represents the exercise of the state's police power to stop a public nuisance. Conversely, it is compensable if it represents the use of the power of eminent domain to confer a public benefit. All that would be needed to eliminate the distinction, and make all takings non-compensable, would be to define a public nuisance as something that prevents the conferring of a public benefit.[443] With that achieved, all it would take to reduce individual and economic freedom without limit would be to interpret any lawfully passed legislation as being for the public benefit. Alternatively, parliament or the courts could inexorably expand the definition of a public benefit through time.

Changes in the United States in the scope of the definition of a public nuisance and, therefore, in the scope of the claim of police power as the justification for a regulation illustrate the dynamic nature of definitions of harm. As discussed in section 6.4.3, a public nuisance was once understood to be limited to cases involving public health, safety, morals and general welfare. The tight limits were reaffirmed in 1905 in *Lochner v New York*. In this case the Supreme Court rejected the proposition that the government could impose a particular labour law as a police power.[444]

However, only a few years later, in *Miller v Schoene* in 1928, the Supreme Court made a decision that the government had the right to cut down cedar trees with a fungus that was a threat to neighbouring apple trees. Further, it could do so without compensation and without regard as to whether the cedar trees constituted a nuisance under common law. According to Richard Epstein, in so doing the court abandoned all efforts to distinguish police power from public use or to place principled limitations on the scope of the police power.[445]

The need for careful, limited definitions of the concepts of a nuisance and public use is a major theme of the remaining chapters in this study. Confusion about these issues has the potential to be a major cause of muddle-headed policies and endless strife. The critical need is to maintain a clear distinction between a government action that controls a defendant's common law wrong and a taking for a public use or benefit.

Typically compensation under a takings clause might take place by restitution, whereas a government regulation that violated a due process clause would be declared invalid.

In addition, the US Fourth Amendment conferred upon the citizenry:

> the right … to be secure in their persons, houses, papers, and effects against unreasonable searches and seizures.

Meltz, Merriam and Frank recently summed up the state of the law in the United States as follows:

> It is by now well settled that the legislative branch of government can affect a compensable taking of property purely through enactment of a statute; that the executive branch can trigger a Fifth Amendment taking when it carries out government police powers and that the executive and legislative branches can

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443 In the absence of a neutral (common law) benchmark, stopping B from swinging a fist into A's nose can be seen as preventing a harm to A, or conferring a benefit on A. The choice is arbitrary.

444 Epstein (1985), *op cit*, p 108.

445 Epstein (1985), *op cit*, p 114.

> suffer joint liability in some circumstances where the former implements an unconstitutional statutory programme enacted by the latter.[446]

In *Burmah Oil Co (Burma Trading) v Lord Advocate* in 1965 Lord Radcliffe found that:

> If the civilian writers are consulted … there is not much room for dispute about their general view. The sovereign power in a state has the power of eminent domain over the property of subjects, but may exercise its power only for the public welfare or advantage or in case of necessity … The power covers use, acquisition and destruction. If it is exercised, compensation to the person dispossessed is manifest equity, since it is not fair that one citizen should be required against his will to make a disproportionate sacrifice to the common wealth.[447]

This famous declaration arguably established that government does not have any open-ended right to take property without compensation. However, the judgment was quickly followed by the War Damages Act 1965 (UK) that precluded further recovery on such grounds.

In New Zealand, the traditional right to compensation is illustrated by the following pieces of legislation.

Section 60 of the Public Works Act 1981 states (prior to its amendment in 1987):

> **60. Basic entitlement to compensation**–(1) Where under this Act any land–
>
> (a) Is acquired or taken for any essential[448] work; or
>
> (b) Suffers any injurious affection resulting from the taking of any other land of the owner for any essential work; or
>
> (c) Suffers any damage from the exercise (whether proper or improper and whether normal or excessive) of–
>
> i. Any power under this Act; or
>
> ii. Any power which relates to a public work and is contained in any other Act–
>
> and no other provision is made under this or any other Act for compensation for that acquisition, taking, injurious affection, or damage, the owner of that land shall be entitled to full compensation from the Minister or local authority as the case may be, for such acquisition, taking, injurious affection, or damage.

Part VII of the Town and Country Planning Act 1977 that was repealed by the RMA similarly confirmed the right to 'full' compensation for the injurious affects on any land or estate caused by provisions in district schemes and controls on development in the absence of the scheme. Section 126 read as follows:

> 126. Persons injuriously affected may claim compensation–(1) Every person having any estate or interest in any land taken for any purpose authorised by

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446 Meltz *et al*, *op cit*, p 154.

447 Cited by Rowan-Robinson and Brand C in Jeremy Rowan-Robinson and C Brand, *Compulsory Purchase and Compensation*, Sweet and Maxwell, London, 1995.

448 In 1987 an amending Act, *inter alia*, replaced the word 'essential' by 'public' in both 60(a) and 60(b).

> section 81 of this Act or otherwise for the purposes of an operative district scheme, or in any land, buildings, or other improvement injuriously affected by the operation of any such scheme or of any refusal or prohibition under Part II of this Act, shall, subject to the provisions of this section, be entitled to full compensation for all loss thereby sustained by him.
>
> (2) Except as otherwise provided in this Act, claims for compensation under this section shall be made and determined in accordance with [the Public Works Act 1981] in respect of land taken under this Act, or in respect of damage done from the exercise of any powers conferred by this Act.

Section 145 of the Soil Conservation and Rivers Control Act 1941 similarly acknowledges the right to compensation:

> 145. Compensation for injury or damage–(1) Every person having any estate or interest in any land taken by any Board for any of the purposes of this Act or injuriously affected thereby, or damaged or injuriously affected by the construction of any works by any Board, or suffering any damage or injurious affection from the exercise by any Board of any other power conferred on it (not being a power conferred by [or under section 149 or paragraphs (b), (e), (f), and (g) of subsection (1) of section 150] of this Act), shall be entitled to full compensation for the same from the Board.

This section was not repealed by the RMA.

The most recent, May 2001 *LAC Guidelines*, state unequivocally that the "principle that property will not be expropriated without full compensation" is a fundamental common law principle. Those preparing legislation are required to establish whether it complies with all the listed fundamental principles. If it does not, the guidelines require the reasons for non-compliance to be determined and the matter referred to the attorney-general.[449]

We discuss the compensation rule extensively in section 7.5.

Mikkelsen argues that the rule of 'no taxation without consent' reflects the "fundamental principle of the Westminster parliamentary tradition that the Crown may not tax the populace without its common assent, expressed through the representatives of the people sitting in Parliament".[450] Mikkelsen traces the origin of this rule from the Magna Carta through the 1340 petition of the Commons, the Petition of Right 1627, article 4 of the Bill of Rights Act 1688 and New Zealand's Legislature Act 1908 to the existing section 32 of the New Zealand Constitution Act 1986. This section states that:

> Parliamentary control of public finance – It shall not be lawful for the Crown, except by or under an Act of Parliament,–
>
> (a) to levy a tax; or
>
> (b) to raise a loan or to receive any money as a loan from any person; or
>
> (c) to spend any public money.

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[449] Legislative Advisory Committee, *LAC Guidelines: Guidelines on Process and Content of Legislation*, *op cit*, pp 49–50.

[450] Mikkelsen, *op cit*, p 46.

The state must obtain the consent of the people's representatives in parliament if it wishes to tax the people.

Blackstone stated in his *Commentaries*:

> … no subject of England can be constrained to pay any aids or taxes even for the defense of the realm or for the support of government, but such as are imposed by his own consent, or that of his representatives in parliament … And what that common assent is, is more fully explained by 34 Edw. I st. 4. cap. I, which enacts that no talliage or aid shall be taken without assent of the arch-bishops, bishops, earls, baron, knights, burgesses, and other freemen of the land …[451]

The issue of what constitutes consent is a moot point. What guide do precedents provide as to what majority constitutes 'consent'? Leoni cites a scholarly view that in medieval England consent meant "no taxation without the consent of the individual taxed". He cites a case in 1221 in which the Bishop of Winchester successfully refused to pay a scutage tax on the grounds that he had dissented when the decision to levy it was made. Leoni suggests that the subsequent evolution of this concept to the notion that a majority of taxpayers could determine the issue reflected expediency.[452]

The principle that those who are to be taxed must give their consent must surely apply, at least in principle, to any subgroup of the people as well as to the people as a whole. However, it is not practical or desirable to have separate parliaments for each subgroup in the community.

This takes us to the heart of the issue of the role of the state in respect of redistribution that was raised in section 3.4. What if a majority of the people's representatives seek to take from a minority, either through tax or through regulation, for the benefit of the majority without the consent of the minority? Such a situation surely offends notions of natural justice. There is an argument that having a majority determine a matter that binds all is less offensive than having a minority bind all. But a simple parliamentary majority fails this test if a majority faction that does not enjoy the support of a majority of voters or their representatives on the issue effectively makes the decision within the governing party or coalition.

There appears to be no 'magic bullet' that addresses such voting concerns satisfactorily. Clearly, it is impractical to require unanimity amongst taxpayers as a general rule. Addressing the issue requires weighing up the merits of diverse partial responses, considered in combination or in isolation. One possibility is to require a supra-majority or a qualified majority to pass a tax that lacks proportionality.[453] Special taxes that leave those who do not benefit outside the loop (such as a road-use related petrol tax) may be appropriate in some circumstances. Richard Epstein has proposed that, as a matter of principle, public policies should attempt to fund any public redistribution out of general revenues collected from the same group of individuals that votes the programme into place.[454] Bans on the type of taxes that can be imposed that eliminate those that lend themselves to majoritarian abuse are another possibility. In the United States there is a ban on export taxes. Another option might be to apply a 'public

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451 Blackstone, *op cit*, Book I, Chapter I.

452 Leoni, *op cit*, p 118. See also his discussion of supra-majority rules, pp 241–248.

453 See for example, Leoni, *op cit*, p 178, footnote 5 and Hayek, *The Constitution of Liberty*, *op cit*, ch 7.

454 Epstein (1995), *Simple Rules for a Complex World*, *op cit*, p 145.

interest' test to the purposes for which taxes can be levied, that is analogous to the tests that could be applied when the Crown takes land or property under the power of eminent domain.[455]

6.4.4 The significance of the rule of law

The rule of law is almost synonymous with constitutionalism. It would be difficult to exaggerate the importance of the existence of a rule of law for civil society.

Walker states that "The rule of law is in fact an essential precondition for all civilized life".[456]

He describes the rule of law in Westminster systems as one of the two pillars of constitutional theory that took their shape in the settlement of the revolution in 1688. (The second pillar is the sovereignty of parliament rather than of the monarch.)[457]

Paul Johnson, reviewing for the *Wall Street Journal* some of the most significant trends in the last millennium, asserted that:

> The most important political development of the second millennium was the firm establishment, first in one or two countries, then in many, of the rule of law.[458]

Johnson argued that the Romans failed to maintain the rule of law when powerful men managed to turn Rome into a republic in which the emperor was above the law. He thereby dates the rule of law to the eleventh and twelfth centuries, singling out Pope Gregory VII and Henry II of England as two critical figures.

Abraham Lincoln described the rule of law as:

> … the greatest barrier against despotism ever conceived by the human mind.

Under a rule of law, none are above the law. The poorest man or woman can bring the highest to a court of justice. Edmund Burke summed up the freedom inherent in this aspect of the rule of law as follows:

> The poorest man may, in his cottage, bid defiance to all the forces of the Crown. It may be frail, its roof may shake; the wind may blow through it; the storms may enter; the rain may enter – but the King of England cannot enter; all his forces dare not cross the threshold of that ruined tenement.

(Of course, the King can enter under a valid warrant. The security of Burke's "poorest man" therefore rests on the application of the rule of law to the issuance of warrants.)

The rule of law also protects individuals against the brute force of other individuals. Jeremy Bentham, a passionate supporter of the rule of law that preserves private property, commented that:

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455 We are grateful to Richard Epstein and Wolfgang Kasper for their assistance on the problem of consent.

456 Walker, *op cit*, p 395.

457 Walker, *op cit*, p 2.

458 Paul Johnson, 'Laying Down the Law', *Wall Street Journal*, 10 March, 1999.

> The law that gives security to private property is 'the noblest triumph of humanity over itself'.[459]

Protection against arbitrary power and force is a necessary freedom for human dignity. George Washington fervently expressed this sentiment in this extract from the final sentence of his Farewell Address on 19 September, 1796 that marked his retirement as president:

> ... I anticipate with pleasing expectation that retreat, in which I promise myself to realize, without alloy, the sweet enjoyment of partaking, in the midst of my fellow Citizens, the benign influence of good Laws under a free Government, the ever favourite object of my heart and the happy reward, as I trust, of our mutual cares, labors and dangers.

6.4.5 Establishing a rule of law

The notion that a sovereign or, in a modern democracy, a political majority, is not free to deprive arbitrarily any individual, or a political minority, of life, liberty, or property echoes through the centuries. Civil wars have been fought over the balance between sovereign power and individual rights and liberties.

Notions of entrenched rights and freedoms can be traced back at least as far as Aristotle. The rhetorical power of the US Declaration of Independence in 1776 is based on its assertion of unalienable rights. Echoes of it have reached New Zealand in the New Zealand Bill of Rights Act 1990. This section discusses these concepts in greater detail.

Notwithstanding the power of such rhetoric, history demonstrates that the rule of law is hard won and easily lost. Paul Johnston suggests that it exists only where a group emerged that was powerful enough to force the government not to abuse its coercive powers.[460] Any observed statutes or written constitutions that seriously restrain governmental powers result from the prior existence of a rule of law, otherwise they could not have emerged. Written and unwritten constitutions are a consequence of a rule of law, not its cause.

From the earliest of times practical constraints and countervailing forces have limited the power of a monarch. These countervailing forces may have come from a powerful church, other family members who were credible contenders for the throne, powerful feudal lords, opposing monarchies who could be invited to invade in order to displace an existing monarch, and the landowning aristocracy. In more recent times, the growth of the merchant class and a middle class has extended the range of property owners.

According to Johnston, the battle to constrain the abuse of sovereign power typically lasts for centuries and takes the form of incremental gains and losses. In English history the Magna Carta remains a seminal event.[461] It was forced on King John I by the

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459 Bethell, *op cit*, as cited on the dust jacket.

460 Johnston, Paul, *The Tree of Liberty*, The Locke Institute, Fairfax, Virginnia, 1998.

461 James Q Wilson, 'Democracy for All?', *Commentary*, March 2000, cites the late Erwin Griswold, Harvard Law School, as saying that the Magna Carta is more important for what it came to be than for what it was at the time. On at least 40 occasions over several centuries kings found themselves obliged to restate their loyalty to it, thus increasing its authority.

countervailing economic and military power of a landowning aristocracy who objected to the arbitrary exercise of sovereign power.

A crucial clause from the much cited chapter 29 read:

> No freeman shall be taken or imprisoned, or be disseised [dispossessed] of his freehold, or liberties or free customs, or be outlawed, or exiled, or any otherwise destroyed; nor will we not pass upon him nor condemn him but by lawful judgment of his peers, or by the law of the land. We will sell to no man, we will not deny or defer to any man either Justice or Right.[462] (The interpretation in the square brackets is not in the original.)

The Magna Carta constrained monarchs to abide by the law of the land. Under the system of English common law, this was not the law of the sovereign. If it were, the barons at Runnymede would have committed a futile and doubtless self-terminating act of defiance against an enraged sovereign – and King John would have had no reason to resist signing it.

The Magna Carta disposed of the notion, in England, that hierarchy could put a monarch (or anyone else) above the law. As a matter of law, the poorest in the land could call the highest to account in a court of law and expect equal treatment. Everyone, regardless of their status, is subject to the ordinary law of the land and the jurisdiction of the ordinary courts.[463]

In New Zealand, the Magna Carta still carries weight. The relevance of chapter 29 to New Zealand law was confirmed by its inclusion in the first schedule to the Imperial Laws Application Act 1988. In 1997, the New Zealand Law Commission referred to the New Zealand Bill of Rights Act 1990 as developing the protection of the citizen provided for in the Magna Carta.[464] The Law Commission explicitly stated that:

> The Crown and other public bodies should have no power or immunity beyond those of the citizen, except to the extent necessary to allow its public functions to be duly performed. Anything more would impact adversely on the rights of the citizen, anything less would impair the efficiency of government by inhibiting public officials in the proper performance of their functions.[465]

Although the Magna Carta was first signed in 1215, parliament did not finally dispose of the monarch's sovereign powers until 1688, after one civil war and the dethroning of James II. Johnston has stressed the role that chance and personalities play in the course of such events.

The titanic struggle early in the seventeenth century between Sir Edward Coke, lord chief justice, and James I over the issue of a monarch's obligation to conform to the laws of the nation illustrates the point. The question as put by Coke was the choice

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462 This is from the 1297 version and the 1 November, 1994 reprint of the New Zealand Act (Magna Carta (Imp)) RS Vol 30, pp 25–26. See also paragraph 18, p 6 in the New Zealand Law Commission's report NZLC R37, *Crown Liability and Judicial Immunity: A response to Baigent's case and Harvey v Derrick*, *op cit*.

463 In New Zealand this equality principle is recognised by sections 3 and 6 of the Crown Proceedings Act 1950 according to the New Zealand Law Commission, NZLC R37, *op cit*, p 9.

464 New Zealand Law Commission, NZLC R37, *op cit*, p 6.

465 New Zealand Law Commission, NZLC R37, *op cit*, p 7, paragraph 22. We are grateful to Dan Riddiford for bringing some of this material to our attention.

between the rule of *law*, the common law of England, and *despotism*, the rule of the King beyond the law. Coke argued that as the Magna Carta had been confirmed over 30 times by the kings of England, it had achieved the status of 'fundamental' law making void judgments and statutes in conflict with it.

A displeased King removed Coke from office in 1616. It was not until the civil war that the Bill of Rights 1688 conceded the sovereignty of parliament subject to the fundamental rights and liberties affirmed in its preambles and the third section.

The independence of the British judiciary was finally assured when parliament passed, after 1700, the Tenure of Judges Act. This Act formed a solid basis for judicial protection of individual rights in England according to Eaton.[466] Coke's concept of fundamental law subsequently played an important role in American constitutional law.

As a corollary, the rule of law can obviously be lost if the powerful institutions that support it become sufficiently eroded. Alexis de Tocqueville pointed out the subtle ways in which the absolute, regular and tutelary power of a mild and provident state could have the effect of diminishing energy, independence and initiative, reducing its people to a perpetual state of childhood. Clearly a state concerned to provide 'cradle-to-the-grave' security for 'its' people would illustrate this concern. The following extract would surely strike a responsive chord amongst farmers and developers who have to contend with New Zealand's tax, resource management, heritage, noxious waste, historic places, human rights or employment law, or occupational health and safety legislation.

> The will of man is not shattered, but softened, bent and guided: men are seldom forced by it to act, but they are constantly restrained from acting: such a power does not destroy, but it prevents existence, it does not tyrannize, but it compresses, enervates, extinguishes, and stupefies a people, till each nation is reduced to nothing better than a flock of timid and industrious animals, of which the government is the shepherd.[467]

A timid, state-reliant people is unlikely to support civil institutions that would defend the rule of law.

Ultimately only countervailing power can limit the expropriation of wealth by those that command political power – and safeguard a desire to ensure that wealth, which can be expropriated, continues to be produced. There always has been and will be a conflict of interest between those who produce things of value and those who wield political power.[468]

It is not obvious how any current government could commit to limit the abuse of power by future governments. Solving this problem requires constitutional arrangements that would make the exercise of limited government the dominant political strategy. If this were easy, the problem would have been solved so many centuries ago that its solution would not be an issue today.

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[466] William Eaton, *Who Killed the Constitution: The Judges v The Law*, Regnery Gateway Publishing, Washington DC, 1988, p 209.

[467] See, for example, Alexis de Tocqueville, 'What Sort of Despotism Democratic Nations Have to Fear' in David Boaz, *The Libertarian Reader*, The Free Press, New York, 1997, pp 22–23.

[468] Johnston, *op cit*.

It is a mistake to think that a rule of law can be achieved by passing laws. To the contrary, laws constraining the abuse of state power reflect a prior understanding that constrains those with state power. This prior understanding must reflect the existence of interest groups that are powerful enough to force those who could otherwise exploit the power of the state to agree to conform to a rule of law.[469]

This insight raises enormously complex issues of interest group formation. Ideas, information, and transaction costs are all-important and situation-specific. The difficulties lead Johnston to opine that:

> … the struggle for the rule of law is far too complicated a matter to be thought up and then put into practice. For it to be achieved and then maintained requires a contest that unfolds through generations. But for a contest to endure through generations, it must have roots deep in morality, in passion, in the subsoil of the community, out of which comes political activity.[470]

6.4.6 Natural or fundamental rights

The short title to the New Zealand Bill of Rights Act 1990 proclaims that it is an Act to promote "human rights and fundamental freedoms in New Zealand". Section 8 refers to the concept of "principles of fundamental justice" that are clearly seen as constraining government action. Section 37 confers a right to "the principles of natural justice". Furthermore, as discussed in section 6.3 above, New Zealand's legal establishment has indicated that it does see limits to the proper scope for parliamentary legislation.

The rules of natural justice relate to the procedures required for the sound administration of justice. Concepts of "natural" or "fundamental" limits to a New Zealand parliament's ability to regulate its citizens may go further and invoke the concept of rights that lie beyond the ability of a current law maker to change.[471] Under such a concept, laws must be just and reasonable as judged by a yardstick that is superior to the state. Differences of interpretation in relation to this concept appear to relate to its origins and content rather than to its existence. Entrenched laws may variously be asserted to derive their status from ancient custom, god, immutable nature, or reason.

As already noted, in England limits to state power were asserted on the basis of historical jurisprudence – the Magna Carta and a concept of an ancient constitution. In contrast, in eighteenth century America, the limits on government were asserted on the basis of both historical jurisprudence and natural law jurisprudence.

Writers commonly trace natural law concepts back to Aristotle's premises about the inherent nature of man. 'Natural law' embodies those obligations on individuals that would appear if mankind's reason and sociality were fully developed and unfolded. Given the passions and fads of imperfect societies there could be a gap between what was 'just by nature' and what was currently lawful. Furthermore, there was something

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469 Johnston, *op cit*.

470 Johnston, *op cit*, p 31.

471 Of course this is not to suggest that all the fundamental rights or principles in the New Zealand Bill of Rights Act 1990 are consistent with natural law concepts. See, for example, Richard Epstein (1996), *Human Rights and Anti-discrimination Legislation*, *op cit*.

immutable about the inherent nature of man so that what constituted natural justice was valid everywhere with the same force, and appeal could be made to it from positive law. An unjust law is no law at all.

Many centuries later Sir Thomas Aquinas, writing from a theological viewpoint, invoked the related concept of eternal law in the rational creature that is man. He therefore saw human law as the particular application of natural law. Human law that departs from the law of nature is not law, it is a perversion of the law.

However, modern day natural rights theories do not need to be based on appeal to divine origins. Hugo Grotius proposed in the first half of the seventeenth century that natural law is valid even if "God does not exist or is not concerned with human affairs".

Grotius was shortly followed by Thomas Hobbes who derived the concept of a "law of nature" from consideration of what rules would be necessary in order to establish a peaceful society out of a savage, mutually destructive "state of nature". Hobbes defined a law of nature as a general rule, deduced by reason, by which man is forbidden to do that which destroys life.

The work of Grotius and Hobbes lay at the heart of attempts to construct a body of law by rational deduction concerning the nature of a 'social contract' that society must have reached in order to escape from a fictitious state of nature.

Natural rights concepts were also very evident in John Locke's writings in the seventeenth century in England and in France in the eighteenth century with the writings of Montesquieu and Rousseau. John Locke's natural rights philosophy based on a social contract envisaged a much less pessimistic state of nature than Hobbes. In the Lockean state of nature, free and equal men were already observing natural law.[472] Locke's ideas were particularly influential in the United States, where the 1776 Declaration of Independence famously asserted that various rights were unalienable and self-evident. The 1789 French Declaration of the Rights of Man and of the Citizen similarly referred to "imprescriptible natural rights".

An obvious purpose for a social contract between autonomous individuals would be to permit coordinated action for self-defence. Such a contract would be consistent with individual rights.

> If each person has the right to defend – even by force – his person, his liberty and his property, then it follows that a group of men have the right to organize and support some common force to protect these rights constantly. Thus the principle of a collective right – its reason for existing, its lawfulness – is based on individual right.[473]

But it immediately follows from such a contract theory that the collective cannot have greater rights in relation to individuals than can the individuals who agree to the contract. Since the rights of any one individual over another only relate to defence of self and property, the right of the collective can be no greater. According to this logic,

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[472] The introspective methodology of these seventeenth century philosophers is reminiscent of John Rawls's device late in the twentieth century of a 'veil of ignorance' to consider the optimal rules that should govern state actions.

[473] Bastiat, *op cit*, p 2.

as Locke observed, the state can have no greater right to regulate the behaviour of others than any individual.

David Hume inferred natural rights instead from convention. Burke asserted that a natural right is human custom conforming to divine intent.

Natural rights theories may be deontological. However, this is not necessarily the case. For example, justifications based on an appeal to enduring ancient laws and customs contain an empirical, consequentialist aspect.[474] Disputes over the detailed content of natural laws and rights cannot be readily resolved in the absence of any agreed higher theory for resolving such disputes. The discussion in section 3.4 on positive and negative rights illustrated the difficulties involved in trying to use rhetoric to settle a dispute over the definition of harm.[475]

However, the enthusiasm for natural rights theories diminished during the nineteenth century. Rousseau's ahistorical invocation of a social contract under a 'state of nature' was widely seen as contributing powerfully to the horrors of the French Revolution.[476] Those concerned to reduce the abuse of totalitarian power, such as Edmund Burke, John Calhoun and John Adams, attacked social contract theory of this ilk on the grounds of its non-existence. No state of nature in which man lived independent of his fellows could or did exist.

But natural rights and related theories also came under attack from more revolutionary writers. Noteworthy here were the rise of Benthamite utilitarianism and the attack of Kant on reason. Jeremy Bentham was a scathing and colourful critic of the concept of natural rights and deduced rights:

> Right … is the child of law: from real laws come real rights; but from imaginary laws, from laws of nature, fancied and invented by poets and rhetoricians, and dealers in moral and intellectual poisons, come imaginary rights, a bastard brood of monsters.
>
> Natural rights is simple nonsense: Natural and imprescriptible rights, rhetorical nonsense – nonsense on stilts.[477]

Bentham's concern about imaginary rights is well-founded, as the debate more than a century later over 'positive' rights illustrates. However, his words lend themselves to the dismissal of the concept of rights that are too entrenched for parliament to overturn. Moreover, they do not address the issue of the need to distinguish sound laws from unsound laws. Indeed, Bentham favoured having parliament codify common law, thereby risking undermining its independence of parliament.

In short, this extract from Bentham's utilitarianism lends itself more obviously to exploitation by a self-serving political majority than the natural rights-based

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474 Section 3 of this report defines these terms.

475 For a thoughtful elaboration of many deontological and consequentialist arguments for libertarianism, see Jeffrey Friedman, 'What's Wrong with Libertarianism', *Critical Review*, Vol 11, No 3, Summer 1997, pp 407–467, and subsequent issues.

476 See, for example, Henry Maine, *Ancient Law*, ch 4, The Modern History of the Law of Nature, 1861.

477 *The Oxford Dictionary of Quotations*, *op cit*, p 64.

libertarianism that it undermined.[478] Arguably it made societies more, not less, vulnerable to the horrors of big government unveiled in the twentieth century.

In time, the disaster of World War II revived the search for better ways of protecting individuals from state power. This is reflected in the 1949 United Nations Universal Declaration of Human Rights.

However, the inclusion in such documents of *ad hoc* 'positive rights' indicates that this search is not based on any principled natural rights doctrine that might control state power. To the contrary, the concept of positive rights or welfare provides big government with further 'justification' for forcing a political minority to satisfy the positive rights of a political majority.

The ancient origins of the common law create a close compatibility with concepts such as 'meta-law', ancient, customary or natural law that underpin a rule of law. Such conceptions provide support for a judiciary willing to protect liberty from despotic legislation. Even so, arguments based on natural rights currently have only a limited ability to protect individuals against regulations that represent an abuse of state power at their expense.

6.5 Concluding observations

Both eighteenth century natural rights arguments and the concept of the rule of law point in favour of more limited government than has become the norm in many countries including New Zealand. The evidence that a high level of economic freedom produces a high degree of prosperity is highly compatible with the emphasis put on individual freedom by natural rights theorists.

All three approaches (consequentionalist, natural rights and rule of law) stress the importance of secure private property rights and the freedom to transact. The importance of a sound legal system and of limits to the scope for government action follow inexorably. A system of secure property rights implies that those who control the state's coercive powers are constrained in their use.

The three approaches differ somewhat in the view they take on the issue of the optimal role of the state. At the heart of natural rights theory is the rejection of the idea that private property and personal liberty are solely the creations of the state. Murder would be unacceptable even if the state made it lawful. Societies oblige the state to make it unlawful because it is wrong (and inefficient).[479] Similarly, trespass is not wrong because the state has made it unlawful, it is wrong because it violates private property.

The rule of law approach emphasises the importance of institutional limits to the powers of government in successful societies. Moreover, it indicates that the durability of a society's institutions depends on the degree to which the institutions that give rise to the rule of law become entrenched through custom and convention. Rules that

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[478] Libertarian Murray Rothbard complains that current free market economics is all too rife with 'a willingness to abandon free-market principles at the drop of a cost-benefit hat'. See Rothbard, Murray, *For a New Liberty: The Libertarian Manifesto*, Fox and Wilkes, San Francisco, 1989, p 16.

[479] Richard Epstein (1985), *Takings*, *op cit*, p 5.

become so entrenched as to serve a dominant function across cultures and millennia almost invariably, according to Richard Epstein, come to be endorsed as natural law.[480]

Section 6.2 placed some emphasis on Aristotle's distinction between a constitutional democracy and a despotic democracy in which a majority exploits a minority. The power of government must be limited if it is not to be available for despotic purposes. Section 6.3 emphasised the importance of a well-defended common law legal system and the importance of the separation of powers. It drew attention to the value of appeals to the Privy Council in ensuring an independent judiciary in New Zealand. It commented on the role of the common law as a check on the abuse of parliamentary power. Trial by jury tends to preserve the independence of the common law from the judiciary and therefore from those who appoint judges.

Many liberals believe that it is critically important to recapture the eighteenth century wisdom on checks and balances to limit government and to end the notion that all property and liberty is fair game as long as political processes are democratic under majority rule. Within this view there is scope for debate as to priorities.

Nobel laureate, James Buchanan, for one, sees the ways of electing governments, and the separation and balancing of powers as being relatively insignificant compared with the task of restraining the scope of what elected representatives might do.

Like others, he finds it hard to find a solution whose robustness does not depend on creating an "overwhelming public philosophy in favour of less government".[481]

We summarise the main points in this section as follows:

- under a constitutional democracy a political majority would not be permitted to oppress a minority, instead it would be constrained to preserve the liberties of *all* citizens;
- a constitutional government would adhere to constitutional principles;
- these principles would limit the laws such governments can pass;
- principled laws cannot be *ad hoc* and arbitrary;
- Aristotle conceived a constitutional state as a partnership of the free that allows citizens to pursue full and independent lives that are lived in accordance with excellence – as distinct from the subjugation of the ruled to the ruler.
- such a purpose does not permit the state to reduce some of the free to the role of providing the means to another group's ends;
- under this conception the primary political good would be ensuring justice – guaranteeing one citizen's just claim against another;
- there are three fundamental constitutional principles – the separation of powers, democracy and the rule of law;

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480 Richard Epstein (1999), *Principles for a Free Society*, *op cit*, p 4.

481 See, for example, the introduction to the compendium of James Buchanan's writings published as *Constitutional Economics*, by the Institute of Economic Affairs, London, 1991.

- critical to the separation of powers is a legal system that protects individual liberty against the abuse of state power. New Zealand's system of independent judges, constrained by the right of appeal to a totally independent Privy Council, trial by jury and a common law tradition that transcends the national border potentially provides for a high degree of independence;
- however, this system has failed to protect individual liberty adequately. This appears to reflect the (worldwide) rise in a false notion of parliamentary sovereignty, legislative excesses that violate common law principles and a judicial reluctance to resist these encroachments on liberty through judicial review and a 'polite' refusal to entertain sweeping dismissals of common law principles;
- while judiciary resistance to the concept of absolute parliamentary sovereignty is not entirely dead, there can be no presumption that judges would use their asserted independence to apply the law rather than to use it to create new 'social policy';
- also in relation to the separation of powers, New Zealand has less separation between the legislature and the executive than some other countries, such as Hong Kong and the United States. The abolition of a bicameral structure in New Zealand arguably reduced this separation;
- establishing the rule of law is also critical to a constitutional democracy, when governments are constrained by the rule of law the people would be subject to the rule of law rather than to the rule of a *ruler* or the rule of *the* law, thought of as statutes;
- for the rule of law to exist, rules of conduct must be general and equal in application and general laws must be abstract rather than particular to time, place or person. Equal in application means equal under the law;
- many laws in New Zealand violate the rule of law;
- the very strongest constitutional presumption should be made that regulations do not violate the rule of compensation for takings under the power of eminent domain and that there be no taxation except with the consent of those being taxed, or their representatives;
- the rule of law cannot be achieved by passing laws;
- achieving the rule of law is far too complicated a matter to be thought up and put into practice; it requires a widespread attitude of constraint and constitutionality, backed up by countervailing power if necessary; and
- natural rights theories can bolster support for the rule of law, but they can also be used to undermine the rule of law as the experience during the last 50 years with positive rights concepts illustrates.

We explore some of these options in greater detail in section 7.

7 Regulatory Reform Options

7.1 Introduction

This section discusses options for constraining government regulation that emerge from the analyses of the fundamental problem in sections 5 and 6.

Section 7.2 discusses the objectives of regulatory reform.

Section 7.3 considers democratic options for strengthening the influence of voters on parliament.

Section 7.4 considers options for making it harder for any one entity to concentrate the coercive powers of the state – the issue of the separation of powers.

Section 7.5 explores the issue of extending the concept of compensation for taking of physical land to regulatory takings.

Section 7.6 presents some concluding observations.

7.2 Reform objectives

Regulatory reform could aim to:

- merely restrict the *processes* that must be followed before regulations can come into force in order to increase transparency and accountability; or
- directly constrain *content* by providing principles for regulations.

A minimal objective for regulatory reform might be to put in place processes that force the executive to account more fully to the legislature for the quality of any regulations that it proposes. Where the executive is able to control parliament, such a reform would have its effect by increasing the public exposure of the executive's proposals. Reforms of the type discussed in section 4.3 fall into this category.

Not all Bills put in front of parliament are the responsibility of the executive. A supplementary regulatory reform would guide and assist parliamentary scrutiny of non-government Bills put before the House. Non-government Bills include members' Bills, private Bills and local Bills.

Regulations may be vulnerable to closer parliamentary (or media) scrutiny for several reasons. For example, parliament may decide that:

- their assessed costs may exceed the benefits from a national interest perspective;
- they unduly impair economic and human freedoms; or
- they embody wealth transfers that parliament is not prepared to sanction when their nature is exposed.

The value of such a limited reform must be questioned, particularly in the light of the experiences to date that were discussed in section 4. No reform of law-making processes can ensure that laws will conform to a rule of law. As discussed in section 6, the rule of law can only exist if the content of legislation is restricted.

What level of success process reform would achieve depends in part on how successfully parliament can force the executive to disclose whether government regulations are transferring wealth to politically important factions rather than increasing the national welfare. The executive will usually be able to assert a national interest rationale for a regulation even if its primary reason for proposing the regulation is to tax one group in the community for the benefit of another.

Ineffectual reform could be worse than no reform at all if the results can be used to discredit subsequent reform proposals. For these reasons, regulatory reform should go well beyond the objective of increasing transparency.

Sound constraints on the *content* of regulations would make it harder in principle for parliament to approve Bills or regulations that violate sound regulatory principles. As part of such a reform, consideration should be given to the role for judicial review in reinforcing content constraints.

Any proposed reform package should be expected to satisfy the requirement that the likely benefits exceed its likely costs. Any reform that increases the constraints on government regulatory processes will increase government administrative costs. The increased constraints could also impair or prevent desirable (welfare enhancing) reforms. This is a second source of cost from regulatory reform. Offsetting these two costs is the hoped-for gain in the form of reduced costs from less welfare-reducing regulation.

The test, in principle, of the merit of any reform proposal is whether it minimises the sum of these three costs – the costs of administration, forgone welfare-enhancing regulations and welfare-reducing regulations.

7.3 Democracy

7.3.1 Introduction

This section explores some options for changes to democratic arrangements. The task is to avoid both the exploitation of minorities and the factionalism that would produce outcomes that the majority of voters would oppose, given the opportunity to do so. Sections 5.2, 5.4 and 6.2 contain introductory material for this section.

Section 7.3.2 considers the issue of binding referenda.

Section 7.3.3 considers the reform of campaign financing and advertising

Section 7.3.4 considers the option of term limits for parliamentarians.

Section 7.3.5 considers voting systems (MMP).

7.3.2 Binding referenda

New Zealand is amongst a number of countries that have moved towards greater use of citizens'-initiated referenda in recent years. A notable recent example is the referendum held at the time of the November 1999 general election on reducing the number of parliamentarians from 120 to 99. Of the 2.06 million of voters (excluding the few who voted informally), representing 82 percent of registered voters, 81 percent voted in favour.

Such results do not bind New Zealand's parliament. Clearly this could be reconsidered.

Voter initiative referenda have the potential to reduce the power of parties, pressure groups and elites.[482] A system of referenda was adopted in Switzerland in 1874 and was later adopted in 23 of the states within the United States, the District of Columbia and Italy.

Voter initiatives can take two forms. Voters could compel a government to hold a binding referendum on a new law that parliament has just passed ('protest' referendum). Alternatively, voters could propose new laws and compel the government to put them to binding referendum ('initiative' referendum). Both options would require a minimum percentage of voters – perhaps 4–8 percent – to sign a petition requesting a referendum.

A referendum might be considered binding if a majority vote alone suffices to create or veto law. A referendum is contingently binding if a majority vote and one or more additional requirements are necessary to create or veto law. For example, in federal systems, a popular majority vote and a majority vote in a majority of federal units may be required. Alternatively, the referendum may be considered binding only if the proposal wins a majority among those voting, and those voting constitute a majority of eligible voters.[483]

Binding initiative and protest referenda would demonstrably put to rest the unconstitutional notion of absolute parliamentary sovereignty.

It is easy to think of issues in New Zealand in which a referendum would be likely to have overturned a parliamentary decision. For example, the electorate could well have struck down self-serving superannuation arrangements voted in by parliamentarians in stealth and urgency. As another example, the interests of the electorate and list MPs surely diverge on the issue of the continuance of MMP and the number of parliamentarians.[484] As another example, parliament may pass legislation that imposes costs on businesses while exempting politicians from the same discipline. Through a limitation on the definition of 'trade', for example, politicians exempted themselves and their parties from being subject to the provision in the Fair Trading Act 1986 that prohibits any person in trade from engaging in conduct that, *inter alia*, is likely to

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[482] Walker, Geoffrey de Q, *The Rule of Law: Foundation of Constitutional Democracy*, *op cit*, p 389, citing his publication *Initiative and Referendum: The People's Law*, Sydney 1987.

[483] Brook Cowen *et al*, *An Analysis of Proposals for Constitutional Change in New Zealand*, *op cit*, p 5.2.

[484] In August 2001, a parliamentary committee advised the government against holding another referendum on the electoral system, or reducing the size of parliament, ignoring the wishes of 76 percent of the voters on the first issue and 80 percent on the second according to *The Dominion*, 9 August, 2001 ('We're stuck with MMP and all 120 of them').

mislead or deceive. As a final illustration, tax experts have recently raised the issue of apparently favourable tax treatment for the tax-free allowances paid to parliamentarians.[485]

There is, of course, no suggestion here that such conflicts of interests are unique to New Zealand. The British referendum on the issue of its entry into the Common Market, held at the public's insistence against the wishes of parliamentarians in 1975, is an example in which the people clearly demonstrated that parliamentary decisions do not always express majority opinion.[486]

Referenda increase the influence of the median voter and reduce the influence of minorities and special interest groups, compared with a legislative process. Most voters do not vote irrationally or without regard to circumstances.

On complex issues, voters are likely to be less informed than representatives. They may also be subject to official misinformation, reflecting the self-interest of those controlling the release of public information. From time to time a demagogue may unduly sway public opinion. In addition, a majority may be swung temporarily by the passions of the day. For example, it seems clear that many who voted for MMP in New Zealand's referenda did so out of animosity towards existing politicians and political parties rather than because they thought it would provide a superior system. Another risk is that a majority vote will be driven by self-interest on a factional issue. For example, to allow a majority to determine a discriminatory rate of tax to apply to a minority would be a denial of natural justice.

Clearly, the outcomes from unconstrained binding referenda will not necessarily accord with constitutional principles. Little may be gained from allowing voters to determine the matter directly if bad legislation reflects voters' preferences. This suggests that referenda may have the greatest potential for change where parliamentarians are not reflecting voter preferences.

Binding protest referenda should be less risky than binding initiatives in these situations. Protest referenda could allow citizens to constrain government and exert a direct role in politics without creating a larger risk for minorities or a greater danger of catastrophic policy mistakes than would otherwise exist.

Binding referenda have their main effect by changing the potential constraints on legislators. Legislators will have to consider the possibility of triggering a referendum from the outset. In most cases a government would prefer to amend a policy so as to avoid a potential referendum rather than to push it through unchanged and risk defeat.[487]

Professor Wolfgang Kasper, the leader of an Australian team that recently explored constitutional issues in Fiji, reported that citizens who can strike down regulations have a greater sense of participation and are more content. Countries that have recourse to referenda appear to have smaller government and taxes, along with higher

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485 Brent Gilchrist, 'Taxing tips for IRD on MPs' perks', *The Dominion*, 8 August, 2001.

486 Walker, *op cit*.

487 Brook Cowen *et al*, *op cit*, p 5.15.

spending on education.[488] Presumably this result is sensitive to the balance in the population between taxpayers and beneficiaries.

In considering binding referenda, one issue is how they can be limited so as to accord with constitutional principles without a written constitution. It is possible to limit a binding referendum by statute law, but the statute itself is likely to reflect the influence of partisan interests. Even putting this point to one side, it may be difficult in any particular case to determine whether a referendum falls under the statute or not.[489]

The notion that there should be no taxation except with the consent of those being taxed or their representatives suggests a possible role for referenda that would be limited to the groups being taxed. For example, departures from a flat statutory income tax rate structure could require the consent of any group that was being asked to pay higher rates of tax at the margin than the bottom group. Those not in such a group but who derived significant benefits would obviously face a conflict of interest in voting on the issue. The practicality of holding such referenda is one issue, taking into account the problem of determining precisely which voters would be eligible to vote. Another debate could concern the true incidences of the burdens and benefits of the tax. Such complexities provide grounds for caution in considering such options.

We conclude that binding protest referenda may curb parliamentary excesses that arise from political failure. They may thereby reduce voter dissatisfaction with democratic processes. However, by themselves they do not offer a solution to the problem of how to stop a democratic majority from acting unconstitutionally.

7.3.3 Reform of campaign financing and advertising

Current arrangements restrict competition between political parties and constrain the ability of voters to spend money to inform and influence other voters through the medium of a new political party.

Section 314B(2) of the Electoral Act 1993 restricts the total election expenses of any party competing for party votes to $1 million (including GST) plus $20,000 for each constituency candidate. Under the Broadcasting Act 1989 $2.081 million of taxpayers' money was allocated to 25 eligible parties in the 1999 election. Free time is also allocated to parties for opening and closing speeches. Under section 79 of this Act no party is allowed to buy radio or television time with its own funds to broadcast an election programme. The prohibition on party broadcasts of election programmes is absolute outside an election period.

The objective of such constraints is presumably to ensure that the electoral process is not unduly influenced by the wealth of the parties contesting an election, and to ensure that those contributing funds do not 'buy' favourable policies from particular candidates.

However, the current arrangements favour well-established parties at the expense of small or new parties. The restriction on spending per constituency candidate favours parties with a large number of constituency candidates. National and Labour obtained

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[488] Wolfgang Kasper, 'Towards Racial Harmony: A New Constitution for Fiji', *Issue Analysis*, No 19, 5 March, 2001.

[489] Brook Cowen *et al*, *op cit*, p 5.15.

over 50 percent of the public broadcasting money allocated to eligible parties. The five parties represented in parliament received two-thirds of the total free time allocated to opening speeches of parties. The restriction on purchasing television and radio time further favours parties already in parliament in that they independently get considerable media exposure on the issues of the day by virtue of their participation in parliamentary processes.

A more level playing field would make it easier for new parties to draw the electorate's attention to the privileges enjoyed by supporters of the major parliamentary parties. It would make it easier for less privileged groups to compete away the privileges enjoyed by others. This more competitive process could conceivably undermine the expected returns from securing of such privileges.

Binding referenda could be one option for constraining parliamentarians from imposing arrangements that give parties represented in parliament an advantage.

7.3.4 Term limits

Limiting parliamentarians to perhaps three terms would prevent them from entrenching themselves as a result of their skill in obtaining safe seats, getting a high place in a party list, or in catering for a faction rather than promoting the interests of all.[490] It could thereby force parliamentarians in general to stay more focused on coming into parliament to achieve something other than their own security of tenure.

Amendments to parliamentary superannuation schemes and to any term-related lifetime perquisites of office would complement this effect.

Arguably the advent of the party list system under MMP increases the case for considering such a measure (see next section).

7.3.5 Mixed Member Proportional (MMP) electoral system

Political parties are not constitutionally recognised under the Westminster system of government. Members of parliament represent all the citizens of the constituency that they represent. When voting on matters of state in parliament, MPs are expected to vote in the national interest as they perceive it. It is commonly accepted that the organisation of MPs into political parties is efficient for this purpose. Under the First-Past-the-Post electoral system, senior members of cabinet who were not fortunate enough to enjoy safe seats were often voted out of office when the swing went against their party.

In contrast, MMP gives explicit recognition to political parties. No constituency of voters can throw out an ineffectual list MP. List MPs would not be in parliament but for their position on a party list. Their natural concern is to preserve or enhance that position.

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[490] For a brief elaboration of this issue, see Richard Epstein, *MMP: The Right Decision*?, New Zealand Business Roundtable, Wellington, 1999, pp 2–5.

The MMP system also gives disproportionate weight to minor parties more frequently than First-Past-the-Post. Under First-Past-The-Post, a broad church party that caters for the median voter is more likely to obtain an outright parliamentary majority.

Minor parties can be represented in parliament even if they make a virtue of not seeking to act in the interests of all voters, and instead explicitly represent the interests of a specific faction or the interests aligning in support of a single issue. The MMP system can thereby arguably give disproportionate influence to self-proclaimed factional interests. In this case, being more overt is not necessarily a virtue. The general offence caused by unabashed and unashamed 'you versus us' tribalism is divisive and corrosive of democracy if unchecked.

Nor is explicit factionalism limited to the minor parties. The Labour-dominated government, elected in 1999, made it clear that it intended to implement the policies that it took to the electorate regardless of any contrary assessments of where the national interest lay, or whether a majority of voters opposed specific policies in its programme. Keeping campaign promises is laudable if the promises serve the interests of voters at large rather than particular factions. Otherwise the effect is likely to bring politics into disrepute.

The regulatory impact statements produced by the Labour-Alliance government at times reduced the requirement to produce a national interest justification for policies to a farce (see section 4.3.2). This practice was compounded by an unfortunate, tribal 'we won, you lost' riposte to objections to some of its policies.

In short, there are grounds for concern that the effect of MMP in New Zealand, at least on the basis of experience to date, may have been to compound factionalism in political decision making and to undermine the concept of government being constitutionally constrained to pursue the common good by protecting the liberty of all, including minorities.

Again this discussion points to the importance of referenda for constraining MPs. Self-serving parliamentarians are all too likely to vote for the preservation of MMP, regardless of the weight of voter preferences on the issue. The right of a binding referendum could alter MP voting on this issue.

7.4 Separation of powers

7.4.1 Introduction

Section 6.3 highlighted the importance of the separation of powers for constitutional government. This section considers aspects of this issue.

7.4.2 Second chamber

One option for constraining the executive is through the introduction of a second legislative chamber. Arguments in favour of a second chamber are generally couched in terms of the ways in which second chambers may constrain executive power by:

- preventing usurpation of power or unscrupulous behaviour by first chamber legislators;
- ensuring a more reasoned or wider representation of the will of the electorate than is possible with a single chamber;
- enhancing the quality of the legislative process and legislative outcomes.[491]

Not all second chambers have the routine capacity to affect legislative outcomes. A second chamber will only be a strong component of a system of government if:

- it is elected and the basis of election differs from the first chamber, so that the composition of the two chambers differs; and
- the powers of the two chambers to influence legislation are roughly equivalent.[492]

In most bicameral systems in established democracies (the United States is an exception), the second chamber is subordinate to the first. Second chambers that are appointed rather than elected lack the democratic legitimacy of their elected counterparts, and are typically allocated more circumscribed powers.

In the early 1970s, Hayek outlined a specific option for a bicameral structure (an upper chamber) designed to protect the rule of law better. He proposed that an elected legislative assembly be created whose task would be restricted to passing laws in the narrow sense of general rules of just conduct. These rules would constrain the lower elected chamber. The lower chamber would be responsible for governing the country, as is parliament today. The chambers would have to be elected on different bases so as to ensure that the same passions and interests did not dominate both. For example, elected members of the legislative assembly might have a 15-year-term with one-fifteenth of their number being elected, perhaps from a different age cohort, each year.[493]

Bicameralism generally alters the basis of representation and the sensitivity of legislatures to minority and special interests. Members of the second chamber, will from time to time, wish to amend or reject the policy decisions of the first and promote their own. The passage of legislation will require the two chambers to reach a consensus. The mode of achieving consensus will differ from a unicameral proportional representation system, because decision making between the two chambers is sequential.

Bicameralism weakens accountability to the extent that it makes decision making by members of the two houses less transparent than in a unicameral system. In so doing, it may open up the possibility of vote trading between houses.[494]

Strong bicameralism reduces the predictability of policy outcomes. It also reduces the ease with which policy may be passed. With a strong bicameral system, legislation can only be passed by achieving the equivalent of a supra-majority in a unicameral system. Two chambers are also harder to manipulate than one.

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491 Brook Cowen *et al*, *op cit*, p 4.10.

492 Brook Cowen *et al*, *op cit*, p 4.2.

493 Economic Freedom and Representative Government, ch 10, pp 392–397 in Friedrich Hayek (1991), *op cit*, pp iv–414.

494 Brook Cowen *et al*, *op cit*, p 4.11.

The impact of bicameralism on the ability of minorities or special interest groups to influence policy depends on the form of bicameralism. Some forms are designed to confer explicit electoral advantage on particular groups. Federalism, when based on states of varying sizes, does so for lightly populated regions.[495]

The very existence of an upper chamber that must process Bills before they can be passed introduces delay into the legislative process. Whether this delay will result in an improvement in the quality of legislation depends on the incentives and ability of members of the second chamber to achieve legislative improvements. It also depends on whether it substitutes for, rather than adds to, processes for reviewing legislation such as the select committee system. As well, it presumes that the character of deliberation in the second chamber will differ in some fundamental way from the first.

Hayek's proposed legislative body could be backed by a constitutional court that would have the power to strike down legislation passed by the governing party dominating the lower house that violated the general laws passed by the legislative chamber. As such it would not necessarily cause delays. Commonly the executive would establish that the legislation it put before its own chamber was likely to confirm to the legislative chamber's requirements before it went to the trouble of getting it passed.

The efficacy of the legislative body would depend to some degree on the quality of its members and the quality and volume of the resources that were at its disposal. Much work would have to be done on this option before it could be transformed into a concrete proposal. Unless there is some likelihood that such a proposal might be seriously considered, it is unlikely to be worthwhile to develop it more fully.

Determining whether a bicameralist parliament in New Zealand would improve the quality of regulation is beyond the scope of this project, but we note that the study by Brook Cowen *et al* opposed this option.[496]

Another option for New Zealand would be to devolve greater power to local government. A related option would be to move to a Swiss canton structure. The poor performance of local government in New Zealand, including the inability of many councils to take a constrained view of their role, discourages greater consideration of such options.

7.4.3 The independence of the judiciary

An alternative way of constraining government would be to increase the power of the judiciary to strike down legislation as unconstitutional. Under the British system, courts have been reluctant to exercise this role, although in section 5.2.5 we provided some evidence that they might be prepared to consider doing so and in section 3.6 we noted the potential for the common law to enhance the independence of the judiciary, should it have the will to use it in a principled and judicial manner.

Parliamentary power could be curbed by greater recourse to judicial review and by achieving a greater separation between the executive and the legislature. The latter is a

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[495] Brook Cowen *et al*, *op cit*, pp 4.12–4.13.

[496] Brook Cowen *et al*, *op cit*, p 6.7.

major constitutional change that should only be contemplated after thorough inquiry and public debate.

Greater scope exists for judicial review of parliamentary takings. The *Westco Lagan* case illustrates the length to which parliamentary select committees are prepared to go to assert the right of parliament to act in a predatory and unprincipled manner when it comes to taking private property without compensation. On the other hand, the case of the Taranaki land leases, and that of *Falkner & Ors v Gisborne District Council* (section 5.2.5) demonstrate that such attempts to achieve absolute and tyrannous power are likely to be resisted.

Against the case for a greater role for judicial review is the issue of judicial activism directed at overriding constitutional limits to the power of the state rather than at preserving the rule of law in the face of government incursions.

Leoni's proposal for rejecting legislation that exploits a minority for the benefit of a majority when the individuals in the majority could achieve their own objectives independently would also serve to increase the role for an independent judiciary.[497] Preserving the right of appeal to the Privy Council would also protect the separation of powers.

More problematic would be a shift to greater reliance on a written constitution. A written constitution empowers the judiciary to strike down derivative legislation directly. Written constitutions do not necessarily prevent tyranny, as the experience of the French Revolution illustrates. There is also a risk that providing more explicit power to the judiciary will induce elected politicians to attack the judiciary to force it to undermine the written constitution, as is illustrated by Roosevelt's New Deal.

There is also an argument that a despotic populist government or an activist court of appeal could subvert a written constitution more easily than the common law precisely because the common law lacks the vulnerable centralised structure of a written constitution. Common law processes are highly decentralised. Each common law decision is specific to the facts of a particular case. The case law created in other countries is also enduringly relevant. For this reason, the common law is arguably less insular that a statute or constitution. In contrast, written constitutions can be amended at any time, with pervasive import within the country concerned.

The process of moving to a written constitution is also fraught with hazard because interest group pressures to entrench privileges may be very strong. For example, rather than asserting the importance of one law for all, the New Zealand Bill of Rights Act 1990 *inter alia* sanctions privileges on the basis of race.

Protecting the judiciary from political party manipulation is vital to the separation of powers. But the judiciary also needs to be held accountable for actions that undermine its integrity, independence and the rule of law.

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[497] Leoni, *op cit*, pp 175–179.

Options for increasing constraints include:

- providing a system of recall that allows a specified number of aggrieved voters to require a ballot to be held of all voters on the motion to remove a named public official from office.[498]

- allowing confirmation ballots. It would be remarkable if a majority of voters opposed any appointment, but the possibility of such a sanction would have an effect; and

- reviewing access to the Privy Council, including expanding or restricting the range of cases that may be appealed. Clearly this provides some protection against local parochialism and judicial activism (for example, in relation to the Treaty of Waitangi) but not against Privy Council activism. The choice is not clear-cut, although to date it has arguably favoured retention of the Privy Council.

In respect of the first point, Walker reports that recalls apply to judges as well as public officials in six states in the United States. He notes that such a power could undermine the rule of law if it allowed populist opinion to strike down judges who have fearlessly applied the principles embodied in common law or laid down by parliament. He therefore suggests that the right of recall might be best reserved for those tribunals (such as, the High Court of Australia, or the US Supreme Court) that have most seen themselves as possessing sweeping legislative, if not constitutional, powers. Walker also suggests that it would be important that recall did not affect pension entitlements too severely. He suggests that the fact that most voters would not know the names of the great majority of judges would also guard against overly partisan voting. He sees recall as being extremely rare; it would have its effect because it existed as a potential sanction, not because it was a ready weapon.

The ability of the courts to make policy rather than enforce the rule of law may also be constrained by better law making. Laws that make parliament's intentions with respect to the protection of property rights and the sanctity of contract more explicit may help. However, a drift towards a written constitution may not. There is a potential conflict here.

7.5 The takings issue

7.5.1 Introduction

This section examines whether increasing the constraints on a government's ability to take rights in private property through regulation could improve economic outcomes. Increased constraints could be imposed by restricting the situations in which the government can take through regulation (for example, any taking must be essential to the achievement of a public purpose) and requiring that, if the government takes through regulation, it must pay compensation.

Section 6.4.3 introduced the concept of compensation for takings under the power of eminent domain. It distinguished between the concept of the exercise of police power – government actions to prevent common law harms for which no compensation is due

[498] Walker, *op cit*, p 395.

– and the exercise of the power of eminent domain, for which compensation is due. It also established the enduring power and prevalence of the doctrine in English law and in the Constitution of the United States that compensation should be paid for property taken for public works.

Governments should have the power to tax and regulate so as to allow transactions to occur that individuals in the community would have undertaken voluntarily but for problems of high transaction costs. Individuals can be presumed not to undertake exchanges voluntarily unless they benefit all those who are a party to them.

When governments use the power of eminent domain to force through mutually beneficial transactions that would otherwise be blocked by high transaction costs they should be able, at least in principle, to preserve this mutually beneficial aspect. Those who relinquish a legal right as part of a forced exchange can be made no worse off if they receive full compensation for that loss.

Governments wishing to conform to the rule of law will seek to protect individuals in their rights, including rights to property. They will resist attempts by factions to use the power of eminent domain for predatory purposes.[499]

Section 7.5 discusses in some detail the complexities that arise in relation to the issues of the proper use of the power of eminent domain and the compensation for regulatory takings.

Section 7.5.2 discusses the issue of principled limits to a government's power to take under eminent domain.

Section 7.5.3 defines a taking and discusses the implications of a liability rule for regulatory takings using this definition.

Section 7.5.4 applies this framework to the use of permits to take and to extract concessions.

Section 7.5.5 considers the issue of takings that occurs when property is transferred within the public sector, for the benefit of some at the expense of others.

Section 7.5.6 considers takings issues that arise when property is transferred from the public sector to the private sector.

Section 7.5.7 summarises our conclusions on the issue of compensation for regulatory takings.

7.5.2 When is it justifiable to use the power of eminent domain?

The potential for the abuse of the power of eminent domain is so serious that its use must be limited. In section 6.4.3 we cited Blackstone (1775) and Lord Radcliffe (1965) to illustrate the recognition of this point by legal authorities. The need for constraint is also acknowledged in the Legislative Advisory Committee 2001 *LAC Guidelines* in the following terms:

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[499] Refer to section 6.4.3 for Blackstone's concept that the public should be treated as an individual treating with another when it takes property.

> Parliamentary democracy is not simply the proposition that anything a majority does must be right and good. Rather it proceeds upon a presumption that when the majority vote for a law which constrains individuals or takes away any of their freedom of person or property it will only be for a good reason.[500]

What constitutes a 'good reason' is not examined in the *LAC Guidelines*. In the United States, the concepts of a 'public use', 'public benefit', or 'public interest' test are common parlance.

In New Zealand, the Public Works Act 1981 currently allows and limits the power to take land for public works – that is, works that are to be constructed, undertaken, established, managed, operated or maintained by or under the control of the Crown or local authority for any public purpose. This constraint is weaker than the requirement in the Act, prior to its amendment in 1987, that the government could only take property for *essential public works*. The type of works that were deemed to be essential included network industries (roads, water, electricity, telecommunications), airports, schools, hospitals, energy, rubbish disposal, defence, police, reserves and wildlife habitats. While the 1987 amendment removed the concept of an essential public work, section 171 of the RMA requires territorial authorities to impose a '*reasonably necessary*' test on designations that permit 'requiring authorities' to access the power of eminent domain.

The degree to which such laws protect individuals against unwarranted expropriation depends on how limited are the definitions of 'essential', 'public work', and 'reasonably necessary' and on how full is the level of compensation. Given the nature of interest group politics, these limits can be expected to change through time. Moreover, whether a particular work should be regarded as a public work may depend on technologies that change through time. The costs and benefits of a regulation in practice depend not just on its design but also in good part on its interpretation, application and enforcement.

In short, limits expressed in imprecise terms, or though long permissive lists that lack any obvious principled basis and permit considerable discretion, can easily prove to be no limit at all in practice.

Richard Epstein has analysed much of the US case law with a view to determining a principled basis for clarifying where it is best to set the limits to the exercise of this power.[501] What is the test of whether an action represents a public use or confers a public benefit?

Epstein suggests that the economists' concept of a *public good* provides a promising basis for a principled approach to determining the proper limits to the exercise of the power of eminent domain. Government intervention may be justified where voluntary arrangements are unsatisfactory because of high transaction costs. In extreme cases, private provision is impossible because of free rider problems – those who benefit cannot be induced to pay. National defence is the classic example of a public good.

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[500] Legislative Advisory Committee, *LAC Guidelines: Guidelines on Process and Content of Legislation*, *op cit*, p 43.

[501] Epstein (1985), *Takings: Private Property and the Power of Eminent Domain*, *op cit*. Refer in particular to chapter 10, pp 107–125.

Other high transaction cost situations include those involving non-point source pollution and monopoly.

One aspect of monopoly is the problem of *hold out*. This problem can arise where the seller has a monopoly because of some situational necessity, over geographic in nature. The exercise of the power of eminent domain may be justifiable as a means of preventing the seller from appropriating the entire surplus arising from the project, or for thwarting the project entirely, perhaps out of malice or incompetence. It may also assist in overcoming the problems of very high transaction costs in linear developments involving many landowners, In the United States, early case law provided for land that would be flooded by private dams for water mills to be condemned under the power of eminent domain.

Epstein suggests, that in these cases, the power of eminent domain should only be made available where: (a) necessity is proven; (b) there is a public right of access in the sense that the service is available to all who are competent to use it and accept the rules and charges that apply to all; and (c) the surplus from the project is shared so as to curb 'avarice and ambition'. He notes a New Hampshire Mill Act 1868 that provided for the owner of flooded land to be compensated at 150 percent of market value.

Epstein also notes that, as a fact of life, a private operator that owes its profits in part to the past exercise of the power of eminent domain may be vulnerable to the ongoing regulation of those profits on the basis that the original use of that power provided for a fair division of the gains.

At first blush, the use of the power of eminent domain to overcome a problem of hold out is inconsistent with the notion of making all parties to the transaction better off than if the power of eminent domain were not exercised. One party loses the ability to use hold out to capture the entire surplus from the desired exchange. However, if the power of eminent domain is only exercised when hold out would otherwise prevent the desired exchanges from occurring, the relevant benchmark for comparison excludes valuations based on the ability to exercise hold out in relation to such exchanges. This example illustrates the importance of limiting the exercise of the power of eminent domain to the most serious cases involving the welfare of the community at large.

Under this approach, the power of eminent domain would be available for transaction cost and hold-out problems that arise in respect of the large network utilities that provide essential infrastructural services to all or most households. In particular cases, geographic limitations could also justify the use of this power in relation to the control and use of surface water, including dams for irrigation or electricity, and the purchase of land for a single airport, sea port, hydro-electric dam, an essential public park or reserve.

The removal, say from a utility operator, of an existing legal right to access the power of eminent domain is another matter. For example, a network operator that has invested irreversibly in the network on the basis of a legal right to the ongoing power of eminent domain for necessary network maintenance and upgrading purposes could be highly vulnerable to opportunistic hold out if that legal right were removed without its consent. A government that took such a step without compensating the investors could be sending a very negative signal to the world's investors about political risks in New Zealand.

The decision as to whether to provide a new entrant with access to the power (of eminent domain) when the dominant incumbent enjoys that power is more difficult. An incumbent that is profit maximising, subject to the constraint of perfect monopoly regulation, will already be satisfying consumer needs at least cost. A new entrant's application for access to the power of eminent domain could fail to pass the proposed test of essentiality for this reason. But to deny the new entrant access to a power (of eminent domain) that the incumbent enjoys is to abandon a level playing field concept. Moreover, if the new entrant would be subject to hold out on irreversible investments in the absence of such a power, the effect could be to prohibit competitive entry.

The regulation of monopoly pricing – an exercise of the power of eminent domain in itself – further complicates the issue. Inevitably, a regulator has to find a balance through time between allowing enough profits to bring forth necessary ongoing investments (a cost-plus issue) while keeping prices low enough to prevent pricing above marginal cost that leads to *ex ante* supernormal profits.[502] Because monopoly regulation invites rent seeking by regulators, competitors, incumbents and user groups, it is political. Politics makes the regulation of monopoly messy and risky (as the regulation of electricity in California has demonstrated). Where a dominant incumbent is regulated on what is effectively a cost-plus basis, the removal of the power of eminent domain could expose the incumbent to hold out. The additional commercial costs could increase consumer prices, even though there is no change in real resource costs from a national viewpoint. This implies a welfare loss from a reduced sum of producer and consumer surplus.

This argument adds a consumer surplus rationale to the earlier (cost of capital) rationale for not arbitrarily removing the legal right of access to the power of eminent domain from an incumbent. Because cost-plus regulation encourages excessive costs, it increases the probability that a new entrant with legal access to the power of eminent domain will be able to reduce costs and consumer prices (until it becomes large enough to be regulated on a cost-plus basis also). This argument suggests that the case for allowing a new entrant access to the power of eminent domain for subsequent maintenance and upgrading purposes is stronger the more monopoly regulation takes on a cost-plus character and the greater the extent of the irreversible investments. The argument would be stronger again if the new entrant was adding to industry capacity, as would commonly be the case.

Outside such areas we suggest that there be a strong presumption that the exercise of the power of eminent domain is not warranted. In particular, the power of eminent domain should not be made available to firms in competitive industries. Hold out of one firm cannot affect overall producer and consumer surplus in such cases.

A government should not use its coercive power of eminent domain simply to facilitate private enterprise, such as the assembling of a parcel of land large enough to cater for a supermarket. Ample sources of substitute land typically exist, or the existing owners could negotiate transfers to build the supermarket instead. The risk of abuse from government intervention is too great for the power of eminent domain to be exercised in these cases. Nor would we see any case in general for the use of this power in relation to the siting of a police station, hospital, school or fire station.

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[502] Of course, investment will not be forthcoming if an entrant faces the risk of *ex post* subnormal returns and no prospect of *ex post* supernormal returns.

Indeed, in most cases legitimate public objectives can be achieved through voluntary exchange. In voluntary transactions, parties will only agree to transact if they expect to gain from the transaction (otherwise they would not agree to take part) – an outcome that is less likely in a coerced situation.

To sum up to this point, we suggest that the government's powers to take under the power of eminent domain should be limited to:

- public good (high transaction cost) problems where the loss of human welfare would be material and widely distributed in the absence of the regulation in all its detail; or
- bilateral monopoly (hold-out) problems where the public use element is similarly high but where one or more individuals could otherwise extract the entire surplus from a necessary project, or thwart it entirely for unworthy reasons.

Expressed in the negative, the power should not be exercised when the transaction costs of dealing through the market are relatively low, third party effects are small, there are alternative efficient ways of meeting the public need, or the gains in consumer and producer surplus are relatively minor.

This formulation provides principles for limiting the type of situations in which recourse to the power of eminent domain could be considered. It does not provide much guidance as to how material the potential gain would need to be in order to justify the use of this power in cases of public good or hold out.

The higher the threshold for triggering recourse to the power to take the less the risk of abuse of this power and the greater the risk of welfare losses from thwarted transactions. Any concern to see excessive regulations reduced implies a concern to see a higher threshold than in the past for justifying recourse to regulations that exercise the power of eminent domain.

In this spirit, we suggest that, in the spirit of the Public Works Act 1981, the concept be maintained (or restored) of a threshold based on the notion of an essential public interest. Expressed differently, a regulation would have to be justified on the basis that it was necessary for the achievement of an essential public interest.

A test of whether a regulation is essential will be ineffective if it permits expansionary interpretations. A regulation should not be regarded as essential simply because it provides a convenient means of achieving a desired benefit. Instead, the benefit must be so important to the well-being of the community at large that its provision can be objectively deemed to be essential. Moreover, it is not enough that the benefit is important: there must also be a requirement that benefits are definitively blocked by a hold-out or high transaction cost (public good) problem.

Putting these elements together, a tight test for whether a regulation that creates a public benefit is necessary might require establishing that:

- the benefit to be derived is essential for the well-being of the community at large; and
- regulation is essential to obtain this benefit because it is highly implausible that voluntary mechanisms could overcome the barriers to its achievement.

Such a test of essentiality is also applicable to the use of the state's police powers.

The second leg of this test may require a greater exercise of judgment than the first. Usually there is an alternative; the problem is its expense or inconvenience rather than its non-existence. A related difficulty arises in assessing whether a current problem may be overcome by the likely evolution of common law remedies for external effects or a future innovation or technology. In time, precedents would establish some guidelines or benchmarks for assisting with these determinations.

Parliament could provide more explicit guidance either at the outset or subsequently if it felt that some undesirable precedents had been set by court interpretations of what was essential. One guideline might provide that public intervention would not be regarded as essential if workable voluntary responses to the public good or transaction cost problems already existed or were developing, either in New Zealand or in other countries that permitted voluntary solutions to emerge. Another might specify that regulation of the community at large could not be justified simply because of concerns that some portions of the community might fail to take what appear to others to be efficient decisions. This should strike out many paternalistic regulations, such as mandatory energy efficiency requirements.

7.5.3 Compensation for takings under eminent domain

Defining takings

Case law as to what constitutes a government taking in the United States provides little clarity beyond two main points: (1) all accept that when governments physically seize private land for public works, such as a public road, compensation will be paid; and (2) the courts have stated that a regulation would be deemed a taking if it went too far.[503] It is not clear what constitutes a taking that goes 'too far'. Nor do the courts appear to have been able to produce economically sound principles for making such assessments.[504]

New Zealand's Public Works Act 1981 has a clear definition of when the Crown is liable for compensation, but the application is limited essentially to physical property. As such it cannot be applied to many regulatory excesses of the type discussed in section 2. However, a valuable feature of the Act is that it allows compensation for "injurious affection or damage" resulting from government action.

The distinction between physical and regulatory takings has little to recommend itself under most economic or ethical theories.[505] Many partial takings are achieved through regulation rather than the exercise of eminent domain.

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503 The landmark case establishing that a 'mere' government restriction on land use (as distinct from actual occupation or appropriation) could be a taking occurred in 1922 in *Pennsylvania Coal Co v Mahon*.

504 For a recent discussion of the case law and related issues, see Meltz, *et al*, *The Takings Issue: Constitutional Limits on Land Use Control and Environmental Regulation*, *op cit*. Refer particularly to chapter 11 for physical takings and chapter 12 for regulatory takings.

505 Rose-Ackerman, S, 'Regulatory Takings: Policy Analysis and Democratic Principles', in Mercuro, N, (ed), *Taking Property and Just Compensation: law and economics perspectives*, Kluwer Academic Publishers, Boston, 1992, p 30.

What stamps an action as a taking is its effect on an individual's property rights, whether this involves a single individual (as is often the case in physical takings) or a large number of individuals (as is often the case with regulatory takings).[506]

For public policy purposes, a clear footing for a compensation rule is required. The need is for sound principles that guide the selection of the desirable policy action in this area. Richard Epstein has addressed this task. He proposes a simple test for whether a government action represents a taking. It is to ask:

> Would the government action be treated as a taking of private property if it had been performed by some private party?[507]

This yardstick uses the common law to determine what constitutes a harm or nuisance and who is an interested party that can take an action. It thereby makes the courts ultimately responsible for determining whether a government action amounts to a taking. The Legislative Advisory Committee's *LAC Guidelines* ask, similarly, if the proposed policy change complies with fundamental common law principles or alters 'vested rights'.[508]

The choice of yardstick for a taking is critical. Richard Epstein summarised its implications as follows:

> In adopting that [ie the above] position, I claimed in effect that any form of standard legislation or adjudication that altered the common law frame-work was a taking. The state then had to show that the taking was justified in one of two ways: either to prevent wrongful conduct by private individuals, or, where it did not, to provide compensation. Here the link to the common law theories of tort must be explicit, for once that link is abandoned, then there is no separate conception of private wrong that limits the scope of state activities, and we reach the dangerous position that we are at today where virtually all government restrictions on use or disposition of property meet what low constitutional standards remain.[509]

The yardstick makes use of a separation of powers. Parliament can appoint local judges but it cannot determine what decisions New Zealand judges or juries will take in particular cases. Moreover, a New Zealand parliament has no ability to influence decisions taken in other common law countries. These decisions may create precedents for the evolution of common law in New Zealand, whether parliaments try to prevent this or not.

A decentralised system of protection for legal rights based on independent impartial judges and a jury of citizens is likely to preserve public confidence in the legitimacy of property rights to a much greater degree than is a politicised one dominated by changing political majorities. There can be no agreement that existing rights are legitimate if they change materially with every change in government.

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506 Epstein (1985), *op cit*, p 94.

507 Epstein (1985), *op cit*, p 36.

508 See sections 3.1 and 3.2 respectively in the Legislative Advisory Committee's *LAC Guidelines on Process and Content of Legislation*, *op cit*.

509 Epstein, Richard, *Bargaining with the State*, Princeton University Press, Princeton, New Jersey, 1993, p xiii.

The issue of compensation must then be addressed if there is a taking under this definition. No issue of eminent domain arises if there is no taking.[510]

Partial takings of property rights encompass both the taking of all of the property rights associated with part of a holding of property (for example, part of a block of land), or the taking of some aspect of property rights. Examples of partial takings include the granting of an easement over private land or a restriction imposed on the overseas sale of items of cultural significance.

Illustrative implications of a common law benchmark for harm or nuisance

A competitive harm is not a taking under common law. Any legitimate voluntary exchange can affect the value of a third party's unchanged rights. For example, a merger between two competitors could affect the value of a third competitor's business. Inventions that change relative prices and thereby affect the distribution of wealth are not actionable harms under common law. (These changes in the distribution of wealth result from uninsured risks in the *ex ante* situation.) In similar vein, a decision to close an exit along a particular highway or to build a highway somewhere else may diminish the value of hotels and restaurants along the original highway but is unlikely to be considered to affect property rights directly.[511]

A regulation that enjoins a common law harm would not be a taking under this definition. Regulations that simply better enforce existing rights cause no harm to legal rights and reflect the exercise of 'police power'.

Deregulation, per se, does not violate common law rights. When governments create privileges they seldom bind future governments contractually. Privileges conferred by a government that create no legal contract with any party will not *prima facie* provide a plaintiff with any cause of action against the government if it withdraws those privileges. A tariff imposed on footwear, a taxi driver's licence, a subsidy for visits to a general practitioner and a tax concession for research and development spending do not bind future governments. No beneficiary of such policies purchases a power of veto over future government actions. Indeed, it may be impossible to determine with any precision who is the real beneficiary. Where there is no contract and no consideration there is no redress for the effects of an action that legally removes those privileges. The only obvious route under common law for creating a Crown liability in respect of the removal of privileges arises in respect of implicit contracts and promises. Normal common law tests should apply.

The same argument suggests that the rescinding of regulations that conferred the right to object to a resource consent on those who would not enjoy that right under earlier common law would not obviously constitute a taking. No government has bound future governments contractually. Under common law, the test of an interested party is based around direct personal harm. Rescinding the requirement for a resource consent would preserve the right of action for the violation of a common law harm.

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[510] Medema, SG, 'Making Choices and Making Law: An Institutional Perspective on the Takings Issue', in Mercuro, N (ed), *Taking Property and Just Compensation: law and economics perspectives*, Kluwer Academic Publishers, Boston, 1992, proposes a similar definition, p 46.

[511] Laffer, WG, 'The Private Property Rights Act Forcing Federal Regulators to Obey the Bill of Rights', *Issues Bulletin*, No 173, 1992, p 5.

Compensation would be payable for a taken property right even if the owner of the right knew there was a risk that a current or future government might try to take that property without consideration. The common law does not turn a blind eye to rustling just because a farmer knew there was a risk it would occur.

Legislation that rewrites existing legal contracts, as in the recent case of Maori reserve land in Taranaki, would be a regulatory taking under the proposed test. No private entity could extinguish such contracts without having to pay the incumbent for the right to do so.

Regulations that oblige persons to fill in forms for Statistics New Zealand at their own expense would be a taking under the proposed test. No private person would be able to take a common law action against a business that refused to fill out a form on demand. (In addressing the separate question of compensation for such a taking, the question of reciprocal benefits may be relevant.)

Similarly, a private party that wished to take a common law action against a property owner that cut down a tree, drained a swamp, painted or demolished a building, or destroyed a historical site, would have to satisfy a court it was an interested party that had suffered a common law harm. Government regulations that make such actions subject to the consent of a government agency are likely to be judged to be a taking.

The abolition in New Zealand of the right to sue for losses from personal injury arising from an accident stripped victims of a common law remedy for harm. Such an action appears, therefore, to be a taking. Deregulation in the form of the restoration of the right to sue would not appear to be a taking as argued above.

We can also illustrate the utility of the benchmark not by its presence but by its absence. In the absence of a common law benchmark there may be no distinction between a government action that prevents a nuisance or a harm (and thus for which there is no compensation) and an action that takes private property in order to create a public benefit. In section 6.4.3, we noted that in 1928 the US Supreme Court stepped into this abyss in *Miller v Schoene*.

It is the absence of any sense of the relevance of existing legal property rights that makes conferring a benefit equivalent to the prevention of harm. A harm is equivalent to a forgone benefit and a benefit is equivalent to an avoided harm.[512]

The fence that keeps cattle from eating a crop might be said to confer a benefit on the crop farmer in the form of an avoided harm. Alternatively, the same fence could be said to impose a harm on the cattle ranger who has to forgo the benefit of open ranch cattle farming. As another example, a law stopping pollution might be said to harm the polluter, by depriving them of a forgone benefit. Alternatively, it might be said to confer a benefit on the polluter's victim, in the form of an avoided harm.

Is a law that requires the crop farmer to erect a fence, or the victim of pollution to clean up the mess, a taking? In the absence of any benchmark grounded in existing property rights, any government could simply deny the need for compensation on the grounds that the cost in each case was offset by a benefit in the form of an avoided harm.

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[512] Miceli, J and Segerson, K, 'Takings', in *Encyclopedia of Law and Economics*, Edward Elgar, Cheltenham, 1998, p 10 and Epstein (1985), *op cit*, p 116.

Owners who have been formally notified that compulsory government appropriation (physical or regulatory) is contemplated may lose valuable development options. This loss is a taking. Compensation processes need to take this into account if the principle that all parties to forced exchanges should gain is to be preserved. Presumably such a notice could state that the government would not compensate for expenditures not already committed that were incurred on the property subject to serving notice. But it would remain liable in principle for the loss of valuable development options. The burden of proof that the government has provided adequate notice should rest with the government.

Possible difficulties with the benchmark

In hard cases, legal experts will disagree as to whether a government action is a taking under existing law. No alternative yardstick can avoid the problem of hard cases.

A related problem arises where the legitimacy of existing legal rights is in dispute. This may occur following ancient injustices. Common law rights of action, and indeed any legal system, adopt some form of a statute of limitations in order to allow an existing owner to put the asset to productive use with confidence in secure possession. Epstein has a careful discussion of the relative merits of this approach compared with government attempts to find a just solution long after the death of the original victims and their immediate descendants.[513]

Another issue may arise where the evolution of common law has been stunted or warped by regulation. In these cases deregulation may create a period of considerable uncertainty as to the new allocation of property rights. For example, the abrupt restoration of the right to sue for personal injury by accident could generate considerable uncertainty as to what defences a court would accept against a claim of liability.

In all such cases the public policy question is whether it is better to let imperfect judges and juries fill in the gaps or correct misplaced past enthusiasms or errors or to have imperfect politicians pass laws that attempt to shorten the adjustment phase. We raised this issue in sections 3.5 and 5.2.5.

While in particular cases this may be a difficult choice, in general there is a strong case for leaving the evolution of common law to common law processes. The intensive testing of the common law over the centuries suggests that a particularly high burden of proof should be imposed on regulations that change existing hard-reached definitions of a harm, remove long-enduring remedies for harms, or change long-enduring definitions of an interested party.

How long is long enduring? One of the lessons of the twentieth century's experience with governments is that destructive regulation and regimes can endure for decades. New Zealand's import licensing regime was introduced as a temporary measure in 1938. This suggests that the measure of what constitutes a long-enduring benchmark should perhaps be measured in centuries rather than in decades.

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513 Epstein (1985), *op cit*, pp 346–350.

The proportional distribution of surpluses

When a transaction produces a surplus, the distribution of that surplus invites wasteful contest and the opportunistic abuse of the power of eminent domain by politically powerful factions. In order to a guard against an exploitative distribution, any proposed distribution should be tested against a neutral, non-exploitative yardstick.

Here we adopt Epstein's suggestion that governments should aim to distribute any surpluses from the exercise of the power of eminent domain proportionately between the parties to a forced exchange. The existence of a surplus should permit all parties to the forced exchange to be made better off than if it did not occur.[514] In general, neither the Crown nor any subgroup should be permitted to capture the entire surplus.[515]

This proportionality principle is consistent with a common notion of fairness – equal sharing where none has made a disproportionate contribution.[516] It may imply, for example, that the portion of the surplus accruing to those who have sold property rights will be shared amongst them in proportion to the value of the rights each had sold. Similarly, the portion of the surplus accruing to those who gain property rights as a result of the forced transfer would be shared amongst this group in proportion to each member's contribution to the cost of compensating those whose rights were taken. The sharing in the surplus between these two groups would also aim to be non-exploitative.

Where a surplus would not otherwise be distributed proportionately it is logical to ask, at least in principle, that those who would otherwise gain a disproportionate benefit compensate those who would otherwise lose disproportionately.

A key case in the United States that established the importance of requiring compensation where benefits were not proportionate to costs is *Armstrong v United States* (1960). In this case the Supreme Court determined that Armstrong should be compensated for a government action that extinguished liens that would have been robust between private parties.[517]

Cases where compensation is not payable for takings

Determining that a regulation is a taking only creates a *prima facie* case for compensation. Compensation may not be payable for a taking where:

- the costs of identifying all those whose property rights have been taken and assessing their losses are so high as to exceed the benefits from paying compensation;

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514 By definition, those who are not parties to the exchange will experience no gain or loss in legal rights and will not be forced by the government to cross-subsidise the parties to the exchange. This does not make them immune from the effects of such an exchange, as the case of no compensation for competitive harms illustrates.

515 In a voluntary transaction, the distribution of a surplus depends on supply and demand (the state of the market). If the seller faces competing sellers, any surplus is likely to go to the buyer, and vice versa.

516 Epstein (1985), *op cit*, p 5.

517 Epstein (1985), *op cit*, p 43 and 197.

- the benefits from the taking fall on the same people who have incurred the costs, in proportions that reflect transaction costs realities rather than the manipulations of self-interested parties; or
- the government is constraining a firm's exercise of market power while allowing an investor to obtain the (*ex ante*) risk adjusted return on capital.[518]

In respect of the second point, where the costs and benefits of a particular government regulation fall on the same parties in proportions that preserve their original positions, there are sound transaction cost reasons for not requiring compensation. For example, a zoning rule that applied to all properties equally may constrain property rights while at the same time conferring mutual benefits on neighbouring properties. Zoning restrictions that prevent one person from building a high-rise building on their land also protect it from a similar development on the neighbouring property, which could overlook and shade it from the sun. Although constraints could be agreed between neighbours, the transaction costs of reaching such an agreement may be high, particularly for established neighbourhoods where large numbers of individuals are involved.

Requiring compensation for externally imposed constraints that are mutually desirable would impose unnecessary administrative costs for no obvious net benefit.

Improvements in the value of property because of a public work or regulation are referred to as *betterments*. For example, the government might take land from a property owner to construct a road, in the process substantially improving the value of the property owner's remaining land.

Consistently with the proportionality principle, the New Zealand Public Works Act 1981 and the Local Government Act 1974 explicitly allow for compensation to be reduced by the amount of betterment.

In respect of the third bullet point, we defer to the long-accepted doctrine that the law can intervene in respect of monopoly situations. We do so without in any way endorsing the efficacy of this law as it has evolved today in many countries. There are ample grounds for concern about the extent to which such laws are used for anti-competitive purposes. All too often government policies appear to create or entrench monopolies rather than attack them.

Finally, the remedy for a regulation that violates a human freedom would normally be to rescind it. For example, it would be impractical to contemplate compensation for regulations that reduce the freedom of speech for all or the freedom of association.

Charging the beneficiaries of takings

In principle, those who gain legal rights as a result of a forced exchange should compensate those who relinquish those rights, just as would be expected to occur were the exchange voluntary. Their willingness to do so is, in general, a fundamental test of whether the benefits from the exchange exceed the cost.

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[518] These issues were reviewed for the US Supreme Court recently in *Duquesne Light Co v Barasch*, 488 US 299 [1989]. For a brief comment on the issues see Epstein (1993), *Bargaining with the State*, *op cit*, fn 18, p 203.

Requiring, the beneficiaries to pay to use others' private property or to constrain its use gives them better incentives to balance the costs and benefits of the government interventions that they are promoting.

The same requirement would make it harder for regulations to be used to redistribute wealth in favour of particular interest groups by stealth compared with what might have occurred if the same transactions had been conducted voluntarily. The requirement accords with the common equity principle that 'those who benefit should pay'. In so doing it should protect taxpayers from being raided for the benefit of a lobby group.

Where users can be excluded (as is the case for electricity) or where a tied tax is possible (as in the case of roads), users of the service should pay for it, perhaps by way of user charges. If the benefits fall widely, funding of compensation should be from general taxation or local taxes as the case may be.

The rationale for confronting beneficiaries with the costs of takings applies even if compensation is not paid for takings, perhaps because it is impractical to do so. Otherwise beneficiaries will lobby excessively for regulations that benefit them at the expense of taxpayers.

Payments from beneficiaries should not be required if the beneficiaries also incur the costs of the same regulation in reasonable proportion.

In many cases, charging beneficiaries may be impracticable for transaction cost reasons. In principle, a beneficiary will be anyone to whom a property right has been transferred. But where a regulation extinguishes a right rather than transfers it (for example, where it extinguishes a land use) it may be impossible to determine with any precision who ultimately benefited.

Given the incentive of governments to use charges to beneficiaries as another source of general revenue, beneficiaries should have the ability to challenge their identification as a beneficiary and the magnitude of betterment payments in court.

Incentive effects of a compensation rule

To be useful a compensation rule has to alter behaviour for the better. In this section we consider its likely effects on:

- lobby groups;
- government regulatory decisions;
- taxpayers; and
- those investing in property rights that could be taken.

One motivation for a takings rule is to subject government decision making to the same sort of calculus that applies to private sector decision making in the absence of government intervention. Another is to secure the rule of law better by protecting the security of property rights.

The hope is that:

- lobby groups will lobby less for regulations that impose disproportionate costs on others – easing the political pressures on governments to regulate excessively;
- governments will find it harder to pass regulations where the costs are large relative to the benefits, in part because the costs will be more transparent and come under greater parliamentary scrutiny; and
- because property rights will be more secure the nation will become more prosperous.

Beneficiary-funded compensation

A compensation rule is most likely to produce desirable results when beneficiaries fund the compensation payment. This arrangement mirrors the exchanges that could be expected to occur under voluntary exchange. It is respectful of property rights and accords with the 'those-who-benefit-should-pay' equity principle.

There is a counter argument. It is based on the point that prior knowledge of a taking could lead to over-investment in the property to be taken. The argument runs as follows.

Takings compensation is akin to insurance against the risk of a taking. Because property owners receive full compensation, they have no incentive to take into account the probability that the government will take their property for a public project. With full compensation, the private return to investment is the return that would be earned with no risk of expropriation. The compensation protects investors against the risk of loss. It is thereby argued that the payment of full compensation induces moral hazard similar to that created by full insurance.

To illustrate this point, it is conceivable that property owners could attempt to deter a public work by raising its costs by investing more heavily in their properties than would otherwise be warranted to raise the cost of compensation. Suppose a state highway is congested near a local community. The operator of the highway wishes to take vacant land that is owned by local government adjacent to the highway in order to expand its capacity. Suppose the local community would prefer the highway authority to ease the problem by making a much more expensive bypass that takes the additional traffic away from the local community. The local community might exercise enough influence over the local council to have the vacant land re-designated as residential and sold to developers for residential housing with the idea of increasing both the number of voices resisting the cheaper highway option and raising the cost of compensation.[519]

Conceivably local government could receive a lower price from the developers for the land than it would have received from the road authority, reflecting the risk of uncompensated inconvenience to the ultimate owners. If so, those opposed to the local state highway project would have effectively raided the value of the local council's land bank in order to raise the state highway operator's costs.

In our view, such arguments against the principle of payment of full compensation are unconvincing. First, the general over-investment argument applies to all private sector

[519] The current battle along the Kapiti Coast in respect of Transit New Zealand's proposal to put another bridge across the Pauatahanui Inlet at Paramata has features of this example.

investment. Someone planning to aggregate diversely owned properties for one purpose, be it a supermarket, office block or service station, takes a risk that an existing owner might improve it for another purpose at any time. That improvement raises its market value, and therefore the acquisition cost for the proposed aggregate development. This is a market risk that should affect the developers' timing and strategy. No government intervention is warranted. Nor is the incentive obviously perverse. Anyone enhancing such a property takes a risk that the market value of the enhancement will be less than its cost. For example, renovating an old building may not change the market's assessment that the building is obsolete and the only real value of the property is in the site. Where a government agency is the buyer, a necessity to pay full compensation gives a minister of finance an incentive to request it to identify its likely future requirements well in advance. The agency could then negotiate with landowners to take out an option to condemn the property based on a pre-investment value. The value of the option will compensate the landowner *ex ante* and avoid the investment that was socially unproductive given the probability of subsequent condemnation.

Second, in a takings context, full compensation means market value compensation. It is likely to under-compensate owners in respect of inconvenience and any infra-marginal rents that they were enjoying. Third, the state highway example is contrived by the introduction of unusual political rent-seeking opportunities that do not apply to the standard takings case. Fourth, the alternative to full compensation is less-than-full compensation. In the absence of private insurance arrangements against less-than-full compensation, risk averse owners of property rights will invest less in enhancing the value of those rights. Uncompensated takings undermine the rule of law and may demoralise local property owners and deter international investors. Less-than-full compensation will also encourage landowners to spend resources trying to ensure that someone else's property is taken rather than their own. This sort of rent seeking by property owners can only be avoided if the designation of the land is truly random, or if full compensation is paid.[520]

We conclude that full compensation funded by the beneficiaries and based on market values should be the starting point for any assessment of compensation. In our view there are cogent arguments for permitting compensation above market value in particular circumstances – as is provided for in the Public Works Act 1981. Commonly, the number of people offering to sell their dwellings at any one point of time is small relative to the total who own dwellings. This makes the point that most owners of property rights are infra-marginal to supply and demand. Their property is worth more to them than to the marginal buyer. Such people can only be made no worse off by a taking if they receive more than the market value by way of compensation.

The argument for compensating at more than market value is heightened where the regulation is likely to produce a significant surplus over the market value of the property rights being taken. The power of eminent domain should not be used to deprive some parties of a share of the surplus that they might have been expected to enjoy under voluntary exchange and in the absence of hold up. Even so, the possibility of exceptional circumstances in which strategic considerations may lead to investments designed to raise the cost of compulsory acquisition may need to be considered. Where relevant, this factor could also be taken into account by any tribunal that is determining the quantum of due compensation under a takings clause.

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[520] Usher, D, 'Victimization, Rent-seeking and Just Compensation', *Public Choice*, 83, 1996, p 9.

We now consider the possibility that it may be impractical to fund compensation from beneficiaries.

Taxpayer-funded compensation alone

Where a regulatory taking transfers private property into property held in common, it may not be possible for transaction cost (public good) reasons to charge those who benefit. In such cases, any compensation must funded by some combination of central or local government taxation and user charges for access to the common property.

The need for scrutiny of the regulation is greater in such cases because of the enhanced risk that the true purpose will be redistributive, as those who benefit seek to shift the burden of funding the benefits to taxpayers, even if the overall costs exceed the benefits.

Funding from taxpayers shifts the incentive to resist the regulation from the owners of the property rights (in the case of uncompensated takings) to taxpayers.

Since transaction costs must be incurred in funding compensation it is valid to ask if there are benefits that exceed these costs in this situation.

It is not clear that taxpayers would oppose the imposition of such a burden more vigorously than the owners of the property rights that were taken. Taxpayers who would bear the costs of compensation and the costs of government projects are unlikely to have strong incentives to oppose minor regulations because the impact on each individual taxpayer would be relatively small.

Shifting the burden of compensation on to taxpayers could induce governments to structure regulations so as to minimise the amount of compensation paid. This could have desirable or perverse results in any particular case. For example, the government may prefer to impose a large loss that could be uncompensated, to a smaller loss that would have to be compensated.[521]

On the other hand, shifting the costs to taxpayers would subject those costs to parliamentary scrutiny under normal budget processes. This may increase the pressure on the government to demonstrate that the benefits of its actions outweigh the costs.

Furthermore, it is also plausible that making those costs more transparent could change the way individual politicians vote on a regulatory proposal. For example, some may fail to appreciate the magnitude of the costs, perhaps regarding assessments not based on court decisions as being politically motivated. Alternatively, they may be quite happy to see the costs fall on what they perceive to be a well-off rural farming group or group of large property investors who do not support their party, but less happy to see the costs fall on taxpayers at large. Of course, in any particular case, the same factors could run in the opposite direction.

In addition, the right to compensation opens the door to judicial review, which provides an important constraint on bureaucratic behaviour.[522]

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[521] Kaplow, L, 'A Economic Analysis of Legal Transitions', *Harvard Law Review*, Vol 99, No 3, January 1986, p 567.

[522] Esposto, FG, 'The Political Economy of Takings and Just Compensation', *Public Choice*, 89, 1996, p 267.

If the choice of land to be taken without compensation is determined politically, the official whose task it is to locate public works may be open to bribery.[523] The authority to expropriate without compensation empowers politicians in office to victimise citizens, bullying them to contribute to political campaigns and to vote appropriately.

If we turn from 'in theory' arguments to practice, it is clear that societies have found it efficient over the centuries to compensate for outright physical takings of land out of taxation. The issue of compensation for partial takings or for regulatory takings is very different. The strength of the political opposition to paying compensation out of taxation in environmental cases is beyond question. The strong political resistance to paying compensation to farmers whose property rights under leases in perpetuity were taken in the Maori Reserved Land Amendment Acts of 1997 and 1998 illustrates the same phenomenon. The Electricity Industry Reform Act 1998 forced private companies to separate their lines and supply businesses without proof of wrong-doing or compensation for losses. The *Westco Lagan* case referred to earlier arose after parliament legislated out of existence the company's contractual entitlements to rimu logs on the South Island's West Coast. The same legislation explicitly prevented any claim for compensation. The company argued to the High Court that the legislation breached a 1986 West Coast Accord, the Magna Carta and the New Zealand Bill of Rights Act 1990. It unsuccessfully sought declarations, an inquiry into damages and an injunction restraining the clerk of the House from presenting the Bill to the governor-general for assent. Currently, the Electricity Industry Bill 2001 is under strong attack for imposing liabilities on land owners without compensation.[524] In none of these cases has there been any serious suggestion that beneficiaries should pay.[525]

We interpret this to demonstrate that there is a strong likelihood that the power to take *physical property and enforceable contracts* outright without compensation is very likely to be abused and undermine the rule of law.

These cases suggest that a requirement to pay compensation, thereby shifting the burden of a regulatory taking from the owners of the taken property rights to taxpayers, may often be of material political significance.

We acknowledge that the above 'revealed preference' argument for a compensation provision in respect of physical property and contracts could be used to argue against extending the rule to wider regulatory takings. Against this, we suggest that the regulatory excesses detailed in section 2 and the evident need for greater respect for constitutional constraints including the rule of law and compliance with sound tax principles favour giving the most serious consideration to extending the compensation rule.

Strengthening the requirement that the government pay compensation seems likely to reduce the number of government projects and/or the use of regulation compared with the status quo. It is likely that some inefficient regulations and government projects would be prevented by a compensation requirement.

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523 Usher, *Public Choice*, *op cit*, p 9.

524 Editorial by Bob Edlin, 'Electricity Bill threatens farmers' and foresters' rights', *The Independent*, 21 March, 2001.

525 It is not clear if this opposition could rightly be attributed to 'fiscal illusion' – that is to flawed decision making in which decisions are based on their budgetary effects rather than on their overall effects.

Against this is the possibility that the same requirement could deter some projects or regulations that were efficiency enhancing. Moreover, the complexity of the processes of government decision making, the seeming willingness of taxpayers to support increased expenditure, and the complexity of interest group interactions may reduce the impact of an expanded compensation requirement.

We conclude that the discussion under this subheading emphasises the desirability of funding compensation from beneficiaries. Introducing a third party, the taxpayer, as a potential source of funding solves some problems by creating others.

Where beneficiaries cannot be made to pay for transaction costs reasons, the question of whether to compensate property owners is essentially a taxation question. The principle of 'no taxation without consent' suggests that in principle neither group should be taxed without their consent. If beneficiaries are widely dispersed through the public at large (as in the 'save-the-whale' or heritage site cases) the proportionality and taxation principles would presumably point to funding from taxpayers at large.

7.5.4 Use of permits to take and exact property rights

Taking by imposing a permit requirement

Regulation, particularly of land activities, is often conducted by way of permit. The resource consent process associated with the RMA illustrates this technique.

The requirement for a permit in order to be able to exercise a property right is similar to a situation of injunctive relief between individuals. A successful application of injunctive relief in favour of party A prevents party B from exercising a property right except by the permission of party A.

Private injunctions are rarely issued. When they are issued it is usually in response to a dispute between neighbours.[526] An injunction, especially an unconditional injunction, shuts down an operation completely unless the defendant can pay the plaintiff to release the injunction. This contrasts with strict or negligence liability that induces defendants to take only cost-justified precautions.

Given the power of injunctions, they are usually confined to situations in which there is actual recurrent damage or an imminent threat of damage. Even when issued, such injunctions are normally structured so as to minimise interference with the defendant's activities while protecting the plaintiff's land from harm inflicted by those activities.[527]

The possibility of hold out and widespread costs may justify regulation by the government rather than reliance on the tort system. However, given the costs that are associated with constraints on the use of private property, an efficiency criterion suggests that the use of permits should be restricted to situations where there is an imminent threat of damage.[528]

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526 Epstein, Richard, 'The Permit Power Meets the Constitution', *Iowa Law Review*, Vol 81, No 2, 1995, p 409.

527 Epstein, *Iowa Law Review, op cit*, p 410.

528 Epstein, *Iowa Law Review, op cit*, p 414.

The current approach to regulation by permits does not take the disciplined approach that applies to private injunctions. Permits restrict individuals even if no threat of harm exists. A permit may be denied without proof that other persons are at risk. Harms can be attributed to inanimate objects, such as rocks or soil, or to abstract concepts such as 'the environment'. No test of an interested party need apply.

Permit powers are cumulative. A number of permits may govern a particular activity.[529] Bureaucrats can delay the issuance of a permit. Permits can be revoked at will, even after people have acted in reliance on them. Permits are generally issued by specialised bodies, which may have a strong ideological position. The absence of a disciplined interested party test means that pressures to delay or deny permits come from competitors of the applicant and those ideologically opposed to development. The party issuing the permit does not bear the risk and costs of delay. On the contrary the permit issuer may have an incentive to be 'safe rather than sorry' when faced with a controversial decision (of course other political circumstances may create an incentive to 'fast track' an application.

Epstein suggests that a solution to the overuse of permits by government would be to view permits as a form of government-initiated injunctive relief that was subject to the same limitations as are routinely applied to private plaintiffs.[530]

Exacting by attaching discretionary conditions to a permit consent

Developers often pay various fees or provide goods in kind or give up other of their rights to get permission for their projects. These payments are collectively known as 'exactions' or conditions.

Developers normally have to provide footpaths, roads, and services such as water and stormwater as a condition of a subdivision permit. These requirements have not generally been of great concern because they are needed for the properties being developed.

However, there has been a tendency for requirements to extend beyond services that are related to the developer's actions and to become a substitute for funding by rates. In Wellington, for example, commercial property developers in the inner city have been granted exemptions to height restrictions if they provide a public work of art as part of their development.

Although the regulated party may be better off obtaining the permit or approval and giving up some rights without compensation, they are worse off compared with the situation in which the government granted approval without conditions. Compared with no condition, the condition may amount to a taking. The tying of exactions to approval provides little protection against exactions that are not justified on a cost benefit basis.[531]

The major risk with exactions is that the value of the concession extracted by the government may be worth less than its value in private hands, that is, the exaction may reduce rather than enhance welfare.[532] This risk is obscured by the fact that the private

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529 Epstein, *Iowa Law Review, op cit,* p 412.

530 Epstein, *Iowa Law Review, op cit.*

531 Epstein (1993), *Bargaining with the State*, *op cit*, pp 98–103.

532 Epstein (1993), *op cit*, p 182.

individual agrees to the bargain offered by government, suggesting that there is a gain in welfare. While welfare may be improved compared with the status quo in which there is no approval and no exaction, welfare may be reduced compared with the situation in which approval is granted but there is no exaction or condition.

Consider, for example, the case of a local government that seeks an easement across a landowner's property and proposes to permit the landowner to develop the property in return for agreeing to the easement without charge. Suppose the easement reduces the property value by $200 but is only worth $100 to the general public. The taking represented by the easement is inefficient. The forced unbundling of this coerced transaction would improve the chance of detecting inefficient transactions.

Arguably, if the activity or outcome achieved by an exaction delivers benefits in excess of costs it should be promoted by the government irrespective of whether or not a landowner applies for a resource consent. A separation of exactions from the granting of permit approvals would increase the scrutiny given to those purposes that government seeks to achieve through exactions, and reduce the likelihood that governments make welfare-reducing demands. Separating the requirements also reduces the likelihood that some individuals will bear a greater share of the burden of providing a desired public good.

What appears to be required here is a process that enables an individual, who believes that they have a cause of action for an unjustified limitation on the conditions attached to the approval for a permit, to be able to take such an action.

7.5.5 Transfers of property within the public sector

A compensation requirement when property is taken from private ownership can help ensure that takings only occur when justified. However, further protection is needed to ensure that once assets are in public hands they are used efficiently.

The transfer of public assets from one use to another within the public sector can materially benefit some at the expense of others if individuals are not charged for the use of the public asset. The failure to charge individual beneficiaries for the use of public assets encourages rent seeking – both to increase the assets held by the public sector and to ensure that the assets are used to benefit a particular group.

Charging beneficiaries for the use of public property is one of the main options for constraining rent seeking and helping to ensure that public assets are allocated to highest valued uses. Individuals confronted with the true opportunity cost of their use of public land would be less likely to lobby for change if the benefits did not exceed the costs.

Constraining the use of land within the public sector does not necessarily ensure that assets are transferred out of the public sector when they could be used more efficiently under private ownership.

Requiring beneficiaries to pay is not a problem-free option. Often, governments are monopoly suppliers of services so that constraints need to apply to ensure that they do not set monopoly prices. Problems are even more severe when the government mandates that 'beneficiaries' must buy services or pay for permits.

As always, care needs to be taken in the choice of a yardstick for determining who is a beneficiary of a publicly owned asset. Again, we suggest that the common law should provide the yardstick. A person is a beneficiary if they would not have the right to continue to make use of the asset without charge if an unrelated private party owned it.

Of course, such a principle will not give a clear answer in all cases. For example, the common law may recognise a customary right of access. However, the task of regulatory reform should be to address clear-cut cases where the likely gains are significant rather than to get bogged down in inconclusive cases.

7.5.6 Transfers of property from the public sector to private ownership

Property transferred from the public sector to the private sector puts taxpayers at risk, except when the property is sold by a disciplined, impartial and arm's length competitive tender process. In significant cases this may be impossible. For example, ownership may be disputed or an original landowner may successfully claim a legal right of first refusal.

A related issue arises where the transfer terminates benefits that some were enjoying while the asset was held in public ownership – and to which they had a valid ongoing claim.

Again, it is vital for the prevention of corruption that any transfers of property from the public sector to the private sector are intensively scrutinised.

7.5.7 Takings, taxes and redistribution

The foregoing discussion has accepted that governments should have the power to tax and regulate so as to allow transactions to occur that individuals in the community would have undertaken voluntarily but for problems of high transaction costs. It has focused on developing a principled approach to limiting the abuses of this power.

Transactions undertaken voluntarily can normally be presumed to be mutually beneficial to those who are party to them. When governments use the power to take or to tax in order to facilitate such transactions they should preserve this mutually beneficial feature if they respect the rule of law and wish to be non-predatory.

The argument to this point is essentially the same as the argument that governments should have the power to tax in order to be able to fund public goods that are to be provided by government, such as national defence. Taxpayers in general can be expected to consent to taxes to fund public goods where those being taxed derive the benefit from the public goods in proportions that are as fair as it is practicable to make them. This is a (contrived) example of reciprocal benefits and costs.

The problem of predation arises when factions can vote for taxes on others for their own benefit. Conflicts of interest lie at the heart of the democratic problems discussed here.

With respect to a regulatory taking, the principle of a neutral distribution of a surplus suggests that non-neutral distributions should be seen as a tax and exposed to similar

disciplines and scrutiny. The power to tax should be held close to the legislature, and, in principle, the consent of those being taxed should be ascertained.

In both cases – the provision of public goods out of taxes and regulatory takings – it may not be practicable to ensure that all parties to the forced exchange are made better off. In many cases it may only be possible to fund compensation for a regulatory taking from taxpayers' pockets rather than from the pockets of those who derive the benefits from the taking. In other cases it may not be practicable to identify all those who should be compensated or to put a value on the losses of those who can be identified.

Civil society is likely to be corroded when particular groups perceive that others are using political power to tax them disproportionately. It seems clear that taxpayers in New Zealand generally concur in being taxed in order to provide a welfare safety net. The disagreements are probably most material in relation to the level of support and the conditions of support.

We suspect that regulations and taxes that transfer wealth at the expense of the least well off would attract far greater controversy and attention if these effects were more clearly identified. Referenda could also have a role to play here.

A more rigorous compensation rule will not provide clear answers in all cases to the questions of when the power of eminent domain should be exercised, whether a taking has occurred, whether compensation should be paid and at what level and in what form.

Even so, a more rigorous rule should enhance the rule of law. By raising the political costs of unmeritorious transfers of wealth it should reduce the incidence of such cases. In the longer term the existence of such a rule should alter perceptions and patterns of behaviour.

8 Design Options for Possible Regulatory Constraints

8.1 Introduction

There are many ways of using the measures outlined in section 7 to tighten the constraints on the Crown's regulatory activities in terms of process, accountability and content.

Section 8.2 proposes principles for screening regulations based on the concepts discussed in sections 6 and 7.

Section 8.3 proposes some tests that are based on these principles for evaluating regulations.

Section 8.4 discusses in general terms the task of a one-off review of laws and regulations using these principles and tests to cull out existing regulatory excesses.

Section 8.5 canvasses some options for reforming regulatory processes to guard better against future regulatory excesses.

Section 8.6 provides some concluding comments.

We do not focus in this section on ensuring that laws and regulations support the separation of powers. Power should not be concentrated in parliament, even less in the executive. The centralisation of power can be checked in diverse ways. These include citizen's-initiated strike-down referenda, an independent judiciary, an independent governor-general, a second chamber, other independent watchdogs, and checks on the encroachment into local government by central government.[533] The potential for reforms that relate to the separation of powers should not be overlooked, but they lie outside the scope of this section.

8.2 Constitutional principles for testing regulations

Principled measures for reducing regulatory excesses must be based on a coherent and practical vision of the constitutional relationship between the individual and the state. In a despotic democracy sovereign powers are used for predatory purposes. In a constitutional democracy, any democratic majority is constrained to conform to a constitution that protects individual liberties, and thereby minorities. The constraints do not need to take the form of a written constitution.

Sections 6 and 7 discussed principles for assessing laws in a constitutional democracy. This section brings these principles together in order to explore some of the possibilities for applying them to the task of weeding out unconstitutional or excessive laws and regulations while preserving the good ones. The tests are intended to be consistent with a shift towards a more constitutional democracy in New Zealand. Successful measures would constrain a parliamentary majority of the day to respect the liberties of political minorities. Laws and regulations should then be more likely to

[533] For a fuller list, see Wolfgang Kasper, *Property Rights and Competition: An Essay on the Constitution of Capitalism*, Centre for Independent Studies, Sydney, 1998, pp 109–115.

improve the welfare of all citizens and promote trust rather than to promote the interests of a majority at the expense of others.

With this preamble, we suggest the following principles could be used to screen regulations for their compliance with the rule of law and the elements of a constitutional democracy. They allow for the use of police power to provide security under the law and for the use of the power of eminent domain in order to facilitate mutually beneficial exchanges.

Suggested principles for evaluating regulations

(a) Laws and regulations should enhance security from legal harms in person, liberty, contract and property;

(b) Laws and regulations should preserve common law causes for action that have prevailed for centuries against harms caused by strangers. They should not introduce novel or expanded concepts of legal harms and expanded definitions of an interested party, or by removing legal harms whose utility has survived the test of centuries;

(c) Laws and regulations should preserve or enlarge the scope for individual action, and thereby for voluntary cooperative action. They should enhance freedom of contract and exchange;

(d) Laws and regulations that reallocate legal rights by force must be justified on the basis that they are necessary for the achievement of an essential public interest. In addition, such laws and regulations must:

  (i) not delegate from parliament the power to levy taxes;

  (ii) preserve the principle that taxes should be levied in the public interest only with the general consent of those who are liable to pay those taxes;

  (iii) preserve the principle of full compensation for those whose legal rights under common law are taken or impaired in the public interest;

  (iv) preserve the principle that such compensation should be funded by the new legal owners or, if the government assumes the taken rights, by those in whose interests the taking was justified;

  (v) preserve the principle that surpluses arising from the exercise of the power of eminent domain are divided amongst those who are parties to the exchange in proportions that reflect the size of their original contributions;

  (vi) require evidence of consent under principle d(ii) from those who are effectively being taxed in cases that are an exception to principles d(iii) or d(v);

(e) Laws and regulations should otherwise preserve or enhance the rule of law. In particular, they should:

  (i) not take retrospective effect;

  (ii) avoid imprecise terms and complexities that materially undermine the ability of citizens to understand the law and therefore to comply with it;

  (iii) increase certainty as to what actions are legal;

(iv) ensure that the exercise of delegated administrative and executive powers in relation to discretion to set user charges, attach conditions to permits or consents, or change the use of assets within the public sector, is subject to judicial review;

(v) uphold the principle that all are subject to the law – including the government and its agencies; and

(vi) uphold the principle of equality under the law. Laws should be general and abstract, not mentioning specific categories of persons, gender, race, creed or religion, time or place.

Principle (a) provides for the use of police power. It allows laws and regulations that assist the state to enforce existing legal rights better. Law-abiding people should be secure in their persons, liberty and possessions. None should be able to force another to serve as a means to someone else's ends. Bad laws undermine a government's ability to exercise the police power role. Bad laws must either be enforced with inevitable unpalatable consequences, or not enforced. Either way the law is brought into disrepute.

Principle (b) is designed to test for stability in laws whose enduring value has been proven through the course of time. Some laws may modify enduring concepts of legal harm. Laws that ban the right to sue, restrict freedom of association in the workplace, impair free speech by expanding the definition of an offence to others, or undermine civil society and the value of investment in reputation by creating the converse problem of sanctioning slander, all illustrate this potential.

This principle embodies a conservative attitude to changing laws that have proven their value through the centuries. Sound laws that are general and abstract and apply to all equally should also endure the changes of centuries. Their value does not depend on the state of technology or who is in power. It derives from their accommodation to the unchanging virtues and vices in human nature. Enduring laws are seen as customary and legitimate. Legitimacy is essential for respect for the law and the development of an attitude of compliance. When laws are changed every time there is a change in government, the virtues of legitimacy, certainty and predictability are put at risk. So is the rule of law itself.

Principle (c) aims to protect the domain for voluntary action from government encroachment by imposing a burden of proof on the latter. This guards against excessive regulations that stem from factional pressures, excessive paternalism, and grandiose presumptions about the ability of those in government to command the information needed to be able to determine what outcomes best serve the interests of diverse individuals.

This principle would conflict with minimum wage laws and laws and regulations that prevent contracting out of restrictive laws by mutual consent. It would also impose a burden of proof on those who would wish to deny freedom of association in a workplace.

Principle (d) allows for the principled use of the power of eminent domain, including the power to tax, in cases of necessity for an agreed essential public interest. Formally, necessity means 'otherwise impossible' as in 'A is a necessary condition for B'. The term 'essential public interest' is intended to impose a high threshold in the form of a

major contribution to community welfare. It might be assessed by the size of the sum of producer and consumer surplus. Subsidiary principles deal with the issues of parliamentary scrutiny, consent, the proportionality principle, compensation for takings, permit power and transfers of assets within the public sector.

Principle (d)(ii) permits taxation for the public interest, including redistributive taxation perhaps for the provision of a welfare safety net, based on consent. Departures from the principles of full compensation or proportionality have the character of a tax rather than of mutually beneficial exchange. Principle d(vi) accommodates this problem.

Principle (d)(iv) guards against the wasteful use of resources that will occur if the power of eminent domain is available to a group that can use it to capture for itself a greater share of the gains of exchange than it would to be able to otherwise negotiate. This principle allows more than full compensation in the event that a forced transfer creates benefits for one group whose value exceeds the costs of compensating fully those who have lost legal rights. Note that benefits in kind count towards full compensation. Where an asset is taken into the common domain, or sold into private ownership from the common domain by competitive tender, there is no exercise of the power of eminent domain and no case for compensation at above the tender amount.

Principle (e) incorporates other elements of the rule of law. Subsection (e)(v) provides for judicial review, thereby making limited use of the separation of powers that create an independent judiciary.

The thrust of these principles is to allow the laws and regulations that are consistent with them to escape the detailed scrutiny that would then be applied to other laws and regulations.

Where a particular regulation fails to conform to screening devices based on constitutional principles, we suggest that, at the very least, it should come under greater scrutiny and be subject to more intensive deliberation. A process for more intensively scrutinising laws and regulations that appear to violate constitutional principles does not stop them from proceeding. On the other hand, changes in outcomes would occur where there is a strong presumption against the unconstitutional use of governmental power, backed by uncompromising judicial review and public opinion.

This approach has much in common with the approach developed in the Legislative Advisory Committee's May 2001 edition of the *LAC Guidelines*. As noted in section 6.4.3, these guidelines require any legislative proposals to be tested for their conformity to 18 "fundamental common law principles". The guidelines state that this list is not comprehensive. There is a lot of commonality between the principles in this list and our principles. In particular, both stress that property should not be taken without full compensation. However, there are also some noteworthy differences. The *LAC Guidelines* list freedom from discrimination and compliance with the Treaty of Waitangi as fundamental common law principles. However, freedom of association and the issue of consent to taxation are not listed. An important, but subtle, difference arises because our takings principle seeks to protect vested rights in general from uncompensated takings, particularly without evidence of the consent of those thus being taxed. The *LAC Guidelines* take the narrower approach of seeking to protect 'property' itself. Our approach is more sympathetic to the view of James Madison and

others that there is an important sense in which people have a property in their (common law) rights.

We reiterate that our purpose is to search for constitutionally principled measures that might detect regulatory excesses while permitting sound regulations to prevail. It is not about forcibly remoulding New Zealand society or its constitution. This would be a futile and unconstitutional endeavour. No set of principles can hope to stand against the will of voters at large.

Ultimately, the enduring fate of any regulation will be determined by public opinion, moulded by experience.

8.3 Tests for evaluating laws and regulations

The principles reviewed in section 8.2 can be converted into a sequence of tests that could be used to screen laws and regulations. The tests in table 8.1 illustrate this approach.

Test 1 in table 8.1 summarises principle (c). It should catch most outcome-oriented laws and regulations of a command and control nature. Regulations that aim to force individuals to conform to state-determined outcomes restrict freedom of action. Regulations that prevent responsible adults from contracting for different allocations of rights or for different outcomes deny freedom of contract.

Examples of laws and regulations that could be caught by this test include:

- energy efficiency laws that attempt to impose outcomes on individuals by depriving them of the freedom to determine what price they want to pay for energy efficiency;
- environmental laws that prevent private initiatives to save endangered species;
- environmental laws that reduce the scope for individual action by allowing competitors and malicious and opportunistic objectors to hold up, or stop, activities that would otherwise be able to proceed legally without these impairments;[534]
- labour market restrictions, such as the minimum wage, that inhibit freedom of contract in the sale of one's own labour and talents;
- safety laws and regulations that reduce freedom of contract by prohibiting contractual re-assignments of risk; and
- security regulations that deny investors or shareholders the freedom to contract out of their provisions.

Laws and regulations that define harms to strangers do not necessarily fail this test. Such laws can facilitate freedom of action by reducing uncertainty as to what actions are legal.

Deregulation – the removal of command and control regulations – should pass test 1.

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[534] Scrutiny of regulations that fail this test may focus on the departure of the definitions of an interested person and of a harm from those that long prevailed under common law.

Taxes to fund state-provided public goods are likely to fail test 1, but see test 4 below.

Test 2 summarises principle (b). It should catch regulations that restrict economic freedom by markedly increasing the range of actions that are regarded as harms to strangers.

Examples of laws and regulations that should be caught by this test include:

- bans on the common law right to sue for accidental personal injury;
- environmental law not based on harms to persons or their property;
- planning processes that extend the power to object to the issuance of a consent beyond common law concepts of an interested party.

In contrast, test 2 should not trip the *restoration* of the right to sue.

Test 3 ascertains that a law or regulation does not exercise the power of eminent domain or otherwise undermine the rule of law as in principle (e). It should catch many laws and regulations that reduce certainty in the exercise of property rights by the use of imprecise terms and the extension of the power to object to competitors and other malicious or opportunistic parties. It also catches laws that are not general and abstract.

Laws and regulations that survive tests 1, 2 and 3 pass the screens proposed in table 8.1. A regulation that precisely codified some aspect of the common law would pass all three tests. Of course, such a regulation would be redundant.

Laws and regulations based on the use of the power of eminent domain may fail those tests, particularly test 3, for practical reasons. The scheme in table 8.1 then screens these and other regulations for their compliance with tests 4 to 7.

Test 4 screens regulations that fail one or other of the first three tests for their necessity in terms of an essential public interest. It allows tax-funded public goods where the tests of necessity and essentiality are satisfied.

Tests 3 and 4 would allow for a taxpayer-funded welfare safety net where tests of the consent of taxpayers or their representatives and of necessity and essentiality were satisfied.

Test 5 aims to ensure that the issue of compensation is addressed by parliament. It also invokes the issue of consent.

Test 6 asks whether the regulation distributes any surpluses that arise from the exercise of the power of eminent domain in a non-proportional, exploitative, manner (refer to the discussion in section 7.5.3). It aims to ensure that the distribution of any surpluses is scrutinised.

Test 7 screens for the abuse of the power to attach conditions to the issuance of permits.

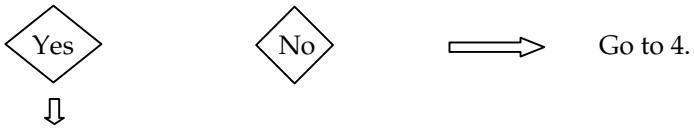
Public good situations that involve coercion should fail test 1. Test 4 should let the most meritorious cases through. Test 5 is intended to allow parliament to continue to support income redistribution programmes subject to the support of those whose income is being taken. The ease or difficulty in assessing that support must depend on

the particular circumstances of the case. A court or independent assessor could evaluate Crown evidence that reasonable means have been taken to assess the degree of support and that it is forthcoming. Statements from group representatives (such as Federated Farmers in the case of a statute that takes landowner property rights) would obviously be relevant to such an inquiry. So would polling of the group by independent professional pollsters.

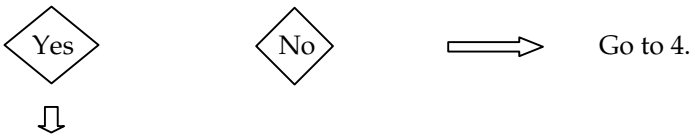
These tests could inform any thorough review of existing regulations. They could also be incorporated into any guidelines or processes put in place to guard against regulatory excesses in new laws or regulations.

Table 8.1: Schema for using the proposed principles to test a law or regulation

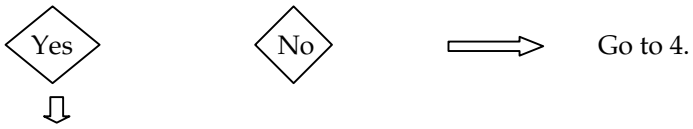
Test 1 Does it increase individual freedom of action, contract and exchange?



Test 2 Does it preserve venerable common law causes of action against harm or remove novel or expanded definitions of legal harms?

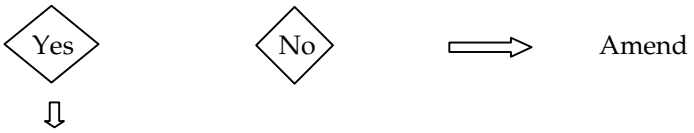


Test 3 Does it preserve existing legal rights and other elements of the rule of law?

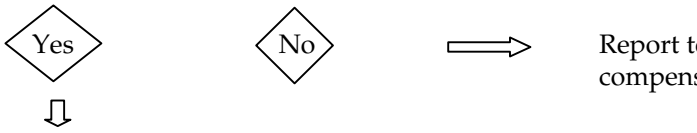


This law or regulation complies with principles (b), (c) and (e).

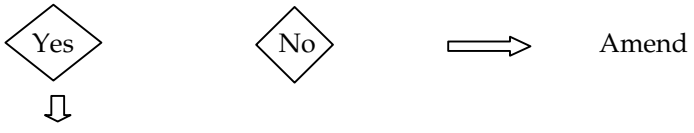
Test 4 Is each and every element that violates Tests 1, 2 or 3 *necessary* in order to obtain a benefit that is *essential* to the well-being of the public at large?



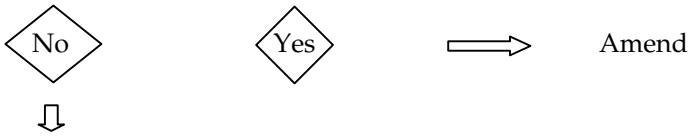
Test 5 Does the proposed law or regulation preserve existing legal rights?



Test 6 Is it consistent with the proportionality principle for the distribution of surpluses?



Test 7 Does it effectively tie a tax to a permit without explicit parliamentary scrutiny?



END TEST

8.4 One-off regulatory reform

Even given the political will, the initial task of weeding out regulatory excesses would be a major 'one-off' exercise. The task would be to excise the bad elements while fine-tuning what remains. Failure to fine tune judiciously and wisely for the common good could bring the whole reform process into disrepute. Where the effect would be to return to a greater reliance on common law judges, the desirability of legislative guidance until gaps in the case law can be filled might have to be carefully considered.

It would be logical for an independent, special-purpose task force to be set up to review existing laws and regulations using approved screening criteria and to advise on priorities for removal of excesses. Priorities for initial reform should fall on:

- laws and regulations that are unsupported by a regulatory impact statement that satisfies professional standards of analysis;
- laws and regulations that surveys have shown to be of greatest concern in terms of the costs of compliance and absurd provisions;
- far-reaching laws and regulations that fail the principles in section 8.2 and the tests in 8.3. Arguably, particular priority should be put on laws that deny freedom of contract and undermine certainty of property rights;
- far-reaching laws and regulations that have proven to be troublesome in application and, as evidenced, for example, by their frequency of amendment, continuing public controversy, concerns about despotic effects in particular cases, and overall ineffectualness;
- laws and regulations that create statutory monopolies, raise entry barriers beyond those implicit in a common law property rights system, and reduce freedom of contract and undermine certainty of property rights;

In respect of the second point, the level of complaint should not be taken as a definitive indicator of reform priorities. The absence of complaints may indicate the absence of competition. Economy-wide surveys of businesses are unlikely to register major concerns about the regulations in nationalised industries, such as education and health, simply because few surveyed businesses are likely to be operating in these areas. Government ownership and other laws and regulations that prevent or inhibit competitive entry should be high on the list of priorities for any review of existing regulations.

In respect of the second to last point, bad laws are likely to give rise to troublesome cases if enforced (as in the examples provided in section 2) or to complaints that they are not enforced. (The insider trading legislation illustrates the latter complaint.) Another indicator of bad law is the frequency with which it is amended. New Zealand's accident compensation and resource management legislation is representative of this category.

Finally, any major review process could access OECD-wide knowledge and experience. The OECD secretariat has documented the major episodes of regulatory reform in the OECD region, as noted in section 4. The experience with privatisation and regulatory reform is particularly encouraging where the reforms are well designed. The recent

disastrous experience in the electricity industry in California illustrates once again the importance of well-designed regulations.

8.5 Institutional reforms to regulatory processes

This section considers some processes that a willing parliament might impose on the executive, or that a willing executive might impose on itself, in order to guard better against regulatory excesses in future.

Reforms that require new legislation or changed rules for parliamentary processes or select committees require a parliamentary majority. We consider these options first.

Section 8.5.1 considers the option of a Regulatory Responsibility Act by which parliament imposes various reporting and compliance requirements on the executive.

Section 8.5.2 considers options for addressing the conflict between the principles that such an Act could be expected to embody and various provisions in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Section 8.5.3 examines the complementary option of enhancing standing orders governing the scrutiny of all Bills, not just government Bills, by select committees.

Even in the absence of parliamentary action, a willing executive could impose on itself the disciplines that a parliament might impose under section 8.5.1. It could institutionalise such reforms through amendments to the *Cabinet Office Manual* and to Cabinet Office Circulars.

Section 8.5.4 considers possible amendments to the requirements in the *Cabinet Office Manual*.

8.5.1 A Regulatory Responsibility Act?

Parliament could legislate to provide that laws and regulations comply with specified regulatory principles, such as those listed in section 8.2. To be effective, such a law would have to specify accountabilities and processes that would allow compliance to be monitored. As with the Fiscal Responsibility Act 1994, penalties for non-compliance could rely on public opinion – that is, political embarrassment. Alternatively, scope for judicial review could be provided.

As an alternative, parliament could go some distance along this path by amending standing orders.

Finally, in the absence of parliamentary action, a willing executive could impose related disciplines on itself by way of Cabinet Office Circulars and rules.

There are many options for specifying reporting requirements in order to focus attention on the quality of regulations and facilitate monitoring of regulatory performance. For example, the executive might be required, or require itself, to:

- maintain a complete electronic record of all parliamentary laws and regulations, along with records of relevant case law, that the public can access at all times;

- maintain, also in electronic form for public access, an up-to-date Regulatory Analysis Statement for each law and regulation (see below). This would be prepared by the ministry with policy responsibility for advising the executive on that law or regulation;
- maintain, for public access, summary lists of all laws and regulations that contain provisions that variously:
  - undermine property rights in respect of individual property rights;
  - deny freedom of contract and exchange between competent adults;
  - deny common law rights to compensation for regulatory takings;
  - remove a longstanding common law remedy;
  - extend the range of long-established common law harms;
  - effectively relax the common law test of an interested person;
  - can be used by incumbents to impede competitive entry or to increase a rival's costs;
  - raise entry barriers to competitors compared with those that would prevail under common law;
  - contain specified terms of an imprecise nature;[535]
  - are certified by the relevant policy ministry to fail to make clear what a law-abiding citizen must do to comply while engaged in their lawful business or trade;
  - are certified by the Ministry of Economic Development or the Treasury to tax implicitly one group for the benefit of another while failing to accord with the principles of full compensation and proportionate sharing in surpluses;
  - are not certified by the relevant policy ministry to comply fully with specified regulatory principles;
  - are not certified by the relevant policy ministry to be necessary for an essential public purpose;
  - are not certified by the relevant policy ministry to confer benefits on persons that exceed the costs imposed on those who are deprived of legal rights by the law or regulation; and
  - allow regulatory agencies discretion in attaching conditions to permits without parliamentary scrutiny.
- table in the House annually a regulatory strategy statement that:
  - sets out the government's objectives for reducing regulatory burdens by: eliminating features that are neither necessary nor essential; increasing the certainty of the law; and increasing freedom of contract and security of property rights;
  - identifies laws and regulations that require to be amended or eliminated in accordance with those objectives;

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[535] Such as 'fair and reasonable', practicable, sustainable, intrinsic value, abuse of a dominant position.

- sets out a programme for achieving those objectives;
- provides a timetable for achieving these amendments or eliminations;
- sets out the government's assessment of the conformity with sound tax principles of each and every law and regulation that the Ministry of Economic Development or the Treasury deem to take legal rights from one group for the benefit of another other than on the basis of mutual advantage. These assessments could oblige the government to identify the groups who are effectively being taxed and assess the degree to which the members of that group consent to the tax. The assessments should include an opinion from the Treasury on the quantum of the tax and the benefit;
- proposes to the House a timetable for removing those features of laws and regulations that the government believes do not comply with sound tax principles; and
- informs the House of the government's reasons for not proposing the elimination of any features of laws and regulations that alter legal rights and that the relevant policy ministry has determined are not necessary for an essential public interest.

- as part of normal budgetary processes, seeks the annual approval of the House, case by case, for laws and regulations that in the opinion of the Ministry of Economic Development or the Treasury effectively deprive one group of legal rights for the benefit of another;
- report at predetermined intervals to the House on the progress made since its last report on the timetable for its regulatory strategy;
- draw to the attention of the House any executive actions or decisions since the last reporting period that have a regulatory effect but escape the currently promulgated definition of a regulation;
- report at predetermined intervals to the House identifying changes to the list of laws and regulations that are deemed to be no longer essential or to conform with sound regulatory principles;
- satisfy the House that the Bills and regulations emanating from the executive satisfactorily comply with any requirements embodied in House standing orders such as standing order 197 and *Cabinet Office Manual* requirements such as those requiring Regulatory Impact Statements and evidence of conformity with due process; and
- incorporate means of making individuals personally accountable for advice for which they are responsible.

Such measures would not be entirely new. For example, the Regulations Review Committee of parliament has recommended that departments systematically monitor and review all regulations for which they are responsible.[536]

Some regulatory principles are already embodied in standing order 197. This standing order governs the Regulations Review Committee's reviews of regulations. Other principles are contained in the Regulatory Impact Statements that Cabinet requires ministers to supply for new regulations that require Cabinet approval. These

[536] Section 5.65 in the *Cabinet Office Manual*, *op cit*.

principles could be amended in order to bring them into greater accord with those set out in section 8.2.

The above suggestions flow from the principles derived in earlier discussion concerning the conditions that need to be satisfied for a constitutional democracy and a rule of law to prevail. Cumulatively, they provide for a large number of lists, possibly too many. If the lists were to be shorter, what would be the priorities? For commercial transactions, the list of laws and regulations that impair freedom of contract and exchange (test 1 in section 8.1) would be a top priority. For human freedom, the lists of laws that draw distinctions between classes of people (for example, laws that mention gender, race and so on) and that materially alter the common law of tort may be the most important.

The effectiveness of reforms to processes depends on the strength of the sanctions accompanying non-performance. There are no grounds for complacency about their effectiveness in the absence of a climate of constitutionality and the rule of law.

Regulatory Analysis Statements

The Regulatory Analysis Statements referred to in this framework could be based around the concept of private property and voluntary exchange, rather than the traditional cost-benefit framework that underlies the existing RIS approach. The following possible requirements illustrate this approach.

Each Regulatory Analysis Statement must:

(a) Identify the problems that motivate the continuing need for the law or regulation, focusing on underlying causes rather than symptoms;

(b) State the national interest regulatory objective at a level of generality that does not pre-justify the regulation. This statement must establish whether the objective is to better enforce the legal rights that would otherwise exist or to reallocate those rights;

(c) Assess how alternative arrangements, including ongoing reliance on common law processes, would be likely to evolve in the absence of the law or regulation. This section should make explicit any assumptions about future changes in information, circumstances or technologies that could reduce or eliminate the need for the regulation;

(d) Express the view of the policy ministry responsible for advising on this law or regulation as to whether the law or regulation is necessary for the achievement of an essential public interest;

(e) Identify possible undesired side effects that could result from the proposed law or regulation, compared with the alternative of reliance on private arrangements and alternative laws and regulations;

(f) Identify the factors that are critical for preferring the regulation to the alternative of no regulation or the next best alternative;

(g) In the event of a likely legal dispute about the allocation of legal rights in the absence of the law and regulation, state the reasons for not seeking a Crown Law Office opinion or a court determination of the issues and the extent of the

potential liability to the Crown of proceeding to introduce a new law or regulation in the absence of such a determination;

(h) Identify any persons or categories of persons whose legal rights are forcibly taken, in whole or in part, by the law or regulation;

(i) Identify those persons or categories of persons who obtain legal rights as a result of the law or regulation. Where the Crown is the new owner, identify those groups in whose interests the Crown is to hold or is to continue to hold the legal rights thus acquired;

(j) Identify what efforts have been made, or could be made, to obtain the consent of those in category (h), and assess the existing degree of consent;

(k) Identify possible ways for requiring those identified in (i) to compensate those identified in (h) so that all parties to the forced exchange can be made better off, and evaluate their feasibility;

(l) Identify the likely cost to the Crown of compensation payments under (k) in the event that the beneficiaries of the taking identified in (i) cannot be obliged to make the payments for reasons of high transaction costs;

(m) State what evidence is being relied upon to support the case that the benefits to those persons exceed the costs to those identified in (h) in the event that the law or regulation does not require those identified in (i) to fund compensation;

(n) State whether the law or regulation shares any excess of benefits over costs proportionally amongst the parties to the transfer of legal rights;

(o) Estimate the quantum of any departures from that principle and identify the categories of persons who gain and who lose as a result of those departures;

(p) State what evidence there is that those who lose consent to this transfer;

(q) Identify any elements of the law or regulation that impair freedom of contract and exchange in respect of the reassigned rights, and justify those elements explicitly;

(r) Specify a future date at which it would be reasonable to review the law or regulation to determine if its continuation is warranted; and

(s) Assess the conformity of the law or regulation with the remaining principles for evaluating regulations.

Certification and statements of responsibility

Compliance with any disclosure requirements and opinions is likely to be perfunctory unless identifiable individuals can be held to account for their professionalism and accuracy.

As indicated in the suggestions for a Regulatory Responsibility Act above, there are many options for requiring ministers and the heads of relevant agencies to certify personally to the accuracy and completeness of required disclosures and opinions.

Parliament could require the minister responsible for a Bill or a regulation to certify that the required statements represent the government's position on the issues and that they are personally satisfied that the government has adequately consulted

professional advisers in the preparation of the required statements. The certificate could be required to identify the source of any legal opinions received on the consistency between the provisions in the Bill or regulation and the proposed constraints. The responsible minister could be required to draw departures to the attention of the House's designated monitor.

Section 4.3.2 highlighted serious shortcomings in the quality of the Regulatory Impact Statements that are currently being produced. It is possible that an oversight body is needed to monitor the professional quality of the reports produced under a Regulatory Impact Statement or Regulatory Analysis Statement process. It would need adequate authority, independence and skills to perform such a function.[537]

One option would be to make the required regulatory analyses subject to judicial review. Interested parties could challenge the process followed by the department undertaking the analysis. A more rigorous requirement would allow the quality of the analysis to be challenged in court.

Systems that increase the pressure on an agency to produce a good quality analysis will increase the tension between the agency and the minister. This has some desirable features because it will constrain a minister's incentive to push for regulation of which the real purpose is to appeal to particular constituencies at the expense of the national interest. However, it also increases the pressure on ministers to make political loyalty rather than advisory quality the key criterion for public sector appointments.

One compromise might be for a minister's official advisers to certify that they have taken responsibility for ensuring that the RIS tabled by a minister satisfies professional standards in terms of completeness, comprehensiveness and conceptual soundness. Professional advisers should be prepared to take responsibility for meeting professional standards in respect of items like those listed immediately above. They could also certify that the analysis correctly identifies areas where subjective judgments are required that the advisers are reluctant to make. These may well concern the final judgment about what is wise or practicable, the net balance between costs and benefits, possible non-compliance with principles (a)–(e) above and the test for 'essentiality'.

To complete the assignment of accountability, parliament could require the responsible minister to certify that the reasoning of the minister's official advisers is consistent with the approach that the executive considers parliament should use to assess whether a Bill or regulation does indeed comply with the proposed constraints.

The Fiscal Responsibility Act 1994 provides a precedent for such a shared responsibility. It requires a 'Statement of Responsibility' that incorporates two separate declarations, one signed by the secretary to the Treasury, the other by the treasurer and the minister of finance (if both exist).

To illustrate the possibilities just discussed, a 'Statement of Responsibility' could require a minister sponsoring or defending a law or regulation to declare:

- that the minister has fully informed the relevant government agency of all government decisions and other circumstances that may be relevant to the Bill or regulation and the attached statement of compliance and regulatory analysis;

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[537] OECD (1997b), *op cit*, p 218.

- what, if any, instructions the minister has given to the department or agency that may have limited the range of alternatives considered, or otherwise influenced the independence of the department's assessment (for example, the minister may have advised that privatisation or price control is not government policy);
- that the reasons given in the attached statement of compliance and the regulatory analysis in respect of the government's judgments on the preferred alternative are indeed the government's reasons for proceeding with the Bill or regulation;
- the length of time the minister expects it will take before the regulation will achieve its intended effects;
- what outcomes the minister would regard as critical to any later assessment of the success or failure of the regulation; and
- what, if any, date should be set for reviewing or terminating the regulation.

In turn, the head of the government agency that is responsible for preparing the statement of compliance and the regulatory analysis could be required to certify:

- that the attached statement of compliance and regulatory analysis are up-to-date in that they apply to the measures embodied in the specified drafted Bill or regulation and take account of all the information about the proposed policy that the government has communicated to the head of the agency;
- what, if any, alternatives have not been thoroughly examined in the statement or the regulatory analysis as a result of ministerial instructions or as a result of the agency's understanding of the government's policy positions;
- what, if any, other factors may have compromised the independence of the agency's report;
- that the statements and the regulatory analysis correctly identify all the key areas in which judgments had to be made about which the agency was unable to reach a firm conclusion;
- whether the agency believes that some of the provisions in the draft Bill or regulation violate supplied regulatory principles and has no doubts that these violations are essential, as defined in the Bill or regulation; and
- that the agency has met its own standards for professionalism and used its best professional judgments in supplying the statement of compliance and an up-to-date Regulatory Analysis Statement, particularly in respect of the identification of: the nature of the policy problem, the correct policy objective, relevant alternative courses of action and the sources of material costs or benefits.

Under parliament's standing orders the attorney-general is parliament's monitor of the compliance of Bills with the New Zealand Bill of Rights Act 1990. The Ministry of Justice services the attorney-general in this role.

Monitoring compliance with the proposed constraints would require skills in law and in regulatory analysis. The attorney-general has one set of skills but not necessarily the other. This suggests that any such monitoring role should be made a joint responsibility of, say, the attorney-general and the minister for economic development. They could be jointly responsible for drawing the attention of the House to any

inconsistencies between the provisions in a Bill and the proposed principles and process constraints. In the case of a given regulation, the Regulations Review Committee could be empowered to ask these ministers for such an opinion.

Pressures on the government's policy advisers to meet professional standards could be increased by including a review of the quality of compliance with regulatory requirements in the annual assessment of departmental chief executives. Specifically, the State Services Commission could review the quality of the Regulatory Analysis Statements and other such statements emanating each year from a government department or regulatory agency for which it is responsible. It could obtain an opinion on these statements from an independent expert in order to assist it to assess the competence of that institution's chief executive. That expert should be required to take into consideration unsolicited or solicited complaints about lack of professionalism from parties who have professional expertise.

Appendix B schematically summarises the amendments to existing constraints on the introduction of new legislation and regulations that the proposed measures contemplate.

Of course the efficacy of all such measures depends on the sanctions for non-compliance. In 2000, the minister of labour, while also attorney-general, was promoting major labour market legislation (now the Employment Relations Act 2000). Columnist Peter Tritt states that the minister of labour did not, as attorney-general, bring parliament's attention to any inconsistencies between the Employment Relations Bill and the New Zealand Bill of Rights Act 1990. (The Bill discriminates against workers who want collective agreements but not to join a union.) No obvious sanctions apply.[538]

Judicial review

The process reform options just outlined do not seek to increase the scope for the judiciary to strike down legislation as unconstitutional. They do, however, increase the scope for judicial activism to extend judicial review (as in the Baigent case in which the Court of Appeal created a new remedy under public law for a violation of the New Zealand Bill of Rights Act 1990).[539]

These issues are referred to in an introductory manner in section 7.4.3. There are clear dangers in moving to greater reliance on a written constitution at a time when the concept of a constitution as being something that limits the power of government, rather than as something that creates privileges, is so little understood.

8.5.2 Interface with the New Zealand Bill of Rights Act 1990

Currently, the New Zealand Bill of Rights Act 1990 provides no explicit protection for the rule of law, the right to sell one's own labour as one sees fit, for freedom of contract or security in private property. It also undermines freedom of association and freedom of speech in employment situations and the concept of one law for all. These deficiencies are carried over into the Human Rights Act 1993.

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538 Peter Tritt, 'Margaret Wilson pays the price of failing to deal with obligations under the Bill of Rights, *National Business Review*, 8 June, 2001.

539 Refer to section 6.3.

The conflict between the provisions in the New Zealand Bill of Rights Act 1990 and the principles for laws and regulations contemplated in this report is heightened by the existing enforcement procedures favouring the former. Standing order 260, section 5.28 of the *Cabinet Office Manual* and Cabinet Office Circular CO 98(19) illustrate this point.[540]

One option would simply be to draw some of the teeth of these two pieces of legislation by eliminating the conflicting parts of these enforcement procedure requirements. This option would leave major conflicting legislation in place, undermining the credibility of any regulatory reform based on asserting the desirability of overriding regulatory principles.

A more credible option would be to amend both the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993 so as to eliminate the conflicts, retaining a separate Regulatory Responsibility Act.[541] The amended Acts would then protect property rights and the freedom to contract (including the freedom to sell one's own labour). They would focus on defending liberties rather than creating duties. The separate Regulatory Responsibility Act could then focus on imposing reporting

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[540] Standing order 260 requires the attorney-general to inform the House before the second reading of a Bill of any inconsistencies between the provisions in a Bill and the rights and freedoms contained in the New Zealand Bill of Rights Act 1990. Section 5.28 of the *Cabinet Office Manual*, *op cit*, makes the Ministry of Justice responsible for advising the attorney-general on these points. (It also requires the Crown Law Office to undertake this examination when the Ministry of Justice drafts the Bill.) Cabinet Office Circular CO 98(19) requires all policy submissions to Cabinet and to Cabinet committees to include a statement about any inconsistencies of the proposal with the Human Rights Act 1993.

[541] In the proposal discussed above, the principles in the New Zealand Bill of Rights Act 1990 would be replaced by the Regulatory Responsibility Principles outlined in the text. Richard Epstein has proposed an alternative, suggesting the replacement of the rights enunciated in the Human Rights Act 1993 by the following list:

(1) Every individual and group shall, in the disposition of property or labour, have the right to contract or otherwise do business with any other individual or group whom they choose on whatever terms and conditions they see fit.

(2) Every individual and group may choose or refuse to contract or otherwise discriminate for or against any other group or individual for whatever reasons they see fit, including without limitation, race, creed, sex, religion, age, disability, marital status, or sexual orientation.

(3)(a) Every individual or group may ask of any other individual or group any question they see fit, no matter how offensive, impertinent, illegitimate, superficial or irrelevant.

(b) Every individual or group may refuse to answer any question, however tactful, pertinent, legitimate, insightful, or relevant.

(4)(a) Every agreement or contract shall be construed in accordance with the ordinary meanings of its terms, as informed by custom and common usage within the relevant trade or industry

(b) No construction or interpretation of any agreement or contract shall be made or influenced by principles of unconscionability, adhesion, inequality of bargaining power, *contra proferentem,* or any other rule that presumes one party to the agreement or contract enjoys a protected or preferred social status relative to the other.

(5) Any application for offering transportation or other services for hire on the public highway or waterways, or in the public airspace, shall be granted on the ground that its approval advances the public interest, convenience and necessity.

(6) All actions brought to enforce rights under any contract or agreement shall be commenced in the High Court.

See Epstein (1996), *Human Rights and Anti-discrimination Legislation*, *op cit*, pp 10–11. (*Contra proferentem* refers to a legal presumption that a dispute concerning ambiguous terms in a contract should be resolved to the disadvantage of the party that provided the disputed words.)

requirements and compliance requirements on the executive that supported the principles embodied in the amended New Zealand Bill of Rights Act.

A third option would be to proceed with just one major piece of legislation. For example, the features of the New Zealand Bill of Rights Act 1990 that should be retained could be included in a Regulatory Responsibility Act. This would allow the New Zealand Bill of Rights Act 1990 to be repealed. It could be easier to introduce a Regulatory Responsibility Act without the New Zealand Bill of Rights Act 1990 since there would be no need to worry about the interfaces between these two pieces of legislation.

The absence of a New Zealand Bill of Rights Act would mean that the provisions in the Regulatory Responsibility Act would have to be more self-contained. The various mechanisms in parliament's standing orders, the *Cabinet Office Manual* and Cabinet Office Circulars that require compliance of Bills and regulations with the New Zealand Bill of Rights Act 1990 could be applied instead to the Regulatory Responsibility Act, where appropriate.

A fourth option would be to have no New Zealand Bill of Rights Act and no Regulatory Responsibility Act. This would represent a clear reversal of the drift to a written constitution for New Zealand. It would move back towards a system based on common law and the enduring protection for human liberties embodied in the English constitution. New Zealand got by for nearly 150 years without a written constitution and the United Kingdom has done well for many centuries without one.

A turning away from the concept of a written constitution could be seen as desirable by those who have little confidence in either the quality of any written constitution that is likely to arise from current faction-driven parliamentary processes, or in an overly activist judiciary.[542] Professional politicians have a conflict of interest when it comes to constitutional changes. The decentralised processes by which the common law evolves are far from immune to social pressures, but they are harder to amend by centralised centres of power.

There is room for debate over the case for a Regulatory Responsibility Act from this perspective.

8.5.3 Enhancing select committee scrutiny of Bills

Existing standing orders could be amended to require members' and government Bills submitted to the House to be accompanied by (certified) statements by their promoters. The amended standing orders would specify what these statements must include. For example, in the absence of a Regulatory Responsibility Act that contained the proposed principles and constraints, standing orders could require that the statement contain a Regulatory Analysis Statement and the member's detailed explanation of why the Bill complied with standing orders.

In the absence of a Regulatory Responsibility Act detailing the constraints, standing orders would have to specify what a member's statement of compliance must contain. For example, a standing order might require the select committee responsible for

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[542] James Allan, 'Why New Zealand Doesn't Need a Written Constitution', *Agenda*, Vol 5, No 4, 1998, pp 487–494.

reporting to the House prior to the third reading of a Bill to include in its report a statement identifying:

- whether the regulation impairs existing common law freedoms or security in property;
- the reasons, if any, why any such impairments are essential and the number of members of the select committee who deem them to be essential;
- which groups in the community would materially gain or lose from the measures in the Bill compared with the distribution that might have resulted from voluntary transactions, should these have been feasible;
- the case for requiring the winners to compensate the losers, where winners and losers are dissimilar;
- the estimated or indicative scale of the potential redistribution of income or wealth and of the Crown's potential liabilities in respect of these losses; and
- any tied taxes associated with conditions imposed by the regulations on individual freedoms or on the use of private property.

A related option would be for parliament to amend its standing orders so as to improve scrutiny of laws and regulations from a constitutional perspective. Standing orders could require the select committee's report on a Bill to attach a statement from the attorney-general and, say, the minister for economic development identifying any infringements on personal liberties or freedom of contract or security in private property embodied in the Bill.

Another option would be to amend standing order 197(2). This standing order provides the Regulations Review Committee with a list of grounds against which secondary legislation can be tested. These grounds include 'undue' trespasses of personal rights and liberties, without providing any guidance as to what might be deemed to be undue. They provide no explicit protection for freedom of contract or security in private property. Nor do they screen for essentiality. This standing order could be amended explicitly to protect freedom of contract and security in private property and to test for essentiality. This could be done regardless of whether a Regulatory Responsibility Act existed.

Given the adoption of a Regulatory Responsibility Act, one option would be to simplify standing order 197 so as to require the Regulations Review Committee to test regulations coming before it against the principles in a Regulatory Responsibility Act.

8.5.4 Possible amendments to the *Cabinet Office Manual*

Section 5.28 of the *Cabinet Office Manual* requires the Cabinet Legislation Committee (LEG) to examine all draft Bills to ensure that their policy content has been approved by the appropriate Cabinet committee and that the relevant requirements of the *Cabinet Office Manual* have been satisfied. It is not the function of this committee to revisit policy decisions underlying a Bill, or to round them out, so much as to be assured all necessary decisions have been properly taken and that the Bill conforms with legal principles.

Section 5.27 of the *Cabinet Office Manual* currently requires, *inter alia*, that Bills be drafted in accordance with the guidelines produced by the Legislative Advisory Committee that were mentioned in section 8.2. Bills are to be tested, amongst other things, for their consistency with the Treaty of Waitangi, the New Zealand Bill of Rights Act 1990, the Human Rights Act 1993, the Privacy Act 1993, and international obligations. Section 5.35 of the *Cabinet Office Manual* imposes similar requirements on ministers making 'bids' for Bills to be included in the government's legislative programme.

Section 5.28 of the manual requires the Cabinet Legislation Committee to ensure that all draft Bills comply with the requirements in a Cabinet Office publication called the *Step by Step Guide*. Section 3.23 of this guide requires all policy proposals submitted to Cabinet that result in government Bills or statutory regulations to be accompanied by a Regulatory Impact Statement. Section 3.24 specifies the content of that statement. Section 8 of this guide requires proposed regulations to be evaluated in case they could provide grounds for parliament's Regulations Review Committee to draw them to the attention of the House.

The LEG is high-powered. In 2001, its 12 members included the prime minister, the deputy prime minister, the minister of finance (chair), the attorney-general and the minister of justice.

Having considered and amended proposals for Bills and regulations, the LEG refers them to Cabinet for final approval. Under section 5.28 of the *Cabinet Office Manual*, a government Bill may not be introduced into the House until both the LEG and the Cabinet have approved it. Regulations approved by the LEG and by Cabinet would normally pass to the executive council.

There are many options for adding compliance with the proposed principles and constraints to the list of requirements that the executive imposes on itself via the *Cabinet Office Manual* or by amendments to Cabinet Office Circulars. An obvious option would be to incorporate them in the *LAC Guidelines*. Inconsistencies (lack of compossibility) with the existing guidelines would need to be addressed.

Obviously, the greater the thrust to make laws and regulations conform more closely with the rule of law the greater the conflict with inconsistent requirements. Coherency requires a thorough, principled review of all the current requirements.

8.6 Concluding comments

This section has outlined some possibilities for applying the general measures discussed in earlier sections to specific institutional arrangements in New Zealand. It is relatively easy to construct options by which parliament could force the executive to provide greater justification for laws and regulations. The options would also build in much closer parliamentary scrutiny of the use of laws and regulations to tax effectively some groups for the benefit of others. They could also make it much easier to review the body of regulations as a whole in order to assess the degree to which they undermined basic freedoms and security in property and contract.

A critic might seek to dismiss these proposals with the gibe that there is something amiss if the cure for an excess of regulation is to pass more regulation. This riposte

overlooks the critical distinction between legislation that constrains the interactions between private citizens and legislation that constrains parliaments and the executive.

Even so, it is valid to ask why parliaments that wish to legislate to excess should be expected to pass legislation that would make this more difficult. It is also valid to ask how it can be consistently argued that parliaments lack the information and incentives to legislate usefully on many things, yet might usefully legislate on the proper boundaries between legislation and the common law. Leoni, a noted advocate of shifting the balance from statute law in favour of the common law, argued that the application of rules is a continuing process that nobody could bring to a conclusion in a finite time. To the contrary, he suggests trying to stop anyone from attempting to do so.

We hasten to note that we are under no delusion that the measures discussed in section 8.5 would bring these matters to a conclusion. In our earlier discussion on the issue of returning to the rule of law, we noted the view that this was far too complicated a matter to be thought up and then put in to practice. Any proposal must be evaluated on its merits as just one step towards the larger goal.

The impact of the various reforms to regulatory processes canvassed in section 8.5 would depend on the degree to which greater parliamentary, media and voter scrutiny altered the behaviour of the executive and parliament. The risks here are two-fold. The greater the potential effects of the proposed measures, the more difficult it might be to implement them in the first place for political reasons. On the other hand, the more they are weakened, the less difference they would make if implemented.

The benefits from the measures considered in this section depend on the balance that can be found between these two risks.

To explore the step of a Regulatory Responsibility Act is not to rule out the many other actions. The remaining remarks in this section reflect more broadly on the material covered in this report on this point.

It is difficult to avoid the conclusion that voter failure is a significant cause of the regulatory excesses examined in section 2. This implies that regulatory reforms aimed at improving regulatory processes, thereby reducing political failure and bureaucratic failure, are likely by themselves to produce disappointing outcomes.

The voter failure problem is not simply one of excesses that result from pressures from a majority of voters. Few voters could be expected to desire a regulatory environment in which the majority of businesses (being small) cannot knowingly comply with the law. This supports Hayek's conjecture that majoritarian democracy can deliver outcomes that a majority would oppose.

The options discussed in section 7 of a second chamber and binding strike-down referenda have some appeal in the light of such problems. They might be considered in greater detail, should it become propitious to do so. This would be a major undertaking.

Indeed, there are many possible options for improving the rule of law in New Zealand and moving towards a more constitutional democracy. This report has not attempted to identify all possibilities, let alone explore them all. Grounds for pessimism stem not from the paucity of options but from the difficulties posed by voting problems and lack

of political will to take action except in a crisis. Of course, there is no guarantee that the reaction to such a crisis will be wise.

The insistence on the supremacy of a parliamentary majority, no matter how predatory its actions, lies at the heart of the problem. There needs to be far greater acceptance of the constitutional principle of limited government. Requiring supra-majorities for major constitutional changes is highly desirable.

Parliament's energies need to be concentrated on core police power functions, that protect the realm and secure individual liberties, and on providing for public goods where necessary. The exercise of the power of eminent domain in the public interest needs to be principled and constrained.

Meanwhile, parliament continues to be aggressive in its assumption of the unlimited power to tax and spend at the pleasure of the governing parties. Voters hold politicians in low esteem, but persist in voting for political parties that promise to make ever more spending and regulation work. The inevitable voter disappointment and disgruntlement provides an opportunity for principled regulatory reform – or for the next opportunistic populist politician to be elected on the basis of promises that cannot be kept. In the longer run, such opportunism only exacerbates all the other problems.

Even so, grounds for some optimism can be found in the episodes of successful deregulation around the world during the last two decades. The continuing privatisations worldwide and the pressures on countries to reduce tax rates and spending in the light of the successes of the countries that have done so represent a remarkable break from the post-World War II trend. Furthermore, there is ample evidence in the United States of much increased judicial attention to the issue of limiting regulatory takings to a tighter public-use test and to considering the issue of compensation. In New Zealand, a lens of greater magnifying power is required to discern signs of change. One positive is the inclusion in the latest *LAC Guidelines* of an unequivocal statement in support of full compensation for takings of property. Another positive is evidence of the willingness of the judiciary to warn (the executive) of limits to the ability of a parliament to deprive individuals of their rights.

There are also ample grounds for confidence that significant gains can be achieved when the political will arises. Regulations of interactions between private citizens cry out for critical review and examination where they draw distinctions between groups of citizens or activities, impose outcomes, override freedom of contract or choice, gratuitously expand or eliminate common law harms, so widen the test of an interested party as to open up opportunities for corrupt objections, and rely on fuzzy terms.

Undoubtedly, governments will not be able to get away indefinitely with evading the problem of regulatory burdens while standards of living continue to decline in New Zealand relative to those in other comparable countries. Sooner or later a government will wish to address these issues in a fundamental manner. It may take a crisis.

Whatever the cause, the one-off regulatory reform review option discussed in section 8.4 would offer the best prospects for immediate meaningful change. The process reforms discussed in section 8.5 could help build an attitude of legality, but probably not on their own.

Appendix A: Reform Experience in Australia, the United States, the United Kingdom and Canada

A.1 Australia

According to the OECD, the 1996–2000 review in Australia of federal and state regulations, aimed at eliminating unjustified anti-competitive effects was 'unprecedented in its scope and ambition in OECD countries'.[543] Financial incentives for reform were built into the Competition Principles Agreement signed by the Council of Australian Governments in April 1995. The Commonwealth government has given state governments a financial incentive to meet deadlines for regulatory review and 'effective implementation' of commitments in the Agreement.

Some state governments, notably in Victoria and New South Wales, have been more active than the Commonwealth government in pursuing regulatory reform. Some have set up an Office for Regulatory Reform. Victoria and New South Wales have very active parliamentary select committees. Victoria has two such committees. It has adopted five- and 10-year sunset clauses and is pursuing the concept of cost-reducing alternative compliance measures (ACMs) for businesses.

A.2 United States

Arguably the United States has the most comprehensive record of executive and legislative attempts to improve the quality of regulations in the last 30 years.

An overview of reform initiatives in the United States since 1971 is provided below.[544]

- In 1971, president Nixon established a Quality Life Review of selected regulations. Supervised by the US Office of Management and Budget (OMB), agencies were required to consider regulatory alternatives and their costs when developing 'significant' regulations. Many agencies ignored the process and the OMB's authority was very limited.
- In November 1974, president Ford's Executive Order 11821 required regulatory agencies to prepare Inflation Impact Statements that were designed to expose the economic impact of regulatory proposals, particularly in relation to productivity and competition. These statements were to be reviewed by a (since abolished) review group – the Council of Wage and Price Stability – that was under the control of the executive.

  However, independent agencies are not required to obey presidential executive orders. The US-based Committee for Economic Development (CED) reports that "[w]ith some exceptions, the agencies paid only lip service to this initiative.

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[543] OECD (1997b), *op cit*, p 40. For a brief overview of regulatory reform in Australia, see Rimmer, S, 'Regulation Reform in the '90s: Challenges and Opportunities', *Policy*, Spring 1995, pp 41–44.

[544] The summary is based on Hahn (1998), *Journal of Economic Perspectives*, Weidenbaum, M, 'Regulatory Process Reform: From Ford to Clinton', *Regulation*, Winter 1997, and the final report to the House of Representatives of the Commerce Committee 1998 *Inquiry into Compliance Costs for Business*. See these sources for further details.

Nevertheless, this general approach to regulatory review has continued under successive administrations, with revisions in the details reflecting experience gained in conducting the reviews".[545] The major accomplishments occurred in the US departments and agencies that came under the direct purview of the president.

- In 1978, president Carter's Executive Order 12044 required a detailed Regulatory Analysis of proposed rule-makings with an estimated economic impact of US$100 million or more. Each analysis had to include a description of the problem, a list of alternative ways of achieving the policy goal and an analysis of the potential economic impact of the regulation. Each analysis was to be reviewed by the Executive Office of the President. The president also established a Regulatory Analysis Review Group to examine a limited number of regulations and a Regulatory Council that was charged with publishing a *Calendar of Federal Regulations* for regulations under development. The schedule of proposed regulations became a lasting reform.

- In 1980, the last year of the Carter administration, Congress passed two procedural Acts: the Regulatory Flexibility Act that required rule-making agencies to write regulations in a manner that would minimise the impact on small businesses and the Paperwork Reduction Act that created the Office of Information and Regulatory Affairs (OIRA) in OMB to supervise enforcement of the law's objective of reducing federal reporting requirements.[546]

  Compliance with the Regulatory Flexibility Act 1980 was minimal and perfunctory whereas the Paperwork Reduction Act 1980 was far more useful.[547]

  Both Ford and Carter attempted unsuccessfully to get congressional committees to insert cost-benefit analysis requirements into new regulatory statutes.[548]

- Regulatory reform was one of president Reagan's 'four pillars' for economic recovery. One of his first steps was to establish a high-level Task Force on Regulatory Relief, chaired by the vice-president, to oversee this effort. This task force focused on reviewing existing regulations and often acted as a Court of Appeal on disputes between a regulatory agency and the OIRA.

- In February 1981, president Reagan issued Executive Order 12291. It:

  - stated that "regulatory action shall not be undertaken unless the potential benefits to society from the regulation outweigh the potential costs to society";
  - required regulatory agencies to prepare a Regulatory Impact Analysis for each 'major rule', subject to review by the OIRA;
  - provided that no notice of a proposed rule could be published until an OIRA review was complete and its concerns addressed; and
  - allowed the OIRA to identify any rule as a 'major' rule.

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545 Committee for Economic Development, *Modernizing Government Regulation: The Need for Action, a Policy Statement by the Research and Policy Committee of the Committee for Economic Development*, Committee for Economic Development, New York, 1998, p 21.

546 See Shanahan, J, *Regulation*, *op cit*, pp 27–32 for a detailed discussion of these initiatives.

547 Committee for Economic Development, *op cit*, p 22.

548 Weidenbaum, *Regulation*, *op cit*.

Weidenbaum reports that these steps, in conjunction with "the mood of Congress and the declining political clout of traditional constituencies for regulation" resulted in fewer rules. The Reagan administration reduced the budgets of regulatory agencies, with staff numbers falling by 16 percent between 1980 and 1985. Weidenbaum also reports that "In total, the Reagan regulatory reforms resulted in an estimated $9 billion to $11 billion in one-time savings and an additional $10 billion in annual savings".[549]

The Bush administration replaced the Task Force on Regulatory Relief with the Council for Competitiveness headed by the vice-president. It was authorised to review all federal regulations with the goal of eliminating those inhibiting competitiveness. However, its procedures resulted in criticisms of the whole idea of presidential review. The Bush administration also supported a number of significant regulatory statutes relating to disabilities, clear air and civil rights.

President Clinton rescinded the existing executive orders on regulatory review and abolished the Council for Competitiveness. In September 1993, he issued Executive Order 12866 that requires similar regulatory analyses to those provided for in the Reagan Executive Order 12991. Under Order 12866, the OMB has no formal power to hold up rule making or to require a regulatory agency to demonstrate that the estimated benefits exceed the costs. Instead a regulatory agency has only to 'find' that the benefits 'justify' the costs. In addition, Clinton initiated a National Performance Review aimed at helping to 'reinvent government'.

Following the Clinton initiatives, Congress considered several comprehensive regulatory reform Bills that called for greater use of cost-benefit analysis and improved risk analysis. While these all failed to be passed, some legislation was passed that increased congressional oversight of regulation. Examples include the Unfunded Mandates Reform Act 1995, the Small Business Regulatory Enforcement Fairness Act 1966 and the Stevens amendment.

According to a 1996 survey, 27 states have statutes requiring economic impact analyses for all proposed rules and 10 states require cost-benefit analyses for all proposed rules. The level of compliance, the quality of the analyses and the influence of these requirements is unclear.[550]

United States experience with regulatory *process* reform provides evidence of some limited progress:[551]

- formal systems of review help convince often-reluctant regulatory officials of the need to analyse the implications of rules before issuing them;
- regulators and interest groups now think more about the costs of regulations; and
- there is limited evidence that the news media are now drawing potential costs to the attention of the wider public.

However, the review process in the United States has been fundamentally impeded by some regulatory agencies' governing statutes that exempt them from a requirement to

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549 Weidenbaum, *Regulation*, *op cit*, p 23.

550 Hahn, *Journal of Economic Perspectives*, *op cit*.

551 Weidenbaum, *Regulation*, *op cit*.

examine the potential impact or effectiveness of a proposed law. Changes in these statutes are seen as being necessary for effective reform.[552] The power of presidential executive orders is further reduced because various independent regulatory agencies are not subject to their jurisdiction. Shanahan observes that regulatory agencies are also experienced in:

> … a ritual performance of some perfunctory economic analysis, [that] enables the agencies to ignore the spirit of the entire effort while still meeting the formal requirements.[553]

He argues that process reforms that provide those subject to regulation with the power to obtain a judicial review and systematically pressure agencies to change their cultures and processes are small steps in the right direction.[554]

A.3 United Kingdom

Under the earlier Thatcher regime, the British government imposed controls on the bureaucracy, although regulations were not targeted per se. The civil service was made more accountable to the central government and bureaucrats were subject to performance indicators. In her first term, Thatcher deregulated numerous sectors of the economy, including telecommunications, transportation, oil, and gas. However, deregulation typically proceeded 'from above' in the form of concentrated bursts of activity. Thatcher did not develop an effective plan for stemming the ongoing flow of regulations from extant agencies. In her second term, Thatcher focused on privatising government agencies, with success, but again without a systematic policy for regulatory reform.[555]

A.4 Canada

Canada has made a number of efforts in the area of regulatory reform. The Liberal government of Pierre Trudeau required that all new regulations be accompanied by a Socio-Economic Impact Analysis. The Progressive Conservative Government of Joe Clark created a minister responsible for regulatory reform, the Office of the Coordinator for Regulatory Reform. The government of Brian Mulroney required that regulations be subject to periodic review and that a 'Regulatory Impact Analysis Statement' accompany new regulations.[556]

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552 Shanahan, *Regulation*, *op cit*.

553 Weidenbaum, *Regulation*, *op cit*, p 26.

554 Shanahan, *Regulation*, *op cit*, p 32.

555 On the Thatcher years, see Savoie, *Thatcher Regan Mulroney: In Search of a New Bureaucracy*, *op cit*.

556 See Stanbury, WT, 'Efforts to Reform the Federal Regulatory Process in Canada', in Hopkins, TD, (ed), *Regulatory Policy in Canada and the United States: Proceedings of a Conference*, Rochester Institute of Technology, Rochester, New York, 1992, pp 43–74 on these reforms.

Appendix B: Current and Proposed Compliance and Monitoring Arrangements for New Legislation and Regulations

Table B.1: Government bills: current compliance and monitoring arrangements

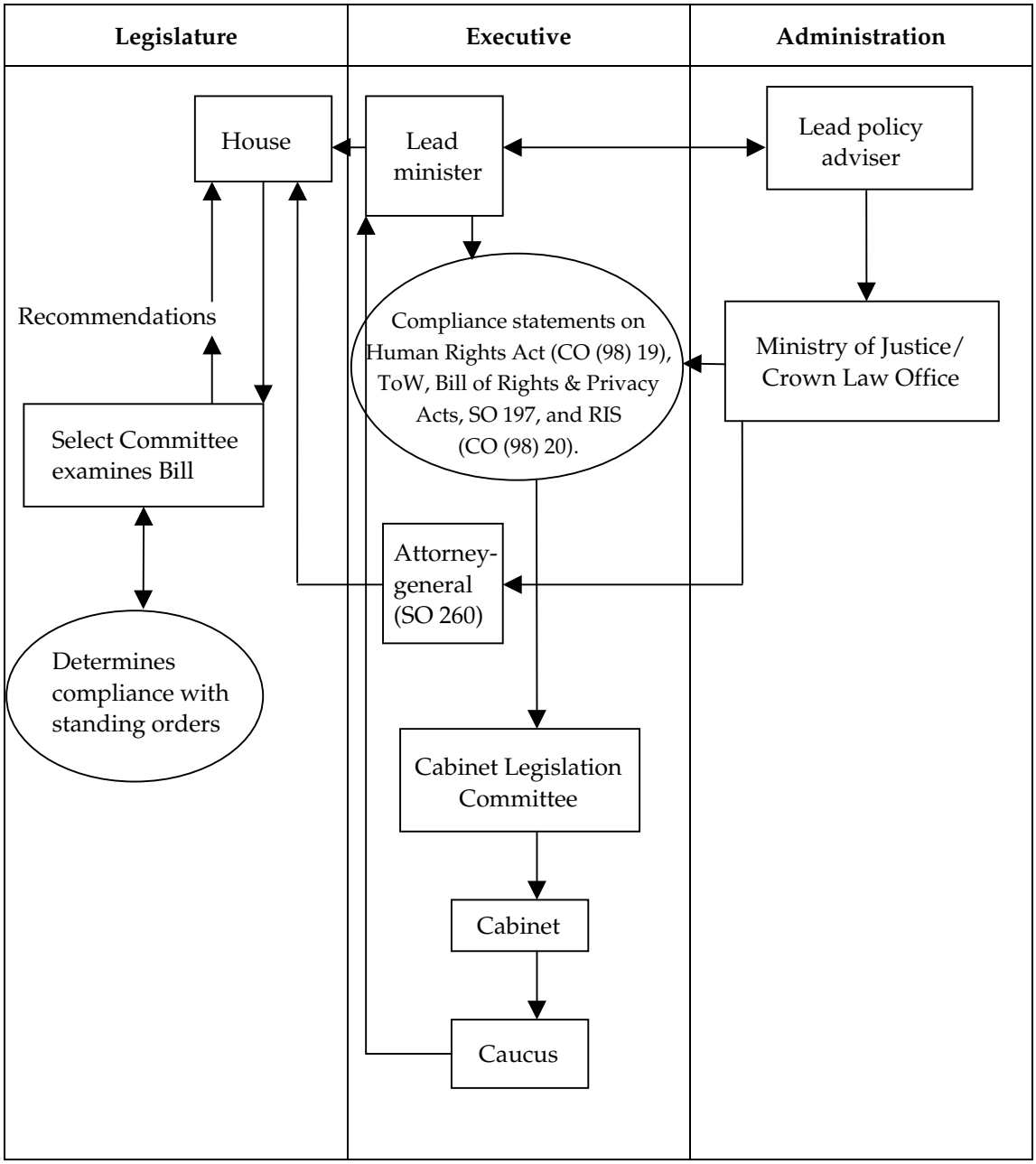


Table B.2: Government bills: proposed compliance and monitoring arrangements

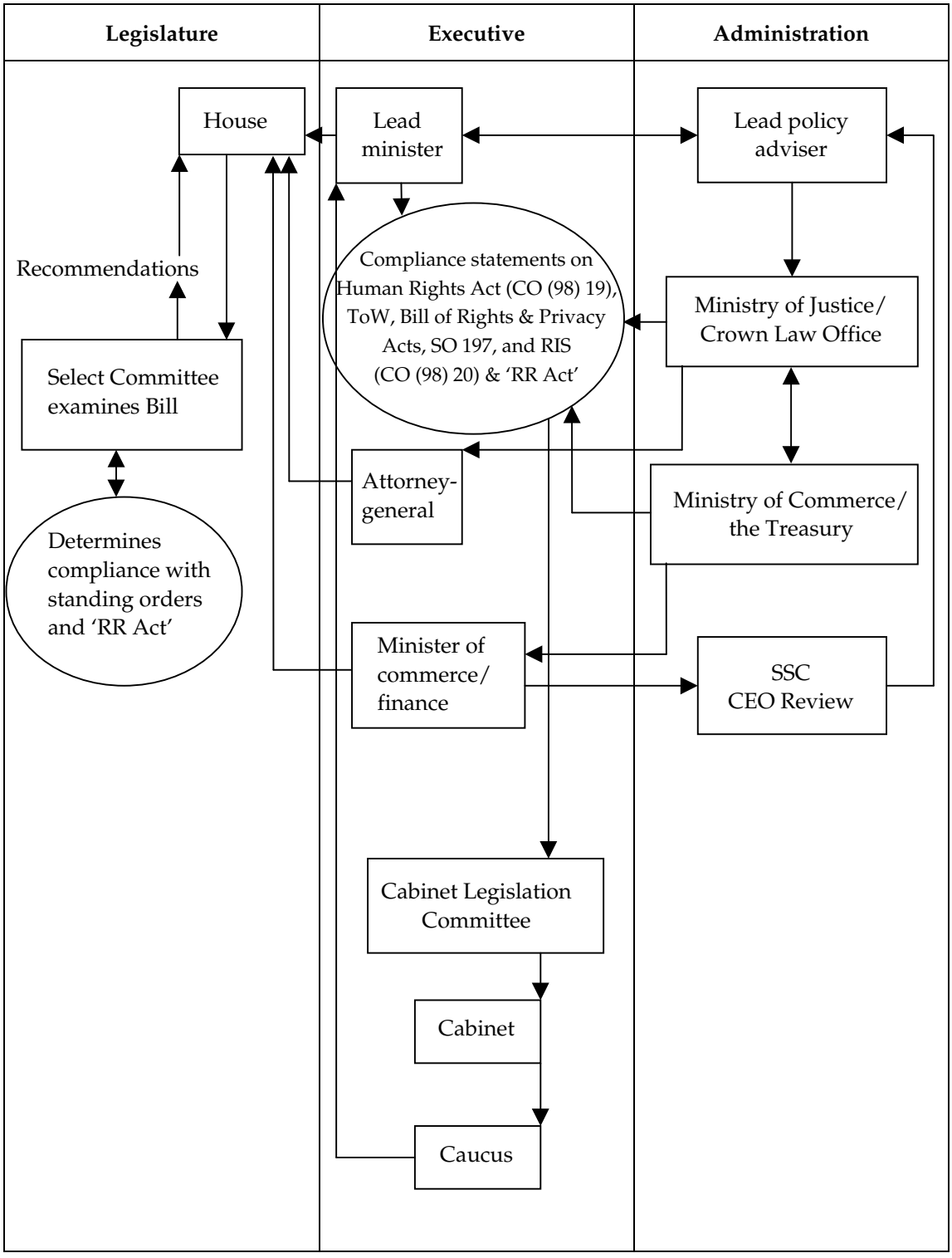


Table B.3: Government regulations: current compliance and monitoring arrangements

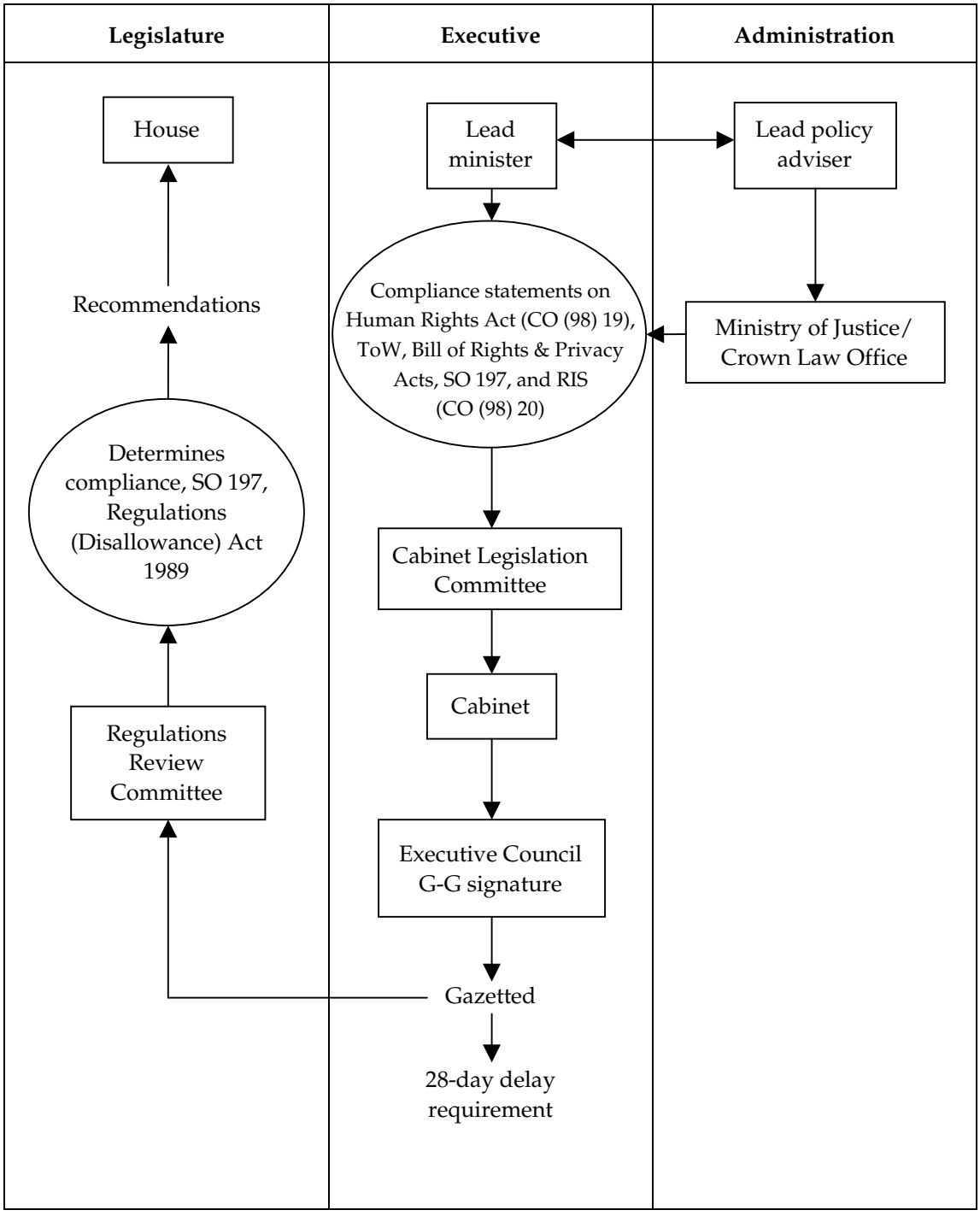
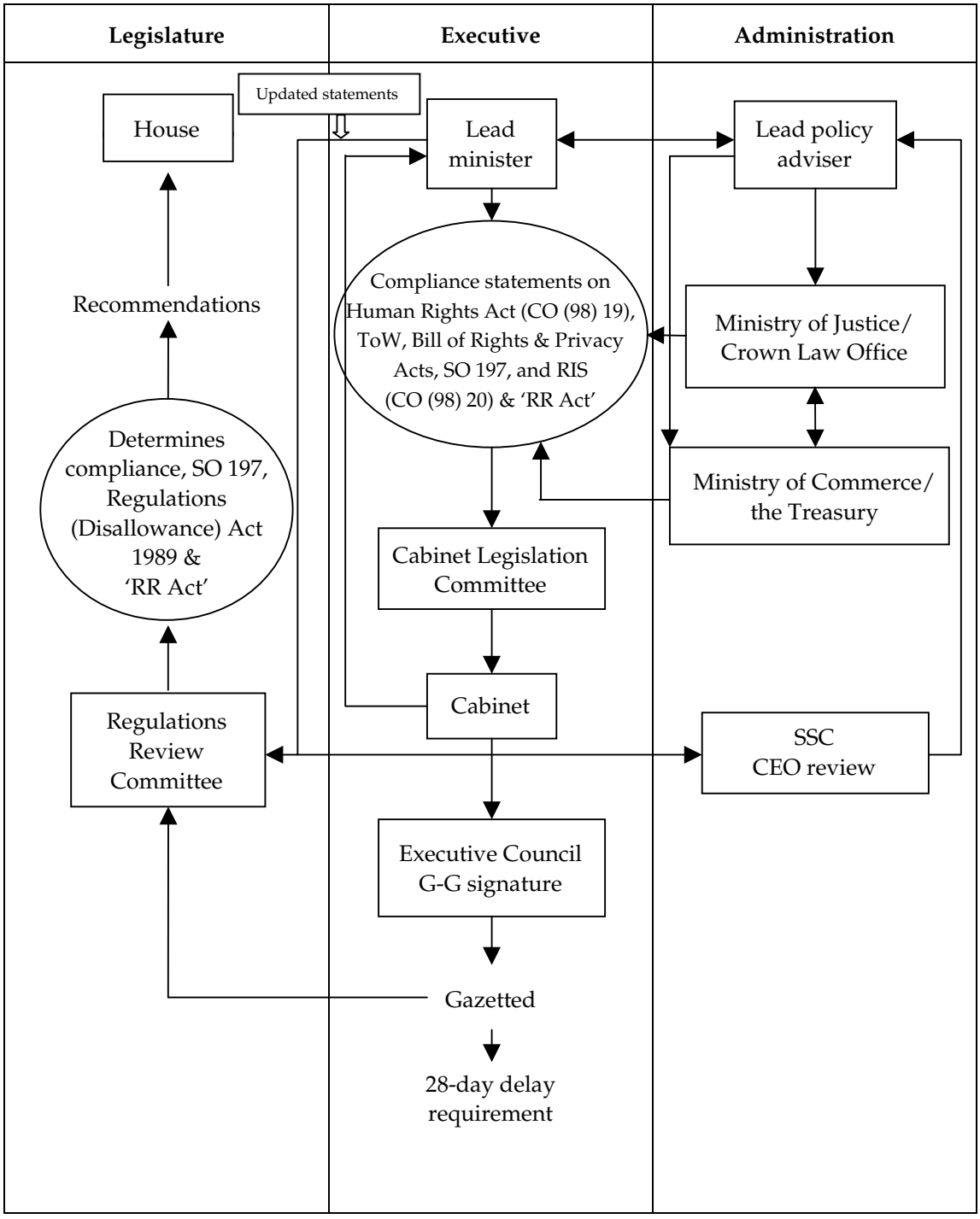


Table B.4: Government regulations: proposed compliance and monitoring arrangements



Appendix C: Regulatory Responsibility Act

This appendix outlines a possible approach to the development of a Regulatory Responsibility Act based on the principles developed in this report. Its purpose is illustrative. It aims to provide a basis for discussion, development and refinement rather than a fully developed proposal.

Regulatory Responsibility Act

Analysis

An Act to improve parliamentary laws and regulations in New Zealand by specifying principles of responsible regulatory management and by strengthening the reporting requirements of the Crown and, in particular, –

(a) By requiring the Treasurer and Minister for Economic Development to report jointly and regularly to the House of Representatives on the extent to which the government's regulatory policies and existing parliamentary laws and regulations comply with the regulatory principles specified in this Act, and to justify in their report any departures from those principles which the government does not propose that the House or the Executive, as appropriate, should eliminate;

(b) By requiring the Treasurer–

  (i) To include, in each Budget Policy Statement required under the Fiscal Responsibility Act 1994, a regulatory policy statement that sets out the government's objectives and intentions with regard to reducing regulatory burdens by eliminating features that are no longer necessary for achieving an essential public purpose or fail to accord with specified regulatory principles; increasing certainty as to what actions are lawful; and increasing freedom of contract and security in possessions;

  (ii) To lay before the House of Representatives, on the day on which the first Appropriation Bill relating to a financial year is introduced, a regulatory strategy report assessing the consistency of the Budget's regulatory policies with the Budget Policy Statement;

  (iii) To lay before the House of Representatives, on the day on which the first Appropriation Bill relating to a financial year is introduced, a statement that lists all laws and regulations that are certified by the Ministry of Economic Development or the Treasury to impose an avoidable burden for the benefit of another group on those who would otherwise enjoy greater legal rights; identifies the relevant groups; comments on the degree to which the consent of the members of the burdened group has been obtained; provides the Secretary to the Treasury's opinion as to whether the transfers are material and accord with sound tax policy principles; and provides the House with the Treasurer's assessment of the case for the House to endorse or refuse to endorse those transfers that are deemed not to comply with sound tax principles;

BE IT ENACTED by the Parliament of New Zealand as follows:

1. **Short title and commencement –** (1) This Act may be cited as the Regulatory Responsibility Act 200X.

(2) This Act shall come into force on the 1st day of July 200X.

2. **Interpretation –** (1) In this Act, unless the context otherwise requires,

"Essential" means that the effect of its deprival would be a major reduction in the public interest.

"Full compensation" means compensation that makes a person whose legal rights have been taken or impaired at least as well off as if the forced taking or impairment did not occur. Where a forced taking creates a surplus for the public interest, full compensation includes a proportionate share of that surplus.

"Necessary" means otherwise impossible.

"Public interest" means an increase in the benefits that consumers and producers jointly derive in excess of the real resource costs of production as a result of greater efficiency. A transfer from one producer to another or between consumers and producers does not add to the public interest in itself.

"Regulations" means– [To be completed: One possibility would be to insert here the definition provided in the Regulations (Disallowance) Act 1989, subject to any amendments made to that definition.]

"Taking" means an action that deprives a person in whole or in part of a pre-existing legal right.

3. **Act to Bind the Crown –** This Act shall bind the Crown.

4. **Principles of sound regulatory management –** (1) Subject to subsection (3) of this section, the Government shall pursue its policy objectives in accordance with the principles of responsible regulatory management specified in subsection (2) of this section.

(2) The principles of responsible regulatory management are–

(a) Every law and regulation must be supported by an up-to-date published statement of its objectives and rationale that conforms to the provisions set out in subsection (3) of this section;

(b) Laws and regulations should enhance security under the law in person, liberty, contract and property from unwanted incursions;

(c) Laws and regulations should preserve common law causes for action that have prevailed for centuries against harms caused by strangers. They should not introduce novel or expanded harms or causes;

(d) Laws and regulations should preserve or enlarge the scope for individual action, and thereby for voluntary cooperative action. They should enhance freedom of contract and exchange;

(e) Laws and regulations that reallocate legal rights by force must be justified on the basis that they are necessary for the achievement of an essential public interest. In addition, such laws and regulations should;

(i) not delegate from Parliament the power to levy taxes;

(ii) preserve the principle that taxes are not levied and property is not taken in the public interest except with the consent of the affected taxpayers or property owners or their elected representatives;

(iii) preserve the principle of full compensation for those whose rights under common law are taken or impaired in the public interest;

(iv) preserve the principle that such compensation should be funded by the new legal owners or, if the government assumes the taken rights, by those in whose interests the taking was justified;

(v) preserve the principle of proportional sharing in the net benefits arising from a forced exchange amongst those who are parties to that exchange;

(f) Laws and regulations should otherwise preserve or enhance the rule of law. In particular they should:

(i) avoid laws that have retrospective effect;

(ii) avoid imprecise terms and complexities that materially undermine the ability of citizens to understand the law and therefore to comply with it;

(iii) increase certainty as to what actions are legal;

(iv) ensure that the exercise of delegated administrative and executive powers in relation to discretion to set user charges, attach conditions to permits or consents, or change the use of assets within the public sector, is subject to judicial review;

(v) uphold the principle that all are subject to the law – including the government and its agencies; and

(vi) uphold the principle of equality under the law. Laws should be general and abstract, not mentioning specific categories of persons, gender, race, creed or religion, time or place.

(3) The statement of the rationale for any law or regulation referred to in subsection (1) of this section must:

(a) Identify the problems that motivate the continuing need for the law or regulation, focusing on underlying causes rather than symptoms;

(b) State the national interest regulatory objective at a level of generality that does not pre-justify the regulation. This statement must establish whether the objective is to enforce better the legal rights that would otherwise exist or to reallocate those rights;

(c) Assess how alternative arrangements, including ongoing reliance on common law processes, would be likely to evolve in the absence of the law or regulation. This section should make explicit any assumptions about future changes in information, circumstances or technologies that could reduce or eliminate the need for the regulation;

(d) Express the view of the policy ministry responsible for advising on this law or regulation as to whether the law or regulation is necessary for the achievement of an essential public interest;

(e) Identify possible undesired side effects that could result from the proposed law or regulation, compared with the alternative of reliance on private arrangements and alternative laws and regulations;

(f) Identify the factors that are critical for preferring the regulation to the alternative of no regulation or the next best alternative;

(g) In the event of a likely legal dispute about the allocation of legal rights in the absence of the law and regulation, identify the reasons for not seeking a Crown Law Office opinion or a court determination of the issues and the extent of the potential liability to the Crown of proceeding to introduce a new law or regulation in the absence of such a determination;

(h) Identify any persons or categories of persons whose legal rights are forcibly taken in whole or in part by the law or regulation;

(i) Identify those persons or categories of persons who obtain legal rights as a result of the law or regulation. Where the Crown is the new owner, identify those groups in whose interests the Crown is to hold or is to continue to hold the legal rights thus acquired;

(j) Identify what efforts have been made, or could be made, to obtain the consent of those in category (h), and assess the existing degree of consent;

(k) Identify possible ways for requiring those identified in (i) to compensate those identified in (h) so that all parties to the forced exchange can be made better off, and evaluate their feasibility;

(l) Identify the likely cost to the Crown of compensation payments under (k) in the event that the beneficiaries of the taking identified in (i) cannot be obliged to make the payments for reasons of high transaction costs;

(m) State what evidence is being relied upon to support the case that the benefits to those persons exceed the costs to those identified in (h) in the event that the law or regulation does not require those identified in (i) to fund compensation;

(n) State whether the law or regulation shares any excess of benefits over costs proportionally amongst the parties to the transfer of legal rights;

(o) Estimate the quantum of any departures from that principle and identify the categories of persons who gain and who lose as a result of those departures;

(p) State what evidence there is that those who lose have consented to this transfer;

(q) Identify any elements of the law or regulation that impair freedom of contract and exchange in respect of the reassigned rights, and justify those elements explicitly;

(r) Specify a future date at which it would be reasonable to review the law or regulation to determine if its continuation is warranted; and

(s) Assess the law or regulation's conformity with the remaining principles in subsection (2) of this section.

(4) Nothing in subsection (2) of this section shall infringe on a government's ability to make and retain laws and regulations that:

(a) Provide the Crown with the revenues that are necessary to fund publicly provided goods and services such as national defence, the protection of individual liberty and private property and the administrative costs of government: or

(b) Provide for essential public interests.

(5) The Government may depart from the principles of responsible regulatory management specified in subsection (2) of this section but when the Government does so **–**

(a) Any such departure shall be temporary; and

(b) The Minister for Economic Development shall, in accordance with this Act, specify–

(i) The reasons for the Government's departure from those principles; and

(ii) The approach the Government intends to take to return to those principles; and

(iii) The period of time that the Government intends to take to return to those principles.

5. Statements of Responsibility – Every statement prepared under section 4(3) of this Act shall be accompanied by statements of responsibility signed by the Minister with portfolio responsibility for any law or regulation, the head of the department or Crown agency responsible for advising the Minister on that issue, the Secretary for Economic Development (or the Secretary to the Treasury where the Ministry of Economic Development has portfolio responsibility for the regulation) and the Secretary of Justice:

The Minister with portfolio responsibility will certify that in their view all the restrictions any law or regulation imposes on freedom of contract and exchange are necessary for the achievement of an essential public purpose. The Statement will also certify that the Minister has given no instructions to the responsible department concerning problem definition, the selection of the objective, the consideration of alternatives, or the assessment of costs and benefits other than those disclosed in the Statement. It will also certify whether the Minister is satisfied that enough has been done to ascertain the consent of those whose legal rights would be taken or impaired as a result of the regulation and to ensure that those persons had access to full compensation.

The head of the department or agency responsible for preparing the Statement for the responsible Minister will certify that it correctly stated all the ministerial instructions it had received that had affected the preparation of the paper and that in their view it complied with the requirements set out in section 4(3) in accordance with the standards the department set itself for professional analysis, or if it did not, in what respects it failed to do so. This Statement will also certify the department's professional assessment as to whether the law or regulation complied with the principles set out in section 4(2) reduced uncertainty as to what actions were lawful, conferred benefits to persons that exceed the costs imposed on those from whom legal rights were taken or impaired, and was necessary for an essential public interest.

The Secretary for Economic Development (or in the case of conflict the Secretary to the Treasury) would certify that the analysis in the Statement achieved a professional standard of regulatory analysis and whether the law or regulation served to tax one group of persons for the benefit of another group by failing to accord with the principles of full compensation and proportionate sharing of surpluses.

The Secretary of Justice or the Attorney-General would certify that the analysis in the Statement was professionally competent with respect to its analysis of legal issues.

6. Power of the Secretary of Justice, the Attorney-General or the Secretary for Economic Development to obtain information – (1) The aforesaid officials may from time to time request any department or any entity mentioned in section 37(3) of the Public Finance Act 1989, or any entity that [is responsible for proposing or administering regulations] to supply to them such information as is necessary to enable them to satisfy the reporting requirements referred to in section 6 of this Act.

(2) Any request made under subsection (1) of this section may specify the date by which and the manner in which the information requested is to be provided.

(3) Where a date is specified under subsection (2) of this section, that date shall be reasonable having regard to the time limits prescribed by this Act for the laying before the House of Representatives or the publishing of the report for which the information is being requested.

(4) Where any request under subsection (1) of this section is made to a department or entity, that request shall be made in writing and that department or entity shall comply with that request.

7. State Sector Regulatory Management Report– (1) The State Services Commission shall lay before the House of Representatives each year a regulatory management report that assesses the overall professional quality of the Statements required and produced under section 4(3), agency by agency, in the preceding financial year.

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