

***Submission***

**By**



**to the**

**Ministry for the Environment**

**on the**

**Proposed National Policy Statement on Flood Risk  
Management**

**June 2007**

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# **NATIONAL POLICY STATEMENT ON FLOOD RISK MANAGEMENT**

## **SUBMISSION BY BUSINESS NEW ZEALAND<sup>1</sup>**

### **1.0 Introduction**

- 1.1 Business New Zealand welcomes the opportunity to make a submission on the proposed National Policy Statement (NPS) on Flood Risk Management.
- 1.2 Business New Zealand has serious concerns with the proposal to adopt an NPS on Flood Risk Management and recommends that it does not proceed for the reasons outlined below.
- 1.3 While the Minister for the Environment and Cabinet concluded in March 2007 that an NPS on managing flood risk is desirable, there is limited rationale in the background paper for proceeding with such a NPS. There is no analysis as to the nature of current problems with flood risk management which would justify the development of an NPS, the costs and benefits of developing an NPS, nor whether developing an NPS would achieve anything apart from potentially raising costs for residents and businesses. The potential unintended consequences would also need to be analysed.

### **Recommendations:**

Business New Zealand **recommends** that:

**The proposed NPS on flood risk management does not proceed until a clearer indication of the alleged weaknesses of current approaches to flood risk management have been more fully investigated; and**

**If significant weaknesses are identified with current approaches to flood risk management, then officials clearly need to articulate why an NPS would be the most appropriate and effective option to overcome any perceived failures of current approaches compared to other alternative options such as greater education and information to market participants on potential risks.**

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<sup>1</sup> Background information on Business New Zealand is attached as Appendix 1.

## 2.0 **General Discussion**

- 2.1 Business New Zealand is strongly supportive of local councils determining and managing risks which reflect their unique circumstances where systems and processes reflect the needs and wants of both businesses and the citizens living in communities. It is most unlikely that a “one-size fits all approach” is appropriate given the unique issues facing particular communities, including population bases, environmental effects etc. It is noted that feedback from councils confirms that: *“Local authorities use a variety of methods and tools to manage flood risk. A clear benefit is that the chosen approach can be responsive to the local conditions. However, some councils have better resources, including information and funding, to achieve robust flood risk management. Comparison across the country is difficult as there is no one standard approach to management flood risk.”*
- 2.2 Business New Zealand is not surprised by the above statement from councils and to a certain extent it reflects the different and unique risks faced by different communities and infrastructure. It in fact reflects a logical approach to dealing with different risks facing particular communities.
- 2.3 It is important to appreciate that there will be an “optimal” amount of risk taking into account the economic and environmental sustainability of resource use. Total emphasis on short-term economic outcomes without due regard to environmental outcomes could well be detrimental to long-term economic growth and an increased standard of living for current and future New Zealanders. By the same token, total emphasis on environmental outcomes to the detriment of economic growth and improved standards of living for New Zealanders could be similarly detrimental.
- 2.4 Risk cannot be completely eliminated, not at least without great cost. Risks may be able to be reduced, but beyond a certain point the marginal cost of taking action to minimise adverse effects associated with flooding becomes progressively higher, while the potential returns from taking action become less. In this respect it pays for companies and individuals to invest in risk minimisation strategies up to the point at which the marginal cost equals the marginal benefits of taking action.

- 2.5 Before any moves towards the adoption of a NPS is considered desirable, it is first important to fully understand the nature of the problem, who is affected, the costs of taking action, and who bears those costs. Regulatory intervention, because of its cost, should generally be considered as a last resort, only to be taken when all other cost effective approaches have been exhausted, including greater education of risks in particular communities.
- 2.6 In order to justify an NPS, there must be a clear case of market failure with current arrangements and the problem of market failure must be significant. To the best of Business NZ's knowledge, the existence of significant market failure has not been proven in this case.
- 2.7 Before coming to any decisions as to the merits or otherwise of the NPS proposed, it is crucial that policymakers take a step back and ask some fundamental questions. These include – but are not limited to:
- Is there a problem with current flood risk management systems (i.e. are there significant issues of “market failure” which need to be addressed)?
  - If there is a problem, is the problem significant?
  - What are the potential options to improve outcomes which don't impose significant costs (e.g. by improving information/education to market participants)?
  - What are the costs and benefits (including unintended costs) of the NPS proposed?
  - Will an NPS achieve the outcomes desired and at what cost?
- Only then, if the analysis justifies it, should an NPS be considered.

- 2.8 As a general principle, individuals and companies should bear the full costs associated with their behaviour (i.e. costs should be internalised) or individuals will over-consume resources if they can shift costs onto third parties. Management of flood risk minimisation is no different in this respect. In order for individuals to make rational decisions in respect to flood risk management, they should ideally bear the costs (and benefits) associated with specific options/outcomes. On the other hand, if individuals and companies are forced to pay greater amounts than any costs those individuals and businesses impose, the outcome will be either more expensive products and/or reduced commercial activity and the associated flow-on implications for employment etc of that.

*Market Failure – a possible case for government involvement?*

- 2.9 Before determining whether an NPS on flood risk management is justified as part of sound policy, it is first necessary to determine on what grounds government might decide to pursue an NPS.
- 2.10 It is important to determine conceptually what might be potential areas of “market failure” in flood risk management which might justify government involvement via an NPS (or similar).
- 2.11 While there are a number of potential “market failures” often quoted in economic literature, the only one which is likely to have any relevance for analysing government involvement in developing an NPS for flood risk management would be the potential for externalities.

*Externalities*

- 2.12 Externalities (or spillovers) lead to a divergence between private and social (public) costs or benefits, where “private” refers to the costs and benefits to those participating in the market transactions and “social” refers to the costs and benefits to all members of society.
- 2.13 Wherever there are such externalities, resource allocation provided by the market may not be efficient. If individuals and firms do not bear the full cost of the negative externalities they generate, they will engage in an excessive amount of such activities thereby creating costs on others. Conversely, since individuals and firms do not reap the full benefits of activities generating positive externalities, they will engage in less than a socially optimal amount of these activities.
- 2.14 Government can respond to externalities in several ways. In some cases (mainly involving negative externalities) they can attempt to regulate or levy (tax) the activity in question. They can also simply ban or prohibit certain activities that create adverse externalities. Alternatively, the government can encourage activities where positive externalities are created, for example, through subsidies or cash payments or other support mechanisms to people participating in such activities. Often these are “output” based to encourage increased production or supply of the positive externalities.

- 2.15 Notwithstanding the above, virtually every activity has spillover (externality) consequences which do not necessarily justify government involvement to address such externalities. For government involvement to be justified in any particular case, it needs to be shown that the externalities are particularly large, and not successfully dealt with through current market mechanisms including negotiated outcomes between various parties.
- 2.16 The adoption of a NPS *could* have the potential to seriously restrict the ability of individuals and businesses to build infrastructure where they are quite happy to bear the costs and benefits associated with that activity. Rather than allowing individuals to make these decisions, an NPS, particularly if it seriously restricted the ability of people to build to continue to maintain assets in close proximity to potential flood prone areas, could seriously increase costs on commercial activity and reduce the returns to businesses by restricting land use options. This is already a serious issue in many parts of the country where constraints on new housing sub-divisions and commercial activities are imposed by local councils. While clearly often existing constraints on building activity does not relate to potential for “flood risk” the same principles apply.
- 2.17 Artificially restricting supply or the ability to undertake activities will generally result in increased inflationary pressures and reduced commercial activity which can be very critical in some communities’ and regions particularly where employment in a region may be highly dependent on one or two major industries.
- 2.18 Trying to second guess the impacts of climate change over a significant time-period is also fraught with difficulties and could result in highly restricted use of land if a very conservative approach was taken to potential flood risks. The key is to ensure that reasonable information is available for individuals and companies to make rational decisions on investments based on their unique risk management profiles.
- 2.19 Given the above considerations, the potential case of “market failure” in terms of flood risk management which might justify the adoption of an NPS appears negligible. The potential focus should be on the issue of externalities, i.e. where the full costs of “activity” are not borne by the person or company undertaking that activity.

- 2.20 Provided individuals are reasonably informed about known and potential risks, then they should be free to go about their lawful business including developing buildings and infrastructure on “flood prone” land.
- 2.21 Notwithstanding the above, there will be cases where individual councils may need to make decisions restricting potential building sites and or land use options if there are clear public benefits in doing so given the potential impacts on communities and third parties should significant flooding occur. However, such restrictions should be done on a local case-by-case basis and not nationally imposed. Moreover, any such restrictions should be based on sound scientific evidence and also taking account of the costs and benefits of potentially restricting land use. Where potential restrictions are placed on current land users, then they should be fully consulted and ideally compensated for any losses they may incur from restrictions on current or potential future land use options.

Business New Zealand **recommends** that:

**The proposed NPS on flood risk management does not proceed until a clearer indication of the alleged weaknesses of current approaches to flood risk management have been more fully investigated; and**

**If significant weaknesses are identified with current approaches to flood risk management, then officials clearly need to articulate why an NPS would be the most appropriate and effective option to overcome any perceived failures of current approaches compared to other alternative options such as greater education and information to market participants on potential risks.**

## **APPENDIX 1**

### **BACKGROUND INFORMATION ON BUSINESS NEW ZEALAND**

Encompassing four regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 66 member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

In addition to advocacy on behalf of enterprise, Business New Zealand contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.

Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). An increase in GDP of at least 4% per capita per year is required to achieve this goal in the medium term.

The health of the economy also determines the ability of a nation to deliver on the social and environmental outcomes desired by all. First class social services and a clean and healthy environment are possible only in prosperous, first world economies.