

Treasury Report: New Zealand Productivity Commission – Briefing

Date:	16 November	Report No:	T2009/2508
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Consider recommendations in this report Refer report to Associate Ministers of Finance Meet with the Associate Ministers of Finance to seek their views on the report	22 November 2009
Minister of Regulatory Reform (Hon Rodney Hide)	Consider recommendations in this report	22 November 2009

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Michele Lloyd	Manager, Regulatory Quality	[*] (wk)	[*]
Peter Mumford	Principal Advisor	[*] (wk)	[*]

* [Withheld under s.9(2)(a) to protect the privacy of natural persons]

Minister of Finance's Office Actions (if required)

If the Minister of Finance agrees, copy this report to the Associate Ministers of Finance

Enclosure: No

Treasury Report: New Zealand Productivity Commission - Briefing

Executive Summary

Placing New Zealand's productivity performance on a new trajectory requires a high level of ambition in the sorts of policy options that are considered by the government and supported by the community. This in turn requires:

- Analysis that is grounded in evidence and well regarded by peers and critics;
- Ideas that test the boundaries of what is currently known or considered to be possible; and
- A process of stakeholder and public engagement that involves the community with both the analysis and ideas.

Government agencies that provide policy advice on productivity are not always well placed to deliver the level of ambition required. Some attribute this to a lack of critical mass of micro-economists well versed in productivity related ideas and analysis or, more to the point, the existing capability is often required to focus on shorter term deliverables rather than in-depth analysis. Others argue that independence is required to materially challenge the status quo. Our view is that it is a mix of both.

Australia has addressed both critical mass and constraints through establishing the Productivity Commission (APC). This institution is regarded as best practice by the OECD and World Bank. New Zealand has a productivity problem but we don't have this type of institution. Cabinet agreed that we investigate such an institution and we have benchmarked the design and analysis of a possible New Zealand Productivity Commission (NZPC) against the APC and Victorian Competition & Efficiency Commission (VCEC). We have concluded that there would be a substantial benefit from establishing a NZPC, but there are risks. For the most part these risks are best managed through ensuring the independence of the agency and employing the best possible people to lead and staff it. The APC has also agreed to support a NZPC during its establishment and cooperate on an ongoing basis.

The purpose of a NZPC would be to improve productivity in both the public and private sectors in a way that is directed at supporting the overall well-being of New Zealanders. It would be a statutorily independent organisation that carries out inquiries in areas of particular importance to New Zealand's productivity performance.

A NZPC would require legislation and a budget in the order of \$4.4 – 5 million per annum when fully up and running in 2011/12 (establishment costs of \$1.6 million would be incurred in 2010/11) and a capital injection of \$0.5 million. We are assuming that there would be no new money and hence the costs would need to be found through a reallocation from the budgets of departments that undertake productivity-related analysis. We consider that a NZPC would in part substitute for work undertaken or commissioned by such agencies, and in part represent a better deployment of the government's investment in policy advice.

We are required to report back to EGI in November but consider that we need to establish sources of funding before we do so. We suggest that the Minister of Finance discuss the idea of a NZPC with the Associate Ministers of Finance. If there is agreement to recommend a NZPC to Cabinet, we also suggest that the Minister of Finance write and subsequently meet with relevant Cabinet colleagues to gauge their support and seek their agreement to contribute to the costs.

Recommended Action

We recommend that you:

- a **agree** that there is a case for a New Zealand Productivity Commission (NZPC).

Agree/disagree.

- b **agree** that the purpose of the NZPC is to improve productivity in both the public and private sectors in a way that is directed at supporting the overall well-being of New Zealanders.

Agree/disagree.

- c **agree** that the NZPC would be an advisory body established by statute that conducts inquiries and reviews on the basis of a reference from the responsible Minister, and makes recommendations.

Agree/disagree.

- d **agree** that the key functions of the NZPC would be to:

- hold inquiries into, and report to the Minister about, productivity related matters that are referred to it by the Minister.
- conduct *ex post* reviews of regulatory regimes.
- conduct one-off reviews of the efficiency and effectiveness of regulatory agencies.
- undertake ex-ante regulatory impact analysis for specific regulatory proposals.
- undertake and publish its own research into productivity related matters to build its institutional knowledge and as such support its inquiry and reviews functions.
- promote public understanding of matters relating to productivity.

Agree/disagree.

- e **agree** that the NZPC would be an Independent Crown Entity (ICE).

Agree/disagree.

note that a number of options are currently under consideration for providing support to the NZPC, ranging from shared services with Treasury, to the NZPC contracting the Treasury to provide the resources (staff and administrative) to support its functions. We will report further on these when our analysis is complete.

- f **note** that the detail design of the NZPC be will contained in the report back to Cabinet.

- g **note** that the cost of the NZPC will be in the range of \$4.4 - \$5 million per annum and a capital injection of \$0.5 million.

- h **agree** that a preferred source of funding is from government agencies that currently carry out productivity-related analysis.

Agree/disagree

i **agree** the following process for determining sources of funding for the NZPC:

- The Minister of Finance refers this report to the Associate Ministers of Finance and meets with them to discuss the NZPC proposal and funding issues.
- Subsequently the Minister of Finance meets with relevant Ministers, including the Minister of Economic Development and Minister of Labour, again to discuss the NZPC proposal and funding issues.

Agree/disagree.

j **agree** that the report back to EGI in November 2009 be deferred until funding issues have been worked through.

Agree/disagree.

Michele Lloyd
**Manager, Regulatory Quality Team
for Secretary to the Treasury**

Hon Bill English
Minister of Finance

Hon Rodney Hide
Minister of Regulatory Reform

Purpose of Report

The purpose of this report is to present to you the case for, and detailed design and analysis of, a possible New Zealand Productivity Commission (NZPC), and seek the agreement of the Minister of Finance to a process of engagement with the Associate Ministers of Finance and subsequently other Ministers with a view to gauging support and identifying possible sources of funding for the agency.

Analysis

Background

The National-ACT Confidence and Supply Agreement included a commitment to explore the concept of a NZPC associated with the Productivity Commission in Australia. Officials undertook an initial assessment of the case for such an institution and concluded that:

- Current institutional arrangements leave a gap for a new institution with specialised internal investigative capacity and a mandate to actively survey the views of a range of stakeholders to undertake inquiries and significant *ex-post* reviews; and
- The organisation most likely to fill this gap would be either (1) a separate, independent agency, or (2) an independent statutory function within an existing organisation.

On the basis of this advice Cabinet agreed that officials undertake the detailed design, analysis and costing of a possible agency to carry out inquiries into productivity related matters and *ex post* reviews of regulatory regimes and potentially other functions (EGI(09)17/15).

In addition, you and the Australian Treasurer agreed earlier this year that if New Zealand chose to establish a Commission there would be cooperation between this agency and the Australian Productivity Commission (APC). This was endorsed by the two Prime Ministers in the Joint Statement they issued following their meeting in August.

Design features

Officials benchmarked the design of a possible NZPC against the APC and Victoria Competition and Efficiency Commission (VCEC).

The following outlines the broad design features of a possible NZPC:

- The purpose of the agency is to improve productivity in both the public and private sectors in a way that is directed at supporting the overall well-being of New Zealanders;
- The agency is an advisory body established by statute that conducts inquiries and reviews on the basis of a reference from the responsible Minister, and makes recommendations. Both the terms of reference and reports will be made public;
- Recognising that productivity performance is associated with a broad range of factors, a broad scope is envisaged that includes: enterprise (tax, regulation, competition); skills; innovation; infrastructure; natural resources; investment; international connectedness, and; public sector performance (this is broadly the same scope as the APC);

- The agency would be headed by independent Commissioners, of which there will be 3-4, who will act in both a governance capacity and head specific inquiries or reviews. It is expected that the Commissioners will be part-time. The agency would have a full-time director/CE, and a total establishment of around 23 (including Commissioners).

The key functions of the agency would be as follows:

- Hold inquiries into, and report to the Minister about, productivity related matters that are referred to it by the Minister;
- Conduct *ex post* reviews of regulatory regimes;
- Conduct one-off reviews of the efficiency and effectiveness of regulatory agencies;
- Undertake ex-ante regulatory impact analysis for specific regulatory proposals as a specialist body;
- Undertake and publish its own research into productivity related matters to build its institutional knowledge and as such support its inquiry and review functions;
- Promote public understanding of matters relating to productivity.

It is important to note that these functions describe what the NZPC could do, but in fact the agency will be limited to doing what is most important to the government. With only two to three inquiries and reviews each year, the government is likely apply a high materiality test. In this regard the NZPC would complement other agencies providing productivity related advice such as Treasury, the Ministry of Economic Development and Department of Labour, not substitute for them.

We do not recommend that Treasury's responsibility for the regulatory impact analysis regime be transferred to the NZPC. The RIA regime agreed by Cabinet earlier this year and currently being implemented includes elements of agency capability building and coordination, and ensuring that policy agencies have robust internal processes for regulatory impact analysis development and assessment, as well as a Treasury assessment of significant proposals. This mix of functions is better suited to a central agency with a broad regulatory reform mandate and established relationships.

Discussions have also been held with both the Australian Treasury and APC on options for cooperation. These discussions have been very fruitful. Should New Zealand decide to establish a NZPC, the APC would support a mutual commitment to co-operate in respect of supporting the establishment of the New Zealand agency and co-operation in regard to how issues of mutual interest can be taken forward.

This cooperation could extend to the APC considering secondment and exchange possibilities as well as visits from senior APC staff and a mechanism for regular engagement between the two Commissions. There is also agreement that we should aspire to jointness in future Single Economic Market (SEM) related inquiries or studies. The modalities for these have yet to be worked out, but the APC would work with us to identify any issues and potential solutions if they arise.

Value of a NZPC

A cost/benefit analysis has been undertaken. It concludes that the expected benefits of a NZPC are likely to significantly exceed the expected costs, but this conclusion is subject to implementation and design risks. The benefits are associated with an independent source of advice to the government on ways to improve New Zealand's productivity performance,

generated by a specialist body that develops its advice through transparent, community-wide processes.

The context for assessing the benefits of a NZPC is of particular importance. New Zealand needs to significantly improve its productivity performance to underpin economic performance and national prosperity. This requires our productivity performance to be placed on a new trajectory, and to do this we need to be open to ideas that challenge the status quo. These ideas need to be supported by evidence-based analysis that is credible to external stakeholders, often on different sides of a policy issue.

Given that a number of departments, including Treasury, MED and DOL, provide policy advice on productivity, what is the constraint on delivering evidence-based analysis and advice? The reality is that departments are not unfettered in the preparation and delivery of policy advice. They are influenced by Ministerial preferences and government policy frameworks, and in some cases the immediate demands of the day crowd out or limit the effort they might otherwise make into forward looking evidence-based analysis. An agency that goes too far beyond what is acceptable to the government of the day would soon lose its relevance, but one that pushes the boundaries beyond what is generally possible with departments would be an asset.

What New Zealand lacks, relative to Australia, is an independent 'centre of analytical excellence' in public and private sector productivity that has the defined role of testing the boundaries of current thinking through both analysis and engagement with the community.

Risks

There are risks to establishing an NZPC. These can be broadly categorised as independence, relevance, capability and hollowing out. Each of these is discussed in turn.

Independence has been identified as a critical attribute of a NZPC. A report on the 30 years of the APC notes that independence '... depends not only on statutory form, but also on custom and use, and adequate funding'. The legal form we propose is an Independent Crown Entity (ICE). This means that the Commissioners would be appointed by the Governor General and have security of tenure. The Minister may not direct the agency to give effect to government policy. The SSC's view is that if the NZPC was a Crown Entity an ICE would seem appropriate.

The risk of an agency that is arms length from the government of the day is that it produces reports that diminish its relevance, if they promote ideas that go well beyond what is acceptable to the government. To a large extent this risk is managed by making good appointments at the Commissioner level, and the Commission in turn making good staff appointments. Further, under the model that is proposed (consistent with the APC and VCEC) the NZPC would only undertake inquiries and reviews that were commissioned by the government and reflected in a detailed terms of reference.

Capability is dependent on good appointments and adequate resourcing. Importantly in the context of establishing a NZPC is the ability to leverage off the embodied knowledge and established systems of the APC (including systems for peer review). Rather than having to start from scratch, the support that the APC is prepared to offer will enable a NZPC to hit the ground running. There is also a direct relationship between the level of funding and the capability of the agency. This must be a high performing organisation and performance is people dependent. The agency must have the ability to attract and retain top people.

Linked to capability is the risk of hollowing out, with the NZPC attracting the best micro-economists from the rest of the public service. While we can expect that there will be some

movement of departmental staff to the NZPC, we anticipate that the catchment for a PC would be broader than the public service, as independent agencies of this type attract competent analysts who would not otherwise want to be public servants. In addition, we anticipate that departmental staff will be seconded to the NZPC to join inquiry teams, in addition to permanent staff, and this will be seen as an important career development opportunity by the home department.

Other Relevant Information

Administrative support for NZPC

We have considered four options for configuring support for a NZPC:

Option 1: A stand-alone agency (analogy – Commerce Commission, Law Commission);

Option 2: Co-located with the Treasury and shared services;

Option 3: Co-located with another agency and shared service;

Option 4: The Commission contracting the Treasury to provide the resources (staff and administrative) to support the performance of the NZPC's functions (this is the model operated in Victoria with the VCEC).

Relative to option 1, a shared services model would produce annual savings in the order of \$210,000. Co-location with Treasury would make it easier for the Treasury to provide support 'in kind', such as floor space.

Option 4 is the most challenging. It would be consistent with the government's objective to reduce proliferation of government agencies and reduce the risk of hollowing out, but may be perceived as reducing the NZPC's independence. This issue has been recognised in the VCEC arrangement with the Victorian Treasury (DTF), and this arrangement is underlined by a Framework Agreement between the two agencies. In the introduction to the Agreement the underlying principle is set out:

The underlying principle of this Framework Agreement is that the analysis, advice and other work of the VCEC and VCEC Secretariat is clearly independent of the DTF. On administrative matters, the VCEC Secretariat is supported like all other outputs in DTF.

On balance, our preference is for option 2 (co-location with the Treasury and shared services), as we consider that option 4 may be perceived to reduce the NZPC's independence, even if it does not do so in fact (option 2 also carries this risk, but to a lesser extent). However, option 4 could be made to work, if proliferation concerns were a determining factor. We will report further on these options.

Funding

A preliminary budget for a NZPC is provided below. This assumes that the required legislation will be passed by the end of calendar year 2010, and the NZPC commences two inquiries prior to the election, but reporting post-election.

	2010/11	2011/12	2012/13	2012/14
Establishment Unit (in Tsy)	At Treasury's cost			
Establishment costs*	1.57 million			
2 inquiries/reviews/yr		4.40 million		
3 inquiries/reviews/yr			4.86 million	4.95 million

* Would also require a capital injection of \$0.5 million

We assume that there is no new money for the agency, and hence it will need to be funding through a reallocation from existing votes. There is justification for this:

- There will be some substitution for what policy departments (including Treasury, MED, DoL) either do themselves, or contract out to specialist agencies;
- As a centre of excellence on productivity-related matters the NZPC may provide an opportunity to consolidate 'like' functions carried out in more than one department, and thus reduce fragmentation; and
- The NZPC also opens up the possibility that some existing expenditure on policy advice could be better spent on PC analysis rather than departmental analysis.

However, the episodic nature of departmental reviews that could be undertaken by a NZPC means that it is not easy to look into a department (or in some cases multiple departments as sometimes more than one agency contributes to a review) and identify direct substitutes for a future NZPC work programme. Effectively what this requires is anticipating what a department might otherwise do in 2011/12 or 2012/13, and this is not easy to do.

In light of this we are of the view that selected departments should be asked to identify savings that could be relocated to a NZPC, having regard to the value of such an agency and the future role that it could play in delivering evidence-based analysis and advice aimed at materially improving New Zealand's productivity performance. Treasury has already commenced this process.

While some two thirds of the NZPC costs will need to be funded directly, there may be opportunities for departments to also contribute 'in kind', through seconding staff to specific inquiries and reviews.