

Treasury Report: New Zealand Productivity Commission Initial Inquiry
Terms of References: Draft Cabinet Paper for Ministerial Consultation

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| Date: | 3 March 2011 | Report No: | T2011/317 |
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Action Sought

| | Action Sought | Deadline |
|---|--|-----------------|
| Minister of Finance (Hon Bill English) | Review the enclosed draft cabinet paper, consult with relevant Ministers, and provide any feedback to Treasury. | 8 March 2011 |
| Associate Minister of Finance (Hon Simon Power) | Note the contents of this report | 8 March 2011 |
| Associate Minister of Finance (Hon Steven Joyce) | Note the contents of this report | 8 March 2011 |

Contact for Telephone Discussion (if required)

| Name | Position | Telephone | 1st Contact |
|----------------------------|---|----------------------------|--------------------|
| [Withheld under s.9(2)(a)] | | | |
| James Beard | Manager, Economic Overview & Coordination | [Withheld under s.9(2)(a)] | |

Minister of Finance's Office Actions (if required)

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| Consult with other relevant Ministers' offices about the enclosed draft cabinet paper |
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Enclosure: Yes

Treasury Report: New Zealand Productivity Commission Initial Inquiry
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Ministerial Consultation

Executive Summary

We have enclosed for your review, and for Ministerial consultation, a draft cabinet paper seeking approval of terms of references for two initial inquiries for the New Zealand Productivity Commission ("the Commission"). The paper is scheduled to be considered by the Economic Growth and Infrastructure Cabinet Committee on 16 March 2011.

The two inquiry topics are (i) "housing affordability", and (ii) "international freight transport services", which were your preferred topics. You discussed draft terms of references on these topics with the Prime Minister, the Ministers of Commerce, Transport and Housing, and with the Minister for Regulatory Reform. The draft terms of references have been subsequently refined in consultation with portfolio departments, and feedback from the Minister of Transport has also been incorporated into the terms of reference for the international freight transport services inquiry.

The Chair of the Commission, Murray Sherwin, has indicated that he is comfortable with the terms of references as currently drafted. However, in his view, the scope of the inquiry into international freight transport services could be usefully extended to include trade in services. The current scope is restricted to the freight of goods.

Our view is that including trade in services would overly extend the scope of the inquiry and would reduce the feasible depth of analysis and/or stretch the Commission in its first year of operation. We therefore recommend that the scope of inquiry is not broadened to incorporate trade in services, which could be considered as a potential future inquiry topic.

Recommended Action

We recommend that you:

- a **note** the draft cabinet paper enclosed for your review and for Ministerial consultation.
- b **provide** the Treasury with any feedback on the draft cabinet paper by 8 March 2011.

Agree/disagree.

James Beard
**Manager, Economic Performance Overview & Coordination
for Secretary to the Treasury**

Hon Bill English
Minister of Finance

Chair

CABINET ECONOMIC GROWTH AND INFRASTRUCTURE COMMITTEE

NEW ZEALAND PRODUCTIVITY COMMISSION INITIAL INQUIRY TERMS OF REFERENCES

Proposal

1. This paper seeks Cabinet approval to terms of references for initial New Zealand Productivity Commission ("the Commission") inquiries into housing affordability and international freight transport services.

Background

2. The New Zealand Productivity Commission was established by the New Zealand Productivity Commission Act 2010 ("the Act"). The Minister of Finance has been authorised by the Prime Minister to be the Minister responsible for the administration of the Act ("the responsible Minister").
3. The establishment process is proceeding according to plan, with the Commission set to be operational from 1 April 2011. Murray Sherwin has been appointed and publicly announced as the Chair of the Commission, and Commissioner and senior staff appointments are progressing well. It is expected that the Commission will operate at 25% capacity from 1 April 2011, 75% from 1 July 2011 and 100% from 1 January 2012.
4. The Commission's functions are to:
 - (a) hold inquiries into and report on productivity-related matters, on referral by the responsible Minister in conjunction with relevant portfolio Ministers (collectively, the referring Ministers); and
 - (b) undertake and publish research about productivity-related matters and promote public understanding of productivity-related matters.

This paper seeks Cabinet approval to terms of references for inquiry topics as noted in point (a).

Comment

5. Both Ministers and leaders of other political parties were consulted late in 2010 in order to identify potential initial topics of inquiry for the Commission. A range of potential inquiry topics were put forward.

6. Of these potential inquiry topics, housing affordability and international freight transport services are recommended for approval as the two initial inquiry topics for the Commission. Both of these inquiry topics are expected to:
 - be highly feasible and able to be completed within the Commission's first 18 months of operation;
 - be relatively uncontroversial (which is important given the desire to establish broad political support for the Commission);
 - utilize the Commission's unique position as an independent agency with high quality analytical ability and community engagement processes;
 - support the establishment of the Commission by developing its capability, capacity and reputation; and
 - have the potential to improve productivity and support the overall well-being of New Zealanders.
7. Terms of references for the two initial inquiry topics on housing affordability and international freight transport services are contained in Appendix One and Appendix Two respectively, for Cabinet approval. The terms of references have been deliberately drafted to provide the Commission with a high degree of flexibility to investigate key issues as and where they are identified during the inquiry. The paragraphs below provide a brief summary of the scope and context for the two inquiry topics.
8. *Housing Affordability:* Issues relating to housing affordability have been widely linked with New Zealand's productivity performance given its relationship with both the productivity of the housing industry and household debt accumulation. With respect to the latter, sharp rises in household debt arguably led to higher interest and exchange rates during the last economic upturn, with negative effects on the cost of capital and New Zealand's international competitiveness. The rise in house prices and household debt is also generally considered to have contributed to New Zealand's current macroeconomic vulnerabilities. Given these issues, it is proposed that the Commission evaluate the factors influencing the affordability of housing (both rental and owner-occupied housing), and to examine potential opportunities to increase housing affordability.
9. *International Freight Transport Services:* Given New Zealand's small size and distance from markets, increasing international trade is a critical part of achieving productivity growth. Freight transport costs represent a sizeable proportion of international trading costs for New Zealand firms, and it is therefore important to ensure that infrastructure and regulatory regimes are effective in promoting efficient international freight transport services. It is proposed that the Commission evaluate the factors influencing the accessibility and efficiency of international freight transport services available to New Zealand firms, and opportunities to increase the accessibility and efficiency of these services.
10. In addition to outlining the scope of each inquiry, the terms of references require the Commission to consult with key interest groups and affected parties, and to publish a draft report and/or discussion papers. As part of the consultation process, it can be expected that the Commission will take account of other relevant Government work streams. For example the Commerce Commission is separately required to report to Ministers in or after 2012 on aspects of the

regulatory regime for specified international airports, which may be relevant to the inquiry on international freight transport services.

11. The terms of references require final reports on the housing affordability and international freight transport services inquiries to be submitted to each of the referring Ministers by 1 February 2012 and 1 April 2012 respectively. The Act requires that copies of final reports be presented by the responsible Minister to the House of Representatives as soon as practicable after they have been received from the Commission. The Commission is then subsequently required make the final report publicly available.
12. Following Cabinet approval, the terms of reference for the inquiry into housing affordability will be provided to the Commission by the Minister of Finance by 1 April 2011, and terms of reference for the inquiry into international freight transport services by 1 July 2011. The Act requires the Commission to make the terms of reference for each inquiry publicly available as soon as practicable following receipt.
13. The staggered timing of the inquiries is intended to be consistent with the buildup in operating capacity of the Commission from 1 April 2011, as noted in paragraph 3. Once fully established, it is anticipated that the Commission will have capacity to undertake two different inquiries at any one time, with a typical inquiry duration of 9 months.

Consultation

14. The Ministry of Economic Development, the Ministry of Transport, the Ministry for the Environment, the Department of Building and Housing and the Housing Corporation of New Zealand were consulted during the development of the terms of references appended to this paper.
15. Given the Commission is yet to be established, consultation about the terms of references was undertaken with the Commission's Chair, Murray Sherwin, in order to fulfill the consultation requirements required by the Act. Informal comments were also received from the Australian Productivity Commission.

Financial Implications

16. There are no fiscal implications arising from the recommendations in this paper.

Human Rights

17. This paper has no human rights implications.

Legislative Implications

18. This paper has no immediate legislative implications.

Regulatory Impact Analysis

19. A regulatory impact analysis is not required.

Publicity

20. In accordance with the New Zealand Productivity Commission Act 2010, the terms of references will be made publicly available by the Commission as soon as practicable after the Commission receives them.

Recommendations

21. The Minister of Finance recommends that the Committee:
 1. **note** the Prime Minister has authorized the Minister of Finance to be responsible for the administration of the New Zealand Productivity Act 2010 ("the Act");
 2. **note** the New Zealand Productivity Commission ('the Commission') will be operational from 1 April 2011;
 3. **approve** the terms of reference attached as Appendix One for a Commission inquiry into housing affordability;
 4. **approve** the terms of reference attached as Appendix Two for a Commission inquiry into international freight transport services;
 5. **note** that both the aforementioned inquiry terms of references require the Commission to:
 - 5.1 consult with key interest groups and affected parties;
 - 5.2 publish a draft report and/or discussion papers; and
 - 5.3 submit a final report to referring Ministers by 1 February 2012 on the inquiry into housing affordability, and by 1 April 2012 on the inquiry into international freight transport services;
 6. **note** that the Act requires the responsible Minister to present a copy of final reports to the House of Representatives as soon as practicable after receipt from the Commission, and requires the Commission to make the final report publicly available thereafter;
 7. **note** the Minister of Finance will provide the Commission with the terms of references, if approved by Cabinet, and the terms of references will be subsequently made public by the Commission.

Hon Bill English
Minister of Finance
Date

Appendix One – New Zealand Productivity Commission Inquiry into Housing Affordability

Issued by the Minister of Finance, the Minister for the Environment, the Minister of Housing, the Minister for Building and Construction, and the Minister for Regulatory Reform ('the referring Ministers').

Pursuant to sections 9 and 11 of the New Zealand Productivity Commission Act 2010, we hereby request that the New Zealand Productivity Commission ("the Commission") undertake an inquiry into housing affordability.

Context

Stability of the home environment is widely considered to be important for social cohesion and family stability. Real house prices in New Zealand are markedly higher than they were a decade ago. The rise in real house prices has been associated with general declines in housing affordability, as indicated by a number of different measures, and in the rate of home ownership. These declines have contributed to increased demand for rental accommodation and additional pressure on the social housing sector. The debt accumulation and wealth effects associated with the rise in house prices may have also exacerbated New Zealand's last economic cycle. Interest rates and exchange rates were arguably higher than they otherwise would have been during the upturn and there has been greater contraction in demand during the recession. Debt accumulation may also be a factor in on-going economic risks.

Scope

Having regard to the context outlined above, the Commission is requested to undertake an inquiry to evaluate the factors influencing the affordability of housing (both rental and owner-occupied housing), and to examine potential opportunities to increase housing affordability. For the purposes of this evaluation the Commission should:

- Identify and analyse all components of the cost and price of housing;
- Identify mechanisms to improve the affordability of housing, with respect to both the demand and supply of housing and associated infrastructure;
- Identify any significant impediments to home ownership, and assess the feasibility and implications of reducing or removing such impediments.

Particular attention should be given, without limitation, to the following matters:

- (a) factors influencing the supply of land and basic infrastructure for residential construction;
- (b) factors influencing the cost of residential construction, including the effect of standards, specifications, approval and title requirements on the cost of new housing construction;
- (c) the level and growth of productivity in the land development and residential construction industries, and the effect of government regulations on productivity in these industries;

- (d) the efficiency of taxes, levies and charges imposed at all stages of the housing supply chain;
- (e) the efficiency of the tax treatment of owner-occupied and rental housing;
- (f) the influence of changing consumer housing preferences, willingness to pay, and financing costs on housing affordability; and
- (g) the operation of the overall housing market, with specific reference to the availability of a range of public and private housing types, the demand for housing, and the efficiency of use of the existing residential housing stock.

Consultation Requirements

In undertaking this review, the Commission should consult with key interest groups and affected parties.

Timeframe

The Commission must publish a draft report and/or discussion paper(s) on the inquiry for public comment, followed by a final report, which must be submitted to each of the referring Ministers by 1 February 2012.

BILL ENGLISH, MINISTER OF FINANCE
NICK SMITH, MINISTER FOR THE ENVIRONMENT
PHIL HEATLEY, MINISTER OF HOUSING
MAURICE WILLIAMSON, MINISTER FOR BUILDING AND CONSTRUCTION
RODNEY HIDE, MINISTER FOR REGULATORY REFORM

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Appendix Two – New Zealand Productivity Commission Inquiry into International Freight Transport Services

Issued by the Minister of Finance, the Minister of Commerce, the Minister of Transport, and the Minister for Regulatory Reform ('the referring Ministers').

Pursuant to sections 9 and 11 of the New Zealand Productivity Commission Act 2010, we hereby request that the New Zealand Productivity Commission ("the Commission") undertake an inquiry into international freight transport services.

Context

Increasing international trade is a critical part of achieving productivity growth in New Zealand. Given that freight transport costs (including port charges) currently represent a sizeable proportion of international trading costs for New Zealand firms, it is important to ensure that New Zealand's infrastructure and regulatory regimes are effective in promoting accessibility and efficiency in international freight transport services, while continuing to meet New Zealand's international obligations. Currently, certain aspects of international carriage by air and sea are exempted from parts of the Commerce Act 1986 and subject to industry specific regimes under Part IX of the Civil Aviation Act 1990 and Part 1 of the Shipping Act 1987 respectively.

Scope

Having regard to the context outlined above, the referring Ministers request that the Commission undertake an inquiry to evaluate the factors influencing the accessibility and efficiency of international freight transport services available to New Zealand firms, and opportunities to increase the accessibility and efficiency of these services. For the purposes of this evaluation the Commission should:

- Identify and analyse the cost of all components of the international freight transport supply chain for New Zealand importers and exporters;
- Identify any impediments to the accessibility of the international freight transport services, and to competition within and between the components of the international freight transport supply chain;
- Identify mechanisms available to improve the accessibility and efficiency of the international transport supply chain.

Particular attention should be given, without limitation, to the following matters:

- (a) the nature of New Zealand's international trade, including the effects of distance from overseas markets and reliance on overseas providers of international freight transport services;
- (b) factors influencing the accessibility, cost and efficiency of New Zealand's international freight transport supply chain, with international comparisons;
- (c) the level and growth of productivity in all components of New Zealand's international freight transport supply chain, with international comparisons;

- (d) the effectiveness of current regulatory regimes (including those noted above in the Civil Aviation Act 1990 and the Shipping Act 1987) affecting international freight transport services in promoting accessibility and competition, and the potential costs and benefits of alternative regulatory arrangements with international comparisons.

Consultation Requirements

In undertaking this review, the Commission should consult with key interest groups and affected parties

Timeframe

The Commission must publish a draft report and/or discussion paper(s) on the inquiry for public comment, followed by a final report, which must be submitted to each of the referring Ministers by 1 April 2012.

BILL ENGLISH, MINISTER OF FINANCE
SIMON POWER, MINISTER OF COMMERCE
STEVEN JOYCE, MINISTER OF TRANSPORT
RODNEY HIDE, MINISTER FOR REGULATORY REFORM

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