

Regulatory Impact Statement

Title of Proposal

Establishment of New Zealand Productivity Commission

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by the Treasury.

It provides an analysis of options to establish an independent source of advice to the government on productivity-related issues in both the public and private sectors.

The need for the government to receive advice on productivity-related matters is not questioned. The question is whether one source of that advice should be a new agency that is statutorily independent. The RIS addresses this critical question, while at the same time summarising the overall costs and benefits of a new agency.

The design and analysis of the preferred option has also been significantly influenced by the design and performance of the Australian Productivity Commission (APC), and Victorian Competition and Efficiency Commission (VCEC) which was in turn modelled on the APC. The APC is regarded as best-practice internationally and provides an appropriate benchmark for a New Zealand agency.

The decision to establish a Productivity Commission is one that requires judgment, as many of the benefits and costs are not quantifiable. The full analysis, of which this document provides a summary, will be made publicly available.

Peter Mumford, Principal Advisor, The Treasury

Status quo and problem definition

Currently the Government seeks advice on productivity-related matters from Government departments and, from time to time taskforces, commissions of inquiry and international organisations such as the OECD. These sources of advice are in turn informed by expert bodies, including consultants and academic institutions. Free and frank advice from Government departments, and contestable advice generally, is seen by many to contribute to good quality policy outcomes.

Notwithstanding these sources of advice, analysis by Treasury and the Ministry of Economic Development has concluded that current institutional arrangements leave a gap for a new and independent 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 of regulatory regimes. On the basis of this conclusion Cabinet agreed that officials undertake the detailed design, analysis and costing of a possible agency to carry such inquiries and reviews.

The case for such an agency is made in the context of New Zealand's current economic challenges. These include: regulatory settings that are believed to be constraining investment and limiting productivity growth; R&D expenditure that is below the OECD average; future limits on resource use in relation to freshwater supply, marine space, fisheries, and the assimilative capacity of the atmosphere, soil, waterways and groundwater; relative low rates of participation in education and training amongst some population groups (eg, some age groups, socioeconomic groups, and Māori and Pacific Island peoples); inadequate infrastructure in some areas, and; low domestic savings and shallow equity and bond markets.

New Zealand needs to significantly improve its economic performance through addressing constraints and exploiting opportunities. The economic measure of performance is productivity, directed to the overall well-being of New Zealanders. Given the complex challenges facing New Zealand the government must have access to a wide range of new ideas that potentially challenge the status quo. These ideas need to be supported by widely consulted and evidence-based analysis that is credible to both the government and external stakeholders, often on different sides of a policy issue. MMP has increased the complexity of the decision-making environment in this regard.

While Government departments provide productivity-related policy advice, in reality they are not unfettered in the preparation and delivery of such 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 policy. In effect, departments cannot be expected to consistently act as independently as an agency that is given statutory independence.

A plausible alternative to government departments is *ad hoc* bodies such as taskforces. While such bodies have their place, their temporary nature makes it harder for them to support the accumulation of knowledge over time. In addition, they are less likely to have at their foundation a methodology that (a) is capable of replication, thus reducing the costs of having to develop a new methodology each time an inquiry or review is required (b) has been accepted by the government, departments and external stakeholders as producing high quality analysis, and (c) provides the focus of building and maintaining analytical capability.

Objectives

The desired Government outcome is an alternative source of credible policy advice on opportunities to improve significantly New Zealand's productivity performance that are highly complex and potentially controversial (there is a diversity of views and interests on the issue held by influential stakeholders). The new body should improve the net quality of advice available to decision-makers.

The agency that provides such advice needs to be persuasive, and this is associated with independence, relevance to the government's policy agenda, and competence. These criteria reflect the Australian objectives and experience with the APC and VCEC.

Regulatory impact analysis

Options

Having regard to the problem definition which is associated with constraints on the main alternative sources of advice, government departments and *ad hoc* bodies, a single option has been analysed, but there are alternative ways in which that option can be configured.

The option is an independent agency which has as its purpose the improvement of productivity in both the public and private sectors in a way that is directed at supporting the overall well-being of New Zealanders.

The scope of the agency will include, but will not be limited to: enterprise (tax, regulation and competition), skills, innovation, infrastructure, natural resources, investment, international connectedness, and public sector productivity.

The functions of the agency will be to:

Primary

- Hold inquiries into, and report to the Minister about, productivity related matters that are referred to it by the Minister (there would be provision for joint work with the APC into productivity related matters);
- Conduct *ex post* reviews of regulatory regimes;
- Conduct one-off reviews of the efficiency and effectiveness of regulatory agencies; and
- Undertake *ex ante* regulatory impact analysis (RIA) for specific regulatory proposals.

Secondary

- Undertake and publish its own research into productivity-related matters to build its institutional knowledge and, as such, support its inquiry and reviews functions; and
- Promote public understanding of matters relating to productivity.

The agency would be headed by 3-4 part-time Commissioners, one of whom would be Chair, and there is also provision to appoint Associate Commissioners. The Commission would be supported by a staff of approximately 21 FTEs. This equates to an annual budget of about \$5 million.

The government would determine the work programme for the agency, and it would only undertake inquiries, reviews and RIA on the basis of a reference from the government. The work programme would be made public, as would the terms of reference. The responsible Minister would be required to table agency reports pursuant to inquiries and reviews, but there would not be an obligation on the government to respond.

The agency would be an Independent Crown Entity (ICE). There a number of ways in which support for the agency can be configured. Because different configurations have implications for perceived independence, and independence has been identified as a key criterion, the options and analysis have been included in the RIS.

Analysis

The evidence that an independent, relevant and competent agency with the purpose and functions described above, will provide an alternative source of credible policy advice on opportunities to significantly improve New Zealand's productivity performance comes from both the Australian experience with the APC and VCEC, and domestic consultation.

Both the APC and VCEC assess their performance by reference to the number of recommendations they make that are accepted by the Federal and State Governments. These show that many recommendations are accepted. However, this is not the only assessment criteria that the APC and VCEC apply. They also judge their success on the basis of whether their contribution to the debate on complex and controversial issues has contributed to the quality of the debate, even if their recommendations are not accepted.

A dimension to this is whether they generate repeat business from the Governments i.e. if the governments continue to give them complex and controversial inquiries this indicates that they are valued as avenues for having such issues analysed and debated. On both the reputational and repeat business measures the APC and VCEC illustrate positive performance.

As documented in the full analysis, there is evidence of the potential value of an analogous organisation in New Zealand in the form of statements of latent demand by New Zealand decision-makers and by those who understand the policy-making process in New Zealand.

While consultation both in Australia and domestically confirmed the normative proposition that there is a gap for an agency of the type that exists in Australia and proposed for New Zealand, the risks were also highlighted. The remainder of this analysis identifies the risks and how the design and implementation of the agency is planned to manage them.

The risk to independence: Independence is seen as critical, and this includes perceived independence. Establishing the agency as an ICE is intended to secure the independence of the agency. This gives Commissioners security of tenure (the threshold for removal is very high) and the Minister is not able to direct the entity to have regard to or give effect to government policy. Requiring public inquiries, and publishing both the terms of reference and final reports (the APC is also required to publish draft reports) is intended to contribute to transparency. The appointment of Commissioners who have a high level of credibility is a key implementation strategy.

In relation to perceived independence, the way support is configured may have an influence.

| Option | Sub-options | Costs and benefits |
|--|---------------------------------|---|
| Stand-alone agency | | Benefits: seen to be a fully independent agency. Costs: because of size and novelty may not be seen as an attractive place to work. |
| Shared services | Treasury | Benefits: cost savings in the order of \$200,000. |
| | Other policy agency | Costs: low risk that agency will be seen to be influenced by thinking of agency with whom it shares services, if a policy agency. |
| | Non-policy agency | |
| Shared services and co-location | Treasury or other policy agency | Benefits: co-location may contribute to capability through facilitating 'communities of interest' between analysts. Costs: low-medium risk that agency will be seen to be influenced by thinking of policy agency. |
| | Non-policy agency | Benefits and costs – nil (beyond sharing services) |
| Shared services, co-location and staff employed by host agency | Treasury or other policy agency | Benefits: large host agency may make the NZPC a more attractive employer. Co-location may contribute to capability through facilitating 'communities of interest' between analysts. Contributes to the government's objective of reducing proliferation of public sector bodies. Costs: medium-high risk that agency will be seen to be influenced by thinking of policy agency. Risk drops to medium if the NZPC is not co-located. |
| Independent function within an existing agency | Treasury or other policy agency | Benefits: as for previous option. Costs: high risk that agency will be perceived be influenced by thinking of policy agency. |

Risk to relevance: If the analysis undertaken by the agency is not considered by the government to be relevant then the agency will not be effective, or seen to be effective, by either the government or stakeholders. Requiring the agency to undertake inquiries only by way of reference from the government, and terms of reference which highlight the government's particular questions, is intended to ensure that agency only does what the government values.

Commissioners will need to exercise a critical judgement when making recommendations on how far to push a policy approach. The Australian commentators noted that the agency should avoid being seen as 'ideological'. While the NZPC would be able to undertake its own research and promote public understanding of productivity-related matters, it could not do this in a manner that is inconsistent with the principle that the government directs the Commission on what policy work it should undertake.

Risk to competence: The agency must have critical mass and the correct skill sets critical for competence. The size of the proposed agency has been benchmarked against the VCEC as a comparable body that has achieved critical mass. The agency will need to attract and retain competent staff. The Commission will need to be funded to offer competitive salaries. It is also expected that there will be a high level of cooperation between the agency and the APC, and the agency will leverage off the APC's knowledge and experience, as well as engaging in joint work.

Consultation

Discussions were held with a small number of New Zealand senior public servants, current and past politicians and informed commentators from consultancies and academia. Discussions were also held with the APC, VCEC and Australian Treasury.

The purpose of the domestic consultation was not intended to represent a comprehensive survey of all of those who have knowledge of, or interest in, the issue, but rather to test key propositions in relation to the problem definition, benefits and risks that were identified through the Australian experience. The consultation confirmed the Australian experience, and it was judged that further consultation in New Zealand would quickly reach diminishing returns.

Conclusions and recommendations

The analysis that has been undertaken concludes that the expected benefits of a NZPC are likely to significantly exceed the expected costs. 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 rigorous, transparent, community-wide processes. This conclusion is subject to implementation and design risks associated with perceived independence, relevance and competence. Strategies have been developed to manage these risks and these have been reflected in the design.

Implementation

The agency would be established by statute. An implementation unit would be established and would have responsibility for putting in place the physical infrastructure and administrative arrangements, and running the appointments process.

Monitoring, evaluation and review

The agency will be subject to ongoing monitoring by the Treasury.

A five year review of the agency is proposed.