



29 March 2018

Hon Grant Robertson  
Minister of Finance  
By email: [REDACTED]

Dear Minister,

## Triannual Report – 1 November 2017 to 28 February 2018

I am pleased to submit the Commission's second triannual report for the 2017/18 year. While intended to cover the reporting period 1 November 2017 to 28 February 2018, this report also comments on matters outside of the reporting timeframe where relevant.

Work is progressing on the two inquiries initiated earlier in 2017: *State sector productivity* (measuring and improving state sector productivity) and *Low emissions economy* (transitioning to a low emissions economy). The Commission published the draft report for *State Sector productivity* on 14 December 2017. Submissions are currently being received and the team are on schedule to release the final report in August 2018.

The *Low emissions economy* inquiry has generated a very high level of interest, with numerous high-quality submissions and an equally high demand for engagement meetings. The draft report will be published on 27 April 2018. Conducting a comprehensive engagement process has, however, created time pressures. In addition, critical modelling work required to support the report is only now being completed. We are determined to deliver a high-quality and timely piece of analysis and have allocated additional resource to assist the inquiry, but we now anticipate delivering the final report in late August 2018, rather than the scheduled end June date.

The Commission's research outside of our inquiries continues with the recent publication of papers on estimating quality-adjusted productivity in tertiary education, innovation, residential construction and population growth, and the ability of New Zealand firms to learn from their external environment.

Our 2018 Productivity Conference on Technological Change and Productivity brought together delegates across the country to hear from international and local experts. The conference included sessions on state sector productivity and on policies for an efficient transition to a lower emissions economy, as well as sessions about the productivity narrative, innovation and diffusion.

Overall the Commission tracked \$37k under budget for the reporting period.

We look forward to working on new topics in 2018/19.

Yours sincerely

**Murray Sherwin**  
Chair

# Triannual Report: 1 November 2017 to 28 February 2018

## Report structure

- Operational delivery
- Financial performance
- Capability
- Priorities and issues ahead

## Operational delivery

This table is a high-level summary of our operational delivery. Green indicates progress according to schedule; orange indicates delays or other issues.

	Status	Comment
Inquiries		<p>The Commission published a draft report for the <b>State sector productivity</b> inquiry on 14 December 2017.</p> <p>The Commission also published the <b>Low emissions economy</b> issues paper on 9 August 2017.</p>
Research		<p>The Commission research outside of our inquiries continues with the recent publication of papers on estimating quality-adjusted productivity in tertiary education, innovation, residential construction and population growth, and the ability of New Zealand firms to learn from their external environment.</p> <p>The Commission's work on spatial economics (regional development) is proceeding and enhancing our understanding of the growth process across New Zealand cities. The aim of this work is to build an evidence base for regional development policy.</p> <p>Through the Productivity Hub, the Commission is also doing some work on competition and we will be making a submission to the Tax Working Group in April.</p>
Promoting understanding		<p>The Commission continues to promote understanding of productivity related matters. In February, the Commission held the 2018 Productivity Conference on Technological Change and Productivity. Speakers included the Minister of Finance, Hon Grant Robertson MP, and five international experts: Dr Dirk Pilat, Professor Filippo di Mauro, Dr Abrie Swanepoel, Professor Patrick Dunleavy, and Professor Geoffrey Heal as well as local speakers: Donna Purdue, Liz MacPherson, Ross Young, Judy Kavanagh, Dr Suzi Kerr, Paul Conway and Murray Sherwin. The conference included sessions on state sector productivity and on policies for an efficient transition to a lower emissions economy, as well as sessions about the productivity narrative, innovation and diffusion. <a href="#">See here for the programme and presentations.</a></p>

## Inquiry: *Measuring and improving state sector productivity*

	Status	Comment
Right focus		<p>The terms of reference for the inquiry ask the Commission to undertake an inquiry into how the New Zealand state sector can effectively measure and improve productivity in core public services with a particular focus on health, education, justice and social support. The Commission has published a draft report which provides guidance on how to measure efficiency/productivity in public services, taking into consideration measurement issues and how imperfect measures are most appropriately and usefully employed. The Commission has endeavoured to provide examples of productivity measurement in all four sectors.</p> <p>From draft to final report, the Commission will undertake further work (as per the terms of reference) on providing advice on the appropriate role of efficiency/productivity measures in public sector performance frameworks and the capability and systems that are needed to better measure, understand and improve productivity.</p>
High-quality work		<p>The OECD notes the lack of measures to appropriately capture public sector productivity beyond the system of National Accounts, internationally. The work being undertaken by this inquiry is therefore pushing into uncharted territory. The quality of the work has been commended by Professor Patrick Dunleavy of the London School of Economics (one of the few scholars investigating how to measure the productivity of UK public services). Professor Dunleavy was a keynote speaker at the 2018 Productivity Conference on Technological Change and Productivity in February and he also spoke at a number of workshops organised by the Commission, including with groups of state sector leaders.</p>
Effective engagement		<p>Demonstrating how to measure state sector productivity will be neither enduring nor successful unless state sector agencies are engaged and along for the journey.</p> <p>The inquiry team has found it difficult to meaningfully engage with the Ministries of Health, Justice and Education and has relied on publicly available data to produce productivity measures.</p> <p>The team has, however, been able to work with the New Zealand Police and the Ministry of Social Development on measurement projects that use their existing administrative data and systems to answer productivity questions of interest to these agencies. The Commission also has an excellent working relationship with the District Health Board shared service agency (TAS) and with Primary Health Care Organisations around the measurement of health sector productivity. The Commission has found that there is scepticism about productivity measurement in Ministries but a real appetite for assistance and advice around measurement in operational departments and agencies.</p> <p>The relationship with central agencies - the Treasury and the State Services Commission is patchy despite ongoing engagement. Both</p>

		agencies are sceptical of the value of productivity measurement and concerned about any deviation from a focus on outcomes. The State Services Commission submission to the inquiry, for example, highlights SSC's concern about the risks and costs of productivity measurement. Some of the issues from this section will be resolved with greater clarity around the inquiry's key messages from draft to final.
Clear delivery of message		<p>The Commission will focus on clarifying the key messages around productivity measurement and improvement:</p> <ol style="list-style-type: none"> <li>1. Making it clear that both effectiveness in achieving outcomes and efficiency in delivering services are important – it's not just one or the other</li> <li>2. Productivity is but one dimension of performance, but it has been given scant attention in recent times</li> <li>3. The risks (and potential gaming) associated with productivity measurement depends entirely on how the measures are to be used – as a learning tool or to give account for performance</li> <li>4. There are risks of <i>not</i> focussing on productivity – wasting resources that could be deployed in providing more public services or deployed elsewhere</li> <li>5. There are risks around the sustainability of public services in the future and being able to meet citizens' needs and demands.</li> </ol>

### **Inquiry: Transitioning to a low emissions economy**

	Status	Comment
Right focus		<p>The new Minister has indicated no substantive modifications to our terms of reference and for us to continue our current inquiry process. A letter from the Minister to the Chair of the Productivity Commission has signalled the new Government's greater level of ambition for reducing GHG emissions.</p> <p>There has been a high level of engagement with a diverse group interested in climate change and mitigation policy. The Commission has completed over 120 engagement meetings and the inquiry team has participated in 15 conferences and seminars relating to climate change research and policy.</p>
High-quality work		<p>Chapters for the draft report are being prepared, ready to be published on 27 April 2018. These chapters are undergoing an extensive quality assurance process, being reviewed by the wider inquiry team, external experts, Maori partners, and Commissioners.</p> <p>The Commission has collaborated with <i>Motu Economic and Public Policy Research</i> to convene four half-day roundtables to bring together diverse experts from New Zealand and overseas to shed new light on particularly thorny questions for New Zealand's low-emission transition. Other</p>

		<p>partners include the Institute for Governance and Policy Studies at Victoria University of Wellington and the Environmental Defence Society. The final roundtable, which is open to a wider public audience, is scheduled for 13 April 2018.</p> <p>Two substantial consultancy projects have been commissioned, which will feed into the draft report. These are:</p> <ol style="list-style-type: none"> <li>1. <i>Towards a very low emissions electricity market</i> (Sapere, Wellington); and</li> <li>2. <i>Modelling the transition pathways to a low emissions economy</i> (Vivid Economics, London).</li> </ol> <p>Vivid Economics are based in London and are leading a consortium that includes Concept Consulting and Motu Economic and Public Policy Research. This consortium provides extensive experience in scenario analysis, and the modelling and analysis of climate policy which is vital to delivering on our terms of reference. Vivid led earlier work communicated by the Globe NZ Group. The Sapere report has been completed and the Vivid consortium report is due at the end of March 2018.</p> <p>The timings for this modelling, together with the high level of submissions and demand for engagement meetings has created time pressures. Additional resource has been allocated to assist the inquiry, but we anticipate a delay in delivering a comprehensive and high-quality final report from June to August 2018.</p>
Effective engagement		<p>There is a high level of engagement with a diverse group interested in climate change and mitigation policy. The high level of interest in the inquiry has seen many requests for meetings from interested parties, and those wishing to talk through their submission. Over 120 engagement meetings has been completed and requests continue to be received.</p> <p>The inquiry is liaising with representatives from the Climate Change Iwi Leadership Group and has sent material for review and feedback. Material has also been sent for review and feedback to Ngāi Tahu, who provided an excellent submission and are very keen to contribute to the draft report.</p> <p>The inquiry team meet regularly with the Ministry for the Environment Climate Change Transition Hub. The Transition Hub, made up of representatives from government agencies in the natural resources sector, provides the Government advice on transition pathways and advice to Cabinet on the range of cost and benefits of policies available for the Government to reduce emissions.</p>
Clear delivery of message		<p>This inquiry has a diverse audience with varied and deep interests. It is important that messages are clear and accessible. This involves careful drafting, with the receiving audience in mind. Use of illustrations and pictures are being used to convey complex information. Draft chapters are also being reviewed by a specialist external editor, as well as an internal editing and proofreading process to ensure clarity and accessibility. It is anticipated that an animation highlighting key findings and recommendations will be developed and used for the final report.</p>

## Previous inquiries

After each inquiry is completed, it is evaluated against a set of inquiry performance measures, using the following external sources of feedback:

- an independent expert review
- an independently facilitated stakeholder focus group
- a survey of inquiry participants.

Reviews have been completed for both the *Better urban planning* and *New models of tertiary education* inquiries, and are available on the Commission's website under each inquiry topic.

The Commission is still waiting for the Government's formal response to the *Better urban planning* inquiry. An earlier inquiry, *Boosting productivity in the services sector* (2014) is the only other report of the 10 produced to date without a formal response.

## Research

Work has been completed on residential construction and on the capacity of New Zealand firms to "absorb" knowledge and new technology from their external environment. The Commission's work on spatial productivity (regional development) and competition is proceeding.

### **Residential construction and population growth in New Zealand: 1996-2016**

Between 1996 and 2016 Auckland's population increased by 499,000, or by slightly more than the increase in the rest of New Zealand. Yet only half the number of building permits were issued in Auckland as in the rest of the country. To understand this difference, this paper uses regional data to investigate how population growth affects residential construction. It estimates that if Auckland had built houses at the same rate as the rest of the country (adjusted for population growth) it would have needed to have built an additional 40 – 55,000 dwellings during the period – and needed nearly 9000 more construction sector workers. The shortfall was modest until 2005, but sharply accelerated due to the cessation of apartment building in central Auckland. The results show the large increase in the average size of dwellings was not a major factor in Auckland's shortfall relative to the rest of the country as new dwellings were smaller in Auckland than elsewhere.

### **Absorptive Capacity in NZ Firms: measurement and importance**

This paper reports nationally representative results on the importance of 'absorptive capacity' across New Zealand firms. Absorptive capacity measures a firm's ability to internalise external knowledge. Using data from the New Zealand Business Operations Survey, we measure absorptive capacity across a 10-year period and investigate if it remains stable in the long term. This is followed by considering how firms' characteristics vary across levels of absorptive capacity and whether such capacity determines firms' productivity performance across the primary, manufacturing and service sectors. Results show that relative to other influences, absorptive capacity as measured here has a substantial influence on exporting, innovation, and undertaking R&D. Set against relatively poor performance, the paper concludes with a discussion of how government should consider helping firms to boost their levels of absorptive capacity.

### **Spatial productivity (Regional development)**

Our work on spatial productivity (regional development) is progressing and we will have a draft paper for discussion at the start of April. This paper will explore how and why patterns of industry employment change have differed across cities and outline industries that have managed growth in regional cities. By better understanding the process of growth and development across New Zealand's cities, we hope to use this work to build a strong evidence base for regional development policy.

## **The Productivity Hub**

The Productivity Hub is a cross-agency partnership of agencies which aims to improve how policy can contribute to the productivity performance of the New Zealand economy and the wellbeing of New Zealanders.

During the reporting period, the Hub's work on competition progressed. This work is aimed at building the data infrastructure necessary to measure competition in different parts of the economy and assess the impact of competition and market size on firm performance. This project will also update our firm-level productivity numbers, which are currently only available from 2000 to 2012.

The Productivity Hub continues to run a successful events programme. In February, the Commission held the 2018 Productivity Conference on Technological Change and Productivity, which was attended by more than 200 people. The conference covered a range of topics including: technological change and firm performance; the growing potential of data; improving the productivity of government services; financial and technological prerequisites for the energy transition and the future of work: adaptability, resilience and inclusion. A host of other events were also arranged around the conference with our international speakers and local experts.

## **Promoting understanding**

The Commission has been promoting understanding of productivity issues primarily through an extensive speaking and presentation programme to a wide range of audiences, across both our inquiry and non-inquiry work. Our work through the Productivity Hub also increases the profile and understanding of productivity issues. The Commission is working with other agencies to develop a consistent and accessible introduction to productivity and why it matters.

### **Speaking engagements**

The Commission's Chair (Murray Sherwin) was invited to speak at a variety of events during the last quarter including the opening address at the Wellington GEN Conference. A number of his presentations have related to urban planning and RMA reform issues building on the inquiries the Commission has now completed in that field.

## Financial performance

Overall the Commission tracked \$37k under budget for the reporting period. The first six months of the year tracked to budget. The Commission is forecasting a deficit of (\$18k) at end of the financial year, as it is anticipated that flexi-resources (i.e. consultancy, contracting, etc) will slightly over-spend as the work on the *Low emissions economy inquiry* is completed.

The tables below provide a summary of financial performance across the Commission, and in output areas, for the eight-month reporting period:

### All financial activity

Financial Performance (\$000's)	8 months to February 2018		2017/18 year
	Actual	Variance to budget	Forecast
Income	3,355	(5)	5,032
Expenditure	3,332	37	5,050
<b>Net surplus</b>	<b>23</b>	<b>32</b>	<b>(18)</b>
<b>Total equity</b>			

### Output cost breakdown

Output performance (000's)	Actual (8 months to end- February 18)	Variance to budget (8 months to end- February 18)	Allocation remaining (full year)
Inquiries	2,888	(-29)	1,522 (35%)
Research	443	66	187 (30%)

## Capability

Both inquiries are challenging and given the breadth and depth of the topics, the Commission has had to carefully balance in-house resource with external specialist resource.

We have had the benefit of the following secondments to assist with the inquiries:

- Sandra Moore, Principal Adviser with the Ministry of Social Development has been seconded to the state sector productivity team until its conclusion in August 2018.
- Chris Holland from the Ministry for the Environment worked with the low emissions economy team two days a week until March 2018.

Other additional resource for the inquiries:

- Teresa Weeks is working three-days a week on the low emissions economy inquiry. Teresa brings legal expertise to the inquiry and has worked on climate change issues in the United Kingdom.
- Paul Young is working with the low emissions inquiry team full-time until publication of the draft report. Paul brings specific pathways modelling experience and general expertise in a number of sectors in regard to understanding the emissions profile of these sectors and policies to reduce emissions (for example, forestry, transport and industrial heat processes).

- The Productivity Commission and the Chair in Public Finance at Victoria University of Wellington have jointly provided a scholarship for an undergraduate student (Huon Fraser) to undertake research on health sector productivity. His work contributes to the state sector productivity inquiry.
- Kennedy Graham, former MP and convener of the Globe NZ group, has been retained in an advisory and review role assisting our work on the *Low emissions economy* inquiry.

Two people have left the Commission: Sally Aitken, Communications Specialist, and Kevin Moar, Principal Inquiry Advisor. Both have moved on for career development reasons. We have appointed Louise Winspear as our new part-time Communications Specialist.

## Priorities and issues ahead

On the horizon for the next triannual period (March - June 2018) and beyond:

- The *Low emissions economy* draft report will be publicly released on 27 April 2018.
- A submission for the Tax Working Group will be published in April.
- The *State sector productivity and Low emissions economy* final report will be publicly released in August 2018.