

OC241242

19 November 2024

Tēnā koe

I refer to your email dated 21 October 2024, requesting the following under the Official Information Act 1982 (the Act):

*“Back in November 2013 NZIER completed a study for you titled “Construction Industry Study: implications for cost escalation and Road building maintenance and operation”*

- 1) *Please provide, either just as a response to this query, or as an OIA request, any documentation you hold regarding the briefing you provided for the study and what was the response or consequent action by your Ministry when you received it.*
- 2) *Please also advise if there was any follow-up action on the recommendations or if there has been any subsequent study or follow-up study which is more recent.*
- 3) *Please also provide any procurement policy advice you have provided for NZTA or local government since 2013 as a consequence of the study or other work.”*

#### Part 1: Documentation regarding the briefing and Ministry response

The Ministry of Transport (the Ministry) holds six documents that fall within the scope of part 1 of your request. These documents have been released to you and are detailed in the document schedule attached as **Annex 1**. Some information has been withheld from these documents under the following section of the Act:

9(2)(a) to protect the privacy of natural persons.

#### Part 2: Subsequent action or studies

Follow up actions taken on the recommendations of the NZIER study included:

- Ministry officials explored how an emphasis on moderating cost increases could be included in the Government Policy Statement on Land Transport 2015.
- The Minister of Transport wrote to the Chair of the New Zealand Transport Agency (NZTA) asking them to review the findings of the study and report back.
- Ministry officials were in contact with Ministry for the Environment counterparts to outline concerns raised that the Resource Management Act 2002 has constrained the supply of locally sourced inputs.

I can advise that in June 2017, EquiP, a branch of Local Government New Zealand, provided a report for the Ministry titled 'Further opportunities for cost savings in road maintenance and construction'. The report outlined factors that contributed to cost escalation in the maintenance and construction of state highways and local roads, identified opportunities for the Government Policy Statement on land transport 2018 to manage or influence costs to improve value for money, and proposed a monitoring and evaluation framework to measure long-term delivery of value for money.

Part 3: Procurement policy advice for NZTA or local government

The Ministry provided the findings of the NZIER study to relevant parties for their consideration and implementation, but did not provide its own procurement advice. I am therefore refusing this part of your request under the following section of the Act:

18(e) the document alleged to contain the information requested does not exist, or despite reasonable efforts to locate it, cannot be found.

Regarding the information that has been withheld under section 9 of the Act, I am satisfied that the reasons for withholding the information at this time are not outweighed by public interest considerations that would make it desirable to make the information available.

You have the right to seek an investigation and review of this response by the Ombudsman, in accordance with section 28(3) of the Act. The relevant details can be found on the Ombudsman's website ([www.ombudsman.parliament.nz](http://www.ombudsman.parliament.nz)).

The Ministry of Transport publishes Official Information Act responses, so the information contained in our reply to you may be published on our website. Before publishing we will remove any personal or identifiable information.

Nāku noa, nā

A handwritten signature in black ink, appearing to read 'Tim Herbert', written in a cursive style.

Tim Herbert  
**Manager, Investment**

## Annex 1: Document schedule

Document number	Document title	Decision on release
1	<b>OC01999</b> Construction industry performance – Update on research and proposed next steps	Released with some information withheld under s 9(2)(a) of the Act.
2	<b>OC01999_LTR00653</b> Letter to NZTA Board Chair – Construction industry performance report	Released in full.
3	<b>OC02205</b> Release of NZIER construction industry study	Released with some information withheld under s 9(2)(a) of the Act.
4	<b>OC02205_MR00333</b> Media release – Minister welcomes study on road construction costs	Released with some information withheld under s 9(2)(a) of the Act.
5	<b>OC02205_QA</b> Release of NZIER construction study – Questions and answers	Released in full.
6	<b>OC02410</b> NZ Transport Agency response to NZIER construction Industry Study	Released with some information withheld under s 9(2)(a) of the Act.

## CONSTRUCTION INDUSTRY PERFORMANCE – UPDATE ON RESEARCH AND PROPOSED NEXT STEPS

<b>Reason for this briefing</b>	In April 2013, the Ministry of Transport commissioned the NZ Institute of Economic Research (NZIER) to undertake research looking at the factors leading to increasing costs of road construction and maintenance.  The final NZIER report is now completed. This briefing summarises the report, and the full report is attached.
<b>Action required</b>	Agree to the proposed responses to the report recommendations.  Agree to release the report on the Ministry of Transport website.
<b>Deadline</b>	None.
<b>Reason for Deadline</b>	None.

### Contact for telephone discussion (if required)

Name	Position	Telephone		First Contact
		Direct Line	After Hours	
Scott Taylor	Adviser	s 9(2)(a)		
Tim Herbert	Manager - Financial, Economic and Statistical Analysis			✓

### MINISTER'S COMMENTS:

<b>Date:</b>	6 December 2013	<b>Briefing Number:</b>	OC01999
<b>Attention:</b>	Hon Gerry Brownlee (Minister of Transport)	<b>Security level:</b>	In-Confidence

### Minister of Transport's office actions

- Noted*
 *Seen*
 *Approved*  
 *Needs change*
 *Referred to*  
 *Withdrawn*
 *Not seen by Minister*
 *Overtaken by events*

### Purpose of report

1. This report provides you with a summary of the key findings in the NZIER report (the report) and outlines the six recommendations made by NZIER for better mitigation and management of future cost increases in the construction sector.
2. Officials are now seeking your agreement to proposed responses to the report's recommendations.

### NZIER construction industry performance report

3. The purpose of this research by NZIER was to improve understanding of cost pressures in road construction, maintenance and operations and recommend ways in which such pressures could be reduced.
4. The costs of maintenance, operations and renewals of roads in New Zealand have increased at a rate well above inflation for the last 10 years. Over this period, costs have increased by 58 percent in per kilometre of total network terms, while the consumer price index has increased by 28 percent.
5. Construction sector productivity in New Zealand has been poor, with labour productivity growth in the construction sector being the second lowest of all measured sector industries. Construction productivity growth in New Zealand is about half the rate of Australia's. Over the 15 years to 2011, labour productivity growth in New Zealand has averaged at 0.8 percent per year, compared with 1.6 percent per year in Australia.
6. The NZ Transport Agency, Treasury, Ministry of Business Innovation and Employment and Commerce Commission provided feedback on a draft version of the report.
7. The NZ Transport Agency has also separately commissioned a review into State highways procurement issues, with a report being prepared by external consultants Dr Murray Horn and Bruce Gidley. There is some overlap between the issues raised in the Horn and Gidley report and the NZIER report, particularly about the NZ Transport Agency's procurement practices. The Ministry of Transport has provided feedback on a draft version of the Horn and Gidley report and recommended that its findings be included in the NZ Transport Agency's response to the NZIER report. The NZ Transport Agency plans to brief you on the findings of the Horn and Gidley report in future.

### NZIER key findings

8. Nine key factors were identified in the report as contributing to construction industry performance and output price pressures. These are:
  - 8.1. **changes in overall demand for civil construction services:** strong demand across the civil construction sector (roads, irrigation, broadband and Christchurch) has meant ongoing demand side pressure.
  - 8.2. **import cost increases:** bitumen prices have increased by 140 percent between 2002 and 2011. This was counter-balanced by a fall in prices for

transport plant and equipment of approximately 25 percent over the same time period.

- 8.3. **locally sourced input costs:** wages in civil construction have increased by 63 percent between 2000 and 2012 (3.8 percent per year), the highest of any of the construction sectors. The cost of aggregate has also increased above the rate of inflation at an average of 4.2 percent per year against the Consumer Price Index of 2.8 percent per year.
  - 8.4. **structure and conduct of markets:** increasing concentration and vertical integration has occurred within the civil construction market, meaning fewer large companies that are able to cover more functions. Ownership of local quarries and bitumen plants provides companies with opportunities to exert market power in regional markets.
  - 8.5. **the wider regulatory environment:** between 1998 and 2011 there has been a 58 percent reduction in the number of quarries across the country partly due to resource management requirements. Given that the cost of aggregate doubles after the first 30 kilometres of cartage, the lack of local quarries can impact on road construction prices and allow quarry-owning companies to establish a competitive advantage in local/ regional markets.
  - 8.6. **weak industry productivity growth:** there is a continued growing productivity deficit relative to Australia. The size of firms (by employees) in the New Zealand construction sector is proportionally much larger than Australia. The increase in market concentration has occurred over the same period that the construction sector's performance has flat-lined relative to Australia.
  - 8.7. **how expenditure on service level improvements is accounted for:** service level investments (crash barriers, widening road shoulders etc) benefit road users, but can also increase future maintenance and operation costs. It is not clear how much is being spent on service improvements and how much on normal maintenance and renewal. This makes it difficult to make explicit decisions on the trade off between cost and service level improvements.
  - 8.8. **risk management and productivity incentives:** in order to manage cost risk, an index linked contract mechanism is used to compensate suppliers for movement in input prices, including labour. This dampens performance incentives and innovation within the supply chain and ultimately impacts on long term productivity.
  - 8.9. **standards and guidelines:** the NZ Transport Agency specifies over 500 standards and guidelines containing specific technical standards and manufacturing processes. Standards are essential to drive consistent improvements to service levels and can help with dissemination of innovation. However, standards can also act as a constraint on productivity performance and contribute to cost escalation.
9. The report also noted that the NZ Transport Agency is currently looking to reduce cost by moving to a series of larger 9 year contracts that bundle up a range of services and activities. The economies of scale provided by the larger contracts

should deliver cost savings, but in the longer term this approach could lead to further market concentration, reduced competition and increased prices. The report found that at present insufficient information is collected on contracts issued by 75 road controlling authorities around New Zealand (including the NZ Transport Agency). This may impact on the NZ Transport Agency's ability to monitor the impact of their procurement approach on market structure. For example, from 1995/96 only \$11.5 billion of spending can be accounted for, approximately half of the total spent. Data for 2010/11 onwards is unavailable.

### NZIER report recommendations

10. The report notes that it is not possible to determine the contribution of each of the above factors on cost escalation overall. Further, a number of these factors may not be within the control of transport policy makers (e.g. import cost increases, change in demand for construction services).
11. The report provides six main recommendations on specific issues that are contributing to construction sector performance and output price pressures. These issues are identified as being within the control of transport policy makers. The following table is a summary of the issues and corresponding recommendations made in the report.

	<b>Issue being addressed:</b>	<b>NZIER recommendation:</b>
a)	No clarity on how much is spent on service improvements versus normal maintenance or renewal costs.	Restructure National Land Transport Fund activity classes to identify expenditure on operations; maintenance; renewals; service level improvements to road users and capacity expansion to meet increasing demand.
b)	Difficult to measure market conditions due to issues with accuracy, completeness and timeliness of tender data.	Disclose market information (i.e. cost, market share, tender outcomes etc) routinely and regularly publish information on the condition and performance of the local and State highway works.
c)	Risk of collusion.	Monitoring of tender data should be improved and the data should be analysed for the possibility of collusion.
d)	Automatic cost adjustments in contracts do not incentivise improvements in productivity.	Review the practice of compensating suppliers for input price changes, with the aim of compensating for only large and uncontrollable cost disruptions.
e)	Standards may drive up costs and dampen innovation.	All new and existing national network standards should be subject to cost benefit analysis and a mechanism established to promote industry innovation, in the way standards are applied
f)	Risk that longer term contracts increase market concentration and reduce long term competition and value.	Plans to shift to smaller numbers of all encompassing long-term maintenance and operations contracts should be reconsidered, unless impacts on markets have been adequately assessed.

## Proposed responses

12. Officials are seeking your agreement to progress three proposed responses arising from the report recommendations:
  - 12.1. In relation to item (a): the Ministry will explore whether the Government Policy Statement on Land Transport should include a requirement for National Land Transport Fund activity classes to identify expenditure against the appropriate activities (i.e. maintenance, service level improvements, capacity expansion etc).
  - 12.2. In relation to items (b) to (f): it is recommended you commission the NZ Transport Agency to review the NZIER recommendations and report back to you with a response within the next 3 months. This timing would allow the NZ Transport Agency to reflect findings from the Horan and Gidley report in this response. Implementation of this response would be actively monitored by officials with progress reported back to you. A letter is attached to Chris Moller, Chair, NZ Transport Agency should you agree to this proposed response.
  - 12.3. The Australian Government has asked the Australian Productivity Commission to undertake an inquiry into ways to encourage private financing and funding for major infrastructure projects, including issues relating to the high cost and the long lead times. It is recommended that the Ministry work with the NZ Productivity Commission to examine if this enquiry could be expanded to cover New Zealand.

## Risks

13. There has been media comment on the NZ Transport Agency's decision to reduce the number of construction contracts and to extend the term of these contracts to 9 years. Concerns have been raised by smaller companies that they will not be able to compete for these contracts leading to job losses amongst smaller local and regional companies. In the long run this may consequently increase prices as competition for work decreases. Media attention may create pressure for the NZ Transport Agency to review its proposed procurement approach and make it more difficult to achieve decreased prices in the short term.

## Communications strategy

14. Industry has cooperated well in the production of the report and is very interested in its findings. Publication of the report is also likely to stimulate debate on how the issues identified could be addressed. Officials therefore recommend releasing the report on the Ministry of Transport website.
15. To help mitigate the potential risks officials recommend releasing the report through a coordinated communications strategy with the NZ Transport Agency. A coordinated communications approach with the NZ Transport Agency may include:
  - 15.1. a Ministerial media release welcoming the report, outlining responses and actions to address the issues raised



- 15.2. development of questions and answers and supporting material for the Ministry website developed in collaboration with the NZ Transport Agency
- 15.3. a briefing on the findings in the report provided to industry organisations.
16. The Ministry would work with your office and the NZ Transport Agency to finalise the communications approach.
17. Officials also recommend that you provide a copy of this briefing and attached letter and report to the Minister of Finance, Hon Bill English for his information.

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## Recommendations


18. The recommendations are that you:

- (a) **note** the findings and subsequent recommendations made in the NZ Institute of Economic Research (NZIER) report
- (b) **agree** that the Ministry of Transport will explore the inclusion of the NZIER recommendation to restructure the National Land Transport Fund activity classes in the Government Policy Statement on Land Transport 2015/16 2024/25 Yes/No
- (c) **agree** to request the NZ Transport Agency to review the other NZIER recommendations, in conjunction with the findings of the Horn and Gidley report, and provide you with a response within the next 3 months Yes/No
- (d) **agree** to sign the attached letter to Chris Moller, Chair, NZ Transport Agency Yes/No
- (e) **agree** that officials explore with the Australian Productivity Commission and NZ Productivity Commission the possibility of including the New Zealand civil construction sector in their current inquiry into infrastructure spend Yes/No
- (f) **agree** to publish the final NZIER report on the Ministry of Transport website Yes/No
- (g) **agree** to a coordinated communications strategy with the NZ Transport Agency Yes/No
- (h) **agree** to provide a copy of this briefing, the letter to Chris Moller and the NZIER report to the Minister of Finance, Hon Bill English Yes/No



Scott Taylor  
Adviser

**MINISTER'S SIGNATURE:**



Tim Herbert  
Manager – Financial, Economic  
and Statistical Analysis

**DATE:**

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Chris Moller  
Chair  
NZ Transport Agency  
Private Bag 6995  
**WELLINGTON 6141**

Dear Mr Moller

### **Construction Industry Performance report**

I write to advise you that the NZ Institute of Economic Research (NZIER) has now completed research into factors leading to increasing costs of road construction and maintenance. The final report is attached. I am now seeking the Ministry of Transport and the NZ Transport Agency to respond to these recommendations as appropriate.

The Ministry of Transport commissioned NZIER to undertake this research in April 2013. The purpose was to improve understanding of cost pressures in road construction, maintenance and operations and recommend ways to reduce such pressures.

The costs of maintenance, operations and renewals of roads in New Zealand have increased at a rate well above inflation for the last 10 years. Over this period, costs have increased by 58 percent in per kilometre of total network terms, while the consumer price index has increased by 28 percent. In addition, construction sector productivity in New Zealand has been poor, with labour productivity growth in the construction sector being the second lowest of all measured sector industries. Construction productivity growth in New Zealand is about half the rate of Australia's. Over the last 15 years to 2011, labour productivity growth in New Zealand has averaged at 0.8 percent per year, compared with 1.6 percent per year in Australia.

The NZIER report (the report) identifies nine key factors as contributing to construction performance and output price pressures. These are changes in overall demand for civil construction services, import cost increases, locally sourced input cost, structure and conduct of markets, the wider regulatory environment, weak industry productivity growth, how expenditure on service level improvements are accounted for, risk management and productivity incentives and standards and guidelines.

The effect of the procurement approach on market structure and conduct is identified as being a further factor. I understand that the NZ Transport Agency is proposing to move to a series of larger nine year contracts that bundle up a range of services and activities. While the economies of scale provided by the larger contracts may deliver cost savings, this approach could lead to further market concentration, reduced competition and increased prices in the longer term. The report found that at present insufficient information is collected on contracts issued by the NZ Transport Agency to monitor the impact of their procurement approach on market structure. I note that from 1995/96 only \$11.5 billion of spending can be accounted for, approximately half of the total spent. In addition, data from 2010/11 onwards is unavailable.

I understand that the NZ Transport Agency has separately commissioned a review into State highways procurement issues. There may be some overlap between the issues raised in this review and the NZIER report, particularly about the NZ Transport Agency's procurement practices and their wider implications.

The report provides six main recommendations for the mitigation and management of future cost increases. These recommendations are available in the attached copy of the report.

Recommendation 1 is focused on the National Land Transport activity class structure. I have asked the Ministry of Transport to explore whether recommendation 1 should be included within the 2015 Government Policy Statement on Land Transport. Recommendations 2 to 6 are focused on the NZ Transport Agency's current or proposed practices and the potential impacts of these practices on cost pressures in road construction.

I would like the NZ Transport Agency to review recommendations 2 to 6 and report back to me with a response within the next three months outlining measures to mitigate the future impacts of cost pressures. This timing will allow the NZ Transport Agency to reflect the findings from its review of State highways procurement issues in this response. I would expect further progress updates from officials as the response is implemented.

Yours sincerely

Hon Gerry Brownlee  
**Minister of Transport**

**Copy to:** Geoff Dangerfield, Chief Executive, NZ Transport Agency

## RELEASE OF NZIER CONSTRUCTION INDUSTRY STUDY

<b>Reason for this briefing</b>	On Wednesday 19 March you agreed to release the Construction Industry Study prepared by the NZ Institute of Economic Research (NZIER), and asked that we consider additional actions in response to the report.  This briefing provides a draft media statement along with a questions and answers document, and advice on the further actions discussed with officials.
<b>Action required</b>	Approve provision of an embargoed copy of the report, prior to general release, to selected organisations who provided input into the research.  Approve the attached media release and Q&A documents.  Agree to additional actions following release of the report.
<b>Deadline</b>	N/A
<b>Reason for Deadline</b>	N/A

### Contact for telephone discussion (if required)

Name	Position	Telephone		First Contact
		Direct Line	After Hours	
Gavin Middleton	Principal Advisor Communications	s 9(2)(a)		<input checked="" type="checkbox"/>
Ian Duncan	Principal Economist			

### MINISTER'S COMMENTS:

<b>Date:</b>	2 April 2014	<b>Briefing Number:</b>	OC02205
<b>Attention:</b>	Hon Gerry Brownlee	<b>Security level:</b>	In-Confidence

### Minister of Transport's office actions

- |  |  |   |
|--|--|---|
| <input type="checkbox"/> <i>Noted</i>        | <input type="checkbox"/> <i>Seen</i>                 | <input type="checkbox"/> <i>Approved</i>            |
| <input type="checkbox"/> <i>Needs change</i> | <input type="checkbox"/> <i>Referred to</i>          |   |
| <input type="checkbox"/> <i>Withdrawn</i>    | <input type="checkbox"/> <i>Not seen by Minister</i> | <input type="checkbox"/> <i>Overtaken by events</i> |

## **Purpose of report**

1. This briefing seeks your agreement to:
  - a draft media release to accompany publication of the NZIER report, and
  - additional actions in response to the report.

## **Construction Industry Study**

2. In April 2013, the Ministry of Transport commissioned the NZ Institute of Economic Research (NZIER) to report on factors leading to increasing costs of road construction and maintenance in New Zealand.
3. You met with officials on Wednesday 19 March 2014 to discuss the findings of this study and actions proposed by the Ministry (OC01999). You agreed that the Construction Industry Study should be published on the Ministry of Transport website, and to issue a media release.
4. At this meeting, you noted that the implications of the Study were wider than just the NZ Transport Agency. In light of this, we recommend the following additional actions:
  - a. providing copies of the study to local governments, so they can consider the impact of their own decisions (eg closure or opening of quarries) on costs
  - b. forwarding the study to the Commerce Commission, recognising that while the study notes there is no evidence of collusion in the civil construction industry, it identifies the industry's limited numbers and vertical integration as a risk
  - c. raising with your colleague, the Minister for the Environment, the question of whether the Resource Management Act 2002 is affecting costs.

## **Actions taken already**

5. The study's recommendations are now being considered as part of the development of the Government Policy Statement on Land Transport (GPS) 2015.
6. You have also written to the Chair of the NZ Transport Agency Board and the Agency's Chief Executive to ask them to review the recommendations made in the Study, and to report back to you within three months.
7. Ministry of Transport officials have also been in contact with colleagues at the Ministry for the Environment, to outline concerns raised that the Resource Management Act 2002 has constrained the supply of locally sourced inputs.

## **Next steps**

8. A draft media release and question and answers document is attached for your review and approval. Subject to your approval, we propose the following actions:

- a. The Ministry of Transport will provide embargoed copies of the Study to the following organisations which contributed to the study: Aggregate and Quarry Association; Roading NZ; NZ Contractors' Federation; Auckland Transport; Treasury; Ministry of Business, Innovation and Employment; and the NZ Transport Agency. This will allow participants to see their comments in context of the final study, before they are potentially contacted by media.
  - b. Following the media release the Ministry will:
    - provide copies of the Study to local government
    - arrange briefings on the findings of the Study, which would be led by the NZIER authors, in Auckland, Wellington and Christchurch
    - provide you with a draft letter to send to the Commerce Commission and the Minister for the Environment.
9. We will work with your office to confirm these arrangements.

## Risks

10. There is a risk that releasing this study is seen as confirmation that other initiatives to manage cost increases in transport have not been successful. This can be mitigated through emphasising that the study maintains the government's focus on achieving value for money by providing additional information to enable stakeholders to better understand the factors which influence cost increases.
11. Providing embargoed copies of the study raises the potential for recipients to contact media ahead of the study's official release. This can be mitigated through providing an appropriate but limited time period between providing embargoed copies and the formal release.
12. Passing the study to the Commerce Commission could significantly increase media interest in the structure of the civil construction sector, which may draw public attention away from the other concerns raised. The study recognises there is no evidence of collusion and any concerns outlined in the study relate to potential longer term impacts on industry structure (ie - increased vertical integration). Other factors addressed in the report (ie the use of indexed contracts) are shown to be responsible for increasing costs. This risk can be mitigated by not promoting this course of action in your media release, allowing other factors and responses to be emphasised.
13. As noted in the briefing 'Construction industry performance – Update on research and proposed next steps' (OC01999), there remains the potential for public release of the report to create pressure on the NZ Transport Agency to review its proposed procurement approach, and this could make it more difficult to achieve decreased prices in the short term. This is mitigated through NZTA's implementation of a continuous improvement programme to provide best practice in procurement.

## Recommendations

14. The recommendations are that you:

- |    |   |        |
|----|---|--------|
| a) | <b>approve</b> the attached media release and questions and answers documents   | Yes/No |
| b) | <b>approve</b> providing embargoed copies of the study to key stakeholders before public release                            | Yes/No |
| c) | <b>direct</b> that copies of the study be forwarded to local government   | Yes/No |
| d) | <b>agree</b> to write to the Commerce Commission and the Minister for the Environment to outline the findings of the study. | Yes/No |

Gavin Middleton  
**Principal Adviser Communications**

**MINISTER'S SIGNATURE:**

**DATE:**

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# Hon Gerry Brownlee

## Minister for Transport



XX April 2014

**Media Statement**

## **Minister welcomes study on road construction costs**

Transport Minister Gerry Brownlee has welcomed a study from the NZ Institute of Economic Research (NZIER) which looks at the factors behind increasing costs of road construction and maintenance. The study was commissioned by the Ministry of Transport.

“Over the last 10 years, per kilometre costs of road maintenance, operations and renewals have increased 58 percent across the network,” Mr Brownlee says. This compares with a 28 percent increase in the consumers price index.

“This study helps our understanding of what lies behind these cost pressures, and recommends ways in which they might be reduced.”

Six recommendations are made in the study on how future cost pressures can be managed and mitigated.

“In response to the study, I have instructed officials to take action in two initial areas:

- Exploring how an emphasis on moderating cost increases can be included in the next Government Policy Statement on Land Transport.
- Commissioning the New Zealand Transport Agency to review the recommendations and report back within the next three months.

“I have also instructed that the study be passed on to local government. I expect they will want to review the findings and ensure their decisions – particularly around application of the Resource Management Act – are not unnecessarily increasing the costs of locally sourced inputs.

“I will also raise with my colleague, the Minister for the Environment, whether the Resource Management Act 2002 is unnecessarily influencing increases in the cost of locally sourced inputs.

“Limiting cost increases in road construction and maintenance is already an aim of the government’s Road Efficiency Group and several local government programmes. I expect this will remain a priority for both central and local government over coming years.

“I would like to thank the civil construction industry, local government, the NZ Transport Agency, Treasury, and the Ministry of Business, Innovation and Employment for their input into the study,” Mr Brownlee says.

**Media contact: Nick Bryant** s 9(2)(a)

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# Release of NZIER construction study – Questions and answers

## Why was this research undertaken?

About \$3 billion is spent on road construction and maintenance by central and local government each year. Of this, just over \$1 billion is spent on state highway and local road maintenance, operations and renewals. It is a major concern that these maintenance, operations and renewals costs have increased 58 percent (in per kilometre of network terms) over the last 10 years, while by comparison, the Consumers Price Index has risen 28 percent.

The purpose of this research was to improve understanding of cost pressures in road construction, maintenance and operations, and recommend ways in which such pressures could be mitigated or better managed.

## How was the research undertaken?

The research was commissioned by the Ministry of Transport and undertaken by the New Zealand Institute of Economic Research (NZIER). It involved primary research including information analysis, interviews with key stakeholders, and analysis of relevant data.

The project reference group included representatives of the NZ Transport Agency, the Treasury, and the Ministry of Business, Innovation and Employment.

## What input did stakeholders have into the research and report?

Much of the research was based on interviews with participants in the civil construction sector, including Roading NZ, the NZ Contractors' Federation, Auckland Transport, and a range of stakeholders in the civil construction industry.

## What were the main findings?

Nine key factors were identified in the study as contributing to construction industry performance and output price pressures. These are:

1. Changes in overall demand for civil construction services: strong demand across the civil construction sector (including the building of roads, irrigation, broadband infrastructure and rebuilding of Christchurch) has meant ongoing demand side pressure.
2. Import cost increases: bitumen prices increased by 140 percent between 2002 and 2011. This may have been counter-balanced by a fall in prices for transport plant and equipment of approximately 25 percent over the same time period.
3. Locally sourced input costs: wages in civil construction increased by 63 percent between 2000 and 2012 (3.8 percent per year), one of the highest of any of the construction sectors. The cost of aggregate also increased at an average of 4.2 percent per year, against the Consumers Price Index of 2.8 percent per year.
4. Structure and conduct of markets: increasing concentration and vertical integration has occurred within the civil construction market, meaning there are fewer, larger companies able to cover more functions. Ownership of local quarries and bitumen plants provides companies with opportunities to exert market power in regional markets.

5. The wider regulatory environment: between 1998 and 2011 there was a 58 percent reduction in the number of quarries producing up to 85 percent of regional output across the country, partly due to resource management requirements. Given that the cost of aggregate doubles after the first 30km of cartage, fewer local quarries can impact on road construction prices and allow individual quarry-owning construction companies to establish a competitive advantage in local/regional markets.

6. Weak industry productivity growth: there is a continued productivity deficit relative to Australia. The size of firms (by employees) in the New Zealand construction sector is proportionally much larger than Australia. The increase in market concentration has occurred over the same period that the construction sector's performance has flat-lined relative to Australia.

7. How expenditure on service level improvements is accounted for: service level investments, such as crash barriers and widening road shoulders, benefit road users but can also increase future maintenance and operation costs. It is not clear how much is being spent on service improvements and how much on normal maintenance and renewal. This makes it difficult to make explicit decisions on the trade off between cost versus service level improvements.

8. Risk management and productivity incentives: in order to manage cost risk, an index linked contract mechanism is used to compensate suppliers for movement in input prices, including labour. This dampens performance incentives and innovation within the supply chain, and ultimately impacts on long term productivity.

9. Standards and guidelines: the NZ Transport Agency specifies over 500 standards and guidelines containing specific technical standards and manufacturing processes. Standards are essential to drive consistent improvements to service levels and can help with dissemination of innovation, but can also act as a constraint on productivity performance, and contribute to cost escalation.

### What changes were recommended by the study?

The study provides six recommendations on specific issues that are contributing to construction sector performance issues and output price pressures. These issues are identified as being within the control of transport policy makers.

	<b>Issue being addressed:</b>	<b>NZIER recommendation:</b>
a)	Lack of clarity on how much is spent on service improvements versus normal maintenance or renewal costs.	Restructure National Land Transport Fund activity classes to identify expenditure on operations; maintenance; renewals; service level improvements to road users and capacity expansion to meet increasing demand.
b)	Difficult to measure market conditions due to issues with accuracy, completeness and timeliness of tender data.	Disclose market information (ie cost effectiveness, market share, tender outcomes etc) routinely and regularly publish information on the condition and performance of the local and State highway works.
c)	Risk of collusion.	Monitoring of tender data should be improved and the data should be analysed for the possibility of collusion.
d)	Automatic cost adjustments in contracts do not incentivise improvements in productivity.	Review the practice of compensating suppliers for input price changes, with the aim of compensating for only large and uncontrollable cost disruptions.

e)	Standards may drive up costs and dampen innovation.	All new and existing national network standards should be subject to cost benefit analysis and a mechanism established to promote industry innovation, in the way standards are applied.
f)	Risk that longer term contracts increase market concentration and reduce long term competition and value.	Plans to shift to smaller numbers of all encompassing long-term maintenance and operations contracts should be reconsidered, unless impacts on markets have been adequately assessed.

**How will the government respond to the findings?**

Officials are taking action in two initial areas:

1. Exploring how an emphasis on moderating cost increases can be included in the Government Policy Statement on Land Transport;
2. Commissioning the NZ Transport Agency to review the recommendations and report back within the next three months.

The Ministry of Transport is also available to discuss the report and its findings with stakeholder organisations upon request.

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# NZ TRANSPORT AGENCY RESPONSE TO NZIER CONSTRUCTION INDUSTRY STUDY

<b>Reason for this briefing</b>	The NZ Transport Agency Chair replied on 10 June 2014 to your request for their response to the recommendations of the NZIER Construction Industry Study.  This Briefing outlines the key aspects of their response, and provides some suggested talking points for your meeting with the Agency on Wednesday.
<b>Action required</b>	Consider the talking points provided to support your discussion with the Transport Agency.
<b>Deadline</b>	Wednesday 18 June 2014
<b>Reason for Deadline</b>	You are meeting the NZ Transport Agency on Wednesday June 18.

## Contact for telephone discussion (if required)

Name	Position	Telephone		First Contact
		Direct Line	After Hours	
Ian Duncan	Principal Economist	s.8(2)(a)		✓
Tim Herbert	Manager, Financial, Economic and Statistical Analysis			

## MINISTER'S COMMENTS:

<b>Date:</b>	16 June 2014	<b>Briefing Number:</b>	OC02410
<b>Attention:</b>	Hon Gerry Brownlee (Minister of Transport)	<b>Security level:</b>	In-Confidence

## Minister of Transport's office actions

- Noted*
 *Seen*
 *Approved*  
 *Needs change*
 *Referred to*  
 *Withdrawn*
 *Not seen by Minister*
 *Overtaken by events*

## Purpose of report

1. This briefing notes key aspects of the NZ Transport Agency response to your letter dated 19 March 2014 (OC01999) and provides some suggested talking points for your meeting with the NZ Transport Agency on Wednesday 18 June.

## Background

2. The NZIER Construction Industry Study was commissioned by the Ministry in April 2013. Its objective was to improve understanding of the factors underlying cost pressures in 'roading provision' and options for mitigating or better managing these cost pressures. The report recommended actions in six areas in response to the findings:
  - 2.1. Restructure activity classes
  - 2.2. Disclose market information routinely
  - 2.3. Improve monitoring for the possibility of collusion
  - 2.4. Expose suppliers to market price signals
  - 2.5. Improve practice for standards and guidelines
  - 2.6. Review procurement strategies in light of their impact on the structure, conduct and performance of localised markets.

For ease of reference, the relevant page from the NZIER report is attached as an annex.

3. The first of these recommendations relates to the way the GPS sets out activity classes. This recommendation has been taken into account in the current draft GPS. The remaining five recommendations all suggest action by the NZ Transport Agency.
4. On 19 March 2014, you wrote to the Chair of the NZ Transport Agency, Chris Moller, and asked him to report back to you on the measures the NZ Transport Agency is taking to address the concerns raised in the NZIER Construction Industry Study.
5. The NZ Transport Agency has actioned all of the recommendations in the report.

## Ministry comment on response

6. The Ministry welcomes the NZ Transport Agency's positive and constructive approach in their response to your letter.
7. The only area of contention was NZIER's concern that increasing the size of contracts could lead to a reduction in the number of businesses bidding for contracts. The NZ Transport Agency does not agree with this and contends that larger contracts will draw in greater competition for them. Despite this difference of views, the NZ Transport Agency did action the recommendation in this area which was to review their procurement strategy and to ensure ongoing monitoring of the impact of those contracts on market structure. These are all positive and helpful steps which will significantly mitigate the risks identified in the report.
8. We will continue to work with NZ Transport Agency to build the evidence base around the effectiveness and efficiency of its procurement strategies. This evidence building will include setting up appropriate benchmarking and monitoring mechanisms as referred to in the draft GPS 2015.

## Suggested talking points

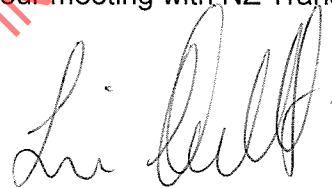
9. We suggest that you raise the following matters in your discussion on 18 June:
- 9.1. The NZ Transport Agency is responsible for procurement matters. However, the government wants to have an assurance that it is achieving value for money. This is in line with the expectations set in the draft Government Policy Statement 2015.
  - 9.2. Accordingly, the Ministry of Transport will play a stronger role in monitoring the performance of investment and procurement. I expect you to work closely with Ministry of Transport officials.
  - 9.3. I acknowledge the difference of views on the benefits of long term contracts. How will the NZ Transport Agency demonstrate the value of this approach?
  - 9.4. What are the next actions the NZ Transport Agency is taking to improve the management of procurement and investment?

## Recommendations

10. The recommendations are that you:
- (a) **note** the suggested talking points to support your meeting with NZ Transport Agency officials on 18 June 2014.



Ian Duncan  
Principal Economist



Andrew Jackson  
Deputy Chief Executive

**MINISTER'S SIGNATURE:**

**DATE:**