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Inquiry into Regulatory Institutions and Practices  
New Zealand Productivity Commission  
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## **NZCID Submission to the Productivity Commission on the Regulatory Institutions and Practices Issues Paper**

The New Zealand Council for Infrastructure Development (NZCID) welcomes the opportunity to provide input into the Productivity Commission's (the Commission) Regulatory Institutions and Practices Issues Paper (the Issues Paper).

NZCID considers an efficient and effective regulatory system to be critical to the competitiveness of New Zealand companies and the quality of life led by all New Zealanders.

As an organisation, we are most concerned with regulation which impacts the delivery and performance of infrastructure and infrastructure-related services.

Our view of infrastructure regulatory settings is that they are, in general, becoming more, not less, burdensome to industry while the benefit of what we sense to be increased regulation is unclear.

### **The impact of regulation on the cost of capital**

Of foremost concern to us at this time is the impact of regulatory uncertainty on the cost of capital.

There is currently little apparent acknowledgement, either from regulators or more generally, of the role capital investment, borrowing and lending play in the delivery of infrastructure and the impact regulation may have on this indispensable activity.

Infrastructure is, by definition, long term. Its investment profile almost always follows a trajectory of high upfront investment through the early delivery stages, before settling to a relatively low level of spend for a period of decades.

Because the majority of infrastructure cost is met or "sunk" in the early years, but the revenue stream used to fund that investment not realised until post construction, infrastructure and associated services are highly vulnerable to policy, regulatory and other shifts over time.

While risk cannot be avoided when investing in infrastructure, it can be – and is – valued. Greater risk, be it from regulatory change or another factor, increases the return on investment demanded by lenders.

Foreign lenders and investors are especially sensitive to regulatory risk. Unlike their domestic counterparts, they are not immersed in the New Zealand decision-making climate and do not necessarily maintain a strong understanding of or interest in policy vacillations or regulatory change. Confusing, complex or otherwise unpredictable regulation reduces the attractiveness of New Zealand as an investment destination for global capital.

Furthermore, such investors and lenders are not confined to or limited by investment opportunities. New Zealand infrastructure companies and projects are, in this regard, competing in a global, competitive marketplace for capital and each additional risk we as a country attach to investment opportunities increases the return on investment expected by lenders.

At the same time, foreign investors and lenders are especially important to the New Zealand infrastructure sector where the scale of capital requirements are frequently such that domestic sources alone are insufficient.

In short, we in New Zealand need international investors and lenders but they do not need us.

An unclear, unpredictable or otherwise uncertain regulatory environment increases the risk of investment failure, reduces the pool of capital available for New Zealand infrastructure investment and places upwards pressure on the rate of return expected by investors.

**This cost is ultimately met by consumers in the final price they pay for services.**

Minimising the potential for unpredictable regulatory intervention must be a core objective of policy makers intent on encouraging efficient investment in infrastructure for the long term benefit of consumers.

NZCID is deeply concerned that the risks involved in building and operating network infrastructure, principally electricity, gas, fibre, copper and mobile infrastructure, are unnecessarily high and having a detrimental effect on the delivery of world class infrastructure for New Zealanders.

We are equally concerned that there is inadequate recognition of the cost regulatory uncertainty is having on the industry and, ultimately, consumers.

We would like to see the Commission explore in some detail the additional cost of borrowing resulting from regulatory uncertainty and the impact regulatory uncertainty is having on the attractiveness of New Zealand as an investment destination.

### **A single infrastructure regulator**

The challenge of regulating industries where investment decisions may be decades old or based on decades of assumed returns may be such that a purpose-built infrastructure regulator warrants consideration and evaluation.

NZCID is interested in the Commission considering the potential for a single infrastructure regulator, consistent with the Essential Services Commission in Victoria.

In addition to adopting the responsibilities of the Commerce Commission in relation to energy, telecommunications, ports and airports, an infrastructure regulator may also assume some responsibility for urban water regulation.

Existing water regulation is extremely limited. Local authorities maintain responsibility for issuing consents to take and dispose of water and the Ministry of Health performs some functions with respect to water supply quality. Pricing, competition and other variables are, however, not actively regulated.

Lack of regulation in the sector means that in many parts of New Zealand water services are not delivered to a standard and consistency that many New Zealanders would consider acceptable.

An established independent regulator for water would also help address community concerns about the impact of rising water charges as cities and districts not already metering water use move towards user charges.

### **NZCID proposed Cost of Regulation Survey**

NZCID is itself investigating the issue of regulatory benefits and costs further.

It is our intention over the first half of 2014 to survey major New Zealand infrastructure companies on whether, in their view, regulatory requirements are increasing or decreasing.

We will also, to the extent possible, attempt to understand whether regulation is becoming more or less effective.

We consider that this workstream will align closely with the work of the Commission and will be happy to forward non-sensitive information onto the Commission should findings be available before the final report to Government in June 2014.

### **Consideration of case studies**

NZCID finds much about the New Zealand regulatory environment to be satisfied with and encourages the Commission to highlight examples of success.

One such example is the package of reforms to telecommunications settings, which have led to increased competition in the mobile services market and greatly reduced prices for consumers.

Comparing the regulatory success of mobile service changes with less effective oversight of the electricity market would, in our view, be extremely valuable.

Electricity price rises have been significant over the past decade and, whether justified or not, the public perception of these rises has been so poor that dramatic reform to the sector, and all the risk that attends such a significant policy shift, is possible.

Whereas regulation to promote competition in the mobile services market was highly successful, the regulatory process in for determining Chorus' copper service charges is an example of poor regulatory settings.

This event and the decisions which have surrounded it provide a potent reminder of the cost suboptimal regulatory processes can have not just on the operators of infrastructure, but upon wider markets, investors and users. Since the Commerce Commission first released its initial pricing decision in December 2012:

- Chorus' share price has dropped heavily, even after gradual improvement following a dramatic fall in the wake of the initial pricing decision, suggesting this decision was not anticipated by the market.

- International shareholding in Chorus has plummeted, indicating foreign investors find the regulatory environment problematic.
- Public debate has erupted over the issue leading to politicisation of what should be a technical decision, creating further uncertainty as to the appropriate and likely outcome.
- Chorus' ability to attract capital has been affected which will materialise as a higher cost of borrowing.
- And, most importantly, a precedent has been established of Government intervention in the activities of an independent regulator. This action risks expanding the issue of regulatory uncertainty from fixed line telecommunications services into wider mobile services, electricity, competition, ports, airports and other activities.

All of this materialises as increased costs to consumers. These costs may not be as high as if there was no regulatory system, but they are higher than if the system was performing effectively.

We must as a society aspire to have the most efficient and effective processes in place to maximise our wellbeing and reduce the impediments to New Zealand's growth and development.

NZCID strongly supports the Commission's investigation into regulatory institutions and practices and looks forward to working further with the Commission over coming months.