

The Chair
CABINET POLICY COMMITTEE

ADVANCING ECONOMIC TRANSFORMATION

PROPOSAL

- 1 This paper describes the substantial progress in implementing the Economic Transformation (ET) agenda over the past year and seeks Ministers' agreement to the areas where more emphasis should be placed in the future to progress the agenda.

EXECUTIVE SUMMARY

- 2 Economic Transformation is fundamentally about changing a country's mix of goods and services towards those that provide higher value and higher returns – products which differentiate on the basis of quality and innovation rather than cost.
- 3 Other small economies with similar characteristics to New Zealand have succeeded in leveraging off their natural resource bases to move into higher value products through collaborative efforts by the public and private sectors. There is no reason why New Zealand cannot have similar success.
- 4 The ET agenda builds on the direction of the Government's Growth and Innovation Framework to improve income per capita through innovation and raising productivity in an environmentally sustainable way. We have made substantial progress in implementing the ET agenda over the past year, including:
 - A new approach to developing the telecommunications sector
 - Developing the NZ Energy Strategy
 - A \$1.3 billion funding package for transport
 - Initiatives to respond to climate change, including an emissions trading scheme
 - Introducing tertiary education reforms
 - A \$3.4 billion package to encourage companies to grow and invest, undertake R and D and expand internationally
 - Deepening capital markets, including enhancing KiwiSaver
 - Launching the Metro Project action plan for transforming Auckland's economy.

- 5 To build on these achievements, a continued, yet sharper focus on a few key priority areas is critical for three reasons:
- our productivity levels and growth rate need to improve;
 - we need to be well placed to respond to and capture the commercial opportunities arising out of the strong and growing pressure for environmental sustainability; and
 - we need to position ourselves to take advantage of an increasingly integrated global economy.
- 6 In a series of meetings on each of the ET sub-themes, Ministers have identified six priorities (in addition to ongoing and planned work) for achieving this sharper focus:
- improving access to quality, fast, reliable broadband services to ensure strong global connections
 - positioning New Zealand as a world-leading exponent of smart and innovative responses to environmental issues
 - developing workplace skills, focussing on basic literacy and numeracy
 - supporting business internationalisation and extracting the best value from global value chains
 - focusing government investment in areas that reflect and extend New Zealand's strengths
 - making Auckland a world-class hub of innovation and internationalisation.
- 7 This paper seeks Cabinet's agreement to proposed actions for achieving these six priorities. Overall the aim for the next steps of the ET agenda is to achieve a step change in New Zealand's productivity and economic growth which builds on New Zealand's unique strengths and which advances New Zealand towards a sustainable future.

BACKGROUND – THE PROCESS OF ECONOMIC TRANSFORMATION

- 8 In March 2006, Cabinet agreed that ET would be one of the government's three priorities for the next decade (CAB Min (06) 7/22). Economic Transformation is fundamentally about changing a country's product (goods and services) mix towards those that provide higher value and higher returns – products which differentiate on the basis of quality and innovation rather than cost.
- 9 Usually countries make this move by developing higher value products which build on their existing capabilities, including skills, infrastructure and institutions. And there is still significant opportunity for New Zealand to develop higher value products from its existing base of capabilities. However, because New Zealand has a reasonably specialised range of products requiring quite specific capabilities (such as those based on natural resources, including many agricultural products), it is likely to be harder to move to a broader range of higher value products unless we also enhance and upgrade our existing capabilities. To achieve this will require clear direction and joint public and private sector effort to coordinate investments and improve our innovation

system, including regulatory settings, international linkages, research, workforce skills, and infrastructure.

- 10 Other small, open, advanced economies of the world with similar characteristics to New Zealand, such as Finland, Sweden, Norway, Denmark and Iceland, have been successful in persistently upgrading their capabilities and leveraging off their natural resource bases to move into higher value products through joint and collaborative efforts from the private and public sectors. There is no reason why New Zealand cannot enjoy the same level of success.
- 11 The ET agenda continues the Government's long term commitment to improving income per capita through innovation and raising productivity in an environmentally sustainable way. In doing so it builds on the direction of the Government's Growth and Innovation Framework (GIF). Both GIF and the ET agenda have encouraged innovation and productivity gains while also helping develop New Zealand's economic foundations: a stable macroeconomic framework, an open and competitive micro-economy, sound infrastructure, a cohesive and socially inclusive society, a healthy and relatively skilled population, a strong innovation system and sound environmental management.
- 12 Ministers agreed that ET work should be advanced within five sub-themes: World Class Infrastructure, Environmental Sustainability, Innovative and Productive Workplaces underpinned by high standards in education, skills and research, Globally Competitive Firms, and Auckland – An Internationally Competitive City. Two Cabinet papers in August 2006 detailed the overall vision underlying the ET agenda and a suite of action plans for each sub-theme. This paper reports on progress on those action plans.
- 13 This paper also responds to a Ministerial decision in March 2007 that the first ET update should be considered by Cabinet in September 2007 and that the update should provide a strategic review of the ET agenda and outline proposals to focus effort.

ET: PROGRESS TO DATE

- 14 We have made a lot of progress in implementing the ET agenda over the past year. The following section outlines some of our most significant achievements. A fuller summary is at Annex A.

World Class Infrastructure

- A new approach to developing the telecommunications sector through:
 - the Telecommunications Amendment Act which will increase competition, and support the development of a better range and quality of competitively priced services to businesses and households;
 - the planned operational separation of Telecom NZ, the revision of the Telecommunications Service Obligations and the facilitation of broadband wireless rollout; and
 - implementation of the Digital Strategy.

- A clear strategic direction for the energy sector through:
 - the NZ Energy Strategy;
 - the New Zealand Energy Efficiency and Conservation Strategy;
 - revision of the Policy Statement on Electricity Governance; and
 - the Energy Research Roadmap.
- A sustained investment approach to transport through:
 - An additional \$1.3 billion funding package, announced as part of Budget 2006, to ensure delivery of the National Land Transport Programme (with more than \$24 billion allocated to improve transport outcomes over the next 10 years);
 - the completion of a number of transport infrastructure projects such as:
 - the Auckland Central Motorway Junction upgrade;
 - Wellington inner city by pass.
 - Implementation of the Next Steps changes to planning and funding, and the regional petrol tax.

Environmental Sustainability

- Initiatives to respond to climate change, including:
 - an emissions trading scheme; and
 - developing a government-primary sector partnership focused on mitigating greenhouse gas emissions, adapting to the effects of climate change and business opportunities from climate change.
- Initiatives to manage our resources sustainably including:
 - progress with the Sustainable Water Programme of Action;
 - reviewing the East Coast Forestry Project to address sustainable land management issues; and
 - establishing the Sustainable Land Management (Hill Country Erosion) Programme as a vehicle for progressing the concept of 'total catchment management'.

Innovative and Productive Workplaces underpinned by high standards in education, skills and research

- Tertiary Education Reforms including:
 - improving the system for planning, funding and monitoring the provision of tertiary education;
 - allocating \$285 million of operating funding over four years to strengthen the ability of the tertiary sector to meet economic, environmental and social challenges.
- Expanding skills training through allocating \$53 million to boost participation in industry training and address skills shortages.
- Supporting excellence and relevance in research, science and technology in the public sector through:
 - increased funding for COREs;

- implementing the stable funding initiative for public sector research; and
- undertaking an OECD review of Innovation policy and performance.

Globally Competitive Firms

- A \$3.4 billion package to encourage companies to grow and invest, undertake R&D, and expand internationally, including:
 - a 3% cut in the company tax rate to 30% from the 2008/09 tax year;
 - an R&D tax credit of 15% from 1 April 2008; and
 - an announcement by the Government that it will remove tax on the foreign active income of NZ companies operating offshore.
- Initiatives to deepen and enlarge capital markets by changing our saving and investment environment, including:
 - enhancements to KiwiSaver;
 - increased funding for and development of venture capital investment; and
 - reducing taxation on widely-held savings vehicles.
- Helping New Zealand companies break into international markets through:
 - Export Year 2007 to improve long term export performance;
 - implementing the Trade Strategy including an FTA with China; and
 - implementing the offshore portion of the NZTE strategy with a strengthened focus on Asia.

An Internationally Competitive City - Auckland

- Launching the Metro Project action plan which takes an integrated approach to transforming Auckland's economy and provides 30 practical initiatives to boost Auckland's performance.
- Reviewing Auckland's governance, reaching agreement to develop an overarching regional strategic plan, and establishing a Royal Commission of Inquiry.
- Completion of a number of significant transport projects, such as the Auckland Central Motorway Junction Upgrade, double-tracking between New Lynn and Henderson (Western Rail Line), and progress on State Highway 20 Mt Roskill extension and the Northern Busway.
- Commitment of \$1b towards electrification of the Auckland metropolitan passenger rail network by 2013.

A SHARPER FOCUS FOR THE ET AGENDA

- 15 In order to build on these achievements, a continued, yet sharper focus on a few key priority areas is critical for three reasons: 1) our productivity levels and growth rate need to improve; 2) we need to be well placed to respond to and

capture commercial opportunities arising out of the strong and growing pressure for environmental sustainability; and 3) we need to position ourselves to take advantage of an increasingly integrated global economy.

Productivity and Growth Rate

- 16 New Zealand's level of aggregate labour productivity and GDP per capita is currently at the lower end of the OECD range (22nd out of 30 using 2005 figures). To maintain or improve our position we need to grow faster. And because we have a very high level of labour force participation, growth will need to come from improvements in productivity. Increased innovation will make a critical contribution to this improved productivity. So will increased skill levels. Investment in RS&T and workplace skills therefore plays a fundamental role within the ET agenda. Overall, we need to ensure our input and institutional base allows us to move to a higher-value product and export mix.

Environmental Positioning

- 17 There is strong and growing pressure for business to prove itself to be environmentally sustainable. Consumers are demanding goods and services with environmental integrity and many international firms are seeking to take advantage of these preferences by giving more weight to environmental considerations in the way they produce, supply and market goods and services. Governments the world over are also enacting regulations to enforce sustainability and reduce greenhouse gas emissions.
- 18 New Zealand's green and trustworthy image can be leveraged to develop new opportunities and obtain a premium for our goods and services. But we also need to counter the perception that our distance means our products are more environmentally costly than those of in-market competitors. This means New Zealand needs to build on our current image and reputation – New Zealand businesses need to invest in sustainable business practices and both public and private sectors need to make a clear commitment to address climate change. Fundamentally, we need to build our country's integrity on environmental sustainability.

International Integration

- 19 Shrinking economic distance, new forms of organisation and distribution practices, sophisticated links between national and international value chains, and trade liberalisation are rapidly altering the nature of the global environment facing business. To survive in this new environment, New Zealand business must organise itself in complex systems spanning many countries, tapping differences in costs, skill, resources and tastes to maximise overall returns. New Zealand cannot compete in all areas of production. It needs, therefore, to be an attractive location for those parts of international value chains that focus on high-value products and activities or which compete in the weightless areas of business, such as design, marketing, and research and development. We will need a world-class communications and transport infrastructure to link with the rest of the world. In sum, we need to extend and deepen our businesses'

connections with the rest of the world to take advantage of market opportunities and attract high quality capital and labour.

PRIORITY AREAS FOR THE NEXT STEPS OF THE ET AGENDA

- 20 Given these points, I propose that the next steps of the ET Agenda should aim to achieve *a step change in New Zealand's productivity and economic growth, which builds on New Zealand's unique strengths, and which advances New Zealand towards a sustainable future*. I have held a series of meetings with other Ministers on each of the five ET sub-themes. In these meetings, we have identified the following six priorities with associated actions for progressing the ET agenda and achieving this step change. This is in addition to other ongoing and planned work which will also make an important contribution to ET and which is listed in the last column of Annex A.

Theme:	<i>World Class Infrastructure</i>
Priority:	<i>Improving access to quality fast, reliable broadband services to ensure strong global connections</i>
Action:	<i>Accelerating Investment in Broadband</i>

- 21 Broadband is key to enabling a small, geographically distant country like New Zealand to participate successfully in the global knowledge economy. It enables firms, including SMEs, to reach and be successful in global markets. It also enables high-value, weightless products such as research, design, broadcast programming (including Māori programming), branding and marketing to be effectively provided to customers anywhere in the world.
- 22 In New Zealand the lack of high-speed broadband, caused in part by limited competition and underinvestment in telecommunications infrastructure relative to OECD benchmarks, is limiting the growth of New Zealand firms¹. The regulatory reforms introduced through the Telecommunications Amendment Act (No. 2) 2006 were designed to increase competition in telecommunications, and incentivise the industry, and particularly the incumbent, to increase investment.
- 23 These regulatory reforms have yet to be fully implemented and the new regulated services will not be in the market until late 2007. Nevertheless, it is unlikely that it will be commercially viable for traditional telecommunications service providers, such as Telecom, to make investments in key infrastructure bottlenecks in areas outside major urban centres in the next three years.
- 24 The challenge of meeting New Zealand's telecommunications needs will be a key priority for November's Digital Future Summit 2.0 and the subsequent refresh of the Digital Strategy. The government will aim to stimulate a

¹ NZ's level of ICT investment as a percentage of Gross Capital Formation has increased from 10.8% in 1995 to 13.6% in 2003 but still places NZ 17th out of 21 OECD countries –upcoming 2007 Economic Indicators report

constructive national debate about building the pathway to New Zealand's broadband future and further fibre infrastructure investment. This debate will require the engagement of telecommunications providers, local government, and the businesses, Māori interests, communities and individuals that want improved connectivity.

- 25 The Government will continue to monitor levels of investment in broadband infrastructure and will initiate a process for engaging with the private sector on this issue.

Theme: *Environmental Sustainability*

Priority: *Positioning New Zealand as a world-leading exponent of smart and innovative responses to environmental issues*

Actions: *Implement emissions trading and associated carbon markets to reduce net greenhouse gas emissions*

Advance environmental solutions, including sustainable land management, eco-verification and test beds for sustainability

Develop Instruments to provide for water quality and future demand for fresh water

- 26 Concerns about environmental sustainability are creating new economic opportunities for countries such as New Zealand that are biologically-based and which have high per capita renewable energy resources.

- 27 In particular, New Zealand has the opportunity to be a leader in the mitigation of agricultural greenhouse gas emissions, areas of bio-energy, soil carbon sequestration and engagement with Māori to apply traditional knowledge to environmental management. We are well-positioned to take a lead in becoming a sustainable economy and society.

- 28 However, Ministers believe we need to make more progress on the institutional frameworks that encourage changes in behaviour; the direction of investment; and the pattern of technological innovation.

Action: *Implement emissions trading and associated carbon markets to reduce net greenhouse gas (GHG) emissions*

- 29 The Government recently announced its intention to introduce a cost for GHG emissions from 2008. This will create incentives for least cost emission reductions and, over time, trigger changes in patterns of investment, technological innovation and resource allocation.

- 30 While carbon markets aligned with the Kyoto Protocol framework are government's paramount concern, "voluntary markets" for carbon, outside the framework, are also emerging. These are being created by consumer demands for "carbon neutrality" from firms or products, and by consumers who want to offset their own GHG emissions. Government can influence the development of these voluntary market responses by providing supporting eco-verification

infrastructure based on internationally recognised standards and approaches, and through its commitment to a carbon neutral public service.

- 31 I propose that MED and MfE, in conjunction with MAF and DoC, be directed to develop a framework for identifying the government's role in supporting the effective development of these voluntary markets, paying particular attention to issues such as emerging market platforms, the capability and application of eco verification methods and clear messaging in engagement with business and households.

Action: *Advance environmental solutions, including sustainable land management, eco-verification and test beds for sustainability*

- 32 Consumer acceptability and market access will increasingly demand verification of claims relating to environmental and broader sustainability impacts. Increasingly, major retail chains are demanding evidence of the impacts of products on the environment. Multinational global supply chains are requiring evidence of verifiable environment management practices based on international standards. The "food miles" arguments highlight the potential risk to NZ's food and beverage exports in key markets – but conversely, the focus on carbon footprinting provides real opportunities.

- 33 The integrity of environmental and sustainability claims also needs to be upheld through standards and verification methods that are accepted by our major trading partners. If New Zealand firms are to utilise standards and conformity assessment methodologies, these need to be easily accessible and internationally-recognised. New Zealand needs to accelerate the uptake of eco-verification in environmental management systems and products through appropriately designed stair-casing instruments designed to lift performance over time. Robust eco-verification systems will support our environmental integrity in world markets. This includes the environmental certification of seafood products and carbon reduction efforts. A comprehensive report back to Ministers on progress in marshalling eco-verification expertise, leveraging existing eco-verification infrastructures and supporting uptake of eco-standards and eco-labels, is due by 30 April 2008.

- 34 Because of New Zealand's small size, and willingness to embrace sustainability there may also be opportunities for New Zealand to be promoted as an internationally- recognised test bed for emerging sustainable technologies. This could support the positioning of New Zealand as a sustainable nation, as well as addressing highly visible aspects of environmental performance. I propose that officials report back by February 2008 on these opportunities.

- 35 Finally, the sustainable land management (hill country erosion) programme also needs to be expanded to more effectively address soil erosion, flood risk, and the downstream impacts of erosion on infrastructure and water quality.

Action *Develop instruments to provide for water quality and future demand for freshwater*

- 36 This action focuses on developing instruments to complement regulation and other tools to ensure the sustainability of New Zealand's water resources by managing water quality, and providing for future demand for freshwater. These instruments may include institutional frameworks, new approaches to water storage and management, pricing mechanisms, enhanced user pays charging, and liability mechanisms to enhance water quality and encourage the efficient use of water.
- 37 Regional councils have faced challenges in implementing their responsibilities for water quality management in catchments. This is partly because of a lack of appropriate tools to change behaviour. Regulation and voluntary improvements to land management practice are the current core tools in protecting water quality. These tools could be complemented by instruments to protect water quality in an efficient way. Such instruments could form part of the "tool box" that can be applied by regional councils in a way that reflects their particular circumstances and which support behavioural changes to protect and enhance water quality.
- 38 When water is scarce the means must also be found to manage competing interests. Institutional frameworks governing water use must reflect the fundamental importance of water to biophysical functioning and human needs and values as well as aiming to improve economic efficiency. A mix of regulatory and/or market-based instruments can be used to manage water. These instruments are interlinked – market instruments depend on regulatory frameworks. Instruments such as consumptive water charging, in conjunction with enhanced transferability, are tools for encouraging efficiency over the use of abstracted freshwater in catchments where water is a scarce resource that is subject to competing demands and values.
- 39 However, market instruments can lead over time to a few economic agents accumulating excessive control over water permits. This can threaten social cohesion. Market instruments also raise issues around the limitations of water permits, how the taking of water should initially be assigned, and how it could be reassigned. Issues also arise when changes in scientific understanding or in social norms mean that water permits need to be changed - for example, to reduce the taking of water because a water resource has been over-allocated. For all these reasons, market instruments need to be developed within a set of clear institutional limits that harmonise economic efficiency and the social and environmental outcomes that government seeks.
- 40 Water storage and management systems (including infrastructure investment and institutional rules) can also help manage demand for water while protecting environmental and social "bottom lines". New approaches to storage and management can help resolve potential conflicts over water in ways that meet environmental, economic, social and cultural aspirations.
- 41 In the light of these points, I propose that officials from MfE, MAF and MED should be asked to report back to Ministers with proposals for instruments to provide for water quality and future demand for freshwater by 31 March 2008.

Other Actions:

- 42 In addition to the above actions, I propose that officials should report back on setting further medium-long term targets for sustainability.
- 43 In the launch of the emissions trading scheme on 20 September, the Prime Minister announced a number of medium to long term targets to move New Zealand towards greater sustainability:
- a by 2025, have ninety per cent of electricity generated from renewable sources;
 - b by 2040, reduce by half per capita emissions from transport;
 - c be one of the first countries to introduce electric cars widely;
 - d by 2020, achieve a net increase in forest area of 250,000 hectares.
- 44 Setting realistic, achievable and consistent targets provides a powerful means of galvanising change. Targets provide a firm basis on which the government and business can partner to achieve change, and which businesses can take into account in their decision-making.
- 45 In my view, there is scope to establish further high level targets in specific areas as a way of completing an overall picture of what a sustainable New Zealand looks like, thus helping to make that vision compelling.
- 46 In May, in the context of setting a goal to position New Zealand as a world-leading exponent of smart, innovative and business-savvy responses to environmental issues, officials were asked to report back with advice on how progress towards this goal could be measured. Work on targets is also underway in respect of land management, energy, transport, water and waste. I consider it would make sense to combine these efforts so that Ministers can consider the question of targets in respect of sustainability as a whole.

Theme:	<i>Innovative and Productive Workplaces</i>
Priority:	<i>Developing workplace skills, focusing on basic literacy and numeracy</i>
Action:	<i>Upskilling the workforce</i>

- 47 A central component of how productivity improvement can be achieved is through improving the human capability of our workers, managers and industry leaders.
- 48 Ministers have directed officials in consultation with the social partners, NZCTU and Business NZ, and the Industry Training Federation to design a comprehensive Skills Strategy aimed at future proofing the economy against inevitable labour shortages. This strategy will build on the new approach to education and training investment delivered through the tertiary education reforms. A paper to progress the development of the strategy will be provided to Cabinet by the end of the year.

- 49 While such a strategy aims to build employers' and employees' interest in skills and life long learning, an essential prerequisite is improving workforce literacy, language and numeracy (LLN). About one third of our 3.25 million strong working age population have LLN skills below those needed to participate fully in a knowledge society.
- 50 Low levels of LLN skills contribute to error, wastage, re-work and poor health and safety outcomes. Workforces with low LLN skills are less able to build the capability to be internationally competitive; and lack effective governance, strong management, innovative workplace cultures and skilled and motivated staff. International evidence shows increases in LLN contribute to firms' productivity.
- 51 Officials from MoE, DoL and TEC are due to report to Cabinet by the end of October on a strategy to "**Upskill the workforce**" which will examine proposals for putting significant effort into workplace LLN development. This paper, which is likely to form a key component of the Skills Strategy, will identify the need for controlled interventions on:
- **Demand:** A focus on priority industries is proposed as a practical way to manage growth in the short to medium-term and allow government to focus resources on clusters of vulnerable workers and firms and leverage its existing engagements with industries.
 - **Supply:** The proposal for increasing the supply of learning opportunities has a three-staged approach to increasing provision from July 2008 through 2011 onwards, where LLN would be fully integrated into the reformed tertiary strategy funding system and the Investing in the Plan process.
 - **Capability:** It is proposed that funding be made available for ITPs and wananga through the Tertiary Education Organization Component (TEOC) to support the organisational change that is required to deliver high-quality embedded LLN delivery. This will be accompanied by an intensive focus on increasing the number of trained educators and the trusted advisory services to bed-in the infrastructure and quality assurance processes.
- 52 Other significant work that will support the Innovative and Productive Workplaces Theme focuses on firm capability, including exploring opportunities to improve cross agency co-ordination of firm capability services (particularly between DoL, MED, NZTE and TEC), enhancing the involvement of social partners and key stakeholders to build consensus on specific gaps and priorities for action, and getting better traction from existing services by leveraging off existing trusted advisor networks.

Theme: <i>Globally Competitive Firms</i>
--

Priority:	<i>Supporting business internationalisation and extracting the best value from global value chains</i>
Actions:	<i>More sophisticated and integrated in-market business support</i> <i>Integrated and targeted onshore support for internationalising firms, and business opportunities with international potential, with a focus on capability development</i>

53 The key challenges arising from international integration are for New Zealand to:

- a. Position itself as an attractive location for investment and skills and for those parts of international supply chains that relate to high-value products and activities and that provide the greatest return (e.g. R&D and design). This includes an imperative to develop more and/or larger internationally successful New Zealand businesses, networks of businesses, and segments of the economy; and
- b. Capture the best return through our businesses being part of international value chains offshore (returning profits to New Zealand), through developing new business models of operating internationally (such as investing directly in offshore product and distribution chains), rather than transferring valuable activities offshore.

Action: *More sophisticated and integrated in-market business support.*

54 I propose that we make a significant investment in shared services and/or infrastructure in a few key markets offshore, drawing on in-market sources of advisory and business services and networks as much as possible. The idea is to create in-market 'eco-systems' and centres of support for New Zealand firms and business opportunities, with private sector services (such as distribution services, research providers, banks, professional services, and investment companies) supporting government provided services (such as technology partnerships and market development).

Action: *Integrated and targeted onshore support for internationalising firms and business opportunities with international potential, with a focus on capability development.*

55 I propose three inter-related initiatives:

- I. Case managed and tailored support from NZTE for up to 10 New Zealand medium to large internationalising businesses (per annum) over the next three years, to enable them to make a significant move into global value chains and market opportunities. The businesses targeted will need to have the capability, desire and long-term commitment to be global players and be at the vanguard of a step change in our foreign exchange earnings (at the multi-hundred million if not billion dollar level). Engagement may involve working with a significant New Zealand company in conjunction with its

domestic supply partners to secure international opportunities for the wider value chain.

- II. Improving the delivery of support for New Zealand's SME emerging international businesses and business opportunities with international potential to develop capability in understanding and managing the requirements of market development and global value chains. This will involve a clearer and integrated 'internationalising support pathway' service facilitated by NZTE (and other agencies) in partnership with the private sector and industry groups, to provide initial diagnostic and ongoing mentoring support for emerging international SMEs and business opportunities, and to facilitate access to relevant government and non-government services.
 - III. Advancing a more applied form of business management education, focused on internationalisation, in partnership with 1-2 tertiary education providers.
- 56 A number of considerations drove the development of these priority actions, including ensuring that:
- New initiatives help New Zealand firms address the key challenges arising from international integration;
 - Support for internationalising firms does not represent an onshore vs. offshore dichotomy, but rather a seamless transition of support between onshore and offshore;
 - The insights gained from dialogue with international businesses during Export Year inform future government policy and decision-making (and the priorities are included in the companion paper on the Export Year Platform and are referred to in the public/private sector Platform document); and
 - The proposals build on the investments that government has already made but represent a step-change in New Zealand's approach to business internationalisation.
- 57 I propose that officials from MED, MFAT and NZTE, in consultation with the Treasury, should report back to Cabinet by 15 December with further details on the nature and implications of these actions.
- 58 Further options on initiatives to transform SME capability, productivity and potential for internationalisation are being considered by ET Ministers. The Minister for Small Business and I will report back to the Cabinet Policy Committee by early November on any further initiatives arising from this consideration which should be incorporated into the ET Agenda.

Theme:	<i>Globally Competitive Firms</i>
Priority:	<i>Focusing government investment in areas that reflect and extend New Zealand's strengths</i>
Action:	<i>Tackling fragmentation and better aligning government spend across education and training, RS&T, business and market development in six areas of focus</i>

- 59 Cabinet has agreed in principle on a number of areas of focus representing economic development priorities for Vote Economic, Industry and Regional

Development, Vote RS&T and the tertiary education component of Vote Education (CAB Min (07) 34/5 and POL Min (07) 21/7 refer). The Government's investment in these areas of focus should build on New Zealand's existing strengths and reputation, have significant market opportunities, and also extend the economy into higher-value products and services. Cabinet has agreed in principle to focusing investment on:

(i) segments that extend our biological sector strengths through the application of human capital, innovation and technology. This includes a proposed focus on pastoral systems, environmental solutions, health solutions, and advanced foods and derivatives;

(ii) niches where small-scale or technology-driven (rather than labour intensive) production is a source of advantage or not a disadvantage. This includes a proposed focus on smart materials and digital content and tools.

- 60 As previously noted, small open economies like New Zealand usually innovate and grow on the basis of resource advantages and long-standing and mature industries. More focused investment across government in key areas that build on these industrial and resource strengths will enable us to create the necessary scale and depth to support economic transformation. It will enable New Zealand to be recognised as a world leader in a small number of priority technology areas through the development of clusters of world class firms, research institutions, tertiary education organisations, and private businesses that collaborate to drive innovation. Targeting of resources into more productive industrial and technology areas will lead to greater overall productivity as there are flow-on or 'pull' effects from these activities to the wider economy. Building critical mass in these areas will help to attract globally competitive talent, R&D and businesses.
- 61 Such increased focus is also an important theme in the companion paper "A New Agenda for New Zealand Research, Science and Technology". It corresponds to recommendations by the OECD's review of innovation in New Zealand to produce a clear statement of national policy towards innovation, science and technology, which recognises the wide range of government policies that affect innovation and serves to foster coherence and co-operation among the various departments and agencies involved.
- 62 Officials are scheduled to report back to the Ministers for Industry and Regional Development, Research, Science and Technology, and Tertiary Education, with final proposals for areas of focus by 31 October 2007 and on mechanisms for implementation by 15 December 2007.
- 63 In addition, in response to the OECD review, Cabinet has directed MoRST and MED, in consultation with relevant agencies, to report to the Minister of Research, Science and Technology and the Minister of Economic Development on future opportunities to further improve the innovation system [EDC Min (07) 13/3 refers]. This work includes consideration of different ways to govern innovation at Ministerial level and a proposed innovation policy strategy. Such a strategy could consolidate recent and planned RS&T, and broader innovation, initiatives into a clear statement of the direction in which we plan to develop our innovation policy.

64 Other significant work that will support the Globally Competitive Firms Theme includes:

- Financial Sector Development - work is currently underway by the Treasury and MED on assessing a range of possible measures to further promote the development of New Zealand's financial system, including programmes to boost independent equity research on New Zealand firms, an integrated finance sector industry body and education initiatives to boost human capability in the sector.
- Knowledge Transfer – options for extending and refining services (such as FRST's) to better assist New Zealand firms and industries to locate, transfer and absorb new knowledge and technologies from overseas are being explored.

Theme:	<i>Auckland – An Internationally Competitive City</i>
Priority:	<i>Making Auckland a world-class hub of innovation and internationalisation</i>
Actions:	<i>Supporting the development of the Auckland Innovation Precinct Enhancing Auckland's Waterfront and Supply Chain Effectiveness</i>

65 The most successful city-regions overseas function increasingly as regional hubs of the global economy via networks of local relationships linked with more extended worldwide networks and value chains. In particular, two essential elements of world-class cities that act as hubs of innovation and internationalisation are:

- Well developed regional innovation systems, including a strongly networked grouping of local businesses and public institutions acting in a supportive manner with one another on R&D and technology transfer; and
- Smart and effective port and waterfront developments, which contribute to the international image of the city reflecting cultural diversity and lift city-regions' economic performance. This is achieved by ensuring that cities' waterfront developments provide urban amenity that help attract knowledge workers and high value firms, and that support the effectiveness and efficiency of domestic and international supply chains.

Action: *Auckland Innovation Precinct*

66 Ministers have already agreed to work on developing a feasibility study and business case for an Auckland Innovation Centre at Tamaki. This is currently being progressed by MED and NZTE with the University of Auckland and other stakeholders. It has become apparent that the potential benefits of the proposal could be significantly increased by assisting Auckland stakeholders with the development of the wider Tamaki Innovation Precinct, including the Tamaki revitalisation initiative. Beyond facilitating the development of the feasibility study and business case for the centre and potential initial seed funding, a broader vision and plan for the Innovation Precinct could entail an expanded role for government, including:

- Alignment and provision of government RS&T, business and export/market development services to businesses in the precinct
- Supporting activities that facilitate greater networking and collaboration between industry and research in the precinct
- Attracting major investment into the precinct
- Facilitating sector development, including the provision of sector-specific infrastructure, in the precinct
- Ensuring that the precinct helps to regenerate Glen Innes, Panmure, Tamaki and Point England and that the economic and employment benefits from the regenerated precinct provide real opportunities for communities in these areas.

67 I propose that officials from MED and NZTE, in consultation with MoRST, TEC, DOL, FRST and the Treasury, report back to the Ministers of Finance/Tertiary Education, Economic Development and Research Science and Technology by 15 December, on the role for government in relation to the wider Innovation Precinct, as part of their report back on the feasibility study for the Auckland Innovation Centre.

Action: Auckland's Waterfront and Supply Chain Effectiveness.

68 I propose that officials work with Auckland stakeholders to provide high level strategic guidance on the future of the waterfront redevelopment, with the aim of facilitating urban transformation that will attract high value firms and skilled workers, and creating an efficient cost and environmental supply chain both regionally and nationally. This would include:

- i) Working with Auckland Regional Council and Auckland City Council on the strategic context for future waterfront development. This would entail an expressed view from government on the aspirational development of all the current waterfront projects (Westhaven Marina, Wynyard Point, the Finger Wharves, the Port, as well as the interface with the CBD). This could include the provision of urban design protocols, assessing international redevelopments, or identifying clustering and agglomeration opportunities. It would not necessarily lead to government funding of individual waterfront projects.
- ii) Working with Māori and Pasifika to integrate cultural diversity as a point of competitive advantage.
- iii) Leveraging off a proposed freight study to help officials assess supply chain choices and port access in the city-region.
- iv) Working with Ports of Auckland to consider support for a short haul inland rail service which would ease pressure on road use in the CBD area and act as an environmental exemplar.

69 I propose that officials report back to the Ministers of Finance, Economic Development, Transport, Environment and Local Government by March 2008 on a recommended action plan for ongoing engagement with local and regional stakeholders on these issues. In the interim, officials will be holding exploratory discussions with controlling parties of waterfront assets (principally Auckland Regional Holdings, Auckland Regional Council and Auckland City Council).

- 70 A number of the other proposed priorities (e.g. broadband, workforce upskilling and focusing government investment) will also support the development of Auckland as a hub of innovation and internationalisation as they will have a significant Auckland dimension.
- 71 I propose that future transformational actions to progress the Auckland Theme be worked up as part of a more comprehensive package via One Plan for Auckland. Government has agreed to contribute to the development of One Plan, recognise its significance, and engage in discussions with Auckland councils on how priorities in One Plan might be achieved. This could provide a vehicle for agreement on priorities, strategies and options for funding from central and local government and the private sector towards Auckland. Local government officers suggest that the first draft, focused on selective infrastructure related actions, be completed by September 2008. In that context we will need to assess the economic benefits of "agglomeration" alongside the marginal costs of infrastructure and other required developments.

ENHANCING MACROECONOMIC AND REGULATORY SETTINGS

- 72 Continued effort at improving our macroeconomic and regulatory setting will be necessary to encourage investment in higher value products and activities. Sound monetary and fiscal management, as evidenced in price stability and budget surpluses and debt reductions, gives business the confidence to invest in the knowledge that external conditions impacting on their business decisions are not likely to change dramatically. Regulation and regulatory frameworks likewise play a critical role in shaping the business environment in which economic activity takes place. It is important that regulatory frameworks are able to address the changing needs of society and the economy, without unnecessarily constraining business growth, productivity and innovation. Work aimed at enhancing our macroeconomic and regulatory settings (e.g. the Quality Regulation Review and the FEC inquiry into monetary policy) has been initiated and is ongoing.

TREASURY COMMENT

- 73 Treasury agrees that all ten of the proposed actions have the potential to contribute to economic transformation. This is a relatively large agenda, and there may be greater impact from focussing effort and resources on a smaller set of actions. Should Ministers wish to pursue a more focussed agenda, in our view the following three actions would have a relatively lower priority than the others (key reasons in brackets):
- Auckland's waterfront (central government's role is not clear – can be pursued via Auckland's One Plan);
 - Advancing Environmental solutions (less transformative in nature – can be pursued via the Sustainability Deputy Secretaries' Work Programme);
 - Water quality and future demand for fresh water (effect of government action will be at the margins only – can be pursued via the Sustainability Deputy Secretaries' Work Programme).

- 74 While there will be further opportunity to consider sequencing and resourcing of all the actions through the Budget process, Ministers may wish to consider now whether they prefer a narrower set of actions to start with.

CONSULTATION

- 75 The following departments and agencies have been consulted: The Department of the Prime Minister and Cabinet, Treasury, Department of Labour, Ministry of Transport, Ministry of Foreign Affairs and Trade, Ministry of Research, Science and Technology, Ministry of Education, Ministry of Agriculture and Forestry, Ministry of Fisheries, Ministry for the Environment, Department of Internal Affairs, Foundation for Science, Research and Technology, New Zealand Trade and Enterprise and Tertiary Education Commission.

FISCAL IMPLICATIONS

- 76 There are no immediate fiscal implications. The proposed priorities will feed into and guide future Budget decisions, and the financial implications of specific initiatives will be identified and considered through the Budget process in the light of the overall fiscal context.

HUMAN RIGHTS

- 77 There are no human rights implications.

LEGISLATIVE IMPLICATIONS

- 78 There are no legislative implications from this paper.

REGULATORY IMPACT AND COMPLIANCE COST STATEMENT

- 79 Regulatory Impact and Compliance Cost Statements are not required.

PUBLICITY

- 80 I recommend that this paper be released publicly. A communications strategy around this release will be developed by MED in consultation with my office.

RECOMMENDATIONS

- 81 I recommend that the Committee:

Background

- 1 **note** that:

- 1.1 in August 2006, Cabinet agreed to a suite of action areas to be progressed as part of the economic transformation agenda, and agreed that Ministers will provide an update every six months on progress in implementing the agenda [CAB Min (06) 31/3];

- 1.2 in April 2007, Cabinet agreed that the first economic transformation update on progress should be included in the September 2007 update [CAB Min (07) 11/6];
- 2 **note** the substantial progress that has been made in implementing the economic transformation agenda;
- 3 **agree** that there is a need to further refine and extend the economic transformation agenda building upon this success;

Future Priorities

- 4 **agree** that future priorities for economic transformation should focus on a few key priority areas for the following reasons:
 - 4.1 New Zealand's productivity levels and growth rate need to improve;
 - 4.2 New Zealand needs to be well placed to respond to and capture the commercial opportunities arising out of the strong and growing pressure for environmental sustainability;
 - 4.3 New Zealand needs to be positioned to take advantage of an increasingly integrated global economy.
- 5 **agree** that the economic transformation priorities and associated actions over the medium term, subject to economic and fiscal conditions, should include the following:
 - 5.1 improving access to quality fast, reliable broadband services to ensure strong global connections:
 - 5.1.1 accelerating investment in broadband;
 - 5.2 positioning New Zealand as a world-leading exponent of smart and innovative responses to environmental issues:
 - 5.2.1 implementing emissions trading and associated carbon markets to reduce net greenhouse gas emissions;
 - 5.2.2 advancing environmental solutions, including sustainable land management, eco-verification and test beds for sustainability;
 - 5.2.3 developing instruments to provide for water quality and future demand for fresh water;
 - 5.3 developing workplace skills, focusing on literacy and numeracy:
 - 5.3.1 upskilling the workforce;
 - 5.4 supporting business internationalisation and extracting the best value from global value chains:

- 5.4.1 more sophisticated and integrated in-market business support;
- 5.4.2 integrated and targeted onshore support for internationalising firms, and business opportunities with international potential, with a focus on capability development;
- 5.5 focussing government investment in areas that reflect and extend New Zealand's strengths:
 - 5.5.1 tackling fragmentation and better aligning government spend across education and training, research, science and technology, business and market development in six areas of focus, namely: pastoral systems, environmental solutions, health solutions, advanced foods, advanced materials and digital content;
- 5.6 making Auckland a world-class hub of innovation and internationalisation:
 - 5.6.1 supporting the development of the Auckland Innovation Precinct;
 - 5.6.2 enhancing Auckland's waterfront and supply chain effectiveness;

Broadband

- 6 **note** that the government will continue to monitor levels of investment in broadband infrastructure and will initiate a process for engaging with the private sector on this issue;

Environmental Issues

- 7 **direct** the Ministry of Economic Development (MED) and the Ministry for the Environment (MfE) in conjunction with the Ministry of Agriculture and Forestry (MAF) and the Department of Conservation (DoC) to:
 - 7.1 develop a framework for identifying the government's role in supporting the effective development of voluntary carbon markets, paying particular attention to issues such as emerging market platforms, the capability and application of eco-verification methods, and clear messaging in engagement with business and households;
 - 7.2 report to the Minister of Finance, Minister of Agriculture, Minister for Economic Development, Minister of Commerce, and Acting Minister for the Environment by 30 April 2008 on a proposed framework;
- 8 **note** that a comprehensive report to Ministers on progress in marshalling eco-verification expertise, leveraging existing eco-verification infrastructures and supporting uptake of eco-standards and eco-labels, is due by 30 April 2008;
- 9 **direct** officials from MED, MfE, MAF and Ministry of Research Science and Technology to report to Cabinet Policy Committee (POL) by February 2008 on the potential for New Zealand to be promoted as an internationally-

recognised test bed for sustainability, with options for how the concept could be grounded;

- 10 **direct** officials from MfE, MAF and MED to report to the Minister of Agriculture, Minister for Economic Development, and Acting Minister for the Environment by 31 March 2008 with proposals for instruments to provide for water quality and future demand for freshwater;
- 11 **agree** that setting realistic, achievable and consistent targets in specific areas as a means of completing an overall picture of what a sustainable New Zealand looks like provides a firm basis on which the government and business can partner to achieve change, and which businesses can take into account in their decision-making;
- 12 **direct** officials to develop targets in specific areas clearly linked to outcomes, and to report to the Minister for Economic Development and the Acting Minister for the Environment with recommendations by 31 January 2008;

Workplace skills

- 13 **note** that the Ministry of Education, the Department of Labour and the Tertiary Education Commission are due to report to POL by 31 October 2007 on a strategy to "Upskill the workforce" which will examine proposals for putting significant effort into workplace language, literacy and numeracy development;

Internationalisation

- 14 **direct** officials from MED, the Ministry of Foreign Affairs and Trade and New Zealand Trade and Enterprise (NZTE), in consultation with the Treasury to report back to POL by 15 December 2007 with further details on the nature and implications of the two supporting business internationalisation proposals, namely:
 - 14.1 more sophisticated and integrated in-market business support;
 - 14.2 integrated and targeted onshore support for internationalising firms, and business opportunities with international potential, with a focus on capability development;
- 15 **note** that further options are being considered by economic transformation Ministers on initiatives to transform small and medium enterprise capability, productivity and potential for internationalisation;
- 16 **invite** the Minister for Economic Development and the Minister for Small Business to report back to POL by early November 2007 on any further initiatives arising from this consideration in paragraph 15 which should be incorporated into the economic transformation agenda;

Research and Technology

- 17 **note** that officials are due to report back to the Minister for Tertiary Education, the Minister of Research, Science and Technology and the Minister for Industry and Regional Development with final proposals for areas of technology focus by 31 October 2007 and on mechanisms for implementation by 15 December 2007;
- 18 **note** that MoRST and MED, in consultation with relevant agencies, will be reporting to the Minister of Research, Science and Technology and the Minister of Economic Development on future opportunities to further improve the innovation system [EDC (07) Min 13/3];

Auckland Issues

- 19 **direct** MED and NZTE in consultation with MoRST, the Tertiary Education Commission, the Department of Labour, the Foundation for Research, Science and Technology and the Treasury, to report to the Minister of Finance, Minister for Tertiary Education, Minister of Research Science and Technology and Minister for Economic Development by 15 December 2007, on the role for government in relation to the wider Innovation Precinct, as part of the report back on the feasibility study for the Auckland Innovation Centre;
- 20 **direct** MED, Ministry of Transport, MfE, Treasury and the Department of Internal Affairs to report to the Minister of Finance, Minister of Transport, Minister for Economic Development, Minister of Local Government and Acting Minister for the Environment by March 2008 on whether, and if so how, central government should engage with local and regional stakeholders on the future of the Auckland waterfront development;
- 21 **note** that in the interim officials will be holding exploratory discussions with controlling parties of waterfront assets;

Next Steps

- 22 **note** that the agreed priorities will feed into and guide future Budget decisions, and the financial implications of specific initiatives will be identified and considered through the Budget process in the light of the overall fiscal context;
- 23 **note** that the Minister of Economic Development intends to publicly release the paper under CAB (07) 554 at an appropriate time, subject to any withholdings that may be required in accordance with the Official Information Act 1982.

Trevor Mallard
Minister for Economic Development

Date signed: