



## COVERSHEET

<b>Minister</b>	Hon David Clark	<b>Portfolio</b>	Commerce and Consumer Affairs
<b>Title of Cabinet paper</b>	Initiating the Third Commerce Commission Market Study	<b>Date to be published</b>	22 November 2021

<b>List of documents that have been proactively released</b>		
<b>Date</b>	<b>Title</b>	<b>Author</b>
November 2021	Initiating the Third Commerce Commission Market Study	Office of the Minister of Commerce and Consumer Affairs
10 November 2021	DEV-21-MIN-0225 Minute	Cabinet Office

### **Information redacted**

### **YES / NO**

Any information redacted in this document is redacted in accordance with MBIE's policy on Proactive Release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Some information has been withheld for the reason of confidential advice to government.

Office of the Minister of Commerce and Consumer Affairs

Chair, Cabinet Economic Development Committee

## Initiating the third Commerce Commission market study

### Proposal

- 1 This paper outlines my intention to require the Commerce Commission (the Commission) to undertake a market study into residential building supplies.

### Relation to government priorities

- 2 Affordable housing is a priority for this Government. The Labour Party 2020 Election Manifesto committed to initiating a market study into building supplies. It was expected that this study would be initiated in late 2021. I intend to deliver on this commitment by commencing a market study into key residential building supplies.

### Executive Summary

- 3 The Commission is empowered under the Commerce Act 1986 (the Act), on its own initiative or at my direction, to carry out studies into any factors that may affect competition for the supply or acquisition of goods or services.
- 4 I intend to require the Commission to carry out a market study into any factors that may affect competition for the supply or acquisition of key building supplies used to build the major components of residential buildings. The major components of residential buildings are the foundation, flooring, roof, walls (structural and non-structural interior and exterior) and insulation. A proposed notice for the study is attached in Annex 1.
- 5 I am satisfied that a market study into residential building supplies is in the public interest. This is particularly the case given the importance of affordable housing to the wellbeing of New Zealanders, indications of potential competition concerns in the sector and the likelihood of the Commission making recommendations to remedy those concerns. The Commission's competition expertise and investigative powers mean that it is likely to add value over and above previous studies into this sector.
- 6 Given the breadth of the issues covered in this study, the importance of good stakeholder engagement, and the fact that I am proposing the study start before the Christmas holiday period, I consider that the Commission will require at least 12 months to carry out this study. I intend to require the Commission to publish its final report by 6 December 2022.

### Background

#### *Market studies power*

- 7 The Act gives the Commission the ability to undertake competition studies (market studies) into the supply or acquisition of goods or services. The purpose of a market study is to determine whether there are any factors that may be impeding

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competition in a market. If so, the Commission may make recommendations as to how competition could be improved.

- 8 Under the Act, the Commission may conduct a study on its own initiative or at my request if it is in the public interest to do so.
- 9 What is in the public interest is not defined, but it should be interpreted consistent with the purpose of the Act, which is to promote competition in markets for the long-term benefit of consumers within New Zealand.
- 10 I consider that it is likely to be in the public interest to carry out a market study if it promotes the purpose of the Act and some or all of the following (non-exhaustive) criteria are met:
- 10.1 there are existing indications of competition problems in the market (such as high prices or low levels of innovation);
  - 10.2 the market is of strategic importance to the New Zealand economy or businesses or of significant importance to consumers;
  - 10.3 it is likely that there are viable solutions to any issues that are found; and
  - 10.4 a formal Commission market study would add value above work that could be done by other government agencies.
- 11 In conducting a study, the Commission may use its mandatory information gathering powers if it is necessary or desirable for the purposes of the study. The Commission must prepare a draft report and release it to the public to allow a reasonable time for comments. The final report must include the Commission's findings and may include recommendations. These recommendations are non-binding, but the Government must respond in a reasonable time.
- 12 Since the Commission was conferred the power to carry out market studies in October 2018, two market studies have been initiated. In December 2019, the Commission completed its first market study into the retail fuel market. The previous Government passed the Fuel Industry Act 2020 to respond to the Commission's recommendations. In November 2020, I directed the Commission to conduct a study into the retail grocery sector. The Commission released its draft report this July 2021 and is set to release its final report in March 2022. I consider that these market study reports (draft and final) have been well received.

*Process for selection of candidate for study*

- 13 The Labour Party 2020 Election Manifesto outlined that the Minister of Commerce and Consumer Affairs would require the Commission to conduct a market study into building supplies.
- 14 This Manifesto commitment reflects earlier requests to the then Minister of Commerce and Consumer Affairs to initiate a market study into building supplies. In particular, the then Minister of Building and Construction with (or supported by) the then Minister of Housing and Urban Development (dated 22 October 2019 and 26 October 2018 respectively) requested a study into residential building supplies. At

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that time, officials from the Ministry of Business, Innovation and Employment (MBIE) considered that such a study was likely to be in the public interest.

- 15 As the Commission is only resourced to carry out one market study at a time, a market study into building supplies was selected to be next candidate after the current study into the retail grocery sector was completed. Given the passage of time since the study into residential building supplies was first requested, however, I must be satisfied before requesting the Commission to conduct this market study that it is in the public interest to do so.

### **Market study into residential building supplies**

- 16 I propose to commence a Commission market study into residential building supplies: specifically, the supply or acquisition of key building supplies used to build the major components of residential buildings.

- 17 In my view, there is a clear public interest in the Commission carrying out a market study into competition factors affecting the cost of residential building supplies. In particular, with reference to the purpose of the Act and the public interest criteria outlined above, I consider that:

- 17.1 The following indicators may suggest there are impediments to competition in the supply or acquisition of residential building supplies:

17.1.1 The supply of some building supplies is highly concentrated. For example, two companies control about 85 per cent of the supply of concrete, three companies control about 85 per cent of the supply of glass wool insulation, one company controls about 94 per cent of the supply of plasterboard and there are only five major building materials merchants.

17.1.2 There is a high level of vertical integration in the supply chain. For example, one company owns manufacturing businesses as well as being a building product merchant. Another company is a key participant in the sawmilling industry and owns a building product merchant.

17.1.3 Pricing of building supplies is not transparent, with the widespread use of rebates and loyalty schemes shaping the market. A Residential Construction Market Study conducted by MBIE in 2013/14 highlighted the potential negative effects of rebates and loyalty schemes on the relationship between suppliers and merchants, merchants and builders, and builders and customers.

17.1.4 Difficulties for new building supplies to enter the New Zealand market, including anecdotal evidence of issues in the building consent process.

- 17.2 A market study into residential buildings supplies is of strategic importance:
- 17.2.1 Housing plays a vital role in the wellbeing of all people living in New Zealand, and housing has become increasingly unaffordable for many people in the community.
  - 17.2.2 Building supplies make up a significant proportion of the costs of developing new residential housing.
  - 17.2.3 Residential building consents have more than tripled in the last ten years. In addition, demand for renovations and extensions to existing homes is at an all-time high. This growth has contributed to strong demand for building supplies.
- 17.3 The Commission's previous market studies have demonstrated that it is able to find workable solutions to competition concerns, which may include redressing any imbalances in power, industry reforms and improving information to customers.
- 17.4 Previous studies into residential building supplies may not have identified or addressed the underlying competition concerns. The Commission is able to add value over and above these studies with its independence, specialist competition expertise and mandatory investigative powers.

*Terms of reference*

- 18 In line with the requirement of the Act, I have prepared a draft notice (terms of reference and timeframe) for a study into any factors that may affect competition for the supply or acquisition of key building supplies used in the major components of residential buildings. I have also consulted with the Commission on the draft notice. The proposed notice is attached as Annex 1.
- 19 In developing the notice for the study, I have made the following judgements:
- 19.1 The market study is to be completed by the end of 2022 and, for the first three to four months, it will overlap with the Commission's current market study into the retail grocery sector. At the same time, the building sector is undergoing significant growth and disruption due to the building boom and the impacts of COVID-19 on supply chains and their resilience. The combination of these factors mean that it is important that the study is well-scoped to get the best value, taking into account the timeframes, available resources and potential compliance costs on market participants. I also expect the Commission to be mindful of any relationship between supply chain resilience and competition as they carry out the study.
  - 19.2 The terms 'key building supplies used to build the major components of residential housing' is intended to focus the study. The major components of residential buildings are the foundation, flooring, roof, walls (structural and non-structural interior and exterior) and insulation. This is neutral to the style of residential building and would range from single story standalone to multi-unit dwellings, the latter of which are increasing as a proportion of residential

building consents. The key building supplies may be those that make up a major proportion of costs of a residential building or are representative of the range of building supplies.

- 19.3 When looking at key residential building supplies, the Commission will be able to investigate across multiple functional levels of the supply chain and the full range of possible impediments to competition. This will enable the Commission to look at relationships between manufacturers/importers through to builders/developers, including evaluating any competition issues such as discounting practices, loyalty and rebate schemes and vertical integration.
- 19.4 I have included a list of matters that the Commission may consider in carrying out the study. This includes considering impediments to the entry or expansion of new or innovative building supplies, and as part of this, I expect the Commission to specifically consider the impacts of the regulatory and standards systems on entry and expansion. In particular, I expect the Commission to look at how the regulatory and standards systems operate in practice rather than simply how they are designed to operate. Reference is also made to impediments affecting the entry or expansion of 'green' building supplies or novel prefabricated products. This will ensure that the study is future-focused, consistent with the Government's objectives for decarbonisation in buildings.
- 19.5 No particular consultation requirements with departments, agencies or classes of persons are specified in the proposed notice. I consider that the Commission will carry out an open and transparent market study process and additional consultation requirements are not necessary.

**Implementation**

20 I intend to initiate this market study following consideration by Cabinet. The major milestones for this project are as follows:

15 November 2021	Initiation of market study.
6 December 2022	Study completed and final report is released to the public.

CONFIDENTIAL ADVICE TO GOVERNMENT

**Financial Implications**

21 The Commission will complete this market study within existing baselines.

**Legislative Implications**

22 There are no legislative implications arising from this paper.

## Population Implications

23 There are no population implications arising from this paper.

## Human Rights

24 The proposals in the paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

## Consultation

25 The Ministry of Housing and Urban Development, the Treasury, Kāinga Ora and the Commission have been consulted on the Notice. The Department of Prime Minister and Cabinet (Policy Advisory Group) has been informed.

## Communications

26 I intend to issue a media statement announcing the initiation of this market study. The notice for the market study will be published in the *New Zealand Gazette* in order to initiate the study and will also be posted on MBIE's website.

## Proactive Release

27 MBIE will publish this Cabinet paper on its website in full within 30 business days of decisions being noted by Cabinet.

## Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Committee:

- 1 **note** that the Commerce Act 1986 gives the Minister of Commerce and Consumer Affairs the ability to require that the Commission undertakes a market study;
- 2 **note** the Labour Party's 2020 Election Manifesto included a commitment for the Minister of Commerce and Consumer Affairs to direct the Commerce Commission to undertake a market study into building supplies;
- 3 **note** that:
  - 3.1. the Minister of Commerce and Consumer Affairs intends to require the Commerce Commission to undertake a study into any factors that may affect competition for the supply or acquisition of key building supplies used to build the major components of residential buildings, in line with the notice set out in Annex 1;
  - 3.2. for this purpose, the major components of residential buildings are the foundation, flooring, roof, walls (structural and non-structural interior and exterior) and insulation;
- 4 **note** that the Minister of Commerce and Consumer Affairs intends to require the Commerce Commission to publish its final report for this market study by 6 December 2022;

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- 5 **note** that statutory consultation with the Commerce Commission on the notice for the market study has occurred;
- 6 **note** that the Commerce Commission will publish and consult on a draft report several months prior to the publication of the final report, which will provide a strong indication of the Commission's conclusions;
- 7 **note** that this Cabinet paper and the notice for the market study will be published on the Ministry of Business, Innovation and Employment's website.

Authorised for lodgement

Hon Dr David Clark

Minister of Commerce and Consumer Affairs

## **Annex 1: Draft notice for a competition study into residential building supplies**

I, Dr David Clark, Minister of Commerce and Consumer Affairs, pursuant to section 51(1) in Part 3A of the Commerce Act 1986, require the Commerce Commission to carry out a competition study into any factors that may affect competition for the supply or acquisition of key building supplies used to build the major components of residential buildings.

Matters to be considered in the study may include, but are not restricted to:

- The industry structure for key building supplies covered by this study
- The nature of competition for these key building supplies, including any industry pricing practices or acquisition requirements that impact on competition
- Impediments to the entry or expansion of new or innovative building supplies, such as 'green' building supplies or novel prefabricated products.

For the purposes of this study, major components of residential buildings are the foundation, flooring, roof, walls (structural and non-structural interior and exterior) and insulation.

The Commerce Commission should make its final report for this study publicly available by 6 December 2022.