

20 December 2012

HERA Submission to Parliamentary Inquiry into Manufacturing

1 Executive Summary

The New Zealand metals-based industry is actively involved with and supports many other industries, such as food processing, energy generation, agriculture or construction. As such, industry-specific figures are difficult to pinpoint, but 2010 estimates are:

- Contributes over **7%** to Annual NZ GDP
- Direct metals-based product manufacturing employs more than **26,000** people
- Over **\$7.3 billion** worth of metals-based product manufactured annually
- More than **\$2.6 billion** of product exported, representing **5.6%** of total NZ exports

HERA developed in co-operation with the sector overarching Metals NZ Incorporated a Metals Engineering Industry Position on Public Policy Issues. This submission heavily draws on this document but is limited to respond only to the inquiry's economic development policy question under the Industry Transformation Policies heading.

Our recommendations are as follows:

Industry R&D

- An R&D tax credit scheme is an ideal broad-based mechanism for industry transformation. However, in the absence of such a scheme a suitable replacement might be to widen the access to R&D grant schemes and deliberately target the sectors of industry which enhance creating high value products and services for exports or as import substitution.
- Continuous availability of company-specific grants over several years to help embed R&D functions within the business, as opposed to the current emphasis on R&D service providers being in charge of the grant funds and providing only time-limited initiatives under their drive.
- Widening the range of approved research providers for the R&D grants schemes to include non-public sector or independent research providers such as HERA.
- Supporting the combined funding of research projects by companies that have common interests e.g. in renewable energy or resilient building systems.
- Government increases support for non-agriculture manufacturing sector groups to create stable industry levy funded R&D streams, provided industry groups are unified behind funding R&D via compulsory levies enshrined in legislation. The legislation should include the industry's right to subsequent abandonment of the scheme should industry consensus be lost.

- Capability of Independent Research Organisation Funding is implemented without delay to ensure important research capability is not lost in the transition from old funding mechanism to the new.
- Making the early stage R&D commercialisation costs 100% tax deductible in the form of depreciation over the first year
- Introducing faster depreciation rates on productive manufacturing equipment

Public-funded research and its impact on industry

- More government R&D money is channelled through industry rather than directly through the research provider to industry. This will result in industry deciding what research provider they wish to spend R&D funds with. Demand will then dictate which research providers and what research services best meet the needs of industry and determine which will expand and thrive
- In largely academic programmes government R&D policy puts more emphasis on industry involvement to determine research needs and its funding, the performance of the research, and in the governance process

Economic Development Strategies

- Inclusion of local industry development objectives in national economic development strategies
- Creation of “Projects of National Significance” for industry development to focus national efforts
- Endorsement of the principles developed in Pure Advantage’s Green Growth Report, including support of the development of an associated Green Growth Strategy. However, this must also include ‘greening’ of essentially “dirty” activities, and New Zealand contributing to harvesting natural resources in a responsible manner

Government Procurement Policy

- Provide balanced government procurement in respect to social, economic and environmental impacts. In particular include the consideration of loss in tax revenue from imported products in government procurement decision making
- Develop the New Zealand-specific business case for procurement excellence via supportive research and case studies
- Develop the technical side of whole-life costing guidelines and implement in the public sector procurement guidelines
- Develop the concept of lead-user innovation as part of the public sector procurement model
- Adoption of the developed guidelines, including the development of Industry Participation Plans, is a mandatory requirement for all major public sector procurement
- No import tariff exemption unless a detailed and satisfactory IPP has been provided
- To further the active adoption of procurement excellence assist in the associated training, especially of whole-life costing, cost management and development of IPPs

SOE Procurement

- Consideration is given for SOEs to follow the above “procurement excellence” principles e.g. a requirement is placed on SOEs that in relation to major projects they operate as

good New Zealand corporate citizens, including support for national priorities in industry development as lead user innovators

- The SOE Act, and any legislation that considers the proposed mixed-ownership model, be reviewed in relation to best practice procurement
- Major project procurement must include establishment and publication of local IPPs

Free Trade Agreements

- Free trade agreements are weighted in relation to the level of equity between New Zealand manufacturers and those overseas

2 Introduction

By way of introduction, HERA is an industry-owned and industry-governed research association representing the metals industry of New Zealand, encompassing approximately 600 member companies. One-third of our funding comes from an industry contribution via a compulsory levy (which companies have the freedom to opt out of) on heavy steel and welding consumables, one-third from membership fees and self generated income while the remaining one-third traditionally came from contestable government grants.

Since our establishment in 1978 we have maintained a consistent presence supporting industries' research and development needs, resulting in a substantial contribution to the development of the NZ metals industry. One of our more significant achievements is the development of cost effective earthquake resisting structural steel systems leading to the growth of structural steel in the multi-storey building sector from a minimal market share in the 1980's to close to 50% today. These systems have been implemented into the NZ construction regulatory system and demonstrated excellent performance in the recent Canterbury earthquakes

HERA represents two sectors of the metals industry, the steel material based construction industry sector which is unified behind a focused sector research strategy driven by HERA and the wider heavy engineering and metals manufacturing industry characterised by very diverse individual company interests which make having a joint industry development strategy rather challenging. It is principally this second group that contains the high value niche manufacturing sector that this inquiry is concerned with.

HERA developed in co-operation with the sector overarching Metals NZ Incorporated a Metals Engineering Industry Position on Public Policy Issues. This submission heavily draws on this document but is limited to respond only to the inquiry's economic development policy question.

3 Industry Transformation Policies

For New Zealand to become more prosperous and sustainable its economy must not only become globally competitive and profitable, but also more export focused and environmentally aware. The productive, high-value-added and export-focused industry sectors will lead the way to improved economic performance.

To achieve this, our industry needs policies that enable:

- business to thrive and innovate
- a focus on developing productive, high-value-added, export-oriented business sectors

We recognise the current constrained economic climate and accept that there is limited additional funding available to support industry transformation. However, industry believes that existing resources must be prioritised and strategically aligned for maximum effect to achieve industry development. The profitable operation of the productive manufacturing based and export oriented sectors will provide the tax revenue required to support government expenditure in the services areas such as social, health or educational activities.

For business to thrive and innovate, the business environment must be right. Many policies, such as tax and spending, influence the business environment. Comment in this document is limited to areas where HERA and Metals NZ feel it is competent and has received industry feedback. These areas include innovation, local industry development and the drive for increased exports.

3.1 Industry Innovation Policies

The ability of any economy to thrive in a competitive global marketplace is enhanced through continued innovation. The main drivers of innovation are industry and public sector R&D investments; our focus, therefore, is on policies that influence this.

3.1.1 Industry R&D

The current reality is New Zealand's industry research spending is extremely poor compared with the average OECD nation, – we are in last place on the OECD R&D spending list, and the only country where industry R&D spending is well below the percentage for government-funded R&D.

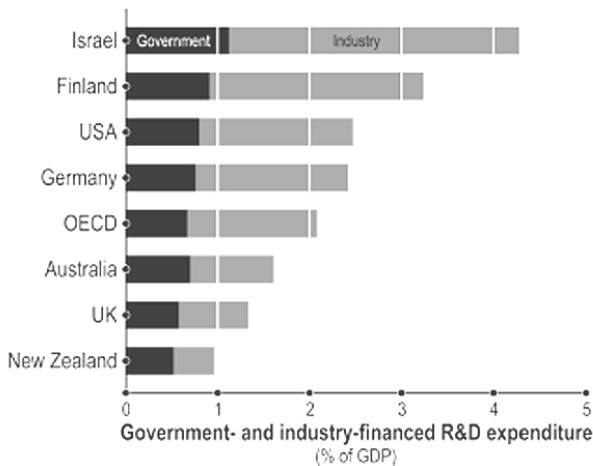


Fig. 3.1: OECD R&D spending list.

New Zealand aspires to emulate nations that have industry R&D spending significantly higher than government R&D spending – in other words, industry leads research, not the government. In these nations industry R&D leadership is likely to happen through an existing R&D business culture and/or appropriate business conditions facilitated by the government.

There is widespread agreement amongst government and industry alike that spending on industry R&D needs to increase for New Zealand to become more innovative, competitive and export focused. Company-specific and company-led R&D strategies embedded in long-term product and services development strategies are the key for any successful industry transformation.

HERA/Metals NZ believes the following policies will lead to effective change:

R&D Incentive Schemes

For R&D-based industry transformation to happen, operating conditions and incentives must be offered to industry. They must be broad-based and readily accessible to all companies wishing to innovate or, more importantly, have the potential to be transformed into innovators. Access must be facilitated for the many “average” performers, not just for

the few hundred high-performance companies who already have an R&D culture. The right incentives will encourage companies to think strategically about the function of R&D and its role in securing future business, and will motivate them to embed a formal R&D strategy.

HERA/Metals NZ recommends:

- An R&D tax credit scheme is an ideal broad-based mechanism for industry transformation. However, in the absence of such a scheme a suitable replacement might be to widen the access to R&D grant schemes and deliberately target the sectors of industry which enhance creating high value products and services for exports or as import substitution.
- Continuous availability of company-specific grants over several years to help embed strategic planning and R&D functions within the business, as opposed to the current emphasis on R&D service providers being in charge of the grant funds and providing only time-limited initiatives under their drive
- Widening the range of approved research providers for the R&D grant schemes to include non-public sector or independent research providers such as HERA
- Supporting the combined funding of research projects by companies that have common interests e.g. in renewable energy or resilient building systems

Support for self-funded industry R&D via industry levies

Sector-specific R&D has been funded effectively and with industry support via levy schemes such as the Commodities Levies Act (which comes under MAF), or by individual Acts of Parliament such as the Building Research Association NZ (BRANZ) Levy Act or the Heavy Engineering Research Levy (HERL) Act.

These funding schemes are very effective, particularly in New Zealand where, due to our small market, we lack substantial key industries such as automotive manufacturing, which normally lead and support downstream industries in their R&D efforts.

HERA/Metals NZ recommends:

- Government increases support for non-agriculture manufacturing sector groups to create stable industry levy funded R&D streams, provided industry groups are unified behind funding R&D via compulsory levies enshrined in legislation. The legislation should include the industry's right to subsequent abandonment of the scheme should industry consensus be lost



Fig. 3.2 HERA industry levy funded research contributed to seismic design solutions, which are now in every multi-storey building in New Zealand. Aurecon's International Structural Engineers UK award-winning Te Puni student accommodation building incorporates damage-avoidance systems such as rocking frames (inset) and sliding hinges.

Capability in Independent Research Organisation Funding

HERA/Metals NZ noted MSI/MBIE's move to introduce Capability of Independent Research Organisation Funding. This is an important step to maintain research capability of national significance outside the publicly funded system of universities and Crown Research Institutes (CRIs).

However, it is noted that associations funded by a commodity or industry levy are excluded from applying with one exception: the Science Board may determine that an organisation is eligible if it has a unique R&D capability of national importance, and is unable to be supported adequately by the income generated by the levy.

HERA/Metals NZ recommends:

- Capability of Independent Research Organisation Funding is implemented without delay to ensure important research capability is not lost in the transition from old funding mechanism to the new

Recognition of R&D and Expensing

While R&D forms the basis of innovation, downstream commercialisation with anticipated returns is the driver. Commercialisation is a costly process that requires investment in new plant and equipment, testing pilot products, staff training and IP protection. Sourcing money to cover these costs often stifles the commercial uptake of R&D results.

A positive measure to financially assist companies is to permit the complete write down of R&D capital for further investment. The measure will be largely cost neutral to government as it is a matter of timing when tax is paid, not a reduction. It has little long-term effect on total company tax paid as increased profits in the following years are likely to more than compensate for a reduced first-year tax take.



Fig. 3.3: The steel fabrication industry has invested heavily in more productive plant over recent years. The new Welded Beam Line installed at Metals New Zealand member Dixon and Haddon is shown here fabricating girders for the Kopu bridge.

Consideration should also be given to stimulating investment in more productive manufacturing equipment by allowing faster depreciation.

HERA/Metals NZ recommends:

- Making the early stage R&D commercialisation costs 100% tax deductible in the form of depreciation over the first year
- Introducing faster depreciation rates on productive manufacturing equipment

3.1.2 Public Funded Research and its Impact on Industry

It is recognised that publicly funded research via the CRIs and the universities has a key role to play, especially in the long-term fundamental and blue sky research area. It is also acknowledged that New Zealand's share in government-funded R&D (refer fig. 3.1) is relatively close to the OECD average, while industry-funded R&D is well below average. Increased industry R&D spending will create the greatest return to investors and generate growth in the New Zealand economy. Effort must focus on how public sector R&D can promote and support increased industry R&D and effectively put industry in the driver's seat for R&D investment.

HERA/Metals NZ supports the development of the Advanced Technology Institute (ATI) now named Callaghan Innovation. HERA contributed via submission and presentation to the formation of ATI and is pleased to note that many of its recommendations concur with industry thinking.

HERA/Metals NZ, however, is concerned that the translation of the ATI vision puts too much emphasis on developing the publicly funded research provider's capability, and not enough on how to empower and support industry to increase its innovation activities through R&D. This latter emphasis would help industry to value research, become effective research managers and, in the process, create a demand-driven research cycle for research providers to interface with.

Additionally HERA/Metals NZ argues that with increased pressure to provide quick improvements under the current economic conditions, the majority of the government-funded research should satisfy immediate- to medium-term needs and have a high probability of implementation and return on investment.

It is noted that, specifically in the government-funded academic R&D programmes, there is often little industry involvement in the definition of R&D needs. This leads to a lack of industry pull with little to no industry involvement in the research, its governance and its funding. With the argument that research is not exploited unless it is applied in industry, the missing link is really more industry involvement.

HERA/Metals NZ recommends:

- More government R&D money is channelled through industry rather than directly through the research provider to industry. This will result in industry deciding what research provider they wish to spend R&D funds with. Demand will then dictate which research providers and what research services best meet the needs of industry and determine which will expand and thrive
- In largely academic programmes government R&D policy puts more emphasis on industry involvement to determine research needs and its funding, the performance of the research, and in the governance process

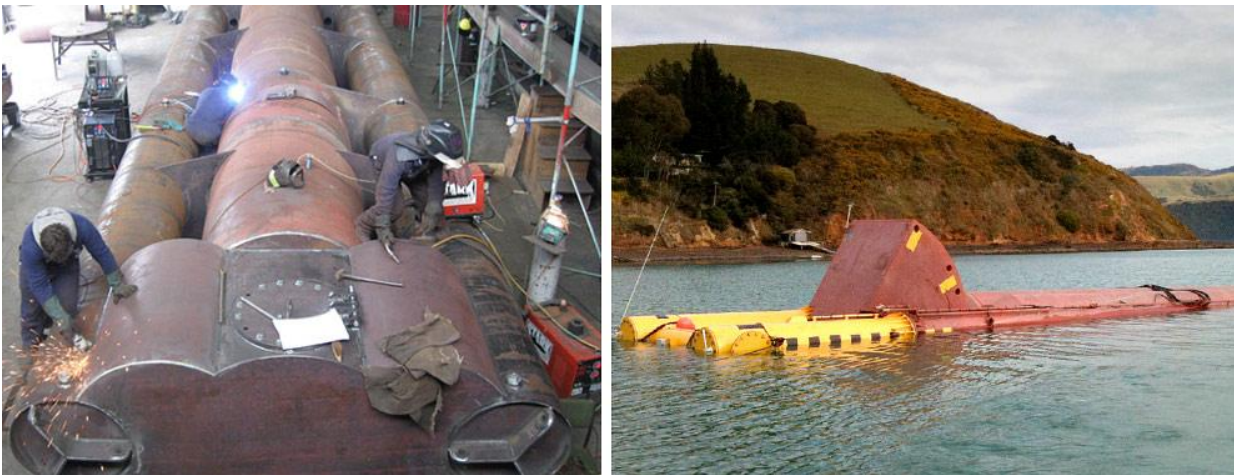


Fig. 3.4: WET-NZ – a research collaboration between IRL and Power Projects Ltd: half-scale wave energy device being fabricated at Stark Brothers in Lyttleton (left); being deployed for first sea trials (right).

3.1.3 Economic Development Strategies

HERA/Metals NZ supports the need to set priorities and support development of selected industries. We feel development opportunities for our industry sector are very much in the high-value manufacturing category.

Our industry sector is also of national strategic importance as it supports a wide range of key industry sectors such as agriculture and food, energy, building and construction, and a range of critical infrastructure. The strong link between our industry and those such as food processing, minerals, petroleum and renewable energy, provide an opportunity for parallel development, providing solutions for local industry that can then be sold into offshore markets.

Local industry development objectives do not feature strongly enough in many of the Government and sector strategies. For example, the objective of the Energy Strategy is to have “90% renewable energy by 2025”, yet the development of a local industry, which could benefit from striving to support this target, does not feature as a development aim.

In the context of setting priorities and galvanising interests, the elevation of selected industry development projects to “Projects of National Significance” would be an effective tool to be applied by government. New Zealand will benefit from well-researched and argued “Projects of National Significance”, as was the case in Denmark when it moved to create a world-leading wind energy industry. For example, elevating the R&D priority around geothermal energy generation technology for export markets to a “Project of National Significance” would allow all relevant government departments to be pulled together under MBIE/NZTE leadership. This, along with an associated industry development roadmap, would contribute significantly to developing a solid export-focused industry.

Equally in the context of setting focus and prioritising national efforts the release of Pure Advantage’s Green Growth Report *New Zealand’s Position in the Green Race* (full report can be downloaded from www.pureadvantage.org) is showing a pathway that our industry sector supports as a thinking model.

However, as an industry that is based on what the report calls “dirty and finite resources”, we believe a more considered approach is needed which must include aspects of ‘greening’ dirty activities based on ongoing innovation. In our view New Zealand should contribute its share in the production of the worldwide demand for such materials including extracting natural resources such as oil and coal.

NZ Steel’s steel production, for example, demonstrates how such activities can be ‘greened’, including furthering research into how carbon emissions can be turned into biofuels using the Lanzatech technology. Metals are near infinitely recyclable and, with a focus on using renewable energy in the recycling process, metals have the potential for an excellent environmental footprint. The important aspect is that as an industry we take sustainability seriously and continuously innovate with sustainability and the prosperity of our country in mind.

The report suggests that New Zealand industry takes a leadership role in developing a Green Growth Strategy and that government supports this development by removing policy roadblocks and provides incentives if industry leaders demonstrate a willingness to invest.

HERA/Metals NZ recommends:

- Inclusion of local industry development objectives in national economic development strategies
- Creation of “Projects of National Significance” for industry development to focus national efforts
- Endorsement of the principles developed in Pure Advantage’s Green Growth Report, including support of the development of an associated Green Growth Strategy. However, this must include ‘greening’ of essentially ‘dirty’ activities, and New Zealand contributing to harvesting natural resources in a responsible manner



Fig. 3.5: The new 100MW Kawarau Geothermal Power Station highlights the potential for geothermal energy in New Zealand. Through the collaborative effort of Geothermal New Zealand, export opportunities for New Zealand geothermal opportunities are explored.

3.2 The Role of Government in Developing Sustainable and Profitable Local Industries

Developing sustainable, profitable industries is accepted government policy in order to increase employment and the general wealth of New Zealand. The local metals engineering industry is a significant, viable and strategically important sector.

Our industry understands that it is required to be not only locally but also internationally competitive as it operates in a global environment. To maintain our competitiveness we need policies that recognise the importance of the industry sector and provide an effective framework to support the development of the industry.

In this development context it is recognised that central and local government play a major role through its own public sector procurement. But government is also able to influence State Owned Enterprise (SOE) procurement policy and the current shift to a mixed private public ownership model through the partial sales process is an opportunity to embed policy in the Mix Ownership Model Bill and/or an amended SOE Act.

3.2.1 Government Procurement Policy

The New Zealand Government's procurement spend alone is approximately \$30 billion per year. If the associated annual operating cost of those procured items is added, under whole-life considerations the estimated total cost is many times the original procurement cost. Due to the extent of this spending, public sector procurers have a major influence on the procurement chain, the follow-up operational cost and the total cost to the taxpayer. What's more, the procurers also have major influence on local industry development through their investment decisions, for example, through the determination of local versus imported content, or driving innovation by being lead users.

We understand that MBIE is currently reviewing the Government Procurement Process and HERA is represented on the Business Reference Group for this development. We welcomed the cabinet approved Five Principles of Government Procurement. We particularly note *Principle 4 Get the best deal for everyone*

- *Get best value for money – account for all costs and benefits over the lifetime of the goods or services.*

- *Make balanced decisions – consider the social, environmental and economic effects of the deal.*
- *Encourage and be receptive to new ideas and ways of doing things – don't be too prescriptive.*
- *Take calculated risks and reward new ideas.*
- *Have clear performance measures – monitor and manage to make sure you get great results.*
- *Work together with suppliers to make ongoing savings and improvements.*
- *It's more than just agreeing the deal – be accountable for the results.*

These principles are a signal issued by the cabinet to base procurement decisions on a comprehensive evaluation including 'consideration of the social, environmental and economic effects of the deal'.

• **Whole-Life Costing**

Government procurement guidelines already stipulate that whole-life costing principles are adopted for all purchases. However, industry notes that the guidelines lack clarity on how to do this and make little reference to their adoption, especially in the context of combining the procurement costing method with operational cost considerations to achieve optimum whole-life cost. It also lacks guidance on how to maximise return on investment via driving local content and local industry development.

The UK is a leader in the field of project procurement and applies a cost minimisation philosophy through its adoption in their *Achieving Procurement Excellence* guidelines. By following these guidelines, not only are lower whole-life project costs achieved, project procurement and operational risks are also reduced. An added benefit is the support such a process provides to undertaking triple-bottom-line reporting: economic, social and environmental outcomes.

Based on the fact that whole-life costing places emphasis not only on the start-up project procurement cost but also the operational cost over its lifetime, there are generally improved tender opportunities for local suppliers. This is because local suppliers have significant competitive advantages if operating, servicing and end-of-life disposal or recycling are considered during project planning and in the tender process. This will result in lower whole-life costs and improved business opportunities for the local industry.

• **Local Industry Participation and Industry Participation Plans**

In a Business & Economic Research Ltd (BERL) report produced for NZTE's Industry Capability Network it was established that for every \$1 million spent in manufacturing activity in New Zealand, an extra 11 jobs are generated. Yet the impact of using local versus imported content extends beyond the direct jobs gained; it also results in \$117,000 of tax revenue, \$195,000 of added purchasing power and, if we assume associated job generation, a \$119,000 saving of government welfare payments.

Industry Participation Plans (IPPs) are typically developed in large projects to research and seek potential involvement of local industry to ensure cost-effective procurement, and to meet obligations and legal requirements imposed on them by government. IPPs include evidence on how local industry has been encouraged to contribute to the project as part of the tender process.

IPPs often find local options that generate benefits both within and outside the project budget. These benefits would not occur if a prime contractor was not required to test the local market and simply used their existing offshore supply chain.

IPP-generated benefits typically found within the project include:

- Savings in set-up and logistic costs by making use of existing maintenance support, skills, facilities, supply chains and local knowledge
- Capacity/capability growth that parallels the project's growing needs

IPP-generated benefits outside the project budget, with relevance to local supply, include:

- Increased capability, capacity, credibility and export opportunities
- Reduced social burdens and increased national skill level
- Generation of GDP growth
- Reduced risk for taxpayer-funded projects
- Contribution to the wealth and social well-being of New Zealand
- Improvement to the balance of payments
- Strong demand drives innovation, competition and growth for New Zealand

The need to develop local content has been recognised by most countries, including those which are part of joint free trade agreements with New Zealand. They actively support the development of local industry input into projects funded by public money or receiving contributions via grants or other means from the public purse. For example, on 6 October 2011 the Australian Government announced its intention to make federal grants to states and territories of \$20 million or more contingent on them maximising opportunities for Australian business (<http://www.alp.org.au/federal-government/news/strengthening-opportunities-for-australian-industry/>).

Additionally, if project developers wish to receive the 5% tariff exemption on imports for major projects they are required to publish more extensive details on opportunities available to Australian business. IPPs are now required to be made public, providing greater transparency. Some Australian states are going further than that: the Victorian Government introduced a local content quota of 90% to build an AU\$1 billion Comprehensive Cancer Centre. It also expressed a strong commitment to the development of a Local Industry Development Plan.

• Lead User Innovation

As nations struggle to pull themselves out of the economic malaise created by the global financial crisis, an enduring theme appears to be 'innovation'. In New Zealand, we have a newly-named Ministry Business, Innovation and Employment; in Australia, they have the Department of Innovation, Industry, Science and Research.

Innovation is, according to the dictionary, "the introduction of something new", and it is easy to see why countries would be focusing on 'something new' in an effort to stimulate economic growth. Of course, there are many different aspects to innovation, but the most compelling is 'lead user innovation'. This is where a procurer/customer works with a company to provide an innovative solution.

Arguably, the transition from concept to commercialisation is a daunting phase for any innovation; the attraction of the lead-user model is its promise of smoothing this process – the commercial need has already been identified and the technology development can focus on a real-life, clearly defined customer need. So it's a win-win situation: the

customer, or lead user, gets the early advantage of the innovation; the company gains a customer-ready solution to take to market.

Indeed, lead user innovation is an especially suitable tool where government funding is constrained, as it is often not the government that invests directly but the lead organisations under the government's direction. In the New Zealand context, State Owned Enterprises, Government departments like Defence or, at a local level, city councils, are among the largest procuring entities in the country. They offer huge opportunities for New Zealand industry to work with them to develop and supply superior solutions to those they sometimes end up with.

Internationally, the US government helps drive R&D procurement and stimulates innovation in smaller companies with its Small Business Innovation Research (SBIR) programme. Launched in 1982, the SBIR programme is the world's largest seed capital programme for science and technology businesses: it makes more than 4,000 awards to small US businesses annually, totaling over USD 2 billion. It has converted billions of dollars of US taxpayer-funded research into highly valuable goods and services for the benefit of society and the economy.

Back home in New Zealand, one example of Government-led lead user innovation is the ANZAC Ship Project where the Ministry of Defence promoted local industry participation. One such local company was electrical control specialist Electropar, which recognised the commercial opportunity. The company formed new local partnerships, and designed and manufactured a new set of military-quality castings to house the fragile electronic componentry.

Electropar's successful delivery for the project ensured ongoing defence opportunities, most recently the supply of naval defence-quality products for the three Air Warfare Defence Destroyers for the Royal Australian Navy.

Developing sustainable, profitable industries to increase employment and the general wealth of New Zealand is accepted government policy. There is no reason that we cannot perfect the art of lead user innovation; all it takes is the leadership to say that's what we are going to do.

- **Some US Government Lead User examples**

nGimat, an intellectual property company and manufacturer of engineered nano-materials, was founded in 1993. It has won SBIR contracts from a number of government agencies including the Department of Defense, the National Science Foundation, the Department of Energy and the Environmental Protection Agency.

A \$700k award from the Navy, which focused on thin film coatings and passive devices that can be embedded on printed circuit boards, led to a \$7 million development and licensing agreement with Rohm & Haas, a subsidiary of Dow Chemicals. Today it has development programmes with several technology companies around the world.

Brewer Science supplies specialty chemicals and instruments to the micro- and opto-electronics industries globally. Its technology is used in products ranging from computers, phones and cameras, to medical instrumentation, telecommunications equipment and cars.

The company has received over 40 SBIR contracts from more than six different government agencies, many of which have led to commercially successful products. Established in 1981, Brewer now employs over 300 people worldwide and receives more than half of its revenue from outside the USA.

There are many examples where lead user innovation could apply in New Zealand: the Defence department purchasing major capabilities such new ships; geothermal SOEs engage with New Zealand companies to improve their plants and, in the process, develop geothermal plants that industry can then take to the world.

• **Procurement Excellence Proposal**

Linking the three principles – whole-life costing, local industry participation plans and lead user innovation – under the heading “Achieving Procurement Excellence” has major potential benefits; higher economic goals that accrue from local content become the focus, shifting attention from the ‘lowest contract price’ mentality.

HERA/Metals NZ accepts that the drivers for local development must be based on maximising the overall returns to the New Zealand economy from taxpayer-funded investments. But as the thrust is on driving excellence in public sector procurement, it will also provide guidance for the astute private investor.

We accept that New Zealand has subscribed to the principles of free trade and therefore the guidance developed must remain within these free trade rules, but we also believe that the fair and equal principles of free trade must be followed when considering public sector investment.

We acknowledge that the proposed procurement process requires considerable planning and its application may consume sizeable resources; its full application may only be economic for projects of a certain minimum project value.

The benefits are considered to be first of all in the interest of the project proponents and include:

- Lower whole-life project cost to project owner
- Reduced project procurement and operational risk including project objectives are met (on time, on budget, to specification)

Associated benefits of testing the local market and buying competitive local products and services can include:

- Lower quality conformance cost
- Lower repair risk
- Options for cost savings through responsiveness to innovation and design changes
- Savings through shorter lead times
- Reduced exchange rate risks
- Fulfilling triple-bottom-line reporting requirements
- Meeting any special contract conditions
- Demonstrating that New Zealand industry has been afforded full, fair and reasonable opportunity to participate in the project
- Providing good public relations as a corporate citizen
- Contributing to development of the local economy

While whole-life cost reductions on its own justifies the use of this guideline to any project owner, meeting the triple-bottom-line reporting requirements is finding increased global recognition. The OECD-endorsed Global Reporting Initiative (GRI) is a widely used and internationally acknowledged sustainability reporting scheme. GRI's core goals include mainstreaming disclosure of environmental, social and governance performance. Landcare Research and Business New Zealand have joined the GRI consortium to support New Zealand businesses manage their sustainability performance effectively and get world-class recognition for their work.

HERA/Metals NZ recommends:

- Provide balanced government procurement in respect to social, economic and environmental impacts. In particular include the consideration of loss in tax revenue from imported products in government procurement decision making
- Develop the New Zealand-specific business case for procurement excellence via supportive research and case studies
- Develop the technical side of whole-life costing guidelines and implement in the public sector procurement guidelines
- Develop the concept of lead-user innovation as part of the public sector procurement model
- Adoption of the developed guidelines, including the development of Industry Participation Plans, is a mandatory requirement for all major public sector procurement
- No import tariff exemption unless a detailed and satisfactory IPP has been provided
- To further the active adoption of procurement excellence assist in the associated training, especially of whole-life costing, cost management and development of IPPs

3.2.2 SOE Procurement

SOEs are a major procurer of assets and services from the metals engineering industry and, as government has a major influence on their operation through the provision of performance expectations, we believe government is able to influence their procurement behaviour, particularly through the objectives as set in its Act. In its current version the State Owned Enterprises Act (1986) places no obligation on SOEs to consider enhancing industry participation or industry capability development. In other words, they can operate without a sense of social responsibility and without regard to the intent of strategic government initiatives.

In the context of a potential SOE Act review to accommodate the requirements of the mixed ownership model, it is an opportune time to include requirements for SOEs to support overriding national interests in the Act.

HERA/Metals NZ recommends:

- Consideration is given for SOEs to follow the above "procurement excellence" principles e.g. a requirement is placed on SOEs that in relation to major projects they operate as good New Zealand corporate citizens, including support for national priorities in industry development as lead user innovators
- The SOE Act, and any legislation that considers the proposed mixed ownership model, be reviewed in relation to best practice procurement
- Major project procurement must include establishment and publication of local IPPs

3.2.3 Free Trade Agreements

HERA/Metals NZ members are generally supportive of free trade agreements, although it is noted that some members who are solely engaged in manufacture for the local market have expressed reservations with this position.

The HERA/Metals NZ position fundamentally is:

- Negotiated trade conditions must be fair and equal (no other non-tariff trade barriers or unequal compliance cost burdens)
- If tariffs are removed it must go both ways i.e. if the tariff applicable in New Zealand is 0%, the tariff with the treaty partner must also be 0%.
- All elements of influencing fair and equal trade need to be considered, including:
 - Health and Safety requirements – a comparable standard should be met
 - Code compliance – design, material and quality requirement should be comparable
 - Practices on imported labour – where an advantage is gained from importing and exploiting guest labourers, as in the case of shipyard workers imported into Singapore from Bangladesh and paid significantly below local wage rates, this is noted as an unfair advantage
 - Safeguards to prevent dumping need to be implemented

HERA/Metals NZ recommends:

- Free trade agreements are weighted in relation to the level of equity between New Zealand manufacturers and those overseas