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ANNUAL REPORT ON COMPETITION POLICY DEVELOPMENTS IN NEW ZEALAND

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EXECUTIVE SUMMARY

1. This report presents the key competition law and policy developments in New Zealand for the year ended 30 June 2016.

2. New Zealand's main competition legislation is the Commerce Act 1986. The Act prohibits conduct that restricts competition (restrictive trade practices). It also prohibits the acquisition of assets of a business or shares if the acquisition leads to a substantial lessening of competition in a market. This legislation is enforced by the New Zealand Commerce Commission (NZCC).

3. While no new competition legislation was enacted in the past year, there have been several proposals for new legislation. These include:

- a review of the Commerce Act's prohibition against misuse of market power;
- a review of dairy sector competition and regulation;
- a review of the Telecommunications Act 2001; and
- the Commerce (Cartels and Other Matters) Amendment Bill, which remains on the order paper of the New Zealand Parliament.

4. This report also outlines the NZCC's key enforcement and merger activities, its role in the formulation of competition-related policies, and the NZCC's resourcing.

5. Finally, the report outlines the findings of a NZCC investigation into the state of competition in the New Zealand dairy sector, the results of research into the profit-elasticity of New Zealand firms, and the outcomes of studies into the residential construction and business mobile telecommunications sectors.

1. Introduction

6. This report describes key competition law and policy developments in New Zealand during the period 1 July 2015 to 30 June 2016. The report addresses key competition developments concerning restrictive trade practices and business acquisitions and mergers. This includes comments on the relevant activities and resourcing of the NZCC.

7. The NZCC is New Zealand's primary competition enforcement and regulatory authority.¹ Its purpose is to achieve the best possible outcomes in competitive and regulated markets for the long-term benefit of New Zealanders. The NZCC is responsible for enforcing the following Acts:

- the Commerce Act 1986;
- the Fair Trading Act 1986;
- the Credit Contracts and Consumer Finance Act 2003;
- the Telecommunications Act 2001; and
- the Dairy Industry Restructuring Act 2001.

8. We do not discuss the Fair Trading Act or the Credit Contracts and Consumer Finance Act further in this report.

1.1 Competition law

9. With respect to competition law, the purpose of the Commerce Act is to promote competition in markets for the long-term benefit of consumers within New Zealand. The Act prohibits conduct that restricts competition (restrictive trade practices). It also prohibits the acquisition of assets of a business or shares if the acquisition leads to a substantial lessening of competition in a market.

10. Restrictive trade practices include anti-competitive coordinated behaviour and unilateral conduct. Coordinated behaviour refers to contracts, arrangements, or understandings that have the purpose, or have or are likely to have the effect, of substantially lessening competition in a market. Such agreements may relate to price fixing, restricting outputs, allocating customers, suppliers or territories, and bid rigging. Unilateral conduct includes a person or business taking advantage of their substantial degree of power in a market for an anti-competitive purpose, or specifying a minimum price at which their goods or services can be sold by another (resale price maintenance). The NZCC is responsible for enforcing the provisions of the Commerce Act relating to restrictive trade practices.

11. In addition to its enforcement functions, the NZCC has some quasi-judicial functions under the Commerce Act. It can approve a business acquisition or merger that does not substantially lessen competition (known as a clearance). It can also authorise a business acquisition that is anti-competitive, or a restrictive trade practice that involves an agreement, but which would ultimately benefit the New Zealand economy (using a total welfare test). The effect of clearance and authorisation determinations by the NZCC is to offer businesses protection from legal action under the Commerce Act.

¹ The NZCC's website address is: <http://www.comcom.govt.nz/>

1.2 Sector-specific regulation

12. In addition to economy-wide competition law, the NZCC is also responsible for implementing several pieces of legislation aimed at regulating specified natural monopoly businesses and markets where competition either is not possible or is limited:

- Under Part 4 of the Commerce Act, the NZCC currently regulates electricity lines businesses, gas pipeline services, and specified airport services supplied at the three major international airports located in the cities of Auckland, Wellington and Christchurch.
- The Telecommunications Act 2001 regulates the supply of telecommunications services in New Zealand. The Act is administered by the NZCC under the stewardship of a Telecommunications Commissioner, a statutory position under the Act.
- Finally, the Dairy Industry Restructuring Act 2001 provides for the regulation of certain aspects of the dairy sector in New Zealand.

13. The remainder of this report focusses primarily on competition law. However, brief reference is made to key developments in sector-specific regulation.

1.3 Institutional design

14. The NZCC is an independent government entity. Whilst it is primarily accountable to the Minister of Commerce and Consumer Affairs for its performance and outputs, it is not subject to direction from the government in carrying out its enforcement, adjudication and regulatory control activities. The NZCC is, however, required to have regard to statements of government economic policy communicated by Ministers under the Commerce Act or the Telecommunications Act. The NZCC's independence requires it to be an impartial promoter and enforcer of the law.

15. The role of providing government with policy advice on competition matters belongs generally to the New Zealand Ministry of Business, Innovation and Employment (MBIE). The demarcation of roles between the NZCC and the Ministry ensures a clear separation and independence between the operational and policy functions respectively within New Zealand's competition regime. That being said, whilst the primary role of the NZCC is an operational one, where relevant, the NZCC uses its experience to provide advice on policy developments and sectoral and legislative reviews, with particular focus on the operational aspects of a regime.

16. Internationally, the NZCC is actively involved with its counterpart agencies through forums such as the Organisation for Economic Co-operation and Development (OECD) and the International Competition Network. The NZCC has cooperation agreements with Australian Competition and Consumer Commission (the ACCC), the Canadian Competition Bureau, and the Taiwan Fair Trade Commission. In addition, the NZCC's relationship with the Australian Competition and Consumer Commission is strengthened through Commissioner cross-appointments.

2. Changes to competition laws and policies, proposed or adopted

2.1 Summary of new legal provisions of competition law and related legislation

17. There have been no new substantive legal provisions relating to competition law introduced in the 2015/16 year. See below for details of proposed legislation.

2.2 *Other relevant measures, including new guidelines*

18. In December last year the NZCC released investigation guidelines designed to help traders and consumers understand how they investigate competition and consumer matters. They cover a wide range of topics to help consumers, traders and lawyers understand what they can expect during a NZCC investigation.²

2.3 *Government proposals for new legislation*

2.3.1 *Commerce (Cartels and Other Matters) Amendment Bill*

19. The Commerce (Cartels and Other Matters) Amendment Bill was introduced into the New Zealand Parliament on 13 October 2011, and is currently awaiting Committee of the Whole House stage in Parliament.

20. The Bill clarifies the definition of cartel conduct to include the forms of cartel behaviour as defined by the OECD: price fixing, output restriction, and market allocation. Cartel conduct is currently prohibited under section 30 of the Commerce Act only to the extent that there is an effect on the price for goods or services. The definition of cartel conduct in the Bill makes it clear that contracts, arrangements and understandings that contain, or give effect to, any of the specified forms of cartel conduct are prohibited.

21. As a counterbalance to this more inclusive definition of cartel conduct, the Bill focuses on the substance of collaborative conduct (rather than on the form) by introducing a collaborative activity exemption. The purpose of the exemption is to ensure that legitimate pro-competitive collaborations are not prohibited. The exemption applies to all pro-competitive, efficiency-enhancing collaborations and not only to structural joint ventures, as currently provided under the Commerce Act.

22. The Bill also introduces a clearance regime to enable firms to approach the NZCC for a ruling on whether a proposed arrangement entered into by parties involved in a collaborative activity would raise competition concerns. In order to grant a clearance, the NZCC would need to be satisfied that the arrangement would not have, or would not be likely to have, the effect of substantially lessening competition in a market, and that if the relevant activity contains a cartel provision, that the provision is reasonably necessary for the purpose of the collaborative activity.

23. The Bill as initially drafted proposed to introduce criminal sanctions for hard-core cartel offences. However, on 8 December 2015, the Minister of Commerce and Consumer Affairs announced his decision to remove the criminal sanctions from the Bill.

2.3.2 *Review of the misuse of market power prohibition and related matters*

24. On 17 November 2015, the Minister of Commerce and Consumer Affairs released a Targeted Review of the Commerce Act Issues Paper. The Issues Paper canvassed whether:

- section 36 of the Commerce Act – which prohibits firms with substantial market power from taking advantage of that power for the purpose of harming competitors – should be reformed;

² Available here: <http://comcom.govt.nz/the-commission/commission-policies/competition-and-consumer-investigation-guidelines/>

- the Commerce Commission's rarely-used cease and desist regime could be replaced with alternative enforcement mechanisms; and
- a formal 'market studies' power should be given to a government agency.

25. 39 submissions on the Issues Paper were received.³ Following a supplementary letter from Dr Mark Berry, Chair of the Commerce Commission, to the Minister of Commerce and Consumer Affairs on 2 June 2016 advocating for reform of section 36, a cross-submission process was launched.

26. This cross-submission process concluded on 21 July 2016. At the time of writing, the Government has made no announcement regarding next steps.

2.3.3 *Review of Competition Regime for International Civil Aviation*

27. Competition in the aviation sector is desirable to promote international aviation services at a cost, frequency, quality and range of destinations that meet New Zealand's needs. Competition in international air services is currently regulated by both Part 9 of the Civil Aviation Act 1990 (CAA) and the Commerce Act. Certain international air services trade practices can be exempted from the Commerce Act if they meet criteria in the CAA and are authorised by the Minister of Transport.

28. In its 2012 International Freight Transport Services Inquiry, the New Zealand Productivity Commission (NZPC) recommended, subject to a review of passenger-specific impacts, that the Government should consider removing the Commerce Act exemption for regulating international air services. The NZPC considered that a process of authorising trade practices under a Commerce Act-only regime would be more effective. It would impart a stricter public benefit test that will maximise the likelihood that efficiency-enhancing trade practices are authorised, and minimise the chances that harmful forms of competition are authorised.

29. The New Zealand Ministry of Transport is currently reviewing the provisions of Part 9 of the CAA as part of a broader CAA review. It is considering whether the competition regime for international air services should remain under the CAA as a sector-specific regime, or be moved to the Commerce Act. It is expected to focus on two primary options:

- A revised CAA regime which increases the transparency of the process and clarifies the way in which benefits and detriments on any proposed arrangements are to be taken into account; or
- Removal of the exemption for aviation by repealing Part 9 of the CAA and providing for regulation under the Commerce Act.

2.3.4 *Dairy industry*

30. The Dairy Industry Restructuring Act 2001 (DIRA) provided for the formation of the dairy co-operative Fonterra — amalgamating New Zealand's two largest dairy co-operatives and the New Zealand Dairy Board. Upon its creation, Fonterra collected 96 per cent of New Zealand's milk production. In recognition of Fonterra's dominant market position, the DIRA set up a unique regulatory regime with the purpose of promoting the efficient operation of New Zealand dairy markets.

³ Submissions have been published online at <http://www.mbie.govt.nz/info-services/business/competition-policy/targeted-review-of-the-commerce-act>

31. Fonterra is still subject to the provisions of the Commerce Act prohibiting restrictive trade practices. However, while the Commerce Act provides for *ex-post* examination of whether or not a company has taken advantage of market power, the DIRA is designed to act as an *ex-ante* incentive regime — such that Fonterra does not have the incentive to act in an anti-competitive manner.

32. The DIRA promotes contestability in the market for farmers' milk by requiring Fonterra to operate an "open entry and exit regime". This means that Fonterra must accept all milk supply offers from dairy farmers in New Zealand and allow relatively costless exit from the co-operative. These requirements ensure that Fonterra cannot "lock in" its farmer-suppliers and, as a consequence, Fonterra faces commercial incentives to pay efficient prices for farmers' milk and capital invested in Fonterra. The DIRA also provides for a farm gate milk price monitoring regime to be undertaken by the NZCC and the ability for independent processors to access regulated volumes of raw milk at the 'factory gate'.

33. The DIRA requires that when Fonterra's market share of milk collected at the farm gate falls below 20%, a report into the state of competition must be conducted. That threshold was met in the 2014/15 season. On 1 March 2016 the NZCC released a report into the state of competition in the New Zealand dairy sector. The report argued that there is not sufficient competition at the 'farm gate' and 'factory gate' to consider full deregulation at this time, but recommended that a pathway to deregulation would be smoothed by facilitating the development of a 'factory gate' market for non-DIRA milk. The NZCC recommended that Ministers consider:

- reducing independent processors' entitlements to DIRA milk; and
- tightening the terms and conditions for DIRA milk supply.

34. The Government is currently considering its response to these recommendations.

2.3.5 *Telecommunications sector*

35. The Telecommunications Act 2001 created an industry-specific regulatory regime for telecommunications, overseen by the Telecommunications Commissioner within the NZCC.

36. The Act provides that the NZCC can set comprehensive terms and conditions for regulated wholesale telecommunications services, such as interconnection, unbundled local loop services, unbundled bitstream services and mobile termination. The NZCC can also investigate and recommend to the Minister for Communications that wholesale telecommunications services be regulated. If the recommendation is accepted by the Minister, the service can then be added to the schedule of regulated services under the Telecommunications Act. The NZCC produces regular reports on developments in competition in telecommunications markets under its general monitoring powers.

37. The Government is currently undertaking a review of the Telecommunications Act⁴. In April 2016, the Minister for Communications announced high-level policy decisions relating to regulation of the telecommunications sector, including:

- moving to a 'building blocks' regulatory pricing regime – which will impose price and/or revenue caps based on the underlying value of network assets – for copper and fibre broadband services from 2020;

⁴ Further information is available here: <http://www.mbie.govt.nz/info-services/sectors-industries/technology-communications/communications/regulating-the-telecommunications-sector>

- supporting competition in the mobile sector, including encouraging the sharing of infrastructure; and
- retaining the requirement that fibre broadband providers ‘unbundle’ parts of their network from 2020.

38. The Government is currently building on high-level announcements to design the detail of the new regulatory regime, in consultation with stakeholders.

3. Enforcement of competition laws and policies

3.1 *Anti-competitive practices*

3.1.1 *Summary of activities*

39. **Table 1** shows the number of cases investigated by the NZCC in relation to anti-competitive practices in the three years ended 30 June 2014, 2015, and 2016.

Table 1. NZCC investigations of anti-competitive practices

	2015/16	2014/15	2013/14
Number of coordinated behaviour cases	7	8	11
Number of unilateral conduct cases	1	3	3

3.1.2 *Significant cases*

- Real estate agencies in court for price fixing

40. In December 2015, the NZCC filed proceedings in the Auckland High Court for alleged price fixing and anti-competitive behaviour by 13 national and regional real estate agencies, a company owned by a number of national real estate agencies, and three individuals. The NZCC also issued warnings to an additional eight agencies for their role in the conduct. The NZCC has agreed settlements with three parties with the court-imposed penalties totalling \$4.35 million. Cases against the other defendants are ongoing.

- Livestock companies fined over \$3 million for price fixing

41. In August 2015, the NZCC filed court proceedings against PGG Wrightson, Elders New Zealand, Rural Livestock and five individuals alleging price fixing in connection with the introduction of the National Animal Identification Tracing Act 2012. Seven other livestock companies and the industry association received a warning.

42. PGG Wrightson and Rural Livestock settled the cases against them, and in December 2015 were ordered by the High Court to pay a penalty of \$2.7 Million.

3.2 *Mergers and acquisitions*

3.2.1 *Statistics*

43. The number of decided clearance applications dropped slightly this year from 14 to 12. However, the NZCC has seen a rise in the number of merger clearance applications decided over the last three years (39), compared to the previous three years (27). Application numbers remain lower than pre-Global Financial Crisis levels.

44. **Table 2** shows the number of merger clearance and authorisation applications processed by the NZCC in the three years to 30 June 2016. It also shows any proposed or actual acquisitions or mergers for which clearances or authorisations were not sought but which were investigated by the NZCC to ascertain their effects on market structure and competition (market structure cases).

Table 2. Merger clearance and authorisation applications

	2015/16	2014/15	2014/13
Number of clearance applications processed	12	14	13
Number of authorisation applications processed	1	1	0
Number of market structure cases investigated	1	2	1

45. **Table 3** sets out the merger and acquisitions applications received by the NZCC in the year ended 30 June 2016, and their outcomes.

Table 3. Outcome of merger applications

Application	Resolution
Z Energy and Chevron New Zealand	Cleared subject to divestment undertaking
FedEx Corporation and TnT Express N.V	Cleared
B100 Limited and Real Cold Limited	Cleared
Wilson Parking New Zealand Limited and Tournament Parking Limited	Cleared
Evolution Healthcare (NZ) Pty Ltd and Medusa Limited & Royston Health Trust Board	Cleared subject to divestment undertaking
Vocus Communications Limited and M2 Group Limited	Cleared
Rheem New Zealand Limited and Peter Cocks (2010) Limited	Cleared
Tennex Capital Limited and San-i-pak Limited	Declined
Spark New Zealand Trading Limited, Craig Wireless Spectrum Operations Limited and Woosh Wireless Holdings Limited	Cleared
Coty Inc. and The Procter and Gamble Company	Cleared
Fletcher Building Holdings New Zealand Limited and Higgins Group Holdings Limited	Cleared
H.B. Fuller Company Australia Pty Limited and Advanced Adhesives (New Zealand) Limited	Cleared
Cavalier Wool Holdings Limited and New Zealand Wool Services International Limited	Authorised (under appeal)
Sky Network Television Limited and Vodafone Europe B.V.	Decision due 11/11/16
NZME Limited and Fairfax Limited	Decision due 15/03/17

3.2.2 Significant cases

- Appeal of wool scouring authorisation

46. This year the NZCC authorised Cavalier Wool Holdings Ltd to acquire NZ Wool Services International Ltd's wool scouring business and assets. This decision was appealed by Godfrey Hirst. The NZCC's decision was upheld by the High Court and Godfrey Hirst has obtained leave to appeal to the Court of Appeal on one issue.

- Z Energy cleared to acquire Chevron subject to divestments

47. The most complex merger this year, in terms of scale and the number of markets involved, was the NZCC's clearance of Z Energy to acquire Chevron New Zealand (owner of the Caltex and Challenge brands) in the wholesale and retail fuel market.

48. In April 2016 the NZCC cleared Z Energy to acquire 100% of Chevron, subject to it divesting 19 retail sites and one truck stop in locations where the NZCC considered competition would be substantially reduced as a result of the merger. The NZCC analysed the competitive impact of the proposed merger on the supply of fuel to retail and commercial customers. The NZCC also considered how the merger would impact on competition in upstream markets associated with refinery, distribution and storage infrastructure. Commissioners were in agreement on the impact of the merger on six of the seven markets analysed, with the exception being retail service stations, where Commissioner Walker held an alternative view.

- Commerce Commission declined clearance Tennex Capital's acquisition of San-i-pak

49. IWL and San-i-pak are the only parties in New Zealand's South Island currently providing the treatment and disposal of medical and quarantine waste services. The NZCC was not satisfied that the merger of IWL and San-i-pak would not have the likely effect of substantially lessening competition (by reducing the market to a monopoly) in the supply of treatment and disposal of medical and quarantine waste services in the South Island.

50. While Tennex submitted that without the merger San-i-pak would exit the market anyway, the NZCC was unable to exclude the real chance that San-i-pak would continue to operate, whether under its current owners or under the ownership of a third party after a sale.

4. The role of competition authorities in formulating and implementing other policies

51. As discussed above, the NZCC is an independent government entity responsible for enforcing a range of legislation. To ensure an appropriate separation of policy and operational functions, the competition regime in New Zealand operates on the basis that responsibility for advising government on policy development issues is assigned to MBIE. However, the NZCC may provide advice on, or information relevant to, policy developments or legislative change when it has relevant expertise or it considers the situation warrants public comment.

5. Resources of the NZCC

5.1 Human resources

52. The NZCC's personnel have a wide range of skills and experience to ensure the organisation's effective functioning. This includes people with backgrounds in economics, finance, engineering, business and law, and with a mix of both private and public sector experience. As at 30 June 2016, the NZCC employed 88.11 full-time equivalent (FTE)⁵ staff in its Competition Branch. This compares with 79.97 FTE staff employed as at 30 June 2015.

53. The Competition Branch deals with both competition (Commerce Act) and consumer (Fair Trading Act and Credit Contracts and Consumer Finance Act) law issues. All staff employed in the Competition Branch can potentially work on either competition or consumer issues. However, personnel are generally divided into teams according to areas of specialisation. **Table 4** shows the numbers of FTE staff in the relevant teams.

⁵ An FTE employee is equivalent to one employee working full time for a full year. There are likely to be fewer FTEs than actual people employed since some employees are hired on a part-time basis.

Table 4. Numbers of Competition Branch FTE employees⁶

Support staff	10.68
Investigators	49.40
Lawyers	16.43
Economists	5
Advocacy	5.60
Total	88.11

54. **Table 5** shows the human resources applied to enforcement activities against anti-competitive practices, merger reviews and enforcement and advocacy efforts.

Table 5. Human resources applied to competition enforcement

Anti-competitive practices	7
Merger review and enforcement	9
Advocacy efforts	5
Lawyers	8
Economists	5

5.2 NZCC Annual budget

55. Table 6 shows the NZCC's annual budget for both general markets (which covers its competition enforcement activities) and for the organisation as a whole.

Table 6. NZCC Annual budget

General Markets⁷		
2015/16	2014/15	Change
\$14.99 million NZD	\$14.84 million NZD	\$0.15 million NZD
\$10.86 million USD ⁸	\$10.75 million USD ⁸	\$0.11 million USD
Commerce Commission Overall⁹		
2015/16	2014/15	Change
\$43.74 million NZD	\$40.67 million NZD	\$3.07 Million NZD
\$31.68 million USD ⁸	\$29.46 million USD ⁸	\$2.15 million USD

6. New reports and studies on competition policy issues

6.1 Competition in the Dairy Industry

56. As noted above, on 30 March 2016 the NZCC released its final report on Competition in the New Zealand Dairy Industry.¹⁰ The NZCC found that competition in the 'factory gate' market was very limited, that Fonterra has buyer-side market power at the 'farm gate', and that there could be barriers to entry for

⁶ Note that Table 4 shows the number of staff in the Competition Branch only, and does not include the regulation and organisational performance branches. It also includes staff working on consumer protection issues.

⁷ The General Markets budget allocation includes enforcement of competition and consumer laws.

⁸ As at 26 September 2016 exchange rates.

⁹ The overall budget for the NZCC covers competition, consumer and regulatory functions in addition to organisational support.

¹⁰ Available here: <http://comcom.govt.nz/regulated-industries/dairy-industry/report-on-the-state-of-competition-in-the-new-zealand-dairy-industry/>

farmer suppliers without the retention of dairy sector regulation. The NZCC noted that the costs and benefits of the dairy sector regulation were finely balanced, but that the risks of removing it too soon outweighed the risks of it remaining longer than it should.

6.2 *Competition in New Zealand industries*

57. In April 2016, MBIE completed a research paper entitled *Competition in New Zealand Industries: Measurement and Evidence*.¹¹ It uses a recently-developed measure of competition – profit elasticity – to assess the degree of competition across a range of industries in New Zealand using firm-level data. It found that manufacturing industries are some of the most competitive sectors in New Zealand. It also found that most sectors – with the exception of finance and insurance – experienced significant increases in competition intensity over the period 2000-2010. Internationally, competition in New Zealand appears slightly more intense than Portugal, but less intense than the Netherlands and Finland.

6.3 *Residential construction sector market study*

58. In November 2015, MBIE concluded a three-year market study into the residential construction sector.¹² Outcomes of the study included work to:

- reduce the impact of tariffs and anti-dumping duties on competition from imports;
- improve the operation of the regulatory building control system;
- reduce the risk of strategic arrangements in the upstream supply chain creating a barrier to competition; and
- increase consumers' confidence to become more active and informed market participants.

6.4 *Competition in the telecommunications sector*

59. In March 2016, the NZCC released a study into the business mobile telecommunications market segment.¹³ The study examined the business mobile market due to its high concentration levels, and sought to understand if there are any barriers to more effective competition such as impediments to switching or perceptions of quality. Overall, the study explored whether anti-competitive behaviour or other factors were inhibiting competitive dynamics in the business segment of the mobile market. The study found most respondents were satisfied with their provider, and uncovered no evidence of anti-competitive behaviour or other factors which were inhibiting competitive dynamics.

¹¹ Available here: <http://www.mbie.govt.nz/publications-research/publications/economic-development/competition-in-new-zealand-industries.pdf>

¹² Available here: <http://www.mbie.govt.nz/info-services/building-construction/legislative-other-reviews/past-work-and-older-topics/residential-construction-sector-market-study/?searchterm=residential%20construction%20market%20study%2A>

¹³ Available here: <http://comcom.govt.nz/regulated-industries/telecommunications/monitoring-reports-and-studies/studies/>