

International Freight Transport Services

Summary version of draft report - January 2012

The New Zealand Productivity Commission

The Commission – an independent Crown Entity – completes in-depth inquiry reports on topics selected by the Government, carries out productivity-related research, and promotes understanding of productivity issues. The Commission’s work is guided by the New Zealand Productivity Commission Act 2010.

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About the summary version

This 'summary version' provides the key points, findings and recommendations from the Commission's international freight transport services inquiry draft report. It is designed to give you a quick route into the key insights from our examination of international freight in New Zealand.

The draft report itself follows the release of an earlier issues paper (July 2011); consideration of over 50 submissions on that paper; a large number of meetings with interested parties; and the Commission undertaking its own research and analysis of issues central to freight transport. Submissions on the draft report are invited by 27 February.

We are keen to hear from you over the remainder of the inquiry period – as part of ensuring we deliver a high-quality final report by 1 April. To see the full version of the draft report – including information on how to make a submission – please visit our website www.productivity.govt.nz or call us on 04 903 5150.

Format of the summary version

Key points

- The key points box at the start of each chapter is a summary of the main considerations and findings on each topic.

F

Findings are shown in numbered order at the end of each chapter.

R

Recommendations are shown in numbered order at the end of each chapter.

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Overview

What has the Commission been asked to do?

The Government has asked the Commission to undertake an inquiry into international freight transport services. The key high-level questions for the inquiry are:

- What factors influence the accessibility and efficiency of international freight transport services available to New Zealand firms?
- Are there opportunities for changes in New Zealand's infrastructure and regulatory regimes that could increase the accessibility and efficiency of international freight transport services for New Zealand firms?

In answering these questions the Commission has been asked to pay particular attention to:

- the effects of New Zealand's distance from overseas markets and reliance on overseas providers of international freight transport services;
- the costs, efficiency, productivity level and growth of all components of New Zealand's international freight services supply chain, with international comparisons; and
- the effectiveness of current regulatory regimes (including those in the Civil Aviation Act 1990 and Shipping Act 1987), and the potential costs and benefits of alternative regulatory arrangements, with international comparisons.

Why the inquiry is important

Trade and freight services are intimately connected

International freight transport services provide essential connections between New Zealand and the international economy. They allow New Zealand firms to access export markets and the imported raw materials, intermediate inputs, and equipment necessary for New Zealand's productive base. If international freight costs can be reduced, and quality and reliability improved, then trade will be enhanced, the economy can be more productive and New Zealanders' wellbeing enhanced.

International trade is particularly relevant for a small and distant island nation such as New Zealand. It enables specialisation and access to resources and products that would otherwise be unavailable locally. It expands the range of technologies available to local firms and consumers, and promotes productivity growth because competition with foreign firms spurs local firms to be more efficient and innovative. New Zealand exporters will be more successful if they have access to required inputs, including imported goods, at internationally competitive prices.

Trade costs include the direct costs of freight, but are wider than that. Examples of additional costs include customs and biosecurity charges, tariffs and the financing costs of goods unavailable while in transit. One of the tasks of this Inquiry is to identify all significant sources of trade costs.

Transport costs are significant

Transport costs affect the profitability of exporting industries, and if too high they may preclude a business from exporting at all. Where imported goods (for example, farm machinery) are used in the production of goods for export, higher trade costs hit exporters twice by making inputs more expensive and outputs less profitable.

Ad valorem sea freight costs (that is, the cost of freight relative to the value of the goods transported) have been falling over the last two decades. Total ad valorem freight costs for New Zealand imports were still about 6% in 2010 (down from about 10% in 1990). Equivalent data for all of New Zealand's exports are not available. However, New Zealand export freight costs to Australia fell from 9% of export value in 1991 to

4% in 2010, and to the USA from 8% in 2002 to 6% in 2010. Ad valorem air freight costs tend to be lower than for sea freight because air tends to be used for higher-value goods.

The total freight costs for imports in 2010 were \$2.4 billion, excluding domestic onshore costs (such as inland transport in New Zealand). On reasonable assumptions, freight costs for exports were about \$2.6 billion in 2010. For both imports and exports this amounts to about 2.7% of GDP.

Figures such as these do not include the costs involved in the transit time that it takes for the product to reach its destination. Longer transit times involve costs such as deterioration of the product and delayed receipt of revenue. If transit times are unpredictable, or there are delays, a market opportunity may be missed and goods arrive when they have less value. Perishable goods in particular may lose value. If the goods are an input to a production process, delays could slow down production, which could be particularly costly for companies that operate 'just in time' production processes.

While it may be difficult to reduce travel times significantly without considerably increasing freight costs (for example, by switching from sea to air transport), useful gains may be made through, for instance, more efficient documentation requirements and customs processing times. Further costs would be incurred if exporters were unable to secure access to transport when they needed it and were willing to pay for it.

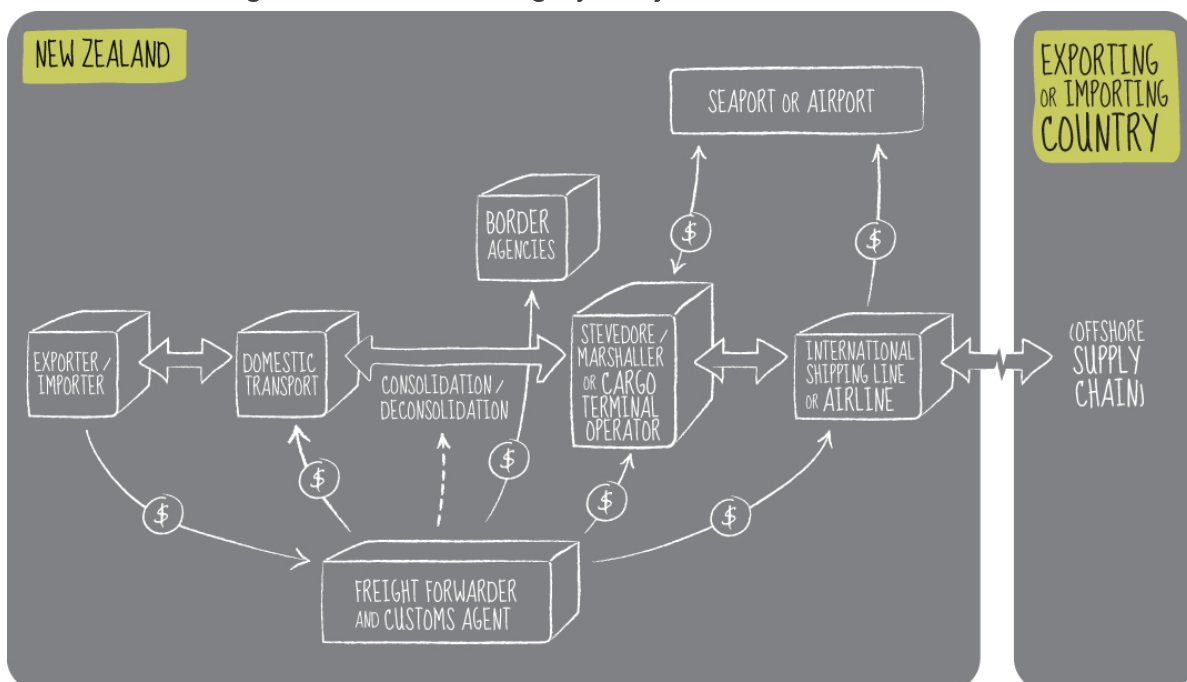
Key characteristics of international freight transport

A complex process

International freight logistics is a complex process involving different operators and various contracting arrangements, as the figure below illustrates. In broad terms, the logistics chain can be split into five distinct phases, with New Zealand exporters and importers at the beginning and end of the chain respectively:

- from factory to port;
- at the export port;
- port to port (sea or air freight service);
- at the import port;
- from port to warehouse.

The New Zealand leg of an international freight journey



Notes:

1. The thick arrows indicate the direction of the physical movement of freight, and the thin arrows indicate where payments for services tend to occur.

From the perspective of an importer or exporter, the key issue is the cost of the total supply chain, rather than simply freight costs. Logistics is the process of efficiently moving goods from their point of production to their point of consumption in order to meet customer requirements, which typically include the quantity and quality of goods as well as the time and place of delivery. Freight is only one component of this logistics process. Logistics management aims to meet customer requirements at minimum cost.

Logistic costs and 'trade costs' are very much the same thing. To the extent these costs include the New Zealand transport leg of any international route, domestic transport costs are also relevant to this inquiry. Smaller importers and exporters may deal only with specialist freight forwarding or logistics firms, who take over responsibility for coordinating the other elements of the chain.

Importantly, it is not just the absolute level of costs that matter. Paying a higher price for a logistics service is justified if the extra value from the customer's perspective outweighs the increment in price. What matters for many New Zealand businesses will be access to a menu of logistics services, from which they can choose the combination of price, quality and timeliness that best meets their requirements.

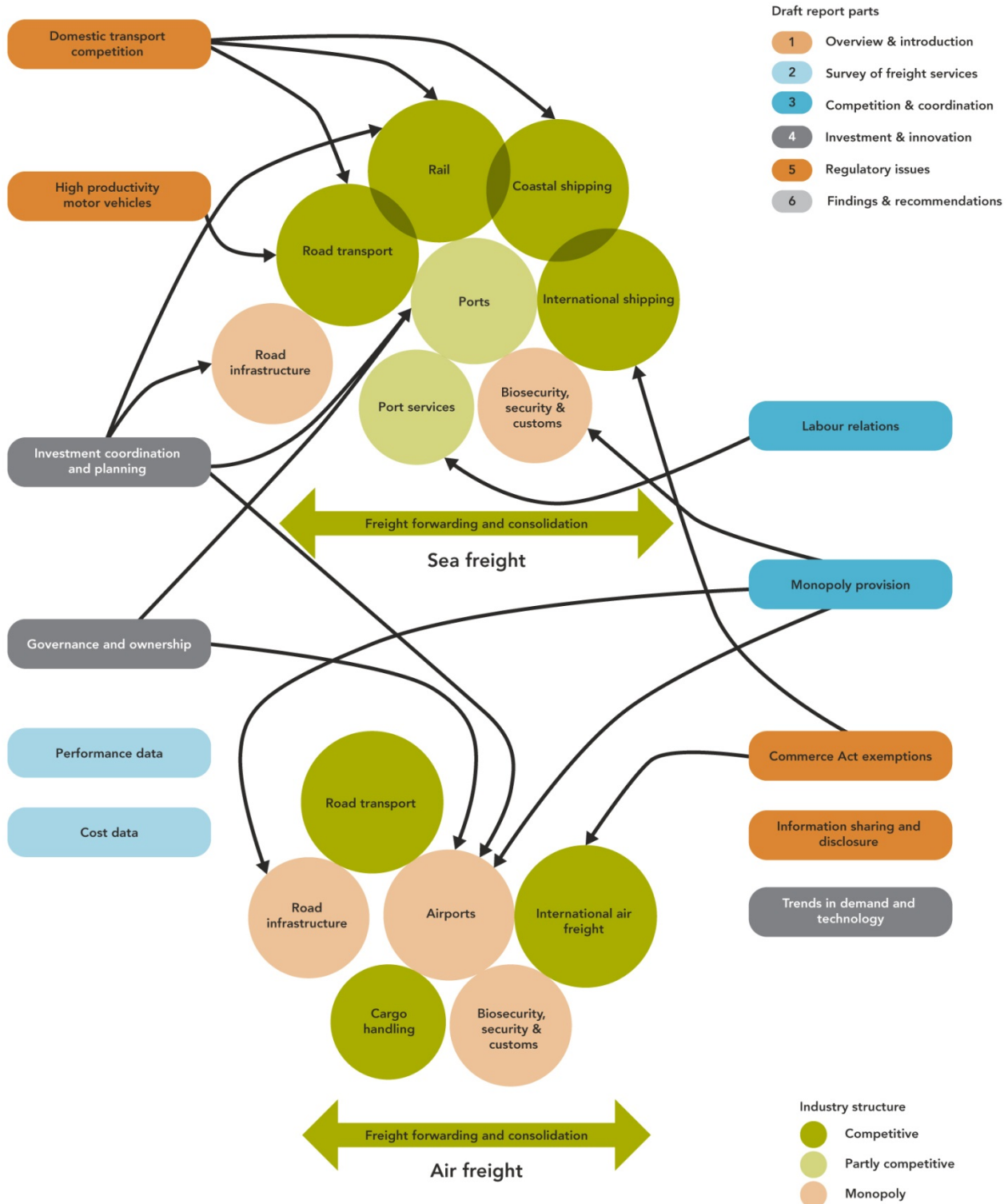
With many components

International freight transport services make up a system that encompasses a number of distinct components. In the diagram below, adjacent circles indicate a logistics interface between components; in essence, a handover point. An overlap between two circles indicates that, in addition to a point of interface, some competition exists between those components. For example, rail sometimes competes with road and coastal shipping transport; but at other times it connects with them as part of an overall logistics chain.

Based on the Commission's analysis of evidence presented during the inquiry, the circles are coloured to reflect an assignment of components into those with natural monopoly characteristics (light orange), those with the characteristics of competitive industries (green), and those that have the potential to be competitive (light green) but where competition may be limited. The boxes on each side of the figure indicate some important issues that are considered in the report.

Freight forwarders interact with all other components and are shown spanning them. While not depicted in the diagram, air and sea are alternative international freight modes. Thus, to some extent, ports compete with airports and international sea freight services compete with air freight services.

International freight transport system framework



How well is the sector performing?

The available data on the international freight sector’s costs, productivity, profitability and innovation indicate both pockets of good performance and significant opportunities for improvement.

Ad valorem freight costs

- As noted above, ad valorem sea freight costs (measured as the price paid for freight relative to the value of the goods being transported) have been coming down over the last 20 years, although the rate of improvement slowed in the 2000s. In aggregate, and after accounting for compositional factors, ad valorem sea freight costs are about 20% higher in New Zealand than in Australia (about 5.2% compared

with 4.3% in 2010). Case studies also indicate that in some instances, the ocean transport component of costs can be higher for Auckland compared to Sydney.

- Ad valorem air freight costs decreased in the 1990s, but have been drifting up since then, after controlling for factors such as fuel price increases. Air freight costs are estimated to be about 15% higher in New Zealand than in Australia (about 12.5% compared with 10.9% in 2010). However, case studies suggest that air freight costs for Auckland can, on occasion, be less than those for Sydney.
- The onshore components of New Zealand's air and sea freight costs, particularly its port handling costs, compare favourably with Australia and other OECD countries.

Productivity indicators

- New Zealand's transport and storage industry experienced strong productivity growth in the 1990s, but virtually no productivity growth in the 2000s.
- Productivity measures indicate that New Zealand ports and airports compare favourably with Australian counterparts. Compared internationally, New Zealand customs services are efficient.
- Container productivity indicators show considerable variation in the performance of New Zealand's ports, with Tauranga being the strongest performer. This suggests there may be opportunities to either lift the performance of the below-average performers or for further shifts in freight towards the top performers.
- Compared internationally, New Zealand has low volumes of freight per kilometre of rail, and 'small' trains and trucks.
- There is little information about the productivity of freight handling at airports, but indicators suggest that Auckland Airport's overall productivity (passenger and freight) compares favourably with other Asian and Pacific airports, while Christchurch is about average.
- The number of days taken to complete New Zealand's export and import requirements compares well with other countries, but is behind international best practice.
- Low asset utilisation rates for New Zealand ports may indicate that ports have invested ahead of demand, or that patterns of international freight have changed, possibly leaving some assets under-used.

Other indicators

- Rates of return on the funds invested in some of the publicly-owned assets, for example, in ports and rail, are too low to cover the cost of the funds, which raises questions about the quality of decision-making regarding investments in these assets.
- Significant technological changes are happening in the transport sector internationally. Some parts of the sector in New Zealand are grasping new innovations, but there are also impediments to innovation in places.
- Governance arrangements for the publicly owned parts of the sector have significant scope for improvement.
- Investment coordination and planning can help to address coordination issues between different parts of the logistics chain. There are different possible approaches to this issue and it is not clear that the current approach in New Zealand is best practice.

Where are the opportunities for improvement?

Those who manage freight assets are responsible for delivering productivity improvements. However, their incentives to do this will be influenced by the regulatory and institutional frameworks within which they operate. This report therefore focuses on possible improvements to these frameworks. It identifies

improvements that are specific to particular parts of the logistics chain, as well as improvements to the framework that applies across the freight sector as a whole. The common theme linking the proposed changes, however, is that they would strengthen the incentives for firms to seek opportunities for higher productivity.

Specific changes

The Commission has identified improvements to the regulatory frameworks that affect shipping lines, ports, airlines, airports, road freight, rail freight and border security.

Liner shipping carriers

Cooperation agreements between international liner shipping carriers have historically been exempt from the full application of domestic competition (anti-trust) laws. The policy rationale for these exemptions was that practices such as price/capacity fixing and revenue pooling were needed to ensure access to reliable liner shipping operations. As such, the public benefits of the agreements were considered so likely to outweigh any anti-competitive detriments that there should be no requirement for carriers to prove that this is indeed the case.

This approach was adopted in New Zealand, which has automatic exemptions from the Commerce Act for all agreements between carriers concerning international shipping, including price/capacity fixing agreements. This approach is in contrast to most other industries, where the onus is on the parties to the agreement to prove to the satisfaction of the Commerce Commission that the public benefits of agreements that would otherwise breach the Commerce Act outweigh any anti-competitive detriments.

Continued developments in international shipping over the past two decades, and in particular the rise of cooperation agreements without price/capacity fixing provisions (non-ratemaking agreements), independent carriers, and individual service contracts, have called into question the need to automatically exempt all types of agreements to ensure adequate and reliable services. There now seems to be little evidence that reliable shipping services are so dependent on the ability to have ratemaking agreements that such agreements should be automatically presumed to be in New Zealand's best interest. In relation to non-ratemaking agreements, it is unclear what proportion of these agreements would breach the Commerce Act (absent the exemption), and if they would, to what extent these would benefit New Zealand, and/or to what extent beneficial agreements would be deterred if the exemptions were removed. Accordingly, there seems to be little reason why international shipping should be treated differently to other industries by having an automatic exemption for agreements, without any analysis of the actual impacts of those agreements.

The Commission's view therefore is that exemptions for the types of agreements with the higher risk of anti-competitive detriment – ratemaking and capacity-limiting agreements – should be removed and authorisation mechanisms should be relied upon for assessing whether these agreements are in the public interest. In the case of non-ratemaking and non-capacity setting agreements, there should only be one exemption (in the Shipping Act), extended to apply to inwards shipping, and the remedial regime in the Shipping Act should be strengthened by introducing a registration regime for these agreements.

Coastal shipping

In New Zealand, the Maritime Transport Act 1994 (s.198) allows international operators to compete on coastal routes against domestic operators, providing they do so as part of an international voyage and do not operate in New Zealand beyond a continuous period of 28 days. An issue raised in some submissions was whether cabotage (reservation of domestic coastal trade to New Zealand-owned shipping operators) should be reintroduced.

The Commission does not support the reintroduction of cabotage. International shipping services carry significant volumes of container cargo around the New Zealand coast, much of it at low marginal cost and low prices. They also reposition thousands of empty containers each year. These services are valuable to New Zealand shippers. Reintroducing cabotage would likely increase prices.

The ports

While port charges are not a large part of total freight costs, the potential impact of ports on the overall supply chain is larger than this would suggest. Ports can be a choke point, because delays or poor reliability in them can have cascading impacts on later stages in the supply chain. The Commission reviewed four main ways to improve ports' performance:

- strengthening governance and/or ownership arrangements;
- more use of facilitative discussions and information sharing to aid investment planning (discussed later in this overview);
- increasing the scope for competitive provision of services within ports; and
- improving labour relations.

Governance and ownership

All commercial ports are majority owned by a local authority within whose territory the port is located. Four ports are listed on the New Zealand Stock Exchange. All other minority ownership stakes are in ports held by other local authorities or other port companies.

Local authorities may desire to control ports for a number of reasons, including to:

- pursue regional economic development objectives;
- resist control from outside the region, which conceivably might include closing an uneconomic port or reducing the scope of its activities;
- balance the financial benefits of owning the port against other amenity values of the port's location and surrounds; and
- limit monopoly pricing.

Difficulties in resolving multiple objectives in publicly-owned firms can contribute to problems in areas such as operational efficiency, labour relations and investment planning. To avoid such problems, it is important that port companies have a clearly defined purpose and that there are ownership and governance models that best suit that purpose. Effective governance of organisations is central to their ability to make value-maximising decisions.

The governance arrangements for publicly-owned enterprises need to be of high quality because publicly-owned enterprises face less discipline from other sources than comparable privately-owned enterprises. Publicly-owned organisations are also, in effect, spending others' money (the public) who are not well placed or sufficiently incentivised to monitor performance of such investments.

There are three areas where the governance framework applying to ports is not currently optimal: lack of clarity of purpose of the companies, failure to properly manage conflicts of interest; and insufficient monitoring and transparency of performance information.

Clarity of purpose

Obligations of council-owned ports are specified in the Port Companies Act 1988, Local Government Act 2002 and Local Government (Auckland Council) Act 2009. The purpose of port companies is not as clear as it could be. The State-Owned Enterprises Act, Local Government Act, Port Companies Act, and Local Government (Auckland Council) Act specify different types of publicly-owned companies and different objectives and governance regimes for each of those types. The State-Owned Enterprises Act provides a clearer purpose statement for ports than does the Port Companies Act. In particular, the requirement to be a "successful business ... as profitable and efficient as comparable businesses that are not owned by the Crown" is a clearer statement of purpose than the requirement to be a "successful business" specified in the Port Companies Act. The objectives of council-owned port companies should be brought into line with the objectives for state-owned enterprises.

Managing conflicts of interest

To manage conflicts of interest, elected representatives and council staff should be precluded from being a director of port and airport companies. Legislation applying to Auckland already prevents elected representatives from being a director of some companies (recognising conflicts arising from political motivations), and some councils already preclude their staff from being directors (recognising a potential conflict with wider council objectives and the council's regulatory role). Council policies regarding director appointments should, as a result, be updated and their public availability improved.

Monitoring

When other competitive forces are muted, 'benchmark competition' can play an important role. The Commission's economic value added (EVA) analysis of selected ports found that negative EVAs were common. This suggests that the ports are making poor use of a scarce resource – capital – and that port owners should therefore be looking to address this by some combination of better cost control, shifting resources to better uses within the port, or retiring capital for redeployment elsewhere.

The Commission believes that EVA figures provide an important overall picture of the economic efficiency with which capital is being invested and used in the freight transport system. In the interests of improved reporting, transparency, and ultimately efficiency, it recommends that EVA figures are regularly published and given greater attention by owners and policy makers. Local authorities could act collectively to improve their ability to monitor port companies – further strengthening ownership disciplines and encouraging better performance. A possible home for such a function would be within the Local Government Commission; however, the Commission is interested to hear other views on hosting arrangements.

Ownership

The questions of the boundaries of the organisation and the ownership structure that will best promote performance are interrelated. As the boundaries change, the best ownership structure is likely also to change. It is therefore essential for avoiding conflict and confusion that the business activities that are to be run by these companies are ones for which commercial objectives are both appropriate and explicitly chosen. This may not cover all of the present assets or activities of port companies. Some assets and activities may not be best managed to commercial objectives where non-commercial objectives are significant, and should be governed differently and to different objectives.

The optimum level of council ownership will depend on the priorities assigned to particular aims by local communities. Full ownership comes with risks of non-transparent actions by councils with consequent risks for ratepayers. On the other hand, 100% private ownership may expose local communities to risks they would prefer not to take. To improve the efficiency of ports, councils should consider increasing the degree of private ownership in them. Councils should evaluate whether they can still achieve important community aims with lower ownership stakes.

One option for public owners seeking to improve governance is to opt out of the relevant public sector governance regime and into the stock exchange regime. A stock market listing offers significant potential governance improvements for larger companies with partial council ownership. These benefits arise from an observable share price, reporting and continuous disclosure rules, and external analysis of management decisions. Council owners of larger port and airport companies should consider listing them on the stock exchange in order to obtain the governance benefits from listing.

Competition within ports

The Commission considered options for increasing competition between service providers within ports for services such as stevedoring and marshalling. A firm seeking to provide such services will typically need access to facilities, such as berths, that belong to the port owner. Section .36 of the Commerce Act can already be used by those seeking access to infrastructure, such as ports, but is difficult to apply as it has to be shown that the infrastructure owner has the purpose and intent of taking advantage of market power, which can provide a difficult threshold for challenging the decision of an infrastructure owner to refuse access. The Commission therefore explored other options.

One option is to separate the ports and service providers structurally. Structural separation, however, imposes transitional costs (which may be substantial) as the assets and operations of the infrastructure owner are detached from the assets and operations of the related service provider. With structural separation, an infrastructure owner is prevented from competing in downstream markets. This means that any benefits from vertical integration can no longer be achieved.

Another set of options involves strengthening the access regime for infrastructure at ports through introducing either a general purpose infrastructure access regime (as found in Australia and the United States) or a 'negotiate-arbitrate' regime, under which port owners are required to negotiate access arrangements with stevedores, with provision for arbitration if negotiation fails. The evidence on the efficiencies that could be gained by enabling access to port infrastructure in New Zealand does not yet, however, provide a compelling case that the benefits of either type of access regime would materially outweigh their costs. However, in the interests of their own productive efficiency and service to customers, port companies should periodically review the extent they unbundle activities within their domains and allow access for competing firms to supply them.

While the Commission would not support introducing a general access regime to cater for issues in the ports, if infrastructure access issues are causing concerns in other sectors, then a general infrastructure access regime is worth exploring for New Zealand.

Labour relations

Seaports have been transformed over the past fifty years in their operational functions and in the scale and sophistication of the equipment used to manage their core tasks. Although these changes have increased productivity, the Commission received many submissions that work practices have not kept pace with the changing nature of the tasks carried out on the waterfront, and that this is impeding further productivity improvements. Ports have long been associated with strained union/management relationships, with allied stress and costs for workers and employers alike, as well as those reliant on port services. This is a history that the Commission considers ports and their employees must move past, given the centrality of the freight system to New Zealand's trading performance.

To form its views on labour relations for this draft report, the Commission used a variety of information and data sources. It conducted ten focused engagement meetings on the issue of labour practices at New Zealand ports. It held individual meetings with senior representatives from six port companies, the Council of Trade Unions, ISO Limited and Business New Zealand. Information from these meetings was supplemented by material contained in submissions and during the Commission's 79 stakeholder engagement meetings. Data from the Department of Labour was also collected and analysed. The Commission also reviewed relevant literature and legislation.

The demand for port services is highly variable, driven by the arrival of ships for loading and unloading. Ports therefore face challenges relating to both optimising investment in capital equipment that may be idle for extended periods between ships, and managing access to labour to meet variable workloads.

Concerns were raised in submissions and discussions that work practices at some ports limit ways of working or unnecessarily increase costs. Inflexible work practices cause some ports to operate less productively or at higher cost than is possible (while maintaining high health and safety standards). Many of these work practices stem from past management decisions that were pragmatic and relevant to the working of ports before the advent of widespread containerisation and bulk material handling. Some originated as measures to limit opportunities for pilfering cargo. Others are an echo of previous systems for paying allowances for dirty or dangerous work or working in inclement weather before machines performed such work.

There are several explanations as to why these practices remain. These include: management reluctance to risk industrial action; management and unions may not share a common view on what constitutes a successful port operation; entrenched positions and cultures among employers, workers and unions; support in common law for 'customary arrangements'; and uncertainty regarding the coverage and implications of the exemptions under s.44(1)(f) of the Commerce Act pertaining to collective agreements,

including a potential perception (whether factual or not) that the exemption provides blanket protection for union activities.

There appears to be no need for a wholesale change to the current employment relations framework, because there is evidence that the current framework works well at some ports. However, the Commission believes that scope exists to make changes that – provided there is effective leadership within ports – would increase productivity and lead to a healthier workplace culture:

- Reviewing the extent to which provisions in existing legislation are sufficient to effectively regulate impediments to competition arising from union activity. This would include clarifying the extent to which labour practices are covered by the exemption set out in s.44 (1) (f) of the Commerce Act.
- Strengthening the governance framework applying to port companies, to ensure decisions related to employment matters are well aligned with the long-term interest of the ports, their shareholders, their customers and their employees, current and future.
- Strengthening the governance framework applying to unions in the Incorporated Societies Act (as is presently being considered by the Law Commission), to better ensure that decisions of unions are made under best practice regimes and aligned with the long-term interests of their members.

While a wider matter than issues relating to this particular inquiry, the Commission heard a number of concerns relating to the Employment Court. The matters raised related both to the length of time taken by the Court to reach (or publish) decisions, and to its apparent tendency to uphold long-standing, but undocumented, practices as employee rights. The Commission has not formed a view on this matter but is interested in evidence that parties may be able to provide about these issues.

Air freight

Air freight is essentially a by-product of the much larger provision of air passenger services. Competition in international air services is regulated in New Zealand by both the Commerce Act 1986 and the Civil Aviation Act 1990. Certain international air services trade practices can be exempted from the Commerce Act's prohibitions on restrictive trade practices if they meet criteria in the Civil Aviation Act and are authorised by the Minister of Transport.

The current competition regime for international air services may not be as effective as it could be. Competition regimes in other countries have evolved in response to market and regulatory developments, but New Zealand's competition regime for international air services has remained the same.

The Commission considers that the most important criterion for assessing options for improving the competition regime is the need to ensure that the process for authorising any trade practices is based on a good analysis of their costs and benefits. This will maximise the likelihood that efficiency-enhancing trade practices are authorised, and minimise the chance that harmful forms of coordination are authorised.

One way to ensure a good analytical process is to remove the specific industry regime in Part 9 of the Civil Aviation Act and rely solely on the Commerce Act regime to assess authorisation proposals. However, the current Civil Aviation Act regime is more suitable than a Commerce Act-only regime in several other respects:

- It requires the decision-maker to consider New Zealand's international obligations and international comity, which are important civil aviation policy considerations.
- It is probably less costly to administer than a Commerce Act-only regime for international air services.
- It is less likely to deter some air services coordination practices that may be beneficial, but have a low commercial return compared to the costs of an authorisation regime.

The cost of changing competition regimes is also an important consideration.

On balance, the Commission favours retaining the current arrangements, but strengthening the analytical requirements for assessing authorisation proposals by assessing and publicly testing costs and benefits, including the impacts on competition.

Airports

The relationship between airlines and airports appears to be strained, with airlines claiming that airports are using their market power as geographic monopolies to overcharge for services. Airports countered with arguments that their ability to exercise market power is constrained.

The three major airports were in 2008 made subject to 'information disclosure' regulation under s.56–56A of the Commerce Act. They are required to disclose a significant quantity of tightly specified information about their operations, including some details on international freight activities. Pricing disclosures under this regime were required by 30 September 2011. Annual performance disclosures for the 2011 financial year are required during the first half of 2012.

A Commerce Commission review of the effectiveness of the information-disclosure regime will be triggered by the first price change for specified airport services during or after 2012. This is likely to be a sufficient mechanism to review whether major airports are exerting market power over freight services providers.

Rail freight

The New Zealand Railways Corporation (trading as KiwiRail) is a state-owned enterprise. Governance and other arrangements are specified in both the State-Owned Enterprises Act 1986 and the New Zealand Railways Corporation Act 1981, which is a potential source of ambiguity and inefficiency. It would be preferable if KiwiRail's governance arrangements were specified only in the State-Owned Enterprises Act.

KiwiRail is currently classified as a 'multiple objective company' whose financial expectations are moderated by public good delivery requirements. However, there is little transparency about exactly what public goods are being delivered and at what cost to the taxpayer. The State-Owned Enterprises Act contains provisions for SOEs to receive direct payments for non-commercial activities (s.7), and it would be preferable if these provisions were used to identify expectations delivery of public goods by KiwiRail and the costs incurred in their provision.

The transparency of KiwiRail's longer-term investment plans is less than might be expected from an equivalent private company (at least one listed on a stock exchange). The public justification for the Government's initial \$250 million contribution towards KiwiRail's \$4.6 billion Turnaround Plan was very limited. This is unusual given the poor history of previous large capital injections into New Zealand railways. A full cost-benefit analysis, comparable to the ones produced for major road projects, would be a valuable contribution to the public debate.

Road freight

High Productivity Motor Vehicles (HPMV), which can raise productivity through longer and/or heavier loads, are required to have a permit from road-controlling authorities (mostly local councils for local roads, and the New Zealand Transport Agency (NZTA) for the state highway network).

The experience with implementing these permits has highlighted transitional problems. Some are coordination problems between different agencies, while others can be described as incentive alignment problems (from a local government perspective). The core obstacle to successful implementation of the HPMV Rule is the adequacy of infrastructure (mainly bridge capacity), difficulties in obtaining an assessment of whether the infrastructure requires upgrading, and the costs and time required to improve infrastructure where warranted.

Customs, security and biosecurity

Customs, security and biosecurity activities provide many benefits for international trade but also add to the costs of international freight – both directly through the payment of border fees and charges, and indirectly through the cost of complying with border regulations and standards. The agencies that supply these services are government monopolies. While their fees and charges compare favourably with those imposed

on exporters and importers in Australia and other OECD countries, opportunities for productivity improvement should still be pursued.

One way to reduce costs would be for New Zealand to relax its border controls and accept more risks. However, on the basis of submissions to the inquiry, the Commission believes the current level of risk tolerance reflected in the activities of New Zealand's border agencies is in line with the expectations and preferences of stakeholders. As such, the Commission does not believe that the level of border risk management is acting as a barrier to the efficiency of the international freight logistics chain.

Given this level of risk tolerance, the question then is whether there is scope for the agencies to achieve that level of risk in a less costly way. The agencies have embraced a risk-based resource allocation model to help them target expenditure and effort where it adds most value. This model can reduce the regulatory burden on companies with a good compliance record (low-risk companies) and increase the burden on those that consistently fail to comply (high-risk companies). Implementing this approach requires timely and accurate data and intelligence in order to correctly assess emerging risks; consistency and transparency in the approaches and assumptions used to assess the consequences of potential threats; and outcome-based performance measures. Border agencies should continue to enhance their performance measures and performance review procedures in order to improve the transparency of agencies' performance and increase management accountability.

The overall efficiency of border services is heavily influenced by the technologies and management practices that are used to achieve the desired outcomes. The introduction of the Joint Border Management System (JBMS), currently being developed by the Ministry of Agriculture and Forestry (MAF) and the New Zealand Customs Service (NZCS), will save costs by reducing duplication of paperwork and simplifying border procedures. While the number of days taken to complete New Zealand's export and import requirements compares well with other countries, the JBMS is an important opportunity for further improvement. The second phase of the JBMS project will largely address coordination issues between MAF and NZCS, but the introduction of this system is several years away. In the meantime, the role of the Border Sector Governance Group should be strengthened and performance measures for border cooperation developed and monitored through joint six-monthly reports to relevant Ministers. These performance measures should be in addition to, and separate from, those developed as part of the JBMS project.

Finally, the current Customs and Excise Act 1996 was developed in the early 1990s. Since then, the trade environment, technology and the types of risks confronted at the border have changed significantly. Given the rapid pace of development in information management and the growing need for accurate and timely communication with overseas agencies, it is important that the adoption of new technologies within border agencies is not unwittingly held back by legislation. The Customs and Excise Act should be added to the Government's legislative review agenda, to assess whether the legislation is fit-for-purpose in light of changes to border management practices and developments in technology since the 1990s.

General issues

The Commission has also considered ways to improve government interventions that impact across the freight sector: subsidisation of domestic freight transport; investment planning and coordination; and managing the external effects of freight transport.

Subsidisation of domestic freight transport modes

Road, rail and coastal shipping largely serve separate markets. Road is best suited to time-sensitive and short-haul freight. Rail is best suited to bulky, heavy products and/or long-distance freight. A high proportion of rail tonnage is to and from industrial plants, mines and ports. Coastal shipping is best suited to bulky, heavy, long-distance, non time-sensitive freight. It is not suited to short-distance freight because of handling costs and the inaccessibility of inland routes. The low frequency of services combined with the need for multiple handling means that in general it is the slowest form of transport.

There is some contestability, however, between transport modes. A small proportion (3–7%) of the road freight task is contestable by rail, and one estimate is that 8% of the overall freight task in tonnage is contestable by coastal shipping. For those products and routes on which transport is contestable by

different modes, it is desirable that price signals encourage shippers to choose the mode that imposes the least costs on society (for the required service quality). To the extent that subsidies distort these choices, they impede this economic efficiency goal. Explicit subsidies involve payments to providers, price discounts to consumers or a government-owned entity deliberately accepting a low return on capital provided. Implicit subsidies occur when externalities are not priced. Examples may include greenhouse gas emissions, water pollution and other forms of air pollution.

Many inquiry participants commented on the existence of subsidies to one or more domestic transport modes. Their general view is that coastal shipping is most disadvantaged by present arrangements, with less clarity on the relative positions of road and rail. Three main arguments were put forward:

- Road freight is subsidised as, under the pay-as-you-go (PAYGO) methodology, user charges are insufficient to generate a rate of return on past road infrastructure investment.
- Rail is subsidised by the government as it does not achieve an acceptable rate of return on the capital invested.
- Users of road and rail create externalities for which they do not pay.

Determining the level and direction of subsidies across transport modes is complex and difficult. Assessing subsidies for road transport is made more difficult by the fact that road infrastructure is used for both passenger and freight transport, and there may be cross-subsidies from one group to another. Furthermore, few externalities are priced, and most are difficult to estimate. The Commission has not examined domestic transport subsidies in detail and confines itself to a few observations in order to aid further analysis and discussion.

The Commission's preliminary view is that the 'PAYGO' methodology does not subsidise road use, as capital spending is recovered in the period in which it occurs. Another argument is that rail is subsidised by the government as it does not achieve an acceptable rate of return on the capital invested. The Commission has not undertaken the analysis needed to reach a conclusion on whether current and envisaged levels of rail subsidies are economically efficient, but it is concerned to see the investment of large amounts of public money without the presentation of a full business case. The Commission therefore recommends that a full cost-benefit analysis should be produced for future government investments in rail infrastructure. Such analysis would make the purposes and amounts of subsidies transparent, and help inform public debate and decision-making.

Investment planning and coordination

Efficient levels of investment are a key to achieving dynamic efficiency in freight industries; however, the nature of investment (large and 'lumpy'), demand (uncertain) and the supply chain (multiple interdependent decision makers) creates significant risks of under- and over-investment. While coordination might reduce these risks, 'coordination failures' of various types can lead to organisations making individually sensible decisions with collectively sub-optimal outcomes. A significant number of inquiry participants identified 'strategic planning' or 'government leadership' as a solution to a wide variety of perceived problems in international freight transport services. However, strategic planning (in its various forms) and government leadership have their own costs and risks. Governments should be wary of calls for it to assume the normal commercial risk of other parties.

Coordination failures may be exacerbated by the multiple objectives associated with public ownership. Such failures may be better addressed through governance and ownership changes rather than strategic planning. Government service providers (eg, road infrastructure providers), particularly those receiving poor price signals, face a difficult problem in collecting reliable market research on which to base their investment decisions. 'Facilitated discussions' can assist with this important task, and also promote relationship building and information sharing, leading to improved coordination.

Directive planning, in the sense of a centralised plan imposed on independent parties, has large associated costs due to the incentives it creates for non-productive behaviour, including rent-seeking, tactical misrepresentation and strategic hold up. Experience has shown directive planning should be avoided in

favour of lower-cost and lower-risk mechanisms. In an environment with considerable uncertainty and risk, there is value in a diversity of approaches. Centralised planning tends to lock in a single approach – with high costs should the future not turn out as expected.

Proposals for government investment in road and rail should be subject to rigorous investment screening in a coordinated way, so that the best projects are selected – be they road, rail, or a combination of the two. Without this level of transparency, the public cannot be confident that scarce resources are being allocated to the most beneficial projects.

In light of investment risks associated with preparing for ‘bigger’ container ships, an evolutionary path with staged investment is preferable. The scenario in which a lack of container ports in New Zealand capable of handling ‘bigger ships’ forces hubbing through Australia with both higher costs and transit times appears unlikely. This is because the commercial viability of this scenario would be undermined by direct services with smaller, albeit less fuel-efficient, container ships.

Port mergers have a number of potentially large benefits and costs. Where a proposed merger would result in a lessening of competition, the Commerce Commission is best placed to evaluate the public benefits relative to the detriments of that proposal.

External effects of freight transport

The international freight logistics chain can generate external costs outside the business producing them – for example, through its impact on the environment. These costs are largely managed through government regulations, which (appropriately) push the external costs (in part or full) onto the companies that produce them and the consumers of their products. The government’s management of external costs can influence the efficiency with which factors of production are allocated within the economy.

In considering the regulation of external costs, the Commission has focused on issues raised by submitters. These are the impacts of:

1. the Resource Management Act on investment in transport infrastructure;
2. the Climate Change Response Act; and
3. the European Emissions Trading Scheme (the EU ETS) on New Zealand exports to and imports from Europe.

The Resource Management Act

Investment in transport infrastructure can impact New Zealand’s natural and physical resources. The principal piece of legislation for managing these impacts is the Resource Management Act 1991 (RMA), the purpose of which is to “promote the sustainable management of natural and physical resources” (s.5 of the Act). This purpose is primarily achieved through district and regional plans that set out activities permitted within a given area. The RMA also includes a process by which an individual or business can apply for a ‘resource consent’ to undertake an activity that requires council approval.

Responsibility for implementing the Act is largely delegated to local authorities, which are expected to have the largest amount of relevant information and to be most affected by decisions. The role of central government under the Act is to provide policy guidance on matters of national significance and to oversee the implementation of its provisions.

The Commission received submissions highlighting the need for a more balanced approach to weighing up local and national implications of transport infrastructure projects. Participants raised concerns about:

- the RMA not recognising the importance of transport infrastructure;
- the need for additional central government guidance in planning for national transport infrastructure;
- the omission of seaports from the list of ‘network utility’ operators;
- the rigidity, complexity and cost of the consent approvals process.

These concerns mirror those expressed during other public inquiries and are acknowledged by both central and local governments. To address these and other issues, in 2008 the Government launched the first of a two-phase RMA reform agenda, leading to the Resource Management (Simplifying and Streamlining) Amendment Act 2009.

The second phase of the RMA reforms is currently in progress and includes work dedicated to improving infrastructure provision, including the application of the Public Works Act 1981. As part of the second phase, the Ministry for the Environment formed the Infrastructure Technical Advisory Group (ITAG). The scope of work for this group included reviewing the application of the designation processes to infrastructure projects, and investigating alternatives to designations for planning for and managing the effects of activities on network infrastructure.

The Commission can see four ways to improve how the RMA provides for the analysis of major infrastructure projects, such as those in the transport sector.

- There is ambiguity about whether the purpose of the Act allows for ‘balancing’ socio-economic aspirations with environmental outcomes, or whether s.5 (a), (b) and (c) represent an ‘environmental bottom line’ that must be secured regardless of the social or economic cost. In light of this ambiguity, there is a case for reviewing s.5, to clarify (and elevate) consideration of net social benefits and costs (including those accruing at a national level).
- The Government might, however, want to consider the case for such a review in a wider context than transport alone. If the Government decides not to review the purpose statement of the RMA, the Commission supports ITAG’s recommendation that s.6 of the RMA be amended to include specific reference to the development and operation of regionally and nationally significant infrastructure. This would mean local authorities would need to ‘recognise and provide for’ transport infrastructure during the planning process and when considering applications for resource consent.
- The Minister for the Environment should commence development of a national policy statement for transport infrastructure, which would provide central government recognition of the importance of New Zealand’s transport infrastructure.
- S.166 of the RMA should be modified to include seaports alongside airports in the list of network utility operators. This would promote efficiency by allowing the expansion of a seaport’s land area to be assessed alongside other possible strategies for expanding port capacity.

The Commission expects that recent reforms to the RMA will, in time, reduce concerns about the rigidity, complexity and cost of the consent approvals process,

Climate Change Response Act

The ETS has been introduced to internalise the costs of greenhouse gases emitted by freight transport operators within New Zealand. The Commission notes that parts of the scheme will directly impact international freight.

- Fuel used by international sea freight and air freight carriers is exempt from the New Zealand ETS under the Climate Change Response Act 2002.
- Coastal shipping is covered by the New Zealand ETS through the inclusion of bunker fuels in the Climate Change (Liquid Fossil Fuels) Regulations 2008. Research conducted by the Ministry of Transport suggests that the ETS adds an average of \$0.86 per 1000 tonne kilometres. The Ministry of Transport estimates that this adds around \$3.4 million per annum to the cost of coastal shipping. At least part of this cost is passed through to shippers – for example, Pacifica currently charges a \$6 per TEU ETS levy.
- Under existing cabotage laws, international carriers can carry domestic cargo on any leg of an international service. However, these ships are exempt from ETS costs.
- Cost increases per litre of diesel from the ETS are expected to be in the vicinity of 3–5 cents. Assuming an increase of 3 cents, the Ministry of Transport estimates that the New Zealand ETS adds around \$1.32

per 1000 tonne kilometre to road vehicle operating costs. It is likely that these costs will be passed through to shippers.

- The Ministry of Transport has estimated that the New Zealand ETS will add \$0.45 per 1000 tonne kilometre to the cost of rail freight.

The European Emissions Trading Scheme

From the start of 2012, emissions from all domestic and international flights that arrive at or depart from an airport in the European Union will be covered by the EU Emissions Trading System and therefore subject to an ETS cost. The Commission estimates that this will impact around 10–15% of New Zealand air freight exports (by value) and that New Zealand exporters may face relatively higher cost increases than their international competitors (who are in general located closer to European markets).

The Commission expects that at least some of the ETS costs will be passed through to freight customers. Information gathered during the inquiry indicated the EU ETS will increase air freight rates from New Zealand to the EU by around \$60–70 per tonne. This constitutes an increase of approximately 1.3% on the price of air freight to Germany and around 1.6% on the price to the United Kingdom. New Zealand exporters will have limited ability to pass these costs on.

Concluding observations

The international transport freight sector has a significant impact on the costs faced in the first instance by New Zealand importers and exporters, much of which is ultimately passed through to industry and consumers. Having an efficient transport sector will help New Zealand's engagement in the international economy and its capacity to take advantage of the considerable benefits that engagement can bring.

This report has identified considerable scope for productivity gains in the sector, and has focused on ways that central and local governments, which are closely involved in the sector through ownership and regulation in particular, can improve their involvement. The international freight transport sector faces considerable challenges in an environment that is exhibiting pressure for change, as reflected in developments in markets, technology and preferences, including for better care of the environment. The Commission considers that the package of proposals in this report will enhance the capacity of the sector to make an even more important contribution to the future prosperity of New Zealanders.

1 The international freight transport services inquiry

Key points

- The Government has asked the Commission to undertake an inquiry into the accessibility and efficiency of international freight transport services available to New Zealand firms, paying particular attention to costs, efficiency, productivity and the effectiveness of current regulatory regimes.
- The Commission released an Issues Paper in July 2011, following which it received over 50 submissions and met with many organisations and individuals who provided their views and other valuable information for the inquiry.
- In preparing this draft report, the Commission sees its challenge as presenting compelling, evidence-based findings and making practical recommendations to improve the international freight transport system, and communicating these well.
- International freight transport services provide essential connections between New Zealand and the international economy. Particularly for a small, distant country such as New Zealand these services enable international trade, lift productivity potential and enhance wellbeing.
- But New Zealand's trade growth has lagged its OECD peers over the last 20 years, and its firms have largely failed to participate in the large expansion of intra-industry trade associated with the growth of complex supply chains and segmented, specialised production.
- New Zealand's small domestic market and distant location from major markets pose difficult challenges. The costs of being economically distant from key markets – both in terms of pure transport costs and the opportunity costs of time – are major challenges to New Zealand's ability to participate effectively in the global economy.
- However, improving New Zealand's international freight system will help to mitigate its geographical challenges and raise its ability to participate effectively in the global economy. A more efficient and effective freight system can raise the prosperity of New Zealand's businesses and workers and enhance consumers' purchasing power.

F1.1

Despite the global economy becoming more trade-oriented over the last 20 years, the growth in New Zealand's export intensity has lagged well behind that of most of its OECD peers.

F1.2

New Zealand's small home market and distant location pose difficult challenges. The costs of being economically distant from key markets – both in terms of pure transport costs and the opportunity costs of time – are substantial impediments to New Zealand's ability to participate effectively in the global economy.

Improving New Zealand's international freight system will help to mitigate its geographical distance from markets and raise its ability to participate effectively in the global economy. A more efficient and effective freight system can raise the prosperity of New Zealand's businesses and workers and enhance consumers' purchasing power.

2 The Commission's framework

Key points

- Competitive markets that do not suffer significantly from 'market failures' generally do a good job in generating efficient outcomes.
- Where 'full efficiency' prevails, firms provide whatever goods and services customers desire whenever they can profitably provide them at prices those customers are willing to pay, but without earning excessive profits; and there are sufficient incentives for firms to provide customers even better value for money in the future by investing and innovating in plant, new technology and infrastructure.
- Economic efficiency (broadly defined) is the key yardstick of performance for the international freight transport system. An efficiency approach is not just about financial outcomes but will take account of harmful effects of freight transport on the environment and other market failures. Other important influences on wellbeing are best dealt with through other channels than international freight transport.
- New Zealand's international freight transport services can be usefully viewed as a *system*. This inquiry focuses on the elements and links of this system – the interactions of institutions and policies on medium- to long-term trends in 'hard' and 'soft' infrastructure investment, the transport services that (predominantly) private-sector firms choose to supply, and the overall logistical system serving exporters and importers. It will examine relationships between modes – air, sea, road, and rail.
- International freight transport has distinctive characteristics such as large, lumpy infrastructure investments, tensions between funding to cover costs and pricing to encourage efficient use, and the importance of coordination and transit time along supply chains. These characteristics require central and local governments and the private sector to play their parts to make the system work efficiently.
- Enhancements in freight can, through a series of responses in the wider economy, lead to improved trade performance, higher GDP per capita, and ultimately higher wellbeing.
- Government has several roles in international freight transport including investing in and owning infrastructure, setting taxes and user charges and regulating. But intervention is only justified where benefits outweigh the costs. Principles of good regulation should be used to design and monitor regulatory interventions, including the decision that regulation is the best option.
- Access to international freight transport does not mean services being provided to everyone regardless of cost, but their being provided where there is willingness to pay to cover the cost. Some cases, where relatively isolated producers cite a lack of access, are unlikely to fulfil this condition.

F2.1

The Commission views economic efficiency (broadly defined) as the key yardstick of performance for the international freight transport system. An efficiency approach will take account of harmful effects of freight transport on the environment and of other market failures. Other important influences on wellbeing are best dealt with through other channels than international freight transport.

F2.2

International freight transport can be viewed as a system with a number of distinctive characteristics such as large, lumpy infrastructure investments, tensions between funding to cover costs and pricing to encourage efficient use, and the importance of coordination and transit time along supply chains. These characteristics require both central and local

governments as well as the private sector to play their parts to make the system work efficiently.

F2.3

Government has a number of roles in international freight transport. But intervention is only justified where benefits outweigh the costs. In particular, principles of good regulation should be used to design and monitor regulatory interventions, including the decision that regulation is the best option.

F2.4

Access to international freight transport does not mean services being provided to everyone regardless of cost, but their being provided where there is willingness to pay to cover the cost. Some cases, where relatively isolated producers cite a lack of access, are unlikely to fulfil this condition.

3 International freight transport – how it operates and performs

Key points

- The international freight chain encompasses a range of components running from 'producer to consumer'. As such, a performance assessment needs to cover all components of the supply chain.
- The New Zealand transport sector was the subject of a number of important reforms from the mid-1980s until the early 1990s. In international comparison, the OECD recently assessed the regulatory environment in the airline, road and rail sectors in New Zealand to be around average in the extent to which they encourage competition.
- New Zealand's transport and storage industry experienced strong productivity growth in the 1990s but virtually no productivity growth in the 2000s.
- Productivity measures indicate that New Zealand ports and airports compare favourably with Australian counterparts. Compared internationally, New Zealand customs services are efficient.
- Container productivity indicators show considerable variation in the performance of New Zealand's ports, with Tauranga being the strongest performer. This suggests there may be opportunities to either lift the performance of the below-average performers or for further shifts in freight towards the top performers.
- Compared internationally, New Zealand has low volumes of freight per kilometre of rail, and 'small' trains and trucks.
- Most of the six major ports analysed recorded negative Economic Value-Added from 2008 to 2011, although there was a trend to less negative figures from 2009 to 2011. This suggests the ports were not able to cover the cost of capital over this period. However, it is important to note that this was a period of very slow growth in trade volumes.

F3.1

Since the end of the 1990s, productivity growth in New Zealand's transport and storage industry has slowed considerably and does not compare well internationally.

F3.2

Available indicators suggest that New Zealand's container port performance is no less and possibly better than in Australia. However, within New Zealand there is notable variation between the ports, with Tauranga being the strongest performer.

F3.3

Subject to some caveats, Auckland Airport appears to have high productivity relative to other Asia and Pacific airports, while Christchurch is about average.

F3.4

Compared internationally, New Zealand has low average loads for road freight.

F3.5

Compared internationally, New Zealand has low volumes of freight per kilometre of rail and low maximum axle load.

F3.6

The six port companies analysed by the Commission recorded mostly negative Economic-Value Added from 2008 to 2011, although there was a trend to less negative figures. This suggests that the port companies have not recovered their cost of capital.

4 Freight transport costs

Key points

- Ad valorem sea freight costs – the freight costs faced by New Zealand importers and exporters as a percentage of shipment value – have been decreasing over the last two decades, even after factors such as changes in the composition of trade and trading partners are accounted for. This suggests that cost-reducing efficiency and technology improvements have outweighed factors such as fuel price increases. A similar pattern is observed for Australia’s ad valorem sea freight costs.
- In aggregate, and after accounting for compositional factors, ad valorem sea freight costs are less than one percentage point higher in New Zealand than in Australia. This indicates significantly higher sea freight costs in absolute terms in New Zealand relative to Australia. Case studies also indicate that in some instances, the ocean transport component of costs can be higher for Auckland compared to Sydney.
- Ad valorem air freight costs decreased in the 1990s, but were flat or even slightly increasing in the 2000s, even after controlling for factors such as fuel price increases. Declines in Australia’s ad valorem air freight costs also flattened off in the 2000s.
- As a result, ad valorem air freight costs are estimated to be around 1.6 percentage points higher in New Zealand vis-à-vis Australia. Again, this indicates that New Zealand importers and exporters pay significantly more for air freight than their Australian counterparts. However, case studies suggest that air freight costs for Auckland can, on occasion, be less than those for Sydney.
- The onshore components of New Zealand’s air and sea freight costs, particularly its port handling costs, compare favourably with Australia and other OECD countries. However, there may still be room for improvement. For instance, cost reductions on trans-Tasman routes in areas such as documentation and security fees would go some way towards the goal of a more seamless single economic market.
- The number of days taken to complete New Zealand’s export and import requirements compares well with other countries, but is behind international best practice.
- The costs of transit times are potentially greater than the costs of tariffs, which highlights the importance of work on trade facilitation. As well as reducing the time taken to complete New Zealand’s domestic export and import requirements, New Zealand should continue to work with trading partners to improve trade facilitation.

F4.1

Ad valorem sea freight costs (the freight costs faced by New Zealand importers and exporters as a percentage of shipment value) have been decreasing over the last two decades, even after accounting for such factors as changes in trade composition. This suggests that cost-reducing efficiency and technology improvements have not been outweighed by factors such as fuel price increases.

F4.2

Ad valorem air freight costs decreased in the 1990s, but were flat or even slightly increasing in the 2000s, even after controlling for factors such as fuel price increases.

F4.3

Ad valorem sea import freight costs are higher in New Zealand than in Australia (even after accounting for compositional factors). However, in both countries sea freight costs exhibit a similar decreasing trend over the past two decades.

F4.4

Reductions in ad valorem air freight costs in Australia flattened off in the 2000s, but not to the same extent as in New Zealand. As a result, ad valorem air freight costs are currently higher in New Zealand than in Australia.

F4.5

The onshore components of New Zealand's freight costs compare favourably with Australia and other OECD countries.

F4.6

Case studies suggest that air freight costs for selected international routes into and out of Auckland are less than those for the analogous routes into and out of Sydney.

F4.7

The number of days taken to complete New Zealand's export and import requirements compares well with other countries, but is behind international best practice.

F4.8

While New Zealand is performing reasonably well in areas such as customs procedures and documentation requirements, there may still be scope for improvement in these areas. In addition, continuing to work with trading partners to improve trade facilitation could reduce transit times.

5 Impediments to competition in international freight

Key points

- In principle, competitive pressures provide incentives for firms to meet the transport needs of their customers in the least costly ways.
- This chapter identifies impediments to competition in parts of freight transport. These include potentially anti-competitive practices in international shipping that are exempt from competition law, port governance arrangements, and work practices at ports. These impediments are discussed in more detail in subsequent chapters.
- Coordination between components of the supply chain is important because the efficiency of one component of the supply chain often depends on the efficiency of other components.
- Participants have identified opportunities to improve coordination in a number of areas, although most seem to be issues for commercial resolution. These opportunities for coordination include combination of freight shipments, minimisation of empty containers, timing of bill payments, and the minimisation of truck waiting times at airport freight handling facilities.

F5.1

Episodes of significant truck queuing at Auckland Airport suggest poor coordination, leading to low operational efficiency. There is scope for market participants to address this issue, through coordination mechanisms such as a slot booking system with variable charges.

F5.2

Limited air freight capacity in and out of a New Zealand airport does not seem to be a coordination problem, because there are no barriers to entry of a dedicated freighter to increase capacity. If they are willing to pay for a dedicated freighter service, exporters should be able to effectively signal this to airlines directly or through a 'consolidation agent'.

6 Employment relations at ports

Key points

- At the heart of modern, high-productivity workplaces are effective employer-employee relationships based on mutual trust, shared values and shared commitment to common outcomes.
- In the course of this inquiry, the Commission received numerous submissions, together with commentary during consultation sessions, contending that workplace relationships, particularly in some ports, fall well short of that ideal. This was presented by some submitters as a significant impediment to improved productivity performance. Further, the Commission heard that the risk of labour-related disputes can, in itself, introduce significant costs by blocking, discouraging or delaying productivity-enhancing investments or other operational changes.
- Ports have long been associated with strained union/management relationships, with allied stress and costs for workers and employers alike, as well as those reliant on port services. This is a history that the Commission considers ports and their employees must move past given the centrality of the freight system to New Zealand's trading performance.
- Based on our work to date, there appear to be work practices and behaviours in some ports that are impeding productivity and innovation. Those same factors may be jeopardising progress towards improved health and safety standards and increased workforce diversity. The Commission is seeking further information and evidence about any such practices and their implications.
- Typically, such practices are not codified in workplace agreements, but originate from unwritten 'customs and practices of the port'. It appears to the Commission that these workplace practices are deeply rooted in history and in the nature of the work on the waterfront in eras long past. Most appear to have little relevance in today's environment and legal or institutional settings.
- Obviously, there are two parties to any relationship. The parties to workplace relationships are the employer and the employees, or the representatives of the employees. Responsibility for establishment and maintenance of constructive and productive relationships cannot rest with either one of those parties alone.
- Governance and management of ports must come under scrutiny as a potential factor when relationships persistently fall short of those required for effective and efficient operation of port services. Governance issues are discussed in Chapter 10. Governance of unions is also likely to be a factor.
- There appears to be scope to ease impediments to improved workplace relationships and productivity performance through improving the governance frameworks applying to both ports and unions. These issues will be the subject of further work and discussion with interested parties.
- Impediments to competition in the provision of port services can reduce the efficiency and long-term viability of New Zealand ports, and undermine broader competition policies and legislation.
- The Commission recommends the Government reviews whether existing legislation is sufficient to effectively regulate barriers to competition that arise as a result of union activity.

F6.1

The demand for port services is highly variable, driven by the arrival of ships for loading and unloading. Ports face a challenge in managing their capacity to meet those variable demands for service. Those challenges relate to both optimising investment in capital

equipment that may be idle for extended periods between ships, and managing access to labour to meet variable workloads.

F6.2

By and large, collective agreements and individual employment agreements do not codify restrictive work practices. There are several possible reasons as to why restrictive practices may remain, including weak governance arrangements for ports and unions; entrenched cultures; and significant negotiation leverage of organised labour arising from a number of factors, including common law support for 'customary arrangements' that makes changing work practices more difficult.

F6.3

There is evidence to suggest that unions have used their influence to limit competition among port service providers.

F6.4

Impediments to competition in the provision of port services can reduce the efficiency and long-term viability of New Zealand ports and undermine broader competition policies and legislation.

F6.5

While subject to further work and discussion with interested parties, there may be scope to remove impediments to improved workplace relationships through improving the governance frameworks applying to ports and unions.

R6.1

The Government should review whether existing legislation is sufficient to effectively regulate barriers to competition that arise as a result of union activity.

7 Customs, security and biosecurity

Key points

- On the basis of the submissions to the inquiry, the Commission believes the level of risk tolerance reflected in the activities of New Zealand's border agencies is in line with the expectations and preferences of stakeholders.
- The risk-based approach adopted by New Zealand's border agencies is a sound approach to allocating border agency resources. Eliminating border risk is not feasible, efficient or desirable.
- Border agencies should continue to enhance their performance measures and review procedures in order to improve the transparency of agencies' performance and increase management accountability.
- The Trade Single Window (TSW), which is scheduled to commence operation towards the end of 2012, will reduce duplication of paperwork by allowing exporters and importers to submit compliance-related information once, rather than to multiple agencies – thus improving the efficiency of service provision and reducing compliance costs for industry.
- The second phase of the new Joint Border Management System (JBMS), subject to government funding approval, will replace the remaining systems used by the Ministry of Agriculture and Forestry (MAF) and the New Zealand Customs Service (NZCS) to undertake business functions such as scheduling audits and tracking compliance records. Replacing these systems will improve 'back office' coordination between MAF and NZCS activities.
- The second phase of the JBMS is several years away from being delivered (assuming funding is secured). In the meantime the Commission believes coordination should be promoted by increasing the role, visibility and accountability of the Border Sector Governance Group.
- Rising security concerns after 9/11 may be placing additional costs on some New Zealand exporters – particularly those with time-sensitive cargos. Mutual Recognition Agreements (MRAs) are being used to ensure that New Zealand's high border standards are recognised by trading partners and are reducing time delays associated with securing arrangements at overseas ports.
- The Government's cost recovery measures are based on either the 'beneficiary pays principle' or the 'risk exacerbator pays principle'. In general, these fees and charges compare favourably with those imposed on exporters and importers in Australia.

F7.1

The complete elimination of border risk is neither feasible nor efficient. Rather an optimal balance between costs and benefits needs to be struck.

F7.2

On the basis of submissions to the inquiry, the Commission believes the current level of risk tolerance reflected in the activities of New Zealand's border agencies is in line with the expectations and preferences of stakeholders. As such, the Commission does not believe that the level of border risk management is acting as a barrier to the efficiency of the international freight logistics chain.

F7.3

A risk-based approach is a sound framework for allocating the resources of New Zealand's border agencies.

F7.4

While the second phase of the Joint Border Management System project will largely address coordination issues between the Ministry of Agriculture and Forestry and the New Zealand Customs Service, the introduction of this system is several years away.

F7.5

While the Commission has not been able to locate quantitative evaluations of the net economic benefits of Mutual Recognition Agreements, qualitative evidence suggests that such programmes improve the efficiency of the international freight logistics chain.

F7.6

In general, registration, certification and inspection fees and charges paid by New Zealand exporters are lower than those imposed on Australian companies exporting similar products.

F7.7

Fees and charges imposed on New Zealand importers generally compare favourably with those imposed by Australian border agencies.

R7.1

Border agencies should continue to enhance their performance measures and performance review procedures in order to improve the transparency of agencies' performance and increase management accountability.

R7.2

The role of the Border Sector Governance Group should be strengthened. Performance measures for border cooperation should be developed and monitored through joint six-monthly reports to the relevant Ministers. These performance measures should be in addition to, and separate from, those developed as part of the Joint Border Management System project.

R7.3

The Customs and Excise Act 1996 should be reviewed to assess whether it is fit for purpose in light of changes to border management practices and developments in technology since 1996.

8 Investment, innovation and dynamic efficiency

Key points

- Dynamic efficiency is finding better ways of producing products or developing new products. It has a large impact on consumer welfare.
- New Zealand freight volumes are predicted to increase substantially in the next 30 years, and these forecasts highlight the need for future investment in capacity and innovation in the freight sector.
- There are impediments to efficient investment and innovation in many parts of freight transport, and there are opportunities to improve regulatory arrangements affecting investment decision-making.
- For example, there are opportunities to improve planning and the consent processes within the *Resource Management Act 1991*, which affect the efficiency of investment decisions at various points in the international freight logistics chain.

F8.1

New Zealand businesses have little influence over the level of investment and innovation by the international shipping lines visiting New Zealand, but New Zealand ports may have a role in enabling more efficient ships to service New Zealand.

F8.2

Except in specialised bulk shipping, coastal shipping struggles to earn returns on investment. This is partly a consequence of government subsidies to rail.

F8.3

The Commission's EVA analysis poses questions about how well ports use capital resources. The potential impediments to efficient investment and innovation at these ports discussed in this report are ownership and governance arrangements for ports, investment planning processes, and the effects of the Resource Management Act.

F8.4

Contestability of stevedoring and marshalling is only occurring at some ports. Provided there is sufficient scale, greater contestability at other ports would improve incentives for innovation in stevedoring and marshalling at these ports.

F8.5

Other than the possible effect of heavy vehicle regulations on the uptake of higher productivity vehicles (discussed in Chapter 13), there do not appear to be any impediments to investment and innovation in road freight.

F8.6

There are indications of investment by cargo terminal operators in bigger freight-handling facilities and new documentation technologies.

F8.7

Freight forwarding innovation is driven by large New Zealand and overseas-based freight forwarders, and by large exporters and importers using forwarders. There do not appear to be any impediments to further innovation in New Zealand freight forwarding.

F8.8

There appears to be ambiguity around the interpretation of the purpose of the RMA and the extent to which the Act allows the balancing of socio-economic aspirations with environmental outcomes.

F8.9

Central government plays an important role in providing direction on issues that involve balancing local values with regional or national benefits. Without clear signals from central government, national benefits and costs may be assigned a lower priority during the planning and consent process – resulting in the potential reduction of economic, social or cultural wellbeing.

F8.10

Recent reforms to the RMA have led to improvements in the timeliness and cost of the consent process. The full benefits of these reforms are likely to take time to filter through into council plans, and into the perceptions of those whose opinions may have been shaped by previous experiences.

R8.1

Section 5 of the Resource Management Act 1991 should be reviewed to clarify (and elevate) the consideration of net social benefits and costs (including those accruing at a national level).

Should the Government decide not to review s.5, s.6 of the Resource Management Act 1991 should be amended to include specific reference to the development and operation of regionally and nationally significant infrastructure.

R8.2

The Minister for the Environment should commence development of a National Policy Statement for transport infrastructure, which would provide central government recognition of the importance of New Zealand's transport infrastructure.

R8.3

Section 166 of the Resource Management Act 1991 should be modified to including port companies as network utility operators.

9 Investment coordination and planning

Key points

- Efficient levels of investment are key to achieving dynamic efficiency in freight industries; however, the nature of investment (large and 'lumpy'), demand (uncertain) and the supply chain (multiple interdependent decision makers) creates significant risks of under- and over-investment.
- While coordination might reduce these risks, 'coordination failures' of various types can lead to organisations making individually sensible decisions with collectively sub-optimal outcomes.
- A significant number of inquiry participants identified 'strategic planning' or 'government leadership' as a solution to a wide variety of perceived problems in international freight transport services. However, strategic planning (in its various forms) and government leadership have their own costs and risks. Governments should be wary of calls for it to assume the normal commercial risk of other parties.
- Coordination failures may be exacerbated by the multiple objectives associated with public ownership. Such failures may be better addressed through governance and ownership changes rather than strategic planning.
- Government service providers (eg, road infrastructure providers), particularly those receiving poor price signals, face a difficult problem in collecting reliable market research on which to base their investment decisions. 'Facilitated discussions' can assist with this important task, and also promote relationship building and information sharing, leading to improved coordination.
- Directive planning, in the sense of a centralised plan imposed on independent parties, has large associated costs due to the incentives it creates for non-productive behaviour, including rent-seeking, tactical misrepresentation and strategic hold up. Experience has shown directive planning should be avoided in favour of lower-cost mechanisms.
- In an environment with considerable uncertainty and risk, there is value in a diversity of approaches. Centralised planning tends to lock in a single approach – with high costs should the future not turn out as expected.
- Proposals for investment in road and rail should be subject to rigorous investment screening in a coordinated way, so that the best projects are selected – be they road, rail, or a combination of the two. Without this level of transparency, the public cannot be confident that scarce resources are being allocated to the most beneficial projects.
- In light of investment risks associated with preparing for 'bigger' container ships, an evolutionary path with staged investment is preferable.
- The scenario in which a lack of container ports in New Zealand capable of handling 'bigger ships' forces hubbing through Australia with both higher costs and transit times appears unlikely because the commercial viability of this scenario would be undermined by direct services with smaller, albeit less fuel-efficient, container ships.
- Port mergers have a number of potentially large benefits and costs. Where a proposed merger would result in a lessening of competition, the Commerce Commission is best placed to evaluate the public benefits relative to the detriments of that proposal.

F9.1

Coordination failures may be exacerbated by the multiple objectives associated with public ownership. Such failures may be better addressed through governance and ownership changes rather than centralised strategic planning.

F9.2

Government service providers, particularly those receiving poor price signals, face a difficult problem in collecting reliable market research on which to base their investment decisions. 'Facilitated discussions' can assist with this important task, and also promote relationship building and information sharing, leading to improved coordination.

F9.3

Leadership models for infrastructure planning need to be based on high-quality information. Leadership in an uncertain environment creates high risks for the leader. Governments should be wary of calls for it to assume the normal commercial risk of other parties.

F9.4

The designation of transport corridors can create valuable outcomes at a relatively low cost. Corridor designation is a worthwhile activity for central and local government.

F9.5

Directive planning, in the sense of a centralised plan imposed on independent parties, has some very large associated costs due to the incentives it creates for non-productive behaviour. It should be avoided in favour of lower-risk mechanisms.

F9.6

'Facilitated discussion' models of cooperation based on information sharing, robust discussion and relationship-building – but with no ability to bind the participants to particular outcomes – do not create strong incentives for the costly behaviours that undermine directive planning models (ie, tactical misinformation, rent-seeking and strategic hold up). There is scope for their increased use by government in coordinating investment planning.

F9.7

Caution needs to be exercised when using publicly available cost figures to reach conclusions on the magnitude of investment needed to support bigger ships.

F9.8

An immediate move to supporting bigger container ships would appear to have high risks and uncertain benefits for New Zealand. These conditions favour an incremental approach in which ports make investments in small stages in response to evolving freight demand and changes in container ship deployment. As well as reducing risk, staged investment reduces the need for explicit centralised strategic planning.

F9.9

While larger container ships servicing one or more New Zealand hub ports would lower voyage operating costs, it is unclear whether these cost savings will be transferred to shippers, or whether the reduced competition between ports (and shipping lines) would result in higher port charges and shipping fees.

F9.10

The domestic hub-and-spoke model required to service bigger container ships would likely lead to reduced freight costs for some shippers and cost increases for others. These uneven effects make it difficult to determine whether shippers, as a whole, will be better or worse off in a bigger ship scenario.

F9.11

The scenario in which a lack of container ports in New Zealand capable of handling 'bigger ships' forces hubbing through Australia with both higher costs and transit times appears unlikely. The commercial viability of this scenario would be undermined by direct services with smaller, albeit less fuel-efficient, container ships.

F9.12

Port mergers have a number of potentially large benefits and costs. Where a proposed merger would result in a lessening of competition, the Commerce Commission is best placed to evaluate the public benefits relative to the detriments of that proposal

R9.1

A full cost benefit analysis (ie, including all externalities) should be published for government investments in rail infrastructure, including further investment in the KiwiRail Turnaround Plan. These analyses should be directly comparable to those produced for major road projects.

Proposals for investment in road and rail should be subject to rigorous investment screening in a coordinated way, which enables the best projects to be selected – be they road, rail, or a combination of the two. Without this level of transparency, the public cannot be confident that scarce resources are being allocated to the most beneficial projects.

10 Governance and ownership

Key points

- Poor governance and the difficulties in resolving multiple objectives in publicly-owned firms have been identified in previous chapters as contributing factors to problems in operational efficiency, labour relations and investment planning.
- Effective governance raises an organisation's capacity to make value-maximising decisions across all of its functions and activities. The governance arrangements for publicly-owned enterprises need to be of high quality because publicly-owned enterprises face less discipline from other sources than comparable privately-owned enterprises.
- The objectives of council-owned port and airport companies should be brought into line with the objectives for state-owned enterprises, ie, to be a successful business as profitable and efficient as comparable businesses that are privately owned.
- To reduce conflicts of interest, roles and objectives, elected representatives and council staff should be precluded from being directors of council-controlled port and airport companies. All relevant legislation should embody this provision.
- Ownership, and the incentives it creates, is an important factor in the efficiency of organisations. While ultimately it is the behaviour of owners and managers that determines organisational outcomes, different ownership models create different incentives that then influence behaviour.
- To improve the efficiency of ports, councils should consider increasing the degree of private ownership. Furthermore, current owners (and the communities they represent) are likely to benefit over the long term from such efficiency improvements.
- One option for public owners seeking to improve governance is to opt out of the relevant public-sector governance regime and into the stock-exchange regime. A stock market listing offers significant potential governance improvements for larger companies with partial public ownership. These benefits arise from an observable share price, reporting and continuous disclosure rules, and external analysis of company decisions. Other options include bringing in a cornerstone private shareholder, or some form of public-private partnership.
- Council control of ports appears to be motivated by a number of non-commercial objectives, including regional economic development and waterfront amenities. Councils are likely to be able to achieve these objectives with lower levels of port ownership.

F10.1

Effective governance is ensuring that the organisation makes value-maximising decisions across all of its functions and activities. The governance arrangements for publicly-owned enterprises need to be of high quality because publicly-owned enterprises face less discipline from other sources than comparable privately-owned enterprises.

F10.2

The Port Companies Act sets the principal objective of every port company as being to operate as a 'successful business'. However, that objective is unclear. In the case of majority council ownership it may be supplemented with the objectives of a port company's owners.

F10.3

The Airport Authorities Act requires airport companies to be managed as a 'commercial undertaking'. In the case of majority council ownership, that requirement may be supplemented with the objectives of the airport company's owners.

F10.4

A holding company can provide partial, but incomplete, insulation between the wider objectives of a council and the commercial objectives of a port or airport company.

F10.5

One option for public owners seeking to improve governance is to opt out of the relevant public-sector governance regime and into the stock-exchange regime. A stock market listing offers significant potential governance improvements for larger companies with partial council ownership. These benefits arise from an observable share price, reporting and continuous disclosure rules, and external analysis of management decisions.

F10.6

While central government ownership of rail has relatively poor incentives for improved efficiency, history suggests that rail (at least at the current network extent) is unlikely to pay its way under any ownership arrangements.

R10.1

The objectives of council-owned port and airport companies should be brought into line with the objectives for state-owned enterprises; ie, to be as profitable and efficient as comparable businesses that are privately owned.

R10.2

To maintain the separation between wider council objectives and the commercial objectives of port and airport companies, elected representatives and council staff should be precluded from being a director of council-owned port and airport companies. All relevant legislation should embody this provision.

R10.3

In the interests of improved reporting and transparency, and the efficient use of capital in the freight transport system, EVA figures for port companies should be regularly published and reviewed, including disaggregated data for significant business segments.

R10.4

A collective monitoring function should be established for port companies, to create independent information on comparative performance of ports for owners to consider – further strengthening ownership disciplines and optimal port performance.

R10.5

Government should use the s.7 provisions in the State-Owned Enterprises Act (providing for SOEs to receive direct payments for non-commercial activities) with KiwiRail to transparently identify expectations around public-good delivery and the costs incurred in their provision.

R10.6

To improve the efficiency of ports, councils should consider increasing the degree of private ownership in them. Councils should evaluate whether they can still achieve important community aims with lower ownership stakes.

R10.7

Councils – in particular those with interests in ports occupying large blocks of central city waterfront land – should consider landlord port models in which land ownership is separated from port operations. This may be an efficient mechanism for maintaining control over port land use while benefiting from the efficiency improvements resulting from increased private involvement in port operations.

11 Regulation of international sea freight competition

Key points

- Collaboration agreements between international liner shipping carriers have historically been exempt from the full application of domestic competition laws.
- The policy rationale for these exemptions was that groups of carriers on a route needed an ability to fix prices and/or capacity and pool revenue to ensure reliable freight shipping services. As such, the public benefits of the agreements were so likely to outweigh any anti-competitive detriments that there should be no onus on carriers to prove that they do so.
- This approach is adopted in New Zealand, which has automatic exemptions from the *Commerce Act 1986* for all agreements between carriers concerning international shipping, including price/capacity fixing agreements (ratemaking agreements). This approach is in contrast to most other industries where the onus is on the parties to an agreement to prove to the satisfaction of the Commerce Commission that the public benefits of specific agreements that would otherwise breach the Commerce Act in fact outweigh any anti-competitive detriments.
- Continued developments in international shipping over the past two decades, and in particular the rise of cooperation agreements without price/capacity fixing provisions (non-ratemaking agreements), independent carriers, and individual service contracts, have called into question the need to automatically exempt all types of agreements to ensure adequate and reliable services.
- There are few agreements applying to services to and from New Zealand which involve either price coordination, discussions to establish floor rates or surcharges and other terms and conditions to be applied. Accordingly, it would appear that exemptions for these types of agreements play a limited role in driving the provision of shipping services into and out of New Zealand. Other forms of cooperative agreements appear more prevalent and may have displaced ratemaking agreements as the preferred form of collaboration.
- There now seems to be little evidence to suggest that reliable shipping services are so dependent on the ability to have ratemaking agreements that such agreements should be automatically presumed to be in New Zealand's best interest.
- In relation to non-ratemaking agreements, it is unclear what proportion of these agreements would breach the Commerce Act (absent the exemption) and, if they would, to what extent these are ultimately beneficial for New Zealand. It is also unclear whether beneficial agreements would be deterred if the exemptions were removed. This is particularly the case given beneficial agreements could still be authorised, and may be able to be 'cleared' if the clearance regime for cartel provisions is introduced.
- Accordingly, there seems to be little reason why international shipping should be treated differently to other industries by having an automatic exemption for agreements, without any analysis of the actual impacts of those agreements.
- While removing the exemption can be expected to deliver benefits from increased competition, such benefits are unlikely to be decisive for New Zealand's economy. Moreover, there could be risks for New Zealand to move radically ahead of other countries and, in particular, ahead of Australia which still maintains such exemptions.
- The benefit of removal is most likely to lie in insurance against future carrier collusion. Incentives for collusion will likely increase in the future as the market moves into a position in the international

shipping cycle of more constrained supply.

- Overall, the Commission recommends removing New Zealand's exemptions for the potentially more damaging types of agreements – price-fixing (for freight and port charges) and capacity-fixing agreements – and reliance on the generic Commerce Act authorisation regime (and proposed clearance regime) for these types of agreements. Conversely, New Zealand should retain an exemption for non-ratemaking and/or non capacity-setting agreements.
- However, this change should be conditional upon a transitional period being introduced to allow any existing ratemaking and capacity-fixing agreements to be cleared, authorised or amended to ensure compliance with the Commerce Act.
- In the case of non-ratemaking and non capacity-setting agreements, New Zealand should also:
 - amend the exemptions by having only one exemption (in the *Shipping Act 1987*);
 - strengthen the remedial regime in the Shipping Act by introducing a registration regime for exempted agreements;
 - extend the application of the regime to inwards shipping; and
 - allow exemption only for agreements that permit and protect confidential individual service contracts.

F11.1

Cooperation agreements between international liner shipping carriers have historically been exempt from the full application of domestic competition laws. The policy rationale for these exemptions was that price/capacity fixing and revenue pooling etc. were needed to ensure reliable liner shipping operations. As such, the public benefits of the agreements were taken as so likely to outweigh any anti-competitive detriments that there should be no onus on carriers to prove that they do so.

F11.2

Compared with other approaches, New Zealand's regulatory regime for international shipping is an outlier in that the exemptions apply widely and largely without the limiting conditions that are found elsewhere. Moreover, there seems little logic for having two somewhat different exemptions, which give rise to complexity and uncertainty and to inconsistent treatment of importing versus exporting.

F11.3

The balance of the limited evidence that exists following the changes in shipping regulation in the US in 1998 and the EU in 2008 appears to favour the view that these changes have not led to material degradation in the quality of shipping services, and may have resulted in some improvements as a result of greater competition.

F11.4

Most evidence suggests that the international shipping industry serving New Zealand is competitive. This, combined with evidence that ratemaking agreements are not in widespread use, indicates that removing the exemptions is unlikely to result in a decisive improvement in shipping services. The benefit of removal is more likely to lie in insurance against a future degradation of outcomes for New Zealand through carrier collusion as the market moves into a position of more constrained supply.

R11.1

Exemptions for the types of agreement with the higher risk of anti-competitive detriment – ratemaking and capacity-limiting agreements – should be removed. These arrangements should have access to the authorisation and clearance mechanisms in the Commerce Act.

There should be a transitional period to allow the agreements in place at the time the exemption is repealed to continue until their compliance with the Commerce Act has been tested.

R11.2

The exemption for non-ratemaking agreements should be retained in the Shipping Act 1987 and be conditional on filing agreements with the Ministry of Transport for placing on a public register.

The exemption and remedial regime should apply equally to outwards and inwards shipping.

The exemptions for international shipping in the Commerce Act 1986 should be repealed.

To be eligible for exemption, agreements must allow and protect confidential individual service contracts.

12 Regulation of international air freight competition

Key points

- Competition in international air services is regulated in New Zealand by both the Commerce Act 1986 and the Civil Aviation Act 1990:
 - The Commerce Act regulates competition in markets in New Zealand, including markets for international air services.
 - However, certain international air services trade practices can be exempted from the Commerce Act's prohibitions on restrictive trade practices if they meet certain criteria in the Civil Aviation Act and are authorised by the Minister of Transport.
- An alternative form of regulation of competition in international air services would to rely solely on the Commerce Act regime, and remove the specific industry regime in Part 9 of the Civil Aviation Act.
- The Commission does not consider that there is a case to remove the current competition regime for international air services in Part 9 of the Civil Aviation Act, based on air freight considerations alone.
- However, the Government should make changes to the Part 9 competition regime to improve the assessment of the benefits and costs of proposals to authorise certain trade practices.
- The Government should also provide for public consultation on assessments of the benefits and costs and publication of authorisation decisions.

R12.1

The Government should retain the Civil Aviation Act Part 9 competition regime, but should amend Part 9 to:

- require the Minister of Transport to have regard to an assessment of the benefits and costs of trade practices that are proposed for authorisation under s.88 or s.90 of the Act, and commission regimes that are proposed under s.89;
- require an assessment of the detriment arising from any potential reduction in competition as part of each assessment of benefits and costs;
- require public consultation on an assessment of benefits and costs, if the proposed trade practice or commission regime is likely to reduce competition in a market; and
- require the public disclosure of section 88 and section 90 authorisations that are granted under that regime.

13 Other regulatory issues

Key points

- Different subsidy rates across the different modes for domestic freight transport have the potential to distort patterns of use and create inefficiency. Determining subsidy rates is complex and difficult but it is important to estimate them for transparency and to enable decisions that promote efficiency.
- 'Cabotage' for New Zealand coastal shipping should not be reintroduced since the current coastal services provided by international shipping lines are valuable to New Zealand shippers.
- High Productivity Motor Vehicles (HPMV) offer significant opportunities to lift productivity in the road freight sector. However, current regulatory arrangements for designating and upgrading roads for these vehicles, and for road transport operators to access HPMV permits and pay road user charges, appear to be impeding these opportunities.
- Given that airports do not charge directly for international air freight services, and that the information disclosure regime for three international airports under the Commerce Act 1986 has not been in place long enough to be properly tested, the Commission does not believe that there is a case for changing this regime at the present time.
- A key efficiency question is whether existing arrangements for firms to gain access to infrastructure and facilities at New Zealand ports and airports provide adequate scope to harness competitive forces for delivering freight-handling services.
- Most New Zealand ports operate at a small scale compared with overseas comparators and are vertically integrated in contrast to the 'landlord' model in which the owner 'unbundles' port services such as stevedoring, and grants access to competing external suppliers to provide them.
- Infrastructure owners may sometimes have an incentive to refuse access even when this would enhance efficiency. The Commerce Act s.36 sets a high threshold for challenging the decision of an infrastructure owner to refuse access.
- After considering a number of alternatives, the Commission concludes that the transaction costs of an alternative access regime, and the relatively even balance between different types of errors from granting or not granting access, suggest there is no compelling case at this stage for any change in the port or airport sectors.
- There is a case for requiring or promoting some form of information gathering and dissemination to assist in monitoring the performance of freight infrastructure providers and in freight planning and investment. The government should develop a proposal to extend its Freight Information Gathering System.
- The government's management of external costs such as environmental costs can influence the productivity of firms within the freight logistics chain.

F13.1

Different subsidy rates across the different modes for domestic freight transport have the potential to distort patterns of use and create inefficiency. Determining subsidy rates is complex and difficult but it is important to estimate them for transparency and to enable efficient decision making.

F13.2

Cabotage should not be reintroduced since the current coastal services provided by international shipping lines are valuable to New Zealand shippers.

F13.3

While there is potential for major airports to exert market power over freight services providers, there is insufficient information for the Commission to make a judgement as to whether this is occurring, and if so, whether it reduces the efficiency of freight services.

The forthcoming review of the information disclosure regime for airports under the Commerce Act is likely to be a sufficient mechanism to allow these issues to be addressed.

F13.4

The Commerce Act allows the Commerce Commission to review the case for economic regulation of ports, if future industry developments shift the balance of costs and benefits more clearly in favour of regulation.

F13.5

The generally modest scale of New Zealand ports and airports, together with the transaction costs of an access regime and the relatively even balance between the expected costs of different types of errors, suggest there is no compelling case at this stage for either a general access regime or a negotiate-arbitrate access regime in the port/airport sector.

F13.6

A well-designed domestic Emissions Trading Scheme is likely to be an efficient mechanism to internalise the costs of greenhouse gases emitted by freight transport operators within New Zealand. International legs continue to be exempt pending the development of effective international arrangements.

F13.7

The New Zealand ETS places coastal shipping at a competitive disadvantage against international ships undertaking coastal voyages since they are exempt from ETS costs.

F13.8

While acknowledging the uncertainties around price sensitivity of air freight, the Commission expects that at least some of the ETS costs will be passed through to freight customers. The Commission expects that air freight prices to Germany will increase by around 1.6%, whereas the price to the UK will increase by approximately 1.3%.

R13.1

In the interests of their own productive efficiency and service to customers, port and airport companies should periodically review the extent they unbundle activities within their domains and allow access for competing firms to supply them.

R13.2

The Government should develop a proposal to extend the Freight Information Gathering System and subject the proposal to a regulatory impact analysis 'efficiency test' to determine whether it would deliver net benefits beyond existing information collection and dissemination.

Terms of Reference

The Government has asked the Productivity Commission to undertake an inquiry into international freight transport services.

New Zealand Productivity Commission Inquiry into International Freight Transport Services

Issued by the Minister of Finance, the Minister of Commerce, the Minister of Transport, and the Minister for Regulatory Reform ('the referring Ministers').

Pursuant to sections 9 and 11 of the New Zealand Productivity Commission Act 2010, we hereby request that the New Zealand Productivity Commission ("the Commission") undertake an inquiry into international freight transport services.

Context

Increasing international trade is a critical part of achieving productivity growth in New Zealand. Given that freight transport costs (including port charges) currently represent a sizeable proportion of international trading costs for New Zealand firms, it is important to ensure that New Zealand's infrastructure and regulatory regimes are effective in promoting accessibility and efficiency in international freight transport services, while continuing to meet New Zealand's international obligations. Currently, certain aspects of international carriage by air and sea are exempted from parts of the Commerce Act 1986 and subject to industry-specific regimes under Part IX of the Civil Aviation Act 1990 and Part 1 of the Shipping Act 1987 respectively.

Scope

Having regard to the context outlined above, the referring Ministers request that the Commission undertake an inquiry to evaluate the factors influencing the accessibility and efficiency of international freight transport services available to New Zealand firms, and opportunities to increase the accessibility and efficiency of these services. For the purposes of this evaluation the Commission should:

- Identify and analyse the cost of all components of the international freight transport supply chain for New Zealand importers and exporters.
- Identify any impediments to the accessibility of the international freight transport services, and to competition within and between the components of the international freight transport supply chain.
- Identify mechanisms available to improve the accessibility and efficiency of the international transport supply chain.

Particular attention should be given, without limitation, to the following matters:

- the nature of New Zealand's international trade, including the effects of distance from overseas markets and reliance on overseas providers of international freight transport services;
- factors influencing the accessibility, cost and efficiency of New Zealand's international freight transport supply chain, with international comparisons;
- the level and growth of productivity in all components of New Zealand's international freight transport supply chain, with international comparisons; and
- the effectiveness of current regulatory regimes (including those noted above in the Civil Aviation Act 1990 and the Shipping Act 1987) affecting international freight transport services in promoting accessibility and competition, and the potential costs and benefits of alternative regulatory arrangements with international comparisons.

Consultation Requirements

In undertaking this review, the Commission should consult with key interest groups and affected parties.

Timeframe

The Commission must publish a draft report and/or discussion paper(s) on the inquiry for public comment, followed by a final report, which must be submitted to each of the referring Ministers by 1 April 2012.

BILL ENGLISH, MINISTER OF FINANCE
SIMON POWER, MINISTER OF COMMERCE
STEVEN JOYCE, MINISTER OF TRANSPORT
RODNEY HIDE, MINISTER FOR REGULATORY REFORM

30 MARCH 2011