NEW ZEALAND
PRODUCTIVITY COMMISSION
Te Kōmihana Whai Hua o Aotearoa

International freight transport services inquiry

Summary version of report

April 2012

The Productivity Commission aims to provide insightful, well-informed and accessible advice that leads to the best possible improvement in the wellbeing of New Zealanders.

International Freight Transport Services Inquiry

Summary version of final report – April 2012

The New Zealand Productivity Commission

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What this 'summary version' is

This 'summary version' provides the overview, key points, findings and recommendations from the Commission's international freight transport services inquiry final report. It is designed to give a quick route into the key insights from the inquiry.

The final report followed the release of an earlier draft report and issues paper; consideration of submissions on both papers; a large number of meetings with interested parties; and the Commission undertaking its own research and analysis of issues central to international freight transport services.

For more information about the final report please visit www.productivity.govt.nz or call the Commission on +64 4 903 5150.

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Overview

What has the Commission been asked to do?

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

- 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 was 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 closely connected

International freight transport services provide essential connections between New Zealand and the international economy. They allow 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.

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

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.

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. 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.

Trade costs also include customs and biosecurity charges, and tariffs. One task of this inquiry is to identify all significant sources of trade costs.

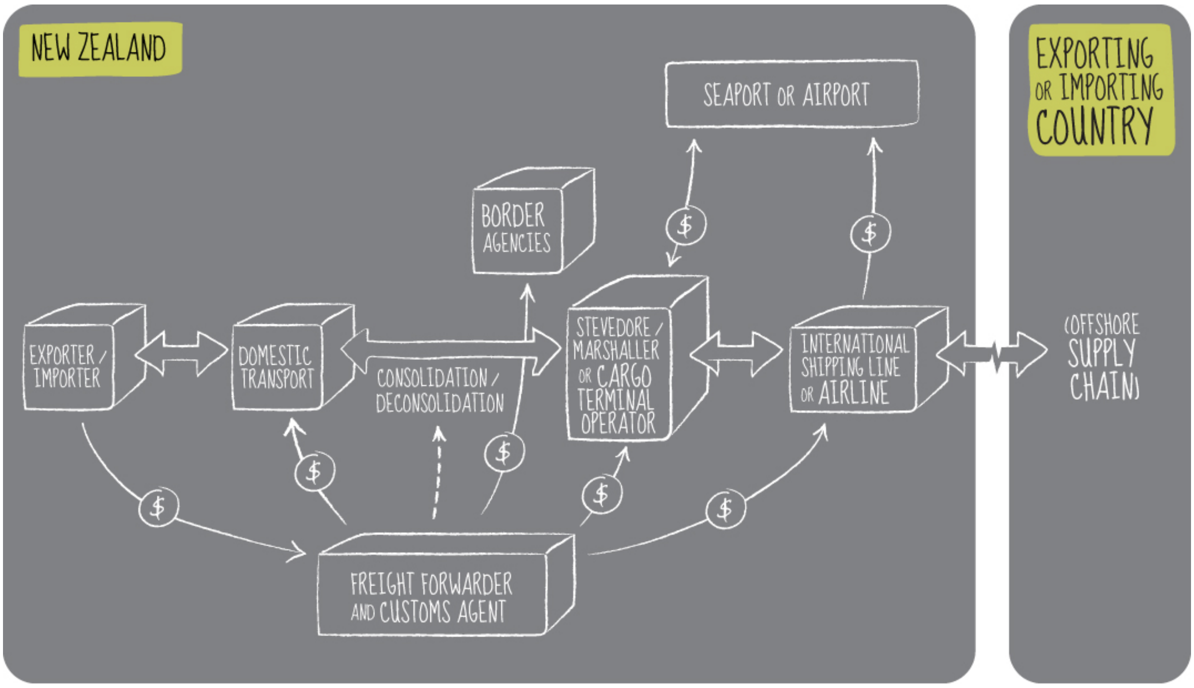
Key characteristics of international freight transport

A complex process

International freight logistics is a complex process involving different operators and contracting arrangements, as the figure below illustrates. 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; and
- from port to warehouse.

Figure 0.1 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 just 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, service frequency, and 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.

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, frequency and timeliness that best meets their requirements.

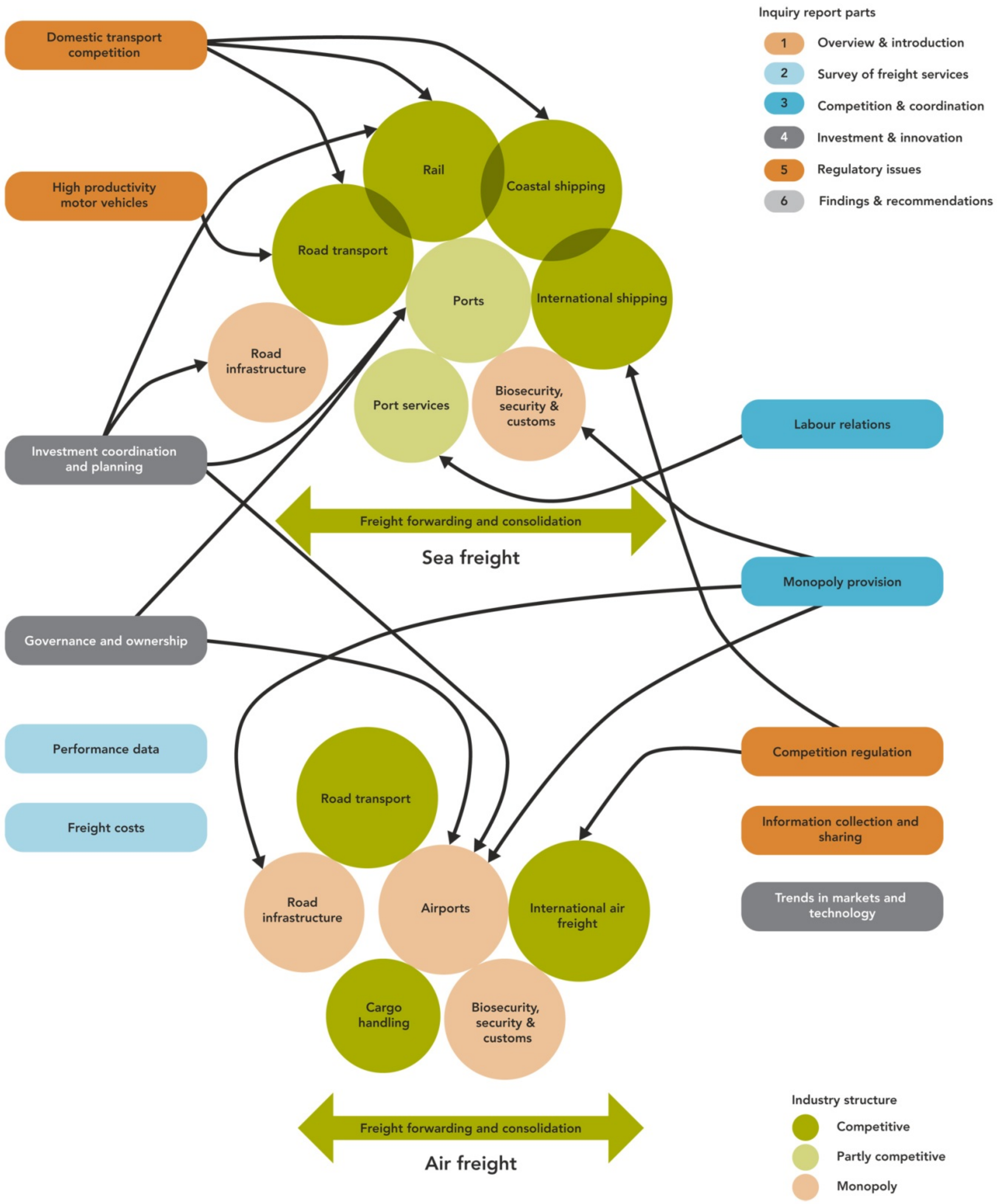
With many components

International freight transport services make up a system with distinct components. In the diagram overleaf, 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 rounded rectangles 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. Air and sea are alternative international freight modes. Thus, for some cargoes, ports compete with airports and international sea freight services compete with air freight services.

Figure 0.2 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.

Freight costs

- 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. After accounting for compositional factors, ad valorem sea freight costs are about 21% higher in New Zealand than in Australia.
- Case studies indicate that the sea transport component of container shipping prices are considerably higher for imports into or exports out of Auckland compared to Sydney. Lower trade volumes create

higher costs for New Zealand container shipping and provide a plausible explanation for at least part of the differences in freight prices observed.

- Ad valorem air freight costs decreased in the 1990s, but have flattened since then. After accounting for compositional factors, ad valorem air freight costs are about 15% higher in New Zealand than in Australia.
- Case studies suggest that air transport prices to and from Auckland are similar to those to and from 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

- Productivity in New Zealand's transport and storage industry grew strongly in the 1990s, but hardly at all 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 the strongest performer. There may be opportunities to either lift the performance of the below-average performers or to shift 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. 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.

Other indicators

- Rates of return on the funds invested in some of the publicly owned assets, for example, in ports and rail, do not achieve a market rate of return on the value of assets recorded in their published accounts. This raises questions about the efficiency of investments in these assets and/or the basis of the asset values.
- 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 impediments to innovation in places.
- Governance arrangements for the publicly owned parts of the sector are below best practice.
- Investment coordination and planning can help to address coordination issues between different parts of the logistics chain. Many inquiry participants consider that governments could improve their contribution to these issues.

Reforms within transport modes

Those who manage freight assets are responsible for delivering productivity improvements. However, their incentives will be influenced by regulatory and institutional frameworks. This report therefore focuses on possible improvements to these frameworks, as they apply to particular parts of the logistics chain and to the freight sector as a whole. The common theme linking the proposed changes is that they would strengthen the incentives for firms to improve their productivity.

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

The competition regime for sea freight

Collaboration 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 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 was 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-fixing and capacity-limiting agreements. New Zealand provides formal exemptions for international shipping in both the Commerce Act 1986 and the Shipping Act 1987 from the Commerce Act's competition regime. The two exemptions are subtly different, with inconsistent treatment of importing versus exporting. 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 found elsewhere. Moreover, there seems little reason to have two somewhat different exemptions, which create complexity and uncertainty.

The automatic exemptions from the Commerce Act contrast with most other New Zealand industries, where the onus is on the parties to the agreement to convince 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 collaboration agreements without price-fixing or capacity-limiting 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.

Ratemaking agreements – ones involving price-fixing or limiting capacity with the intent of raising prices – have a high risk of anti-competitive detriment. Exemptions for such agreements should be removed and authorisation mechanisms should be relied upon for assessing whether these agreements are in the public interest.

Removing the exemption can be expected to deliver benefits from increased competition, but it is not clear how large these will be. On the one hand, there is evidence that New Zealand shippers pay significantly higher freight prices than their Australian counterparts, and that these differences are not fully explained by higher costs. But in other respects international shipping services to and from New Zealand appear competitive. Moreover, there could be risks if New Zealand moves radically ahead of other countries and, in particular, ahead of Australia, which still has exemptions. Another benefit of removal is insurance against future carrier collusion. Incentives for collusion will likely increase in the future as the international shipping cycle moves into more constrained supply.

In the case of non-ratemaking 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. While some submissions suggested that cabotage (reservation of domestic coastal trade to New Zealand-owned shipping operators) should be reintroduced, the Commission does not support this proposal. International shipping services carry significant volumes of container cargo around the New Zealand coast, much of it at low marginal cost and prices. They also reposition tens of thousands of empty containers each year. These services are valuable to New Zealand shippers. Reintroducing cabotage would likely increase prices.

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 port performance:

- strengthening governance and/or ownership arrangements;
- more use of facilitative discussions and information sharing to aid investment planning;
- increasing the scope for competitive provision of services within ports; and
- more productive workplace relationships.

Governance and ownership of ports

All commercial ports are majority owned by a council 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.

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

- balance the financial benefits of owning the port against regional economic development objectives;
- resist control from outside the region, which 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, port companies need a clearly defined purpose, and governance and ownership 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 also, in effect, spend the money of the general 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 council-controlled port companies 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-controlled ports are specified in the Port Companies Act 1988. The legislated purpose of port companies could be clearer.

The principal objective of council-controlled port companies should be changed to: "to be a successful business as profitable and efficient as comparable businesses that are privately owned".

Managing conflicts of interest

Elected representatives have unavoidable conflicts of interest when acting as directors for a council-controlled company – particularly between their responsibilities to the community they represent under the

Local Government Act and their responsibilities to the company under the Companies Act. Similar considerations apply to council staff, since the council is likely to have regulatory functions (eg, under the Resource Management Act) that affect the company.

To manage conflicts of interest, elected representatives and council staff should be precluded from being a director of port companies. This increases the separation between commercial and wider council objectives.

Monitoring

Transparency and reporting are key parts of any governance regime. 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 raises questions about the ports' use of a scarce resource – capital – and about whether port owners should address this through some combination of better cost control, shifting resources to better uses within the port, or retiring capital for redeployment elsewhere.

EVA figures can provide an 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, port companies should regularly publish EVA figures, which should be given greater attention by owners and policy makers. To support benchmark competition between port companies, the Ministry of Transport should publish regularly an independent assessment of their comparative financial and productivity performance.

Ownership

There are convincing empirical and theoretical grounds to suggest that increased private capital participation in ports would improve their governance, and offer improved incentives for port efficiency, and the dynamic efficiency of the freight system in general. But port owners should choose this method only after thoroughly considering the issues. Councils should be clear about the objectives they wish to pursue through port ownership. Having decided those objectives, they should choose the minimum level of council ownership that offers the required control rights.

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.

Councils should consider landlord port models in which land ownership is separated from terminal 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.

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 companies should consider listing them on the stock exchange in order to obtain the governance benefits from listing.

Improving workplace productivity at ports

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.

Work practices and management/worker relationships at some New Zealand ports are far from conducive to high-productivity workplaces. Inefficient work practices represent a forgone opportunity to create value and distribute it in a manner that benefits all parties. Poor relationships between management, workers and unions are a major obstacle to capturing lost value. These relationships are more akin to the traditional adversarial relationships than the 'productive employment relationships' envisioned in the purpose statement of the Employment Relations Act (ERA). A further complication is that port managers are often reluctant to push for changes in collective agreements because they wish to avoid the potential cost of industrial and legal action. This tends to entrench the status quo arrangements.

While poor relationships exist at some ports, a port-specific policy solution is not necessary.

- Other industries have similar characteristics to ports yet manage to have cooperative and effective workplaces – this suggests that relationships, rather than different policies, are at the heart of any industrial relations problems at ports.
- Poor workplace relationships are not systemic throughout all New Zealand ports.
- Strike action or lockouts occur relatively infrequently at New Zealand ports (notwithstanding recent events at the Ports of Auckland).
- There is no evidence to suggest that the processes for mediation and negotiation within the ERA are made less effective by the characteristics of ports.
- The existing competition framework, in conjunction with the ERA, provides means for parties that feel aggrieved by any anti-competitive behaviour associated with the provision of port labour to seek solutions.

Nevertheless, some stakeholders have suggested that reforms to the ERA would reduce the likelihood of protracted negotiations. These include:

- removing, or limiting, the requirement on parties to conclude collective bargaining, in order to reduce the incentive on both parties to hold out for a 'one-sided' outcome;
- reducing the period a collective agreement continues in force after its expiry date (currently up to 12 months); and
- introducing compulsory secret ballots prior to strike action.

These reforms would apply to the whole economy, and are beyond the scope of this inquiry. However, any reform which disproportionately favours the bargaining strength of one party at the expense of the other would be counter-productive.

Improvements to the governance of both ports and unions could play an important role in creating more productive workplace relationships.

For ports, this means ensuring that boards and their management teams have the skills and mandate to engage with workers and their representatives in a way that leads to productive, socially responsible and sustainable port operations. For unions, it means implementing a 'hybrid model' of unionism whereby unions play a role in overcoming the barriers to achieving high-productivity workplaces, while also advancing the wages and conditions of their members.

The development of positive workplace relationships will require both port managers and unions to place less emphasis on areas of conflict and greater emphasis on opportunities for mutual gain.

A common and correct understanding of employment law concepts and processes is an important element in the development of workplace relationships. The report discusses three areas where improved understanding is needed:

- the role of the courts in upholding particular work practices;

- restrictions on communications between employers and workers during the collective bargaining process; and
- the difference between 'casualisation' and 'contracting out'.

The competition regime for 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 international air services market and the international regulatory framework for air services have changed significantly since the current competition regime was established. Competition regimes in other countries have evolved in response to these market and regulatory developments, but New Zealand's competition regime for international air services has remained the same.

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 comprehensive 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 comprehensive 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. While this would remove the requirement in the Civil Aviation Act that the decision-maker considers New Zealand's international obligations and international comity, civil aviation policy considerations do not appear to be essential to the current competition regime for air services:

- The Civil Aviation Act authorisation regime is optional. Businesses seeking an exemption from Commerce Act prohibitions can bypass the Civil Aviation Act and seek a Commerce Act authorisation directly from the Commerce Commission.
- The Australian competition regime operates without specific legislative requirements for considering civil aviation policy objectives.
- Other highly regulated markets in New Zealand are still subject to the Commerce Act's prohibitions.

The Commerce Commission has advised that it could take into account international civil aviation obligations in a Commerce Act authorisation process, if these obligations were described in a submission. The Commerce Commission would assess the net national benefits of fulfilling these obligations to varying extents. However, the focus on civil aviation policy under a Commerce Act regime would not be as strong as under the current regime, where consideration of international obligations and comity is expressly required by the Civil Aviation Act.

On balance, the Commission considers that a Commerce Act-only regime would regulate competition in international air freight services more effectively than the Civil Aviation Act regime. However, the Government should review the passenger-specific costs and benefits of retaining the current competition regime or adopting a Commerce Act-only regime before making any changes.

If the Government retains the current competition regime, it should make changes to Part 9 of the Civil Aviation Act to improve the assessment of the benefits and costs of proposals to authorise certain trade practices.

Airports

The relationship between airlines and airports appears to be strained, with airlines claiming that airports use their market power as geographic monopolies to overcharge for services. Airports disputed this view.

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.

The analysis and recommendations about the governance and ownership of ports is also generally applicable to council-controlled airports.

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 for delivery of public goods by KiwiRail and the costs incurred in their provision.

The Government should improve the transparency of decision making around rail infrastructure projects, including the publication of cost-benefit analyses, comparable to the ones produced for major road projects. Decisions on rail also need to be forward looking. The focus should not be on evaluating whether past investment should have occurred, but on the optimal strategy for the future.

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 some problems, including coordination problems between different agencies, and incentive alignment problems. An obstacle to the successful introduction of HPMVs is the reluctance of some councils to issue permits and fund infrastructure upgrades (mainly bridge capacity).

The Government should examine ways to share the increased road user charge revenue from high productivity motor vehicles with councils, so as to encourage the local road upgrades required to support these vehicles.

Reforms that apply across the freight sector

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

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 current level of risk tolerance reflected in the activities of New Zealand's border agencies appears to be in line with the expectations and preferences of stakeholders. As such, the level of border risk management is not acting as a barrier to the efficiency of the international freight logistics chain.

Given this level of risk tolerance, the question is whether the agencies could achieve that level of risk in a less costly way. They use a risk-based resource allocation model to help them target expenditure and effort where it adds most value. This 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. 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 reduce 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 should lead to further improvement. The second phase of the JBMS project will address back office coordination issues between MAF and NZCS, but is several years away. In the meantime, low cost measures to improve coordination will be explored through the Future Directions for the Border Sector initiative. This initiative needs to develop transparent and quantifiable performance measures for border cooperation. These measures should form the basis of the planned six-monthly reports to Cabinet. Active oversight of the Border Sector Governance Group by border sector Ministers should continue beyond the completion of the Future Directions programme of work.

Finally, the current Customs and Excise Act 1996 was developed in the early 1990s. Since then, the trade environment, technology and border risks 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.

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 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. Two commonly made arguments are:

- 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 a commercial rate of return on the capital invested.

Determining the level and direction of subsidies across transport modes is complex and difficult. 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 view is that the PAYGO methodology does not subsidise road use, as capital spending is recovered in the period in which it occurs. While submissions suggested that rail is subsidised by the government as it does not achieve an acceptable rate of return on the capital invested, the Commission considers that decisions for rail need to be forward looking and made transparently.

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 risks of under- and over-investment. While coordination might reduce these risks, 'coordination challenges' of various types can lead to organisations making individually sensible decisions with collectively sub-optimal outcomes.

Six particular issues raised by participants formed the basis for case studies in this report. Participants indicated that resolution of these issues would require the coordination of different organisations within or between different parts of the freight supply chain or, in one case, different levels of government. The six issues are:

- coordinating road and rail investments;
- whether there are too many ports;
- whether port mergers would improve coordination;
- whether port expansion is required in the upper North Island;
- how to plan for larger container vessels; and
- how to coordinate local and central government interactions with the transport sector.

A significant number of inquiry participants consider that 'strategic planning' or 'government leadership' is needed to resolve issues such as these. However, strategic planning (in its various forms) and government leadership have their own costs and risks, and can lead to governments assuming the normal commercial risk of other parties.

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.

The analysis of the six case studies supports the view that there are significant coordination challenges for those making investment decisions in the freight transport sector; that there are different options for addressing them; and that participants in the sector have incentives to develop these options. Governments can improve decision-making by facilitating information sharing and discussion about different options, while ensuring that there is adequate coordination between different levels of government and between their own investment decisions when these relate to different transport modes.

Collecting freight information

Information about issues such as freight movements, infrastructure-investment plans and future demand can help freight participants make better individual and joint decisions. There are various freight information-gathering initiatives, including the 2008 National Freight Demand Study, the new Freight Information Gathering System (FIGS), and the Transport Monitoring Indicator Framework.

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.

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 inquiry has focused on issues raised by submitters. These are the impacts of:

- the Resource Management Act 1991 (RMA) on investment in transport infrastructure;
- the Climate Change Response Act 2002; and
- the European emissions-trading system (the EU ETS) on New Zealand exports to and imports from Europe.

Improving 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, 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.

Submissions highlighting the need for a more balanced approach to weighing up local and national implications of transport infrastructure projects raised concerns about:

- the RMA's purpose statement being unclear;
- the absence of recognition of the importance of transport infrastructure within the RMA;
- the need for additional central government guidance in planning for transport infrastructure; and

- the omission of seaports from the list of 'network utility' operators.

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 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 the Infrastructure Technical Advisory Group's recommendation that s.6 of the RMA should refer 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 develop a national policy statement (NPS) for transport infrastructure, which would signal central government recognition of the importance of New Zealand's transport infrastructure.
- An NPS for transport infrastructure will only be effective if regional and local policies and plans can be changed, to implement it in a timely way. Long delays can be associated with producing such plans and policies. The Commission recommends a review of ways to reduce the time it takes to produce fully operational local government plans.

Recent reforms to the RMA are likely to reduce concerns about the rigidity, complexity and cost of the consent approvals process.

Climate change

The Climate Change Response Act (as amended) has introduced an emissions-trading scheme to internalise the costs of greenhouse gases emitted by freight transport operators within New Zealand. The scheme will directly impact the domestic parts of the international freight supply chain and is likely to be effective in doing so. International legs will continue to be exempt pending the development of effective international arrangements.

The European Union emissions trading system

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 (ETS) and therefore subject to an ETS cost. This will affect around 10–15% of New Zealand air freight exports (by value) and New Zealand exporters may face relatively higher cost increases than their international competitors (who are in general located closer to European markets).

At least some of the ETS costs are likely to 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% in the price of air freight to Germany and around 1.6% in the price to the United Kingdom. New Zealand exporters 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, many of which are 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 benefits that engagement can bring.

Freight costs have fallen significantly over the last 20 years. This fall in costs is impressive considering price rises in inputs such as fuel and labour over this period. The freight system has taken the steadily rising freight volumes in its stride. It has shown considerable resilience in the face of a number of recent unexpected shocks to its capability – the series of major earthquakes in Christchurch, the grounding of the container vessel *Rena* off the coast of Tauranga, and an extended industrial dispute in Auckland. These are indications of a system that has served New Zealand well; however, there is room for improvement.

This inquiry has identified considerable scope for productivity gains in the sector. While it is transport businesses that will drive productivity improvements, the inquiry has focused on ways that central and local governments, which are closely involved through ownership and regulation in particular, can improve their involvement in the sector and improve its capacity and capability to improve productivity. The Commission has developed 26 recommendations covering a wide range of topics, but in its view the top five opportunities for improvement lie in:

- lifting the quality of infrastructure planning and coordination;
- improving governance of ports and airports;
- making competition regimes more pro-competitive;
- building more productive workplaces at ports; and
- developing a richer information infrastructure.

The international freight transport sector faces considerable challenges, and how it deals with them will make a significant difference to New Zealand's future prosperity. The proposals in this report will enhance the capacity of the sector to meet these challenges.

1 The inquiry and why it is important

Key points

- The Government 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 has aimed to present compelling, evidence-based findings and make practical recommendations in order to improve the international freight transport system, and to communicate these well.
- In July 2011 the Commission released an Issues Paper, following which it received over 50 submissions and met with many organisations and individuals. It published a draft report in January 2012 on which it again consulted and received submissions. This final report to the Government has 75 findings and 26 recommendations about how to improve New Zealand's international freight transport services.
- International freight transport services are important because they 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.
- New Zealand's trade growth has lagged its OECD peers over the last 20 years. New Zealand firms have largely failed to participate in the expansion of international intra-industry trade associated with the growth of complex supply chains and segmented, specialised production.
- Its small domestic market and distance from major foreign markets pose major challenges to New Zealand's ability to participate effectively in the global economy. New Zealand's economic distance from key markets raises both direct transport costs and the costs of longer transit times.
- Taking effective steps to improve New Zealand's international freight system will help to mitigate its geographical challenges and raise its ability to participate effectively in the global economy. In short, a more efficient and effective freight system can raise the prosperity of New Zealand's businesses and workers and enhance consumers' purchasing power.

Findings

F1.1 What matters for many New Zealand businesses is access to a menu of logistics services, from which they can choose the combination of price, quality, frequency and timeliness that best meets their requirements.

F1.2 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.

F1.3 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 direct transport costs and the opportunity costs of time – are substantial impediments to New Zealand's ability to participate effectively in the global economy.

F1.4 Improving New Zealand's international freight system will help 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 generally do a good job in generating efficient outcomes, but sometimes suffer from 'market failures'.
- An efficient outcome occurs when firms provide whatever goods and services customers want 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 takes account of harmful effects of freight transport on the environment and other market failures. Other important influences on wellbeing are better dealt with through broader policy levers than ones connected directly to international freight.
- New Zealand's international freight transport services can be usefully viewed as a *system.* This inquiry focused 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 examined 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.

Findings

F2.1	Economic efficiency (broadly defined) is 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 policy levers than the ones directly connected to international freight transport.

F2.2 International freight transport can be viewed as a system with a number of distinctive characteristics such as diverse needs, 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 supply chain encompasses a range of services connecting producers to consumers. Accordingly, 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 an international comparison, the OECD recently assessed New Zealand's regulations in the airline, road and rail sectors to be around the OECD 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 official border 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 some ports 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 (EVA ®) from 2008 to 2011, although there was improvement from 2009. This raises questions about how efficiently owners have allocated capital to ports over this period and the valuation of port assets. However, it is important to note that this was a period of very slow growth in trade volumes.

Findings

F3.1 Productivity growth in New Zealand's transport and storage industry increased dramatically in the 1990s, but has since slowed considerably. Since 2000 it has been substantially slower than in Australia, the US and Germany.

F3.2 Available indicators suggest that New Zealand's container port performance is no less and possibly better than in Australia. However, there is notable variation between New Zealand ports, with Tauranga being the strongest performer.

F3.3 There is little information about the productivity of freight handling at airports. Auckland Airport's overall productivity (passenger and freight) compares favourably with other Asian and Pacific airports, while Christchurch is about average.

F3.4 New Zealand has low average loads for road freight compared to other countries.

F3.5 Compared internationally, New Zealand has low volumes of freight per kilometre of rail and low maximum axle loads for its trains.

F3.6 The six port companies analysed by in the inquiry recorded mostly negative Economic Value Added (EVA) 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 based on their 2007 asset values.

Recommendations

R3.1 Alongside container productivity measures, the Ministry of Transport should measure and publish the productivity of New Zealand ports in handling logs and other significant non-containerised exports and imports.

4 Freight transport costs

Key points

- Ad valorem freight costs are the freight costs faced by New Zealand importers and exporters as a percentage of shipment value.
- Ad valorem sea freight costs have decreased over the last two decades, even after accounting for changes in the composition of trade and trading partners. Cost-reducing efficiency and technology improvements appear to have outweighed factors such as fuel price increases. Australia's ad valorem sea freight costs show a similar pattern.
- Adjusting for trade composition, ad valorem sea freight costs are estimated to be around 21% higher in New Zealand than Australia. Case studies indicate that the sea transport component of container freight costs is higher for routes in and out of Auckland compared with routes in and out of Sydney.
- Lower trade volumes create higher costs for New Zealand container shipping relative to Australia. These costs provide a plausible explanation for at least part of the significant differences in sea freight prices observed in the case studies.
- 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.
- New Zealand importers and exporters generally pay more for air freight as a percentage of shipment value than their Australian counterparts.
- However, case studies suggest that New Zealand importers and exporters pay less than their Australian counterparts for air freight on certain routes.
- The onshore components of New Zealand's air and sea freight costs, particularly port handling costs, compare favourably with Australia and other OECD countries. However, there remains room for improvement.

Findings

F4.1 Ad valorem sea freight costs – the freight costs faced by New Zealand importers and exporters as a percentage of shipment value – have decreased over the last two decades.

F4.2 Ad valorem air freight costs decreased in the 1990s, but flattened in the 2000s.

F4.3 Ad valorem sea import freight costs are higher in New Zealand than in Australia, after accounting for compositional factors. Sea freight costs for both countries 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. Ad valorem air freight costs are currently higher in New Zealand than in Australia.

F4.5 Container shipping freight costs per kilogram have dropped over time. This suggests that cost-reducing efficiency and technology improvements appear to be important drivers for the decrease in container shipping costs.

F4.6 Onshore costs of New Zealand's sea freight compare favourably with Australia and other OECD countries, but are higher than for Singapore, the country with the lowest costs.

F4.7 Case studies suggest that the sea transport component of total sea freight costs are considerably higher for routes in and out of Auckland compared with routes in and out of Sydney. The onshore components of Auckland's sea freight costs, particularly its port handling costs, compare favourably with Sydney's.

F4.8 Case studies suggest that total 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. The air transport component of total costs is fairly similar for Auckland and Sydney, and most of the differences in total costs are due to lower ground handling costs in Auckland.

F4.9 Lower trade volumes create higher costs for New Zealand container shipping relative to Australia. These costs provide a plausible explanation for at least part of the significant differences in sea freight prices observed in case studies.

F4.10 There are fewer services and fewer competitors for the New Zealand container shipping market relative to Australia.

F4.11 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.

F4.12 There is scope for improving customs procedures and documentation requirements, even though New Zealand is performing reasonably well in these areas. Continuing to work with trading partners to improve trade facilitation could reduce transit times.

5 Impediments to competition in international freight

Key points

- Competitive pressures provide incentives for firms to meet the transport needs of their customers in the least costly ways.
- Impediments to competition in components of the international freight transport supply chain include potentially anti-competitive practices in international shipping that are exempt from competition law, and port governance arrangements.
- 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, although most seem to be issues for commercial resolution. These opportunities include combination of freight shipments, minimisation of empty containers, timing of bill payments, and reducing truck waiting times at airport freight handling facilities.

Findings

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 There are no barriers to entry for dedicated air freighters to increase freight capacity in and out of Christchurch. If shippers are willing to pay for a dedicated freighter service, they should be able to signal this to airlines directly or through a 'consolidation agent'.

6 Improving workplace productivity

Key points

- Workplace productivity is the capability of a company to turn its inputs, including labour and capital, into products and services. The term 'high-productivity workplaces' is used in this chapter to refer to workplaces that are able to do this in an efficient and effective manner while promoting a fair and cooperative relationship between employers and workers.
- The benefits of high-productivity workplaces can include higher real wages, better working conditions, higher levels of job satisfaction, and more competitive and profitable businesses.
- There is no single recipe for increasing workplace productivity; however, key ingredients include innovation, the adoption of new technologies, and investment in worker skills and capital equipment. The ability of an organisation to turn these ingredients into high-productivity workplaces depends on the quality of governance, the level of managerial skills, and the willingness and ability of managers and workers to accept change and undertake ongoing training to enhance their skills and capabilities.
- Good workplace relationships between employers and employees are an essential catalyst for developing high-productivity workplaces. These relationships are typically built on mutual trust, and a shared understanding and vision for the organisation.
- New Zealand's employment legislation attempts to promote good relationships by prescribing the concept of 'good faith' bargaining, protecting the integrity of individual choice, and providing avenues for mediation where differences between parties arise.
- Work practices and management/worker relationships at some New Zealand ports are far from conducive to high-productivity workplaces. Inefficient work practices represent a forgone opportunity to create value and distribute it in a manner that benefits all parties.
- Poor relationships between management, workers and unions are a major obstacle to capturing additional value. These relationships are more akin to the 'old school' adversarial relationships of times past than the 'productive employment relationships' prescribed as an object of the Employment Relations Act 2000.
- A specific policy regime aimed at promoting better workplace relations at ports alone is not warranted. Improving the governance of both ports and unions would contribute to building more productive arrangements. These relationships will inevitably take time to build and to filter through to port performance.
- The concepts of 'contracting out' and 'casualisation' are often confused. While an external services provider (contract company) may indeed employ casual workers, it should not be automatically assumed that the proportion of casual or part-time workers will be higher than if the same services were provided 'in-house'.

Findings

F6.1 Workplace productivity is driven by a number of factors including innovation, the adoption of new technologies, investment in plant and equipment, and investment in worker skills. Healthy relationships between employer and employees, including a shared view of the future, are important facilitators of these drivers in all workplaces, including those within the international freight logistics chain.

F6.2 The persistence of some work practices represents a forgone opportunity to capture lost value and distribute it in a manner that can potentially benefit all parties.

F6.3 A specific policy regime aimed at promoting better workplace relations at ports alone is not required.

F6.4 Improving the governance of both ports and unions, and promoting skilful, persistent, honest and resolute leadership, are important elements in developing relationships conducive to high-productivity workplaces. Such relationships will inevitably take time to build and to filter through to port performance.

F6.5 A well established 'custom and practice' can give rise to a contractual term, or be used by courts to interpret the meaning of an ambiguous term in an employment contract. However, the express terms of an employment contract will always prevail. Both employer and employee can seek to specify or override a custom and practice during the negotiation of an employment contract. The ability to change existing practices will therefore be influenced by the workplace relationships that exist between the parties and the value each party assigns to the custom and practice.

F6.6 While communications that relate to collective bargaining must go through an employees' union, an employer can communicate with employees during the collective bargaining process as long as the communication is consistent with good faith.

F6.7 The concepts of 'contracting out' and 'casualisation' are often confused. While an external services provider (contract company) may indeed employ casual workers, it should not be automatically assumed that the proportion of casual or part-time workers will be higher than if the same services were provided 'in-house'.

7 Customs, security and biosecurity

Key points

- New Zealand's border agencies are tasked with weighing up the benefits and costs of reducing border risks. This can be a complex task as public perceptions, incomplete scientific knowledge, and variations in 'expert' opinion can present conflicting views of how the border should be managed. Conflicting views can also arise when 'hindsight' is used to gauge the level of resources that 'should' have been devoted to preventing a border incursion.
- The general level of risk tolerance reflected in the activities of New Zealand's border agencies appears in line with the expectations of most stakeholders.
- The risk-based approach adopted by New Zealand's border agencies is a sound method for allocating agency resources and recognises that eliminating border risks would be neither feasible nor efficient.
- Border agencies should continue to enhance their performance measures and review procedures in order to improve the transparency of performance and increase management accountability.
- The Trade Single Window, 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.
- The second phase of the new Joint Border Management System (JBMS) will improve 'back office' coordination between Ministry of Agriculture and Forestry and New Zealand Customs Service activities. The second phase is several years away from being delivered (assuming funding is secured). In the meantime, measures to improve border agency coordination are needed – this will be the focus of the Future Directions for the Border Sector initiative.
- The work programme for the Future Directions for the Border Sector initiative should include the development of transparent and quantifiable performance measures for border cooperation. These measures should form the basis of the planned six-monthly reports to Cabinet. Active oversight of the Border Sector Governance Group by border sector Ministers should continue beyond the completion of the Future Directions programme of work.
- Increased security concerns after 9/11 are placing additional costs on some New Zealand exporters – particularly those with time-sensitive cargos. For sea cargo, Mutual Recognition Agreements are being used to ensure that New Zealand's border standards are recognised by trading partners, and are reducing time delays associated with securing arrangements at overseas ports.
- Additional emphasis should be placed on developing 'trusted trader' programmes for New Zealand air cargo exports to reduce delays arising from overseas security requirements.
- Fees and charges imposed by New Zealand border agencies compare favourably, in general, with those imposed on exporters and importers in Australia.

Findings

F7.1 The complete elimination of border risk is neither feasible nor efficient. Rather, a balance between costs and benefits needs to be struck.

F7.2 On the basis of submissions to the inquiry, it appears the general level of risk tolerance reflected in the activities of New Zealand's border agencies is in line with the expectations of stakeholders. The level of border risk management is not 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 The Trade Single Window will provide exporters and importers with a more streamlined, less fragmented interface with border agencies.

F7.5 While the second stage 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.

F7.6 Qualitative evidence suggests that Mutual Recognition Agreements improve the efficiency of the international freight logistics chain.

F7.7 Registration, certification, and inspection fees and charges paid by New Zealand exporters are, in general, lower than those imposed on Australian companies exporting similar products.

F7.8 Fees and charges imposed on New Zealand importers generally compare favourably with those imposed by Australian border agencies.

Recommendations

R7.1 The use of a risk-based approach increases the need for regular monitoring of outcome-based performance measures. Border agencies should continue to enhance their performance measures and review procedures in order to improve the transparency of agency performance.

R7.2 The recently announced Future Directions for the Border Sector initiative should develop transparent and quantifiable performance measures for border cooperation. These measures should form the basis of the planned six-monthly reports to Cabinet. Active oversight of the Border Sector Governance Group by border sector Ministers should continue beyond the completion of the Future Directions programme of work.

R7.3 The Customs and Excise Act 1996 should be added to the Government's Regulatory Review Work Programme with a view to assessing whether it is fit for purpose in light of changes to border management practices and developments in technology since 1996.

R7.4 The Government should place emphasis on developing mutual-recognition schemes for New Zealand air cargo exports with a view to reducing delays for time-sensitive exports caused by increased security requirements.

8 Encouraging efficient investment and innovation

Key points

- New Zealand freight volumes are predicted to increase substantially in the next 30 years. Investment and innovation in the freight sector will be needed.
- There are impediments to efficient investment and innovation in the freight sector. Regulations and institutions can be improved.
- The Resource Management Act can be improved to better encourage efficient investment. Section 5 of the RMA should be reviewed to clarify the consideration of net social benefits and costs. If the Government decides not to review the purpose statement it should develop a National Policy Statement for transport infrastructure.
- The reforms introduced under the Resource Management (Simplifying and Streamlining) Amendment Act 2009 are leading to improvements in the timeliness and cost of the consent process.

Findings

F8.1 There appears to be ambiguity around the interpretation of the purpose of the Resource Management Act 1991 (RMA) and the extent to which the Act allows the balancing of socio-economic aspirations with environmental outcomes.

F8.2 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 a potential reduction in the overall wellbeing of society.

F8.3 Recent reforms to the RMA are likely to lead 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.

Recommendations

R8.1 Section 5 of the Resource Management Act 1991 should be reviewed to clarify 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 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. This would provide guidance for local authorities when considering competing national and local priorities.

R8.3 The Government should review ways to reduce the time it takes to produce fully operational local government plans.

R8.4 The Government should conduct a review of whether to include port companies as network utility operators in s.166 of the RMA.

9 Investment coordination and planning

Key points

- Uncertain demand, multiple decision makers and the lumpy nature of investment in freight transport infrastructure create risks of under- and over-investment. Improved coordination between decision makers could promote more efficient levels of investment.
- Inquiry participants identified 'strategic planning' and 'government leadership' as solutions to a wide variety of coordination challenges, but these approaches have significant costs and risks.
- Transport firms have incentives to resolve many of the coordination challenges described in this chapter. But gaps in these incentives, combined with the fact that governments provide some freight infrastructure, points to a role for government in facilitating investment decision-making.
- Government can perform a useful role in improving coordination within the freight sector by facilitating informed discussions about strategic issues, while leaving decisions to be made on a decentralised basis in most cases. This approach also helps government infrastructure providers – particularly those receiving poor price signals – that face a difficult problem in collecting reliable market research on which to base their investment decisions.
- Directive planning, in the sense of a centralised plan imposed on independent parties, creates incentives for non-productive behaviour, including rent-seeking, tactical misrepresentation and strategic hold-up. It also tends to lock in a single approach, which can be costly if the future does not turn out as expected.
- Central government should screen road and rail investment proposals rigorously and in a coordinated way, so that the best projects are selected. Publishing cost-benefit analyses of proposals would build community confidence that the best decisions are being made.
- Case studies confirm that there are significant coordination challenges for those making investment decisions in the freight transport sector; that there are different options for addressing them; and that participants in the sector have incentives to develop these options. Governments can usefully promote this process by facilitating information sharing and discussion about different options, while ensuring that there is adequate coordination between different levels of government and between their own investment decisions when these cut across transport modes. But if the government adopts a strong leadership approach it may well choose an inferior option, based on incomplete information.

Findings

F9.1 'Facilitated discussions' can improve decentralised decision making through promoting relationship building and information sharing, leading to improved coordination.

F9.2 While there are pressures on the government to provide stronger leadership in the transport sector, this approach involves significant risks. Governments can take a lead where:

- action relies on powers only available to government (eg, transport corridors, regulatory policy); or
- it can do so at low cost to itself, while creating benefits for others (eg, facilitated discussions, transparent decision-making).

F9.3 Governments need to perform a leadership role in designating transport corridors, and coordinate these decisions with their own infrastructure investment planning. Governments should be mindful of the risks of these decisions, and that poor decisions may have unintended consequences.

F9.4 Directive planning, in the sense of a centralised plan imposed on independent parties, has significant disadvantages compared with decentralised, facilitative approaches to planning.

F9.5 String services – with container ships calling at multiple ports – are normal practice in New Zealand, reflecting the geographic distribution of freight demand, costs of inland transport and shipping technology.

F9.6 Decisions about the viability of smaller ports are best left to their owners. An important consideration is whether shippers are willing to pay the full costs of port services, including an adequate return on capital.

F9.7 The Commerce Commission is best placed to evaluate the public benefits relative to the detriments of proposed mergers that might result in a lessening of competition. Such mergers warrant independent evaluation as their benefits and costs are potentially very large.

F9.8 Prescribing a single approach to investing to support bigger container ships is unlikely to be an efficient way to deal with the significant investment risks.

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 freight prices.

F9.10 Unevenly distributed impacts make it difficult to determine whether shippers, as a whole, will be better or worse off in a bigger ship scenario. A domestic hub-and-spoke model will likely reduce the transport costs faced by some shippers, and increase the cost to others – creating both winners and losers.

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.

Recommendations

R9.1 More use should be made of 'facilitated discussion' models of cooperation in coordinating investment planning. These models are based on information sharing, robust discussion and relationship-building, but do not bind the participants to particular outcomes. They do not create the strong incentives for the costly behaviours that undermine directive planning models (such as tactical misinformation, rent-seeking and strategic hold-up).

R9.2

The government should:

- coordinate its assessments of road and rail projects in order to allocate capital where it can add most value; and
- seek ways to improve the transparency of decision making around road and rail infrastructure projects, including the publication of cost-benefit analyses.

10 Governance and ownership

Key points

- Many councils consider current governance and ownership arrangements for port and airport companies to be optimal. The Commission believes that improvements to these arrangements are desirable, with the resulting improvement in productivity benefiting international freight transport and the nation generally.
- Councils have multiple, legitimate objectives; in particular the social, economic, cultural and environmental wellbeings of their communities. They face difficult trade-offs between these objectives.
- Councils should not try to achieve all objectives in every entity they control. Council-controlled port and airport companies should concentrate on increasing productivity and maximising shareholder value. Enhanced financial returns can fund the delivery of non-commercial objectives, either directly or via other council-controlled entities.
- Port and airport companies are likely to be more productive and profitable with narrower, primarily commercial objectives and a governance structure to suit.
- The legislated principal objective of council-controlled port and airport companies should be changed to: "to be a successful business, as profitable and efficient as comparable businesses that are privately owned".
- Effective governance arrangements for publicly owned companies are essential because they face less discipline from other sources than comparable privately owned companies.
- Elected representatives and council staff should be precluded from being directors of council-controlled port and airport companies to reduce conflicts of interest, roles and objectives. All relevant legislation should embody this provision.
- Changes to the ownership of publicly owned companies can help improve governance, through increased transparency and improved incentives to perform commercially. Councils should be clear about the objectives they wish to pursue through port and airport ownership. Having decided those objectives, they should choose the minimum level of council ownership that offers the required control rights.
- 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.

Findings

F10.1	Effective governance ensures that the organisation makes value-maximising decisions across all of its functions and activities. Publicly owned enterprises need high-quality governance arrangements because they 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'. That objective could be clearer for council-controlled port companies. Their potential efficiency may be limited should they pursue the multiple objectives of their shareholders.

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 commercial and non-commercial objectives of the airport company's owners.

F10.4 It is more efficient for councils to optimise their multiple objectives across all the entities they control, rather than pursuing all objectives within each entity. Commercial entities should be separated from the non-commercial, and the commercial entities structured to maximise long-term value. The enhanced financial returns from commercial entities can then be used to fund the achievement of the council's wider objectives.

F10.5 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.

F10.6 Public owners seeking to improve governance can opt out of the relevant public-sector governance regime and into the stock exchange regime. A stock market listing offers 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.

Recommendations

R10.1 The legislated principal objective of council-controlled port and airport companies should be changed to: "to be a successful business, as profitable and efficient as comparable businesses that are privately owned".

R10.2 Elected representatives and council staff should be precluded from being a director of council-controlled port and airport companies. This increases the separation between commercial and wider council objectives.

R10.3 Port companies should regularly publish economic value added analyses for their operations, including disaggregated data for significant business segments. This would improve reporting and transparency, and help to ensure the efficient use of capital in the freight transport system.

R10.4 To support benchmark competition between port companies, the Ministry of Transport should regularly publish an independent assessment of comparative financial performance for port owners and policy makers to consider.

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 goods and the costs incurred in their delivery.

R10.6 Councils should be clear about the objectives they wish to pursue through port ownership. Having decided those objectives, they should choose the minimum level of council ownership that offers the required control rights. Increased private capital participation offers improved incentives for port efficiency, and the dynamic efficiency of the freight system in general.

R10.7 Councils should consider landlord port models in which land ownership is separated from terminal 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 companies have historically been exempt from domestic competition laws. Liner services operate to regular timetables and are largely confined today to container services.
- 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. The public benefits of the agreements were assumed so likely to outweigh any anti-competitive detriments that there should be no onus on carriers to prove that this was the case.
- New Zealand's current law adopts this approach, having automatic exemptions from the Commerce Act 1986 for all agreements between carriers concerning international shipping, including price-fixing and capacity-limiting agreements (ratemaking agreements). This approach is in contrast to most other industries where the onus is on collaborating firms to satisfy the Commerce Commission that the collaboration will have net public benefits.
- Developments in international shipping over the past two decades, in particular the rise of collaboration agreements without price-fixing or capacity-limiting 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.
- Moreover, international policy opinion has shifted against automatic exemption with an influential OECD study opposing exemption, and all 25 EU countries collectively deciding to change EU law and remove the exemption for ratemaking agreements.
- Shipping lines that supply container shipping services to and from New Zealand appear to have reduced their reliance on ratemaking agreements and largely adopted other forms of collaboration agreements.
- With the shift in international thinking and the experience of many services operating without ratemaking agreements, there now seems little reason to treat international shipping differently to other industries, and retain their automatic exemption in New Zealand. This is particularly so in light of the Government's proposed law to make cartel behaviour a criminal offence.
- Removing the exemption can be expected to deliver benefits from increased competition, but it is not clear how large these will be. On the one hand there is evidence that New Zealand shippers pay significantly higher freight prices than their Australian counterparts, but in other respects international shipping services to and from New Zealand appear competitive. Moreover, there could be risks for New Zealand to move radically ahead of other countries and, in particular, ahead of Australia which still has exemptions for ratemaking agreements.
- Another benefit of removal is 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.
- The Commission recommends removing New Zealand's exemptions for the potentially more damaging types of agreements – involving price-fixing, or limiting capacity to raise prices. Exemptions would still be possible, but conditional on authorisation or clearance by the Commerce Commission. New Zealand should retain an automatic exemption for agreements that

neither fix rates nor limit capacity.

- The changes should include a transitional period to allow any existing ratemaking agreements to be cleared, authorised or amended to ensure compliance with the Commerce Act.
- In the case of non-ratemaking agreements, New Zealand should also:
  - have only one exemption (in the Shipping Act 1987) and apply it equally to inward and outward shipping;
  - introduce a registration regime for exempted agreements; and
  - exempt agreements only if they permit and protect confidential individual service contracts.

Findings

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 were needed to ensure reliable liner shipping operations. The benefits of the agreements were taken to be so likely to outweigh any anti-competitive detriments that there should be no onus on carriers to prove that this was the case.

F11.2 Compared with other approaches, New Zealand's regulatory regime for international shipping is something of 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 power under s.12 of the Shipping Act – to regulate shipping in response to foreign government restrictions – may no longer be necessary. Repealing s.12 would enable the government to remove the exemption from Part 4 of the Commerce Act for outwards shipping. The threat of regulation under Part 4 provides an incentive for shipping lines to act competitively.

F11.4 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.

F11.5 A number of indicators suggest that the international shipping industry serving New Zealand is competitive. On the other hand, case studies show evidence of higher sea-freight rates on New Zealand services compared with Australian services that do not seem to be fully explained by cost differences.

Ratemaking agreements are not currently in widespread use; however, there are likely to be net gains from taking a more pro-competitive stance towards international container shipping, with only a small risk of any deterioration in services. A further benefit lies 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.

F11.6 The removal of competition exemptions for ratemaking agreements will not prevent shipping companies from collaborating to jointly purchase port services. However, any increase in the level of competition in the market for shipping services as a result of removing the exemptions could see a higher proportion of any gains from lower port charges passed through to New Zealand shippers.

Recommendations

R11.1 Ratemaking agreements – ones involving price-fixing or limiting capacity with the intent of raising prices – have a high risk of anti-competitive detriment. Exemptions for such agreements should be removed and authorisation mechanisms should be relied upon for assessing whether these agreements are in the public interest.

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 1986 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.

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

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

12 Regulation of international air freight services

Key points

- There is a well established international practice of restricting the rights of airlines to carry passengers and freight between countries.
- Countries exchange traffic rights in and out of their territories through bilateral or multilateral agreements, known as 'air services agreements'.
- Recent international studies have found evidence that more liberal air services agreements are associated with an increase in the amount of passengers and freight that are transported by air. The evidence for New Zealand is not as clear, but there are certain air services agreements that appear to be constraining air freight supply.
- 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.
- Subject to a review of the passenger-specific impacts, the Government should consider adopting a Commerce Act-only regime for regulating international air services. A Commerce Act-only regime provides for comprehensive analysis of costs and benefits of trade practices, and this in turn ensures authorisation decisions that should maintain or improve air services efficiency.
- If the Government retains the current competition regime, it should make changes to Part 9 of the Civil Aviation Act to improve the assessment of the costs and benefits of proposals to authorise certain trade practices.

Recommendations

R12.1 The Government should account for freight-specific costs and benefits whenever it considers changes to air services agreements or new air services agreements.

R12.2 Subject to a review of the passenger-specific impacts, the Government should consider adopting a Commerce Act-only regime for regulating international air services.

R12.3 If the Government decides to retain Part 9 of the Civil Aviation Act, it 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 costs arising from any potential reduction in competition as part of each assessment of benefits and costs;
- require public consultation on the assessment of benefits and costs where the trade practice or commission regime is likely to reduce competition; and
- require the publication of s.88 and s.90 authorisations that are granted.

13 Other regulatory issues

Key points

- The 'Pay As You Go' road funding methodology does not inherently subsidise road users.
- 'Cabotage' (which limits domestic coastal shipping to domestic operators) should not be reintroduced. Coastal services offered 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, funding arrangements appear to be impeding these opportunities.
- The information disclosure regime for airports has not been in place long enough to be properly tested as a means of regulating their potential exercise of market power.
- More information on freight movements in New Zealand – collected and made available on a regular basis – would have considerable value.

Findings

F13.1 Cabotage should not be reintroduced as the coastal services provided by international shipping lines are valuable to New Zealand shippers.

F13.2 The uptake of high-productivity motor vehicles (HPMV) is constrained by the reluctance of some councils to issue HPMV permits and fund upgrades to routes. Their reluctance is understandable, as under current arrangements they face significant upgrade and maintenance costs, without a corresponding increase in road funding.

F13.3 The inquiry has not reviewed whether airports are exerting market power over freight services providers. The forthcoming review of the information disclosure regime for airports under the Commerce Act will address this question.

F13.4 If the market power of ports becomes a concern, the Commerce Act provides for the Commerce Commission to undertake a Part 4 inquiry – either on its own initiative or at the request of the Government. Such an inquiry would look at whether regulation is needed, and if so, what form it should take.

F13.5 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.

F13.6 At least some of the EU emissions trading system charges will be passed through to freight customers. Air freight prices to Germany are likely to increase by around 1.6%, and prices to the UK by approximately 1.3%.

Recommendations

R13.1	The Government should examine ways to share the increased road user charge revenue from high productivity motor vehicles with councils, so as to encourage the local road upgrades required to support these vehicles.
R13.2	Port and airport companies should periodically review the extent they allow access to their facilities by competing suppliers. Competitive provision can improve productive efficiency and customer service
R13.3	The Ministry of Transport 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.

Commonly used terms

Term	Description
ad valorem freight costs	The cost of freight as a proportion of the value of the cargo (percentage of value).
air service agreement	A bilateral or multilateral agreement in which states exchange rights of airlines to carry traffic in and out of their territories. Air services agreements cover matters such as the routes that may be flown, the capacity that may be offered by airlines, how many airlines may operate, and how tariffs (ie, prices) may be regulated.
air transport prices	The prices charged by airlines for the transport of freight between airports; ie, air freight prices less charges incurred on the ground.
allocative efficiency	Achieved when the goods produced correspond best to what people want. In general, no barriers to trade and prices that reflect the marginal social costs of production will result in a product mix that is allocatively efficient.
anti-trust	Competition law is known in the United States as anti-trust law. Competition law promotes or maintains market competition through the regulation of anti-competitive conduct by companies.
barriers to entry	Factors which prevent or deter the entry of new firms into a market.
benchmark competition	Benchmark competition is based on the compilation of performance indicators by an independent organisation. Typically these indicators are published with sufficient analysis to allow interested parties to make an informed comparison of the performance of the companies of interest.
biosecurity	Actions taken to limit the damage caused by biological threats such as invasive species of pest plants and animals.
cabotage	The reservation of a country's domestic coastal trade to shipping operators of that country (In the context of airlines see final report Appendix B.)
capacity-limiting agreement	An agreement between competitors to limit capacity with the intention of increasing price. A form of ratemaking agreement.
carrier	A shipping line or airline.
cartel	An association of competitors that, by agreement, limits the degree of competition that would otherwise prevail in the buying and selling of goods and services by members of the cartel.
casualisation	The process of replacing permanent positions with casual or short-term contract employees. Often confused with 'contracting out'.
collaboration agreement	An agreement between two or more carriers regarding the joint supply of services. (Also called a cooperation agreement.)

Term	Description
collective bargaining	The process through which an employer and representatives of employees (unions) negotiate the terms and conditions of an employment relationship.
collusion	Cooperation of industry rivals for their mutual benefit and at the expense of competitive outcomes.
commission regime	A government authorisation for commissions that travel agents and cargo agents charge airlines for booking passengers or cargo onto aircraft. These commission regimes, once issued, have the effect of exempting commissions from Part 2 of the Commerce Act.
competition regime	The laws that regulate competition in a specific market.
compositional factors	Factors that affect the cost of freight transport at an aggregate level. eg, the composition of goods transported and the mix of trade partners.
consolidation agent	Freight forwarder or other organisation that combines demand for freight services.
contestable	A market in which new entrants are able to enter and compete with existing participants.
continuous disclosure	An ongoing obligation on a company to promptly inform the public of significant corporate events, both favourable and unfavourable.
contracting out	A situation where one company enters into a contract with another to supply services. The concept is often associated with the 'outsourcing' of services whereby a company transfers the provision of a service previously performed by in-house employees to an external supplier. Often confused with casualisation.
cooperation agreement	An agreement between two or more carriers regarding the joint supply of services. (Also called a collaboration agreement.)
cost of capital	The financial return investors require from an investment given its risk.
custom and practice	A long-standing work practice that, in certain circumstances, can be interpreted as a contractual term under a collective agreement, or taken into account by courts when interpreting an ambiguous contractual term.
dynamic efficiency	Dynamic efficiency is achieved when optimal decisions are made on investment, innovation, and market entry and exit, to create productive and allocative efficiency in the longer term.
economic distance	The 'distance' between two geographical locations, as measured by the total cost to trade between them (including freight costs and tariffs).
economic efficiency	Economic efficiency requires an optimal allocation of productive resources and incentives for efficient use over time. Dimensions of economic efficiency are discussed in section 2.1 of the final report.
economic value added (EVA) analysis	EVA analysis assesses the difference between the operating rate of return of a firm and its weighted cost of capital. In broad terms, this shows whether returns were sufficient to justify investment in the company, compared with an alternative use of the funds.

Term	Description
efficiency	Getting the most out of the resources used.
emissions trading scheme (ETS)	A system aimed at minimising the cost of achieving a predetermined reduction in greenhouse gas emissions by creating a market for emission permits and allowing emitters to buy and sell permits.
exemption	A formal exclusion from the provisions of legislation; eg, an exclusion from general competition law.
export intensity	The value of a country's exports as a percentage of its GDP.
external costs and benefits	External costs or benefits arising from an economic activity that affect somebody other than the people engaged in the economic activity and are not reflected fully in prices.
facilitated discussion	Government brings together relevant stakeholders and leads them through a discussion process towards the development of a common view of the future and voluntarily agreed plans for coordinated actions.
factors of production	The ingredients of economic activity: land, labour, capital, information and enterprise.
freight costs	The cost charged for moving goods, including packing, documentation and loading/unloading charges, transport charges, and insurance while in transit.
freight forwarder	A person or company that organises shipments for other firms and may also act as a carrier.
good faith	A legal term used in the Employment Relations Act 2000 to describe a standard of behaviour that parties to an employment relationship must adhere to. For example, under the Act 'good faith' requires parties to be active and constructive in establishing and maintaining a productive employment relationship.
governance	The distribution of rights and responsibilities among the different participants in an organisation – such as the board, managers, shareholders and other stakeholders. Effective governance ensures that the organisation makes value-maximising decisions across all of its functions and activities.
hard infrastructure	Physical infrastructure such as roads, bridges, railway lines, vehicles and ports.
high-productivity motor vehicles (HPMV)	Vehicles that can carry longer and/or heavier loads than normally permitted on New Zealand roads.
high-productivity workplaces	Workplaces that efficiently turn inputs, including labour and capital, into outputs (products and services). At an economy-wide level, workplace productivity is a key driver of income growth and improvements in the material standard of living.
holding company	A firm limited to holding shares in and supervising the management of other firms (a portfolio of subsidiaries). A holding company is an active investor; it can be thus distinguished from passive investors such as mutual funds. Holding companies aim to create value through their roles as financial intermediaries and active shareholders.

Term	Description
hub and spoke	A transportation model in which freight is consolidated at a central port or airport (or hub). The hub port, for example, is fed by road, rail and coastal shipping services (or spokes).
hubbing	The movement of freight through a central port or location.
individual service contract	A contract between a carrier and a single shipper for the supply of freight transport services.
information disclosure regime	A regime specified in Part 4 of the Commerce Act designed to promote the efficient operation of markets through ensuring that suppliers make publicly available reliable and timely information about their operation and behaviour, so that a wide range of people are informed about such factors as profits, costs, asset values, price, quality and reliability.
institutions	A country's institutions – broadly conceived – include all the formal rules and informal conventions or norms that shape the political, economic and social behaviours of members of society.
internalise	When individuals or firms take external costs or benefits into account (eg, because of regulation or taxation), those external costs or benefits are said to be internalised.
liner service	A shipping service that operates within a schedule and has a fixed port rotation with published dates of calls at the advertised ports. Cargo is generally carried in containers.
logistics	Management of the flow of goods between the point of production and the point of consumption in order to meet customer requirements.
lumpy investment	Investments that are, by their nature, large, indivisible and infrequent.
market failure	Market failures are scenarios where otherwise unregulated markets produce results that are not efficient – ie, they can be improved upon from the societal point of view. Examples include the abuse of monopoly power, and environmental degradation.
market power	The ability of a firm to alter the market price of a good or service.
monopoly	A monopoly exists when a specific person or enterprise is the only supplier of a particular commodity.
mutual recognition agreement	An international agreement by which two or more countries agree to recognize one another's compliance procedures for goods traded between those countries.
national policy statement	An instrument available to central government under the Resource Management Act to help local government decide how competing national benefits and local costs should be balanced.
network utility operator	Defined in s.166 of the Resource Management Act 1991 and discussed in section 8.4 of the final report.
non-ratemaking agreement	An agreement between carriers regarding a shipping route that does not involve setting prices, or limiting capacity with the intention of raising prices.

Term	Description
onshore	Located or based within a country's national boundaries.
operational efficiency	Used in this report to mean economic efficiency with a focus on the short to medium term; ie, excluding consideration of dynamic efficiency.
opportunity cost	The cost of passing up the next best choice when making a decision.
pay-as-you-go (PAYGO)	A way of funding and accounting for public infrastructure, applied in New Zealand to roads. All upgrades and maintenance are funded from current revenue, but no financial return is expected from any initial investment.
policy lever	Any tool available to government that can be applied or adjusted to change the behaviour of individuals and groups.
port handling charges	The fees levied on carriers and cargo owners by port authorities.
price fixing	Agreement between competitors to set the price of a good or service, or interfere with how that price is reached by a market.
price signals	The information conveyed by the relative level of prices, or by a change in price. Rising prices generally 'signal' a shortage of supply, an increase in demand, or a rise in input costs. Falling prices generally signal the opposite conditions.
productive efficiency	Achieved when goods and services are produced at the lowest cost of production.
productivity	A measure of output per unit of input. For further definitions see Box 3.2 in Chapter 3 of the final report.
public goods	Goods that satisfy two criteria: they are non-rival (ie, one person's use of the good does not impair others' use) and non-excludable (ie, it is not practical to exclude people who do not pay from using the good). Examples include national defence, basic scientific research and national parks.
rate of return	The financial returns on an investment, expressed as a percentage of the total amount invested.
ratemaking agreement	An agreement between carriers to set prices on a shipping route. Capacity-limiting agreements are also a form of ratemaking agreement.
regulation	A set of tools that governments use to achieve their aims.
regulatory impact analysis	A process for assessing proposals involving regulatory options. Assessment includes determination that the problem cannot be adequately addressed through private or non-regulatory arrangements, and that a regulatory solution is required in the public interest.
rent-seeking	Lobbying to obtain a benefit rather than adding value through creating a benefit.
revenue pooling	An arrangement between the carriers operating a service to share a proportion of revenue. Revenue pools are a mechanism to restrain competition between carriers for

Term	Description
	high freight-rate goods, and to prevent concealed rate undercutting.
road user charges (RUC)	A levy on diesel-powered vehicles based on the vehicle type, axle weight and distance.
sea transport costs	The prices charged by shipping lines for the transport of freight between ports; ie, sea freight prices less charges incurred onshore.
shipping cycle	The business cycle of the shipping industry. Often considered to have four stages: a trough (characterised by excess supply and a period of low prices); a recovery (where demand and prices begin to rise, soaking up some excess capacity from the market); a peak (where strong demand pushes prices high and vessel utilisation to near full capacity); and a collapse (demand slows and prices decline).
shipper	The party on whose account goods are consigned. A shipper can be an importer or an exporter.
soft infrastructure	Non-physical infrastructure – such as knowledge, skills and computer software.
specialisation	When a firm concentrates on making one good or one service in order to improve its productivity.
strategic hold-up	Refusing agreement in order to extract concessions.
strategic planning	Used in this report to refer to long-term planning decisions, typically involving large capital investments and multiple decision makers.
string service	A shipping service that visits a number of ports as part of a larger loop.
supply chain	The stages or steps between the point of origin of goods and the point of consumption. (The term is related to but differentiated from 'logistics' above.)
tactical misinformation	Withholding or misrepresenting privately held information for private advantage.
tariff	A tax on imports typically collected at the border by customs agencies.
time-sensitive cargo	Cargoes whose value declines while being transported, for example perishable or fashion items.
trade facilitation	A concept that considers the simplification, harmonisation and standardisation of trade procedures. Its principal aim is to reduce transaction costs in international trade, especially those between business and government border agencies.
Trade Single Window	An electronic platform aimed at streamlining border procedures. It will ultimately provide a single point for electronic submission of import and export documentation and associated payments. Part of the Government's Joint Border Management System.
transaction costs	Costs incurred by the parties making an economic exchange, other than the amount paid directly for the goods or service purchased.

Term	Description
transit time	The time taken for cargo to be transported from its point of origin to its final destination.
user charges	Charges imposed on consumers for the use of services or products supplied by a government agency.
work practice	A habitual manner of performing required work tasks that may or may not be prescribed in the written employment contract
workplace productivity	The rate at which firms turn inputs, including labour and capital, into outputs (products and services). See also 'high-productivity workplaces'.

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:

a) 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;

b) factors influencing the accessibility, cost and efficiency of New Zealand's international freight transport supply chain, with international comparisons;

c) the level and growth of productivity in all components of New Zealand's international freight transport supply chain, with international comparisons; and

d) 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

NEW ZEALAND
PRODUCTIVITY COMMISSION
Te Kōmihana Whai Hua o Aotearoa