

Auckland Council's response to Productivity Commission – Issues Paper on International Freight Transport Services (July 2011)

23 September 2011

Summary

1. Auckland Council welcomes the Productivity Commission's investigation into the international freight system. Auckland Council plays a critical role in the freight system through our ownership of Ports of Auckland and shareholding in Auckland Airport. We recognise the vital importance of an efficient logistics chain for New Zealand and are planning and investing for the future by improving access to the Port of Auckland (POAL) and Auckland Airport (AIAL).
2. We also recognise that the Port of Auckland is located adjacent to Auckland's CBD which is the most highly concentrated and productive economic area in NZ. Both rely to a large extent on the same infrastructure – road and rail – to meet accessibility needs. Therefore, efficiency of the international freight logistics chain cannot be considered in isolation from the efficiency of the city's wider economy. It is our view that we need both.
3. We believe strongly in the benefit of the continued public ownership of POAL. The governance arrangements now in place effectively separate operational and governance decisions, with ACIL acting as the shareholder. This allows the efficient operation of the port business and the effective integration of the port's activities with the growth and development of the city.
4. The current governance model is well suited to meeting the need of generating fair commercial returns without exploiting any potential market power that may exist within the port sector.
5. But there is an issue around the potential for shipping lines to exercise market power by playing off ports competing for container services which could be addressed through encouraging a more collaborative approach between ports. An issue here is that the Commerce Act may restrict opportunities for ports to collaborate more effectively.
6. The council has signaled to POAL the need for a long-term strategy which addresses the opportunities and implications of co-operation or alliancing arrangements with the Port of Tauranga and North Port (CCO Strategy Review Subcommittee resolutions 21/4/2011). Feedback received in response to the Auckland Plan Discussion Document from Smartgrowth (Environment Bay of Plenty, Tauranga City Council, Western Bay of Plenty District Council) and Northland Regional Council also suggested that the Auckland Plan should be more explicit about the role of POAL, the Port of Tauranga and Northport and about inter-regional trends. POAL have indicated that they do not oppose cooperation with Port of Tauranga and see some potential benefits in such cooperation for the overall supply chain. Previous merger proposals in New Zealand have demonstrated increased value for shareholders as well as supply chain efficiencies. It is imperative that as hubbing from major ports becomes more commonplace an international hub port is available to meet the upper north island's freight needs. It is also apparent that by 2040 all current and planned capacity of POAL and Port of Tauranga will be required to meet demand.

7. The evidence from New Zealand and internationally does not suggest that private ownership will of itself increase operational efficiency of ports in New Zealand.
8. Public ownership with commercially focused boards is an efficient operating model for ports in New Zealand.

Introduction

9. Thank you for the opportunity to provide a submission to the New Zealand Productivity Commission's inquiry into international freight transport services. The Auckland Council welcomes the work of the Productivity Commission to grow productivity and improve the wellbeing of New Zealanders.
10. This submission represents the views of the Auckland Council. It has been developed in consultation with Auckland Transport, Auckland Council Investments Ltd., Auckland Tourism, Events and Economic Development and the Auckland Waterfront Development Agency. Ports of Auckland Ltd is also making a separate submission in response to the questions relating to the operational aspects of ports in New Zealand.
11. Auckland Council owns 100% of Ports of Auckland Ltd (POAL) and 22.55% of Auckland International Airport Ltd (AIAL). Ports of Auckland Ltd owns 19.9% of Northland Port Corporation (NZ) Ltd.

Auckland Council Policy

12. The Auckland Council takes it's responsibility for Auckland's economic prosperity and the role that Auckland plays in contributing to New Zealand's well being very seriously. Council is concerned to ensure that international freight services are as efficient as possible to support Auckland and New Zealand's growth. The Draft Auckland Plan identifies the Council's desire for Auckland to become an internationally connected and export driven city (economy priority 3). "Given the small size of NZ's domestic market, international connectivity is critical to Auckland's economy in several ways - through internationalising firms' activities, earning export income, attracting skilled migrants to Auckland, and improving Auckland's physical connections to the world. To help create the step change in our economic path, we must strengthen the international connections between Auckland and other international cities and countries with the aim of improving trade and investment ties."
13. The Draft Auckland Plan includes the directive (11.6) to "provide for the long-term needs of the Port of Auckland and Auckland Airport to support New Zealand's international freight, trading competitiveness and visitor industry."
14. The Draft Auckland Plan recognises the unique position of Maori as Tangata Whenua, the principles of the Treaty and the obligations of Council under various pieces of legislation. Given the unique position that Maori hold, the Draft Auckland Plan seeks to enable and support Mana Whenua and Mataawaka aspirations and to provide them with the opportunities to contribute to the future development of Auckland. Specific proposals for efficiency of international freight will need to be cognisant of any potential customary interest claims under the new Marine and Coastal Area (Takutai Moana Act) 2011 and the outcomes of treaty settlement negotiations underway in Auckland at present.

15. The council's draft Economic Development Strategy (EDS) is well aligned with the government's economic agenda and the context of the Productivity Commission inquiry, recognising that increasing international trade is a critical part of achieving productivity growth in Auckland.¹
16. Achieving the draft EDS vision of "Auckland as the world's most liveable city with an internationally competitive, prosperous economy that all Aucklanders can benefit from and participate in" is, we believe, contingent on international trade, export growth and efficient infrastructure. An efficient and competitive international freight system is vital to support Auckland's role as New Zealand's global gateway and to promote trade and export opportunities. The draft EDS includes two key strategic directions, that are relevant to the broad context of the inquiry:
 - Auckland is a business friendly and well functioning city
 - Auckland is internationally connected and export driven
17. The draft EDS also includes goals for Auckland's economic performance:
 - An annual increase of regional exports greater than 6%.
 - An annual real GDP increase greater than 5%.
 - An annual productivity growth greater than 2%.
18. Meeting these objectives is expected to raise Auckland's rating by twenty places in twenty years, against other OECD cities.
19. To achieve these goals will require a fundamental change in Auckland's economy, including a structural shift from being an import-led to an export driven economy. An efficient international freight system will be a vital component of this success.

Auckland - International City of Scale

20. Auckland is New Zealand's only international city of scale but it is ranked 69th out of 85 metropolitan regions in the OECD in terms of GDP per capita. Our geographic remoteness, small home market and lack of economic diversity all contribute to this.
21. As with other international and outward facing cities, Auckland's connectivity is a key determinant of advantage, competitiveness and export potential. Given our relative geographical remoteness it is critical that we reduce our transport costs where possible. The efficient operation of Auckland's air and seaports which are our gateways to the global economy are important for both Auckland and New Zealand's economic growth.

¹ New Zealand Productivity Commission (Issues Paper, July 2011). *International Freight Transport Services*, Appendix 1- Terms of Reference, p. 71.

Significant issues for Auckland Council

22. The Issues paper raises a number of questions which are of significant interest to the Auckland Council which we address in this section.

1. Efficiency and the objective of improving overall wellbeing

Commission's View

23. "The Commission's view is that, in the case of the subject of this inquiry, overall wellbeing is best served by promoting the economic efficiency of the logistics supply chain for New Zealand importers and exporters. Efficiency improvements should result in lower prices for imported goods and higher profits for exporting industries. Lower import prices directly benefit New Zealand consumers and firms, and higher returns for exporters are also likely to benefit employees through better wages and opportunities."

Question 1. Are there important issues that may be overlooked as a result of adopting an economic efficiency perspective for this inquiry?

Our view

24. The council fully supports the intention of improving productivity in a way that supports the overall wellbeing of New Zealanders. But we make two points that are relevant to this enquiry.

Need to take a long-term view

25. In relation to ports we would emphasise the need to take a long-term view of efficiency (which includes dynamic efficiency noted on page 7 of the Issues paper). This will require consideration of optimal investment decisions which create efficiencies in the long term. Adopting this approach would imply that efficient prices will reflect the costs of providing the service in a way that is forward looking and capable of generating sufficient revenue to provide for the investment required to meet projected future demand.

Efficiency in one part of the economy (e.g. the freight system) may not improve overall welfare when externalities are present

26. As noted on page 7 of the Issues Paper, achieving allocative efficiency generally requires no barriers to trade and prices that reflect the marginal social cost of production. However, we know for example that road transport is characterised by a lack of efficient prices.² It is travel time delay imposed by other road users rather than price which limits demand for congested road space in peak hours. Road transport also creates other positive and negative externalities such as productivity gains from increased accessibility or emissions impacts from congested traffic conditions which go un-priced. Therefore, a significant concern we have is that a focus on allocative efficiency, where important external costs and benefits are excluded from the analysis will not guarantee that the 'efficient' solution is also the outcome which maximises social welfare.
27. This could arise if freight transport prices which did not reflect these externalities led to an increase in freight traffic volumes travelling to and from the Port of

² Approximately 87% of container movements to and from POAL are by road and 13% by rail. It is expected that over time up to 30% of movements could be undertaken by rail, but 70% will still travel on roads in and around Auckland's CBD.

Auckland and as a consequence reduced accessibility for workers to the Central Business District (CBD) (by road and/or rail). This might encourage firms to locate away from the CBD. Yet the evidence clearly shows that for certain activities (e.g business and financial services) the CBD provides a significant productivity premium over other locations and it is important from a productivity perspective to support further concentration of employment in these activities in the CBD. As Maré (2008) points out, “value added per worker in the Auckland region is 30 to 50 per cent higher than that of regions outside Auckland and for Auckland CBD the premium is even higher (120 to 150 per cent).”³ Therefore, from an overall social wellbeing perspective, it would be desirable to encourage those activities which become more productive when concentrated to agglomerate within the CBD. Where there is an accessibility constraint (for example insufficient rail capacity to meet passenger transport needs into the CBD and freight demand from the port) then the real trade-off becomes one between freight costs versus employment location. If the reduction in freight costs is less than the lost productivity arising from jobs being located away from the CBD this is not the most efficient outcome.

28. A further concern we have is the need to ensure that efficiency is defined sufficiently broadly to fully capture the sustainability and energy conservation impacts of any potential changes to international freight transport services.
29. Therefore, the risk of adopting an economic efficiency approach is that the outcome that could be overlooked is in fact overall wellbeing. This would be best served by promoting the economic efficiency of the logistics supply chain for New Zealand importers and exporters, only where all external costs and benefits are fully recognised. Where this is not the case a broader assessment is needed and an open mind kept as to whether efficiency is most likely to be achieved through markets or some form of intervention.

2. Council ownership of ports and airports

30. The most important questions from Council's perspective are those which relate to governance and local authority ownership of ports and airports. The key questions covering ownership structure of ports and airports in New Zealand and our responses to these are set out below.

Efficiency of public ownership

Question 15. Has local-authority ownership of majority stakes in New Zealand's commercial ports inhibited, enhanced or been neutral for the development of a more efficient and productive port sector?

31. The Issues Paper considers the potential efficiency implications associated with council ownership of ports and airports, and provides some mixed evidence on this point. On page 29 it is stated that “Auckland Regional Holdings released a report in October 2009 that argued that the commercial returns to New Zealand ports are inadequate. For example, their report concluded that the profits of the major ports in 2008 fell \$138 million short of what would be required to achieve a return on equity of 10 per cent.” Using the measure of nominal after tax weighted average cost of capital (WACC) to the value of its assets NZIER (2010) also concluded that between 1989 and 2009 both Ports of Auckland and Tauranga had generated returns that were below the

³ Maré, D.C. (2008) *Labour Productivity in Auckland Firms*, Motu Working Paper 08-12.

cost of capital.⁴ And that from 2003 onwards this trend had worsened and spread across the port sector. However, using the alternative measure of economic returns on historic cost, NZIER (2010) found a quite different result, that all four major container ports made positive economic returns (i.e. they more than covered the cost of the equity and debt capital employed by the ports) in every year from the mid-1990s to 2009.⁵ Auckland Council expects that POAL will improve its return on investment over the next three years.

32. The key question is whether the public ownership model for ports is more or less efficient than private ownership? The Auckland Council strongly believes that the current public ownership model is efficient and delivers a good balance between strong commercial focus and mitigation of potential market power.
33. The governance model provides a good balance between allowing commercial freedom to operate the port as a successful business whilst taking into account the wider planning and policy objectives of the council.
34. A possible area of inefficiency identified in the Issues Paper arises where the board are influenced by councilors in such a way that they end up making sub-optimal commercial decisions. It is noted in the Issues Paper that the local authority shareholder(s) and other shareholders appoint the directors of port companies. "This is one channel through which it is possible that local politicians, reflecting a wider set of interests than simply the commercial profitability of their port company, could be influencing outcomes in a way that is different from what would happen under private-sector owners. NZIER (2010) argues that there is some evidence that this has been the case particularly in relation to ownership restructuring and negotiations with foreign shipping lines, but not in relation to other aspects such as investment or exercising market power."
35. Under Auckland's new governance arrangements POAL is run on a strongly commercial basis. It is the responsibility of Auckland Council Investments Ltd (ACIL) to appoint the directors of POAL. ACIL is governed by an independent board with no elected representative appointed to the board of this organisation. Therefore, the appointment of the directors to POAL is clearly separated from political process.
36. The Auckland Harbour Board (and Harbour Boards across New Zealand) were abolished as part of Port reforms of 1988-89. From 1989 to 1993 the port was owned by the ARC but from 1993 it has been owned by intermediate 'one step removed' agencies, with an appointed board. Consequently, there has been no direct political influence over operational matters of the port post the transfer of ownership from 1993. Unlike the situation in Auckland, other Regional Councils throughout New Zealand have owned ports directly - though some have set up holding companies which unlike Auckland were set up by the councils themselves and not by government legislation.

⁴ NZIER (2010b). *Port Performance and Ownership. An assessment of the evidence*. Report to the Local Government Forum. New Zealand Institute for Economic Research. p40. Retrieved May 11, 2011 from:

<http://www.businessnz.co.nz/file/1947/100813%20Port%20Performance%20and%20Ownership.pdf>.

⁵ NZIER (2010), *Ibid*, p43.

37. Secondly, it is important to note that the report produced by NZIER found that there is no evidence to suggest that the current governance arrangements influence investment decisions or the exercising of market power ports. This strongly suggests that port companies can and do make 'efficient' decisions under public ownership.
38. But, equally importantly, the new council governance structure provides an opportunity to better integrate council activities, POAL operations, transport infrastructure, land use planning and spatial planning. The governance arrangements of the Auckland Council and full ownership of POAL enables the two entities to coordinate and take strategic and investment decisions that will be of benefit to the whole region. This balance is the best way of achieving an efficient port which is well integrated with the city.
39. The Mayor has given a strong signal in his 4 August report 'Mayor's high level direction setting for the Long Term Plan 2012-22' on the question of ownership of the port and airport, emphasising strong support for retaining Council's shares in the Ports of Auckland or Auckland International Airport. The justification supporting the Mayor's view is the ability to align the direction of these strategic assets with the goals of the Auckland Plan and vice versa. These assets also provide an ongoing income stream to the council, thereby contributing to the goal of reducing the level of council operating costs that are required to be funded directly from rates, allowing increased investment in other areas, or reducing the requirement for further rates increases.
40. Auckland Council indicated its commitment to maintaining public ownership and its equity position of the airport shares and Ports of Auckland through its Statement of Corporate Intent letter to the Auckland Council Investments Limited (ACIL), which was passed at a meeting of the Accountability and Performance Committee meeting on 10 February 2011 (delegated from 27 January 2011 Governing Body meeting).
41. Public ownership of Ports of Auckland has supported the development and operation of an efficient port for the Auckland region.

3. Profitability, bargaining power and the Commerce Act

Question 12. Is there evidence of a systemic problem of low port profitability? Or conversely, excessive profitability?

42. The Productivity Commission is quite right to point to a relative decline in the profitability of ports. However, this is not a function of ownership arrangements. In our view the major contributing factor is the increasing market power of container lines and the constraints to port company co-operation inherent in the Commerce Act. Thus, a key area of concern is that the amalgamation of shipping lines has effectively reduced ports' bargaining power with the result being a reduction in profitability for ports, an increase in profits for shipping lines and no cost savings being passed onto New Zealand importers and exporters. As noted in NZIER (2010, p42)⁶ "there is no sign that Maersk's decision in 2006 to favour Auckland has negatively impacted on Port of Tauranga and positively impacted on Ports of Auckland – the evidence suggests the contrary."
43. Therefore, as a result of providing economical freight prices for the international shipping cartels New Zealand ports can actually be viewed as an interesting case of being too competitive, with New Zealand now having some of the lowest freight rates in the OECD. Ports of Auckland and Tauranga are a good examples of this. The competition between these ports has led to the price of containers landed in Auckland being 40% lower than containers landed in the port of Melbourne or Botany Bay.
44. On the other hand, profits from the ports since the ARC resolved not to privatize in March 1993 have exceeded \$1 billion dollars. The major renaissance in Auckland infrastructure, public transport, and waterfront that has taken place over the last 15 years would have been inconceivable without the income stream which has come from Council ownership of Ports of Auckland.
45. Therefore, important issues that need to be examined by this enquiry include:
 - Is the balance of competition and collaboration between major NZ ports right given that shipping lines are consolidating and exerting market power through the presence of a few major buyers?
 - How is it possible to ensure that ports earn an economic return and that benefits of efficiencies are translated into cost savings for importers and exporters in New Zealand?
 - Does the Commerce Act create a barrier to a more cooperative port sector whilst being ineffective at mitigating market power potentially being exercised by shipping lines? In our view it may be necessary for the commerce commission to allow port mergers to enable greater bargaining power which would assist in addressing the bargaining power of shipping lines; however the level of competition and prices would need to be carefully monitored.

⁶ NZIER (2010b). *Port Performance and Ownership. An assessment of the evidence.* Report to the Local Government Forum. New Zealand Institute for Economic Research. Retrieved May 11, 2011 from:
<http://www.businessnz.co.nz/file/1947/100813%20Port%20Performance%20and%20Ownership.pdf>.

Question 59. Are there barriers to the negotiation of efficient agreements between ports and shipping lines?

The Commerce Act is a barrier to ports agreeing amongst themselves a rationalisation of freight services with the lines.

Question 60. Is there an asymmetry of bargaining power between ports and shipping lines? If so, what is the impact of this asymmetry? Are there any regulatory measures that might reduce the asymmetry?

46. As noted above, there is an asymmetry of bargaining power because shipping lines are generally larger entities than port companies and critically, they are able to negotiate with exporters and importers [Commerce Act s 44(2)] which further strengthens their hand; and the container lines can easily change ports and move containers around the country whereas ports are immobile. Conversely, co-operation between port companies is subject to the Commerce Act.

4. Investment Decisions

Question 13. What levels of investment have ports undertaken in recent years? Are they consistent with accessible and efficient services to exporters and importers? Is there an over- or under-investment problem in ports?

Question 57. Should decisions on investments in ports and in the associated infrastructure links to ports be left to the judgments of the individual suppliers of the separate components? Or would some sort of overall strategic plan provide useful guidance and some assurance that complementary investments will happen?

Question 73. What is the best way to achieve efficient decisions and coordination for the large, lumpy and interdependent investments that typically occur along international freight supply chains?

47. Auckland Council would like to note the link between investment levels and the economic return generated by ports. An important consequence of the outcome of the above discussion on return on investment is ensuring this is sufficient to invest in future capacity to meet increasing demand within the freight sector without exploiting a position of market power in order to gain additional returns and to 'gold plate' port infrastructure. Although competing claims have been made in some reviews' evidence (McDouall Stuart (2006)⁷ and Rockpoint (2010))⁸, the findings of NZIER suggests that for POAL between 1995 and 2009 capital stock grew by 1% per annum whilst container volumes grew by almost 6% per annum. NZIER noted that "Between 1995 and 2009, the annual compound rate of growth of container volumes through the 10 ports [we have] analysed has been 9.74%. On this basis, a level of capital expenditure able to support growth in output of around 6.54% per year on average is not obviously excessive." For all ports studied the average annual growth in container volumes at each was significantly in excess of the annual growth in growth in capital expenditure. NZIER (2010, p45) also concluded that "in our opinion, the ratio of capital expenditure to depreciation does not support the contention that port

⁷ McDouall Stuart, *The New Zealand Port Sector: Storm Front Approaching*, April 2006.

⁸ Rockpoint, *New Zealand Port Sector Review*, 2010.

companies have been engaged in manifestly excessive levels of capital expenditure given the growth in container trade they have experienced.”

48. The most significant issue is around future investment. The substantial financial demands required to service ever larger vessels with larger volumes of containers in an environment where international container shipping lines have strong bargaining power and the ability to shift operations between ports creates an environment of uncertainty with the risk of over- or under-investment.
49. There is also a risk that short-term pricing decisions might lead to returns that are insufficient to meet shareholder expectations and support necessary investment in future capacity. Auckland Regional Holdings (ARH, 2009) expressed concern around the ability of New Zealand’s ports to meet future investment needs⁹ and NZIER (2010) suggested that “New Zealand port companies have been agreeing with major container shipping lines prices and service levels that do not cover their full economic costs of efficient provision of the services. The full costs include not only the operating expenses but also the cost of capital for the assets needed to provide the services.”¹⁰
50. There would appear to be sound reasons for providing an operating environment that would encourage future major investment in container ports in the upper north island to be well co-ordinated.

5. Changes in governance and the constraints around councils’ ability to sell port and airport shares

Question 16. What changes in governance, regulations or ownership would offer the best means to improve port performance for exporters and importers?

51. The Issues Paper notes on page 30 that “all commercial ports in New Zealand are majority owned by a local authority within whose territory the port is located and despite some changes in ownership since port companies were established in the late 1980s, this feature has remained in place. It also notes that the Local Government Act 2002 (LGA) automatically deems any equity shareholding by a local authority in a port to be a ‘strategic asset’ and places conditions on the purchase and sale of such assets (even when they amount to a minority stake-holding). The paper states on page 32 that “[W]hile arguably not onerous, these conditions make it less likely that ownership structures will evolve in response to changes in the external environment.”
52. Auckland Council wishes to point out that the provisions referred to are intended to provide transparency around decisions which will have a significant impact on the community. In practice, the legislative requirements have not precluded the sale or purchase of shares in ports and airports. For example, the former Auckland City Council divested itself of a significant proportion of its shareholding in Auckland International Airport (which was deemed to be a strategic asset) whilst the former Auckland Regional Council purchased a 20% shareholding in Ports of Auckland under these provisions. Auckland Council’s shareholding in AIAL was transferred from Auckland and Manukau City Councils. All other city and district councils in Auckland had divested

⁹ Auckland Regional Holdings, *Long-term Optimisation of the New Zealand Port Sector*, October 2009, p.5

¹⁰ NZIER, *Ibid.* p34.

themselves of their allocation of AIAL shares prior to amalgamation. The LGA provisions had not precluded the sale of shares in AIAL and it is unlikely that removing the need for councils to treat port and airport shares as strategic assets would significantly change the level of local authority ownership of ports and airports. Therefore we see no need to amend this part of the Local Government Act as this will simply reduce transparency around decision making without making it any more likely that councils will sell their port and airport shares.

6. Airport ownership and governance

Question 28. Do current ownership and governance arrangements of New Zealand's international freight airports have any significant positive or negative effects on their long-term efficient configuration and operation, with respect to the supply of freight services?

53. Auckland Airport is New Zealand's primary international air freight gateway. AIAL is a listed public company of which Auckland Council owns 22.55% stake. Auckland Council's only influence over AIAL is the same as that of any minority shareholder holding less than 50% of the shares. It is able to participate in the appointment of directors and no single shareholder would be able to secure an 80% shareholding without Council's support. Air freight is different to sea freight. Whilst the value of cargo is high, volume is low. New Zealand's focus on exporting heavy, relatively low value primary commodities is not well suited to air freight. The bulk of air freight exporting appears to be associated with machinery and equipment of which about half of our exports by value leave by air (NZ Institute 2006).¹¹
54. The main efficiency consideration in respect of air freight is the co-ordination between freight and passenger services. The majority of exported air freight travels on passenger flights as this is the most cost effective option and also the most timely option. For exporters who are prepared to pay the additional cost of airfreight timeliness is critical and so too is service to international markets. Therefore ensuring that there is good alignment between available international passenger flights and the need of exporters is critical.

7. Port capacity

Question 14. Does New Zealand have too many ports for a small country? If so, what barriers are inhibiting rationalisation?

55. From an upper north island perspective estimates indicate that the total port capacity provided between Auckland, Tauranga and Whangarei will be insufficient to meet the forecast freight task by 2040. Therefore rationalisation of these ports is not an issue.
56. A potential benefit of rationalisation through forms of consolidated ownership would be that ports could better co-ordinate activities and make the most efficient use of resources to improve supply chain efficiency. Where ports clearly understand their role in the hierarchy (i.e. hub, feeder, regional port)

¹¹ Skilling, D. (2006), The Role of Auckland in meeting New Zealand's Productivity Challenge.

then it becomes easier to justify the appropriate investment required to match that role. With both POAL and POT having shareholdings in Northland Port there are opportunities for specialisation if and when that was needed.

57. As noted above, a potential barrier inhibiting rationalisation between larger ports, specifically POAL and POT could be the interpretation of the Commerce Act by the Commerce Commission.
58. A further consideration is resilience. The Christchurch earthquake has all too clearly demonstrated the importance of being prepared to deal with the consequences of unexpected events. The availability of alternative port facilities is a key concern for a country as export dependant as New Zealand. This concern must be factored in to any assessment of the optimal number of ports.

8. Strategic planning, vertical integration and consolidation

59. The Issues paper poses several questions which relate to strategic planning and the impact of council ownership of ports on potential vertical integration within the international freight sector. These include:

Question 57. Should decisions on investments in ports and in the associated infrastructure links to ports be left to the judgments of the individual suppliers of the separate components? Or would some sort of overall strategic plan provide useful guidance and some assurance that complementary investments will happen?

Question 58. What is the scope for greater consolidation of ports, greater vertical integration of ports with domestic transport operators, or more use of long-term agreements between shippers and port companies, as possible means to overcome coordination problems and achieve more efficient international supply chains?

Question 74. What factors would favour the choice of decentralised vs. centralised strategic planning?

60. In 2009 Auckland Regional Holdings (ARH) considered these points and their findings are relevant to the Auckland Council's response to the Issues Paper. ARH suggested the development of a national ports and freight strategy and/or action plan to address the issues arising from the expected growth in freight volumes over the next 50 years and provide the guidance on future investment in port and transport infrastructure. ARH's view was that removing barriers to port sector consolidation and strategic alliances (e.g. through a review of the current structure of the New Zealand port sector and regulatory and policy environment) may be an important step towards facilitating improved co-ordination within the sector and increasing ports' relative bargaining power with shipping lines. It was felt that this would enable the ports to achieve the sustainable financial returns necessary to invest in long-term infrastructure requirements. The Government's decisions regarding transport policies and investment were also seen to play an important role in shaping the future of the New Zealand port sector, for example by ensuring timely investment in strategic transport infrastructure (ARH 2009).

61. The Auckland Council has signaled to POAL the need for a long-term strategy which addresses the opportunities and implications of co-operation or alliancing arrangements with the Port of Tauranga and North Port (CCO Strategy Review Subcommittee resolutions 21/4/2011)

62. Feedback received in response to the Auckland Plan Discussion Document from Smartgrowth (Environment Bay of Plenty, Tauranga City Council, Western Bay of Plenty District Council) and Northland Regional Council suggested that the Auckland Plan should be more explicit about the role of the Port of Auckland, the Port of Tauranga (POT) and Northport and about inter-regional trends. In the feedback received, there was consensus that New Zealand will need the port capacity of both Auckland and Tauranga to handle the growing freight task. Even if both Ports complete all envisaged expansion plans, and significantly improve current productivity levels, by 2040 there is expected to be insufficient combined capacity between them to meet the upper north island freight needs, which may necessitate further development at Northport, Whangarei. Ongoing discussion on collaborating with Tauranga and Whangarei were seen to be needed. POAL have indicated that they do not oppose cooperation with Port of Tauranga and see some potential benefits in such cooperation for the overall supply chain. Previous merger proposals in New Zealand have demonstrated increased value for shareholders as well as supply chain efficiencies. However, POAL also conclude that given the capacity constraints noted above, such collaboration would not enable a reduction in POAL's footprint nor a scaling back of its development plans, if future customer and freight needs are to be met.

63. Conversely, the competition between POAL and POT for container business could help to provide more choice and lower prices for New Zealand importers and exporters, although, as noted above, there is some reason to believe that the benefits of lower prices are being captured by the international shipping lines, not New Zealand companies.

64. Overall, considering the choice of decentralised vs. centralised strategic planning it is our view that there would appear to be benefits from a more collaborative and strategic approach to port operation and investment in the upper North Island.
 - Port performance may be improved through combined ownership of the major upper North Island ports. Some level of regulatory oversight would be required to ensure an appropriate level of competition in the market and that it does not lead to increased market power that raises costs and reduces services to importers and exporters. The Auckland Council would wish to ensure all councils involved retained a controlling stake on a combined basis, but there would be likely to be a meaningful publicly listed stake given POT's ownership arrangement. Public ownership of land should be continued given the strategic location of the assets but separation of land and operations could be investigated and competition could potentially be introduced by having more than one terminal operator. This is the model typically used offshore, though its effectiveness may be limited in New Zealand due to lack of scale and also due to the fact that current ownership and operational arrangements essentially provide port management with full operational responsibility and clear performance targets including profitability.

- Central government is encouraged to investigate the potential impact(s) of a more strategic approach to port operation and development in New Zealand. As we have noted above, simply letting the market invest in port expansion and inland freight hubs might be inadequate in the future given the changes taking place within the international freight sector. Auckland Council would support an overall strategic plan for ports being developed by public and private sector with the focus on making New Zealand internationally competitive rather than making one region more competitive than another.
65. This is not a call for central planning or nationalisation of ports, but a higher level of facilitation, coordination and leadership from the Government would also be important, along the lines suggested by ARH in its 2010 report which included:
- mandatory national trade data collection,
 - national demand forecasting and scenario analysis,
 - a national supply chain forum with representation from both government and key industry stakeholders to advise Government policy, and
 - published integrated plans for key ports and freight corridors.
66. The establishment of Auckland Council enables the region to deal with regional issues more efficiently, including the inter-regional freight movements. It is also enables central government to work closely with Auckland to achieve the best overall outcomes. Whilst centralised strategic planning could enable a broader perspective to be taken and national interest is protected, decentralised planning will enable more local considerations to be taken into account. In our view a combined approach is required to ensure the supply chain is strong along the entire length.

Response to other questions of relevance to Auckland Council

67. *Question 3. Which components and component interfaces warrant greater attention? What is the evidence that they are inefficient? What contribution could changes make to an improvement in the overall efficiency of the freight system?*
- In the issues paper on page 6, Figure 2 shows sea-ports are coloured orange representing a monopoly. This may be the case for bulk and break-bulk, but as noted on p25, given the relatively close proximity of ports in NZ, this is not the case for containers so Port of Tauranga competes aggressively for Auckland's container volumes through Metroport.
 - The issues paper states on page 10 paragraph 3 that components of the supply chain that more commonly fall short of their efficiency potential are those in which competition fails to work well. However, this is not

consistent with the comment on page 9 that many potential opportunities for efficiency improvements are based on increased co-operation, therefore efficiency will actually be achieved through carefully balancing competition and co-operation. For example, there are many opportunities for improved efficiencies within the port sector that are not driven by increased competition. These include:

- co-ordination of planning and investment across the supply chain to ensure that the most optimal investment in the supply chain is adopted at any given time – this will reduce the risk of under-investment, duplication or stranded assets, as well as encourage more efficient land use.
- operational efficiencies that can be achieved through common ownership including reduction in empty container movements, removal of additional transport costs incurred due to inefficient freight movements etc

Question 5. To what extent is there effective competition for customers between New Zealand ports? Has this led to lower prices and incentives for productivity improvements?

68. It is our view that significant competition exists in the container market between port pairs (e.g. POAL and POT, Lyttelton and Otago). These are high fixed cost businesses located in relatively close proximity and where land transport options make either port within each pair a viable alternative for many users. This has led to efficiencies in handling due to downward pressure on prices. A result of this is that New Zealand's container handling prices are significantly lower than Australia (\$250 vs. \$400 see ARH report (2009)).
69. A particular issue to bear in mind here is the extent that the large consolidated shipping lines may be able to exert a degree of market power and effectively play ports off against each other in price negotiations. As noted above this may result in inefficiently low prices where returns are insufficient to support future investment.

Question 8. Which overseas ports are appropriate comparators for New Zealand port performance? On what basis should this selection be made?

70. We would like to ensure that direct comparisons of New Zealand port efficiency are based on international examples which are similar in scale and functionality. Comparisons based on larger ports with greater economies of scale, more advanced technology and handling systems, and larger ships are not going to provide helpful data. Therefore, to accurately compare port efficiency, we believe that it is important to select comparators with similar volumes, handling systems, and similar size ships to those of NZ ports. These factors will all exert a significant influence on the levels of efficiency that can be achieved.
71. However, there is also the reality that Australian ports are our competition and in the future, as shipping patterns change, this competition will become more intense. Therefore, we believe that New Zealand's ports should be aspiring to be at least as efficient as our Australian competitors and it would be appropriate to set this as our target.

Question 9. Did port productivity improve during the 1990s? What were the drivers of those improvements?

Question 10. Did the rate of productivity improvements flatten during the 2000s? Why? What might reinvigorate performance improvement?

Question 11. What is the most appropriate way to measure port profitability? What is an appropriate rate of return on assets and equity?

72. Each methodology has its advantages and disadvantages. Historical cost can be problematic as it is often not reflective of current market value, and so can overstate returns. Market value is also problematic as it often reflects value that will not be realized in the short term, therefore short term returns based on market value can be misleading. The best approach may be to adopt a variety of different measures and see if the overall results provide a clear picture. However, the key outcome is to ensure that returns are sufficient to cover cost of capital and provide for future investment.

Question 17. How much variation in the efficiency and productivity performance of ports is explained by the way that within-port activities are organised? Do 'contracting out' and 'landlord' models offer a way to increase competition for the benefit of exporters and importers?

Question 18. To what extent do inflexible labour practices and difficulties in employer-union relationships remain an obstacle to lifting efficiency and productivity at New Zealand ports?

Question 29. The objective of a port company under the Port Companies Act is to 'operate as a successful business'. Should airport companies owned by local authorities have the same single objective rather than the multiple objectives specified in the Local Government Act?

Question 51. What changes in domestic transport institutions, policies and regulations might lead to the greatest improvements in the economic efficiency of the international logistics chain?

73. The Draft Auckland Plan proposes a policy approach to improving the transport system in Auckland, including its inter-regional and international links. A key tenet of the plan is to significantly improve transport infrastructure (all modes) which would improve the efficiency of the strategic road network.

74. Specific changes to policy and planning that would be beneficial from a transport perspective include:

- A clear funding policy for funding rail is required, whether for rail freight or passenger rail. In Auckland, different funding arrangements may need to apply to:
 - A new rail line for rail freight only (e.g. Port to Papakura)

- A new rail line for rail freight and rail passengers (e.g. Avondale to Southdown)
- A new rail line for rail passengers only (e.g. City Rail Link)
- Cohesive planning for the future provision of inland freight hubs in and out of the region, rather than just leaving it to the market to decide.
- A broader perspective to be taken when making transport decisions that have wider impacts on the transport network. For example, the decision to close the North Auckland Line by KiwiRail may be made solely on financial returns for KiwiRail's rail freight business without considering the wider impacts on the supply chain, impacts on roads, long term costs and benefits, impact on rail passenger operations, etc.
- More investment in freight infrastructure in the Upper North Island, as a focus.
- Coastal shipping should be encouraged / subsidised where feasible given its wider transport and environmental benefits.

Question 52. The Commission is interested in how well domestic freight transport integrates with ports, airports, and beyond. As noted, there are important interdependencies between the design, location and investment in road and rail networks and the ports and airports that they connect with.

- The attached report on “Transport Access to the Ports of Auckland” to the Transport Committee meeting in July 2011 sets out all issues and matters to be investigated further, along with proposed projects to improve access.
- The South Western Multi-Modal Corridor Study undertaken by Auckland Transport and NZTA address transport access to the airport.
- As the Government owns both the rail and national highway networks, its investment decisions can determine where the freight goes. This has huge ramifications for ports, as they are dependent on their connections with highly efficient transport links. This interdependency between port and transport investment means that the Government cannot take a completely hands off approach when it comes to the NZ port industry. A co-ordinated approach would be hugely beneficial.

Question 53. What are the costs of transit time to importers and exporters?

75. There have been a number of studies done in this respect. NZTA and Auckland Council carry out a congestion survey each year which monitors the level of congestion on state highways and regional arterial roads in Auckland.

Question 54. What sources of delay contribute to transit time? How might those delays be efficiently reduced?

- Road Network: Congestion; Incomplete state highway network; Regional arterial road network which is still being upgraded to provide for required capacity, freight, public transport etc.
- Rail Network: Status of track, signalling, rail track shared with passenger locomotives.

- Port: Lack of coordination in processing, congestion on the approaches to the port, customs, quarantine inspection
- Airport: Road access, air traffic control and airspace restrictions, bad weather, processing, congestion on the approaches to the airport, customs, quarantine inspection

76. See the Draft Auckland Plan (Chapter 11) for the proposed policy approach to improving Auckland's transport system.

- Increased investment in infrastructure for freight movements, in particular is required. Auckland Council supports the additional and exclusive track for rail freight (3rd rail track along the NIMT between Westfield and Papakura) and access between the Ports of Auckland and Grafton Gulley, etc. In addition to the 3rd rail line, investigation and planning for additional freight hub(s) near other industrial areas in and outside Auckland could help to reduce delays at the Port and on the road network. In terms of road freight, priority measures for freight vehicles on roads (freight lanes, for example) could overcome traffic congestion at certain times of the day.
- Other measures such as taking into account the freight benefits in any transport planning decision making process as well as streamlining the customer and quarantine inspection process would be helpful in reducing delays.

Question 55. Are there potential efficiency gains from vertical integration in New Zealand's international sea freight services? What are the disadvantages? What might need to change in order to allow or encourage greater vertical integration?

Question 56. Are there potential efficiency gains from the vertical unbundling of specific components or activities in New Zealand's international sea freight services? What are the disadvantages?

Question 61. Are the time costs associated with international air freight incorporated into current road infrastructure planning? To what extent should they be?

77. It does not appear to be a common practice to measure time costs for air freight in road infrastructure planning. Instead, time costs for air freight are normally lumped together with those of other modes and treated as part of the general freight costs. While it is considered to be a good idea, the air freight costs should probably be singled out for road projects that are significantly relevant to air freight traffic – those areas that are in close proximity to the airport/manufacturing areas that have a significant freight traffic to airport. It is also considered the impacts on this should be part of the consideration in planning the rail/state highway projects by central government.

78. Also we note that:

- Table 13 in the Issues Paper requires an explanation in relation to the percentage (i.e., 4.1) of transit-delay costs as a percentage of value under Inland Transport for New Zealand imports.
- Section 6.2 – Larger Container Ships: Auckland Council (and NZTA) would need to understand the impacts of moving greater numbers of containers on the transport network. The requirement to move large numbers of containers

in a short time period has potentially significant impacts on the local network (rail and road).

Question 64. Does the imbalance of container use create significant costs? What practical measures might efficiently reduce these costs?

79. The imbalance of container movements in/out of NZ could be assisted through better co-operation and co-ordination, between POAL and POT. Currently POAL is exporting empty containers and POT importing empty containers.

Question 65. What are the potential benefits and risks for New Zealand from a move to hub-and- spoke configurations for international shipping? Are there actions New Zealand can take to increase the likelihood of benefits or to manage the risks?

80. The benefits of moving to a hub and spoke configuration for international shipping include economies of scale, which may result in cost savings for importers and exporters. However, significant challenges and risks also exist including the significant investment required (port and transport), greater peak volumes, less frequent services, and risk of hubbing taking place through Australia. A co-ordinated strategy for NZ ports and freight could assist in planning and providing increased certainty and co-ordination of investment across all areas of supply chain to ensure the most optimal investment would be adopted at any given time.
81. Capacity analysis undertaken by ARH in 2009 shows that container volume growth (which over the longer term is expected to be significant), combined with future capacity constraints at both Auckland and Tauranga, means that both ports (rather than one) will be required to grow and develop into the foreseeable future if the projected long-term increase in freight demand is to be met without unacceptable constraints being placed on New Zealand's supply chain. This was confirmed by the NZ Shippers' Council in their August 2010 "The Question of Bigger Ships" report. The capacity analysis in the ARH report indicated that assuming the majority of North Island container volumes over time get hubbed through Auckland and Tauranga, both ports would need to operate at significantly higher productivity rates and utilise all their current, plus planned container terminal land and berth extensions to meet projected container volumes, even at relatively conservative growth rates (and this is only to 2040).

Question 68 Are import and export opportunities excluded or constrained by the lack of access to international freight transport services? Are there changes in institutions, policies or regulations that could lead to better outcomes?

82. The Auckland Plan will highlight the strategic importance of port and airport facilities in the existing locations that need to be safeguarded. Further, the Southern and North-Western areas of Auckland are identified for significant economic development in the next 30 years. There is a need to develop compatible land use policies to ensure the access to international freight transport services between the existing and proposed economic centres are not compromised. Initial freight studies have identified the need to investigate further inland freight hubs (in the South and the Northwest).

Question 78. Has this issues paper covered the key issues? What other questions

need to be asked?

Question 79. What are the most important issues for the Commission to focus on to achieve the greatest improvements in the efficiency and productivity of New Zealand's international freight transport services?

83. Balancing the need for a competitive port sector against the market power being exerted by international shipping lines. The evidence suggests that allowing more collaboration between ports would assist in reducing the ability of the shipping lines to exercise market power.

Attachments

Transport Access to the Ports of Auckland