B Transport services

Air and sea transport services play a key role in the Australian and New Zealand economies and trans-Tasman trade. Australia and New Zealand are separated by more than 2000 kilometres of ocean, unlike most of the world's integrated regions that share a land border. Both countries are also geographically distant from international markets. Reflecting the key role of transport services across the Tasman:

- Australia is the leading source of visitor arrivals in New Zealand and vice versa. In 2011, there were over 40 300 flights between Australia and New Zealand, and 5.65 million passengers moving between the two countries (BITRE 2012).
- Australia and New Zealand rely on shipping as the primary form of transport for exports and imports. Virtually all Australia's and New Zealand's international goods trade, by volume, is carried by ship. Shipping also plays a key role in transporting goods across the Tasman.
- Australia and New Zealand have relatively high international air and sea transport costs for passengers and cargo compared to other OECD countries. For example, average air transport costs (for cargo) are around 40 percent higher than for other OECD countries (Golub and Tomasik 2008). While this is largely due to the distance of Australia and New Zealand from their trading partners and the density of traffic, it does highlight the relative importance of efficient transport services for the two economies.

More efficient and effective sea freight and air services can reduce costs for businesses and improve the welfare of consumers in both economies. While the efficiency of these industries is largely dependent on factors controlled by the industries themselves, governments can play a role by improving the regulatory and institutional frameworks in which they operate.

B.1 Air services

The air services sector worldwide remains highly regulated, despite the role of air services in facilitating growth in trade of goods and services. International air services arrangements are governed by a complex system of negotiated bilateral rights, and sometimes multilateral rights, between countries through air services agreements (ASAs) (box B.1). The bilateral framework for ASAs was originally established through the Chicago Convention in 1944, which starts from the principle of each government having exclusive sovereignty over a country's airspace and allows various freedoms to be granted to carriers from other countries (box B.2).

Box B.1 **Trade in air services through air services agreements**

International trade in air services cannot occur unless it is explicitly permitted, unlike trade in most goods and services, which is generally free unless specifically restricted. Two governments (bilateral partners) must act to open up services between their two countries through negotiation of bilateral ASAs. ASAs set out the terms and conditions under which airlines can fly. Included in ASAs are provisions on:

1. **Freedoms of the air**: determine the rights of carriers to operate cargo and passenger flights to, from and beyond bilateral partners (box B.2). More basic agreements grant 'transit rights' (3^{rd} and 4^{th} freedoms), while few ASAs grant the 7^{th} freedom or cabotage rights (8^{th} and 9^{th} freedoms — enabling foreign airlines to operate domestic flights).
2. **Multiple or single designation**: determines the number of carriers that can operate on a route. Restrictive ASAs allow only a single airline as national carrier, while more liberal agreements allow multiple airlines to operate services.
3. **Cooperative arrangements**: more liberal ASAs allow cooperative arrangements between the designated airlines, such as code sharing.
4. **Capacity**: regulates the number of weekly services each designated airline can operate and the number of seats (by defining the aircraft type to be flown).
5. **Pricing**: prescribes air fares, including double approval (a change in fares requires approval of both parties — more restrictive) or double disapproval (a change in fares can be effected unless both parties object — less restrictive) systems. The least restrictive ASAs allow free pricing.
6. **Designation, ownership and control**: provisions designed to restrict the benefits of an ASA to the airlines of the signatory countries. Restrictive ASAs stipulate that the designated airlines have to be 'substantially owned and effectively controlled' by nationals. Liberal ASAs allow higher levels of foreign investment in airlines.
7. **Exchange of statistics**: restrictive ASAs often contain a provision on the exchange of statistics between the signatory parties to monitor traffic or verify adherence to quantitative restrictions.

Sources: Jomini et al. (2009); WTO (2006).

Box B.2 **The nine freedoms of the air**

’Freedoms of the air’ describe the rights exchanged in air services negotiations. They specify permitted airline routes between the negotiating partners, and where appropriate, other countries.

- **First freedom**: To fly over one country en-route to another.
- **Second freedom**: To make a technical stop (such as for refuelling) in another country.
- **Third freedom**: To carry freight and passengers from the home country to another country.
- **Fourth freedom**: To carry freight and passengers to the home country from another country.
- **Fifth freedom** (beyond rights): To carry freight and passengers between two countries by an airline of a third country on a route with an origin or destination in its home country.
- **Sixth freedom**: To carry freight and passengers between two countries by an airline of a third country on two routes connecting its home country.
- **Seventh freedom**: To carry freight and passengers between two countries by an airline of a third country on a route with no connection in its home country.
- **Eighth freedom** (consecutive cabotage): To carry freight and passengers within a country by an airline of another country on a route with an origin or destination in its home country.
- **Ninth freedom** (standalone cabotage)*:* To carry freight and passengers within a foreign country on a route that has no connection with the airline’s home country.

Sources: Findlay and Round (2006); PC (1998a).

Within this highly regulated environment, the air services arrangements between Australia and New Zealand are relatively liberal. That said, there remains potential for further liberalisation, both within the trans-Tasman arrangements as well as in air services more broadly.

Australian and New Zealand air service regulation

Although air services are excluded from the formal CER Services Protocol, a number of agreements have been negotiated between Australia and New Zealand (box B.3) which specify the terms and conditions under which air services can be provided. A Single Aviation Market (SAM) has been in place since 1996 and, in August 2002, the Australian and New Zealand Governments signed an ‘Open Skies Agreement’. This agreement removes restrictions on capacity, frequency and routes that airlines of either country can operate to, within or beyond the two countries. However, for airlines to be able to take advantage of this agreement, they must meet certain designation criteria, including requirements regarding the ownership and control of the airline (NZ PC 2012).

Box B.3 **Air services agreements between Australia and New Zealand**

In 1992, the Australian and New Zealand Governments concluded a Memorandum of Understanding (MOU), which lifted capacity restrictions across the Tasman, introduced multiple designation and set out phased liberalisation towards full trans-Tasman market access and greater fifth freedom (or 'beyond') rights by 1994. In 1996, Australia and New Zealand signed the Single Aviation Market (SAM) arrangements. The arrangements allowed a SAM carrier to operate without restrictions across the Tasman. Excluded were unlimited fifth freedom rights, which continued to be governed by the bilateral air services agreements and the 1992 MOU (ICAO 2007).

Negotiation of an Open Skies Agreement was concluded in 2000, and the agreement was officially signed in 2002. It formalised the provisions of the SAM arrangements, eliminated the restriction on beyond rights, and allowed seventh freedom rights for cargo services. The arrangements were further relaxed by Australia in 2006 when the *Civil Aviation Legislation Amendment (Mutual Recognition with New Zealand) Act 2006* came into effect. The legislation enabled eligible New Zealand airlines to operate domestically within Australia, subject to New Zealand safety standards (ICAO 2007). The agreement relaxed foreign ownership limits on domestic and trans-Tasman carriers and allowed foreign ownership in domestic operations. In this regard, it is significantly more liberal than typical open sky agreements, most of which do not lift foreign ownership restrictions or allow any form of cabotage (Jomini et al. 2009).

Sources: ICAO (2007); Jomini et al. (2009).

The designation criteria under the Open Skies Agreement create two categories of carriers, with different eligibility constraints, and accordingly different operational rights. It distinguishes between 'designated airlines' and 'SAM airlines'.

- For designated airlines, which can only operate internationally between Australia and New Zealand and beyond, eligibility is based on incorporation and principal place of business. Effective control of the airline must also be vested in the country designating the airline or nationals of that country[1].
- The other category (SAM airlines), can operate unrestricted services between the two countries as well as domestic services in each country. In contrast to designated airlines, SAM airlines must be majority owned and effectively

1 Control refers to the operational oversight of a carrier, with the notion of 'effective control' designed to test whether decision-making within an airline is vested with nationals of the designating country (Duval 2011).

controlled by Australian and New Zealand interests, as well as satisfying other criteria regarding board membership, head office and operational base.[2]

The agreement between Australia and New Zealand grants all freedoms for passenger and cargo movement, with the exception of the seventh freedom for passengers (NZ PC 2012). In contrast to many other ASAs, the agreement also grants full cabotage rights to SAM airlines — that is, SAM airlines are permitted to operate domestic services in Australia and New Zealand.

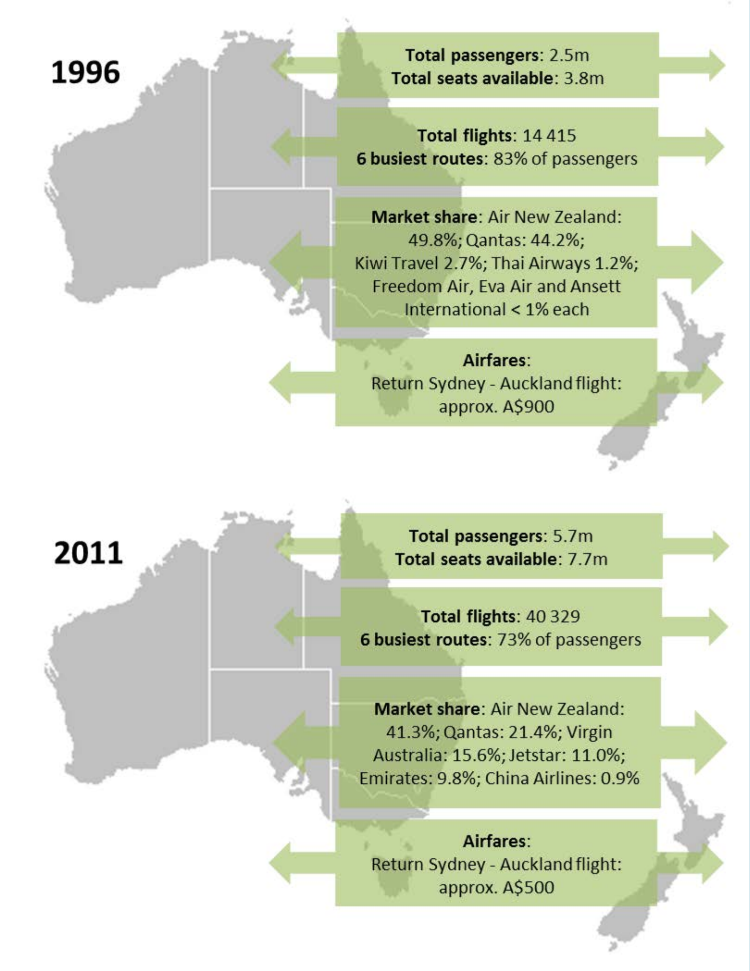
Consequently, the agreement between Australia and New Zealand is one of the most liberal in the world (Vowles and Tierney 2007). The routes between New Zealand and the eastern seaboard of Australia are among the most competitive in the region, with passenger services provided by Qantas, Air New Zealand, Jetstar, and Virgin Australia. Third country carriers, such as Emirates, provide trans-Tasman services through separate bilateral agreements between their home countries and Australia/New Zealand; and extensive code sharing arrangements also exist on flights across the Tasman (box B.4). Australian airlines (such as Jetstar, and previously Qantas and Virgin Blue) have also entered the New Zealand domestic market and for a time Australia's then second largest airline, Ansett Australia, was a wholly owned subsidiary of Air New Zealand. Overall, however, Qantas and Air New Zealand continue to dominate in terms of the number of passengers carried across the Tasman (BITRE 2012).

2 An airline must satisfy a range of requirements to be designated a SAM airline. These include being majority owned and effectively controlled by Australian and/or New Zealand nationals; having at least a two-thirds majority of Australian and/or New Zealand nationals as Board members; having an Australian or New Zealand national as the chairperson of its Board; and having the head office and operational base in Australia or New Zealand.

Box B.4 **Competition in the trans-Tasman aviation market**

Following the liberalisation of the trans-Tasman aviation market from 1996, the number of flights and passengers increased considerably. Several carriers entered and exited the market and airfares have fallen significantly. Although these changes are partially driven by broader market changes, such as the entry of low cost carriers and wider liberalisation, the single aviation market has played an important role, with the trans-Tasman market considered one of the most competitive in the region.

Figure **Changes in trans-Tasman air services 1996–2011**



[a] Airfares are in 2011 prices. The 1996 market share figures for Air New Zealand and Qantas include an even split from passengers on the two airlines' codeshare flights.

Data source: BITRE (2012); Haugh and Hazledine (1999); Australian Commission estimates.

What issues remain for the single aviation market?

There are two main restrictions on a fully integrated Australia-New Zealand aviation market: seventh freedom rights for passenger movement have not been granted; and restrictive designation/ownership requirements for carriers in the trans-Tasman market remain. Given the current level of competition in the trans-Tasman market, and unused capacity on existing routes, the removal of these remaining restrictions may not produce large benefits. Nevertheless, there does not appear to be a strong public interest case for retaining the restrictions, and their removal may support continued competitive pressure on the trans-Tasman route, as well as facilitating greater competition on international routes from Australia and New Zealand.

Seventh freedom rights for passenger movement

The seventh freedom for passenger movements is the only freedom not yet granted. Seventh freedom rights allow carriers to operate 'standalone' services between the bilateral partners and third countries. For example, without seventh freedom passenger rights, Air New Zealand is only able to fly between Australia and Singapore if it incorporates a leg back to New Zealand. In order to operate under seventh freedom rights, agreement is required by each party involved. In the case of the previous example, agreements would be required (either bilaterally or as a group) from the Governments of Australia, New Zealand and Singapore for Air New Zealand to operate this service.

In the 2000 Memorandum of Understanding between Australia and New Zealand, the Ministers undertook 'to examine further the introduction of seventh freedom traffic rights for passenger services by carriers of both parties in the light of the ongoing development of a competitive aviation market.' (Anderson and Gosche 2000). There has not, however, been any further progress in this area.

Granting seventh freedom rights could potentially have benefits for the Australian and New Zealand communities by opening up opportunities for airlines to expand the range and quality of services from Australia and New Zealand, enabling greater competition and exerting downward pressure on airfares. The extent to which such benefits are realised will depend upon the market characteristics of particular routes and the air services agreements of the Australian and New Zealand Governments with other countries.

Designation, ownership and control restrictions

The current requirements for airline designation linked to national ownership and other requirements (box B.5) restrict carrier entry to the trans-Tasman market (in contrast, up to 100 percent foreign ownership of Australian and New Zealand domestic airlines is allowed). Not only do they prevent greater competition, they are also inconsistent with, and more restrictive than, the recent policy positions that the Australian and New Zealand Governments have both committed to in the negotiation of ASAs (DITRDLG 2009; MoT 2012b).

For example, in the 2009 National Aviation Policy White Paper, the Australian Government committed to include ‘incorporation and principal place of business’ criteria for designating airlines in its bilateral agreements wherever possible. These criteria are focussed on where an airline is based and which country has effective regulatory oversight of the airline rather than who owns and controls the company (DITRDLG 2009).

Similarly, the New Zealand Government highlighted in its International Air Transport Policy Review (2012) that it negotiates access on principal place of business, place of incorporation and effective regulatory control. This position is ‘predicated on the view that while under the bilateral system, and for safety reasons, it is necessary to retain a nexus between an airline and the designating state, it should be the right of each country to determine the investment environment for its own airlines’ (MoT 2012a, p. 19).

In the past, designation restrictions that required national ownership were less of an issue, as airlines were generally state-owned and operated in a less commercially-oriented environment. However, with a growing number of airlines worldwide, tight designation rules potentially limit commercial opportunities for airlines and mean that the community does not enjoy the benefits of open markets and increased competition (Hocking 2011). This view was supported by Christchurch International Airport (sub. 21, p. 14) which argued that the designation criteria under the Open Skies Agreement need to be tested afresh and that they should be relaxed to enable more airlines to fly the Tasman.

Overall, while some form of designation is required under the bilateral system, local ownership and other restrictions are not. Both Governments should seek to align the designation requirements in the SAM with their broader designation policies.

Box B.5 **Clarifying ownership and control of airlines**

There are several issues regarding ownership and control of airlines that are closely related but distinct from each other.

The first ownership and control issue relates to airline designation under air services agreements negotiated between governments. ASAs contain an airline designation clause, intended to restrict the benefit of an air services agreement to the signatory countries. For example, many clauses restrict designation to airlines 'substantially owned and effectively controlled' by the state of designation and/or its nationals, though more recently there has been a move towards the 'principal place of business'.

The second aspect is the restrictions in domestic policy and legislation, which govern foreign ownership of airlines. In both Australia and New Zealand, for example, there are separate foreign ownership restrictions for Qantas and Air New Zealand as the national flag carriers, as well as other Australian and New Zealand airlines.

Additionally, a related consideration for New Zealand is the Government's current part-ownership of around 73 percent of Air New Zealand. It has recently announced that it is considering a partial sale of some of its shares in the context of implementing the mixed (government/private) ownership model (MoT 2012a).

Source: Hocking (2011); MoT (2012a).

Looking beyond the trans-Tasman market

The complex, restrictive and inefficient regulation that characterises the international air services market means that it is likely there would be greater benefit from both countries pursuing broader liberalisation of international air services. In the course of pursuing broader liberalisation, there are likely to be spillover benefits for trans-Tasman travellers, as well as domestic travellers in Australia and New Zealand.

The objectives for international air services policy

At present, there appears to be some ambiguity in the two country's policy objectives for international air services. For instance, in Australia the current policy goal for international air services is cast in terms of balancing the interests of the Australian aviation industry and the interests of the community more broadly (DITRDLG 2009). New Zealand's aviation policy objective is to help grow the economy and deliver greater prosperity, security and opportunities for New Zealanders (MoT 2012b). Both Governments should ensure that the objectives of air services policy are to enhance the wellbeing of the whole community, rather than to focus on individual interests.

Pursuing broader liberalisation

Australia and New Zealand have made significant progress in negotiating more liberal ASAs and bilateral open skies agreements with other partners. However, progress has not been uniform. For instance, the Australian Government has only three, albeit significant, open skies agreements in place with New Zealand, Japan and the United States (as well as two 'open capacity' agreements with the United Kingdom and Singapore). New Zealand has 18 agreements, including with the United Kingdom, United States and Canada, as well as the Multilateral Agreement on the Liberalisation of International Air Transportation, with the United States, Singapore, Chile and Brunei. Moreover, restrictions on third party carriers accessing key international routes remain, such as between Australia and the United States.

Christchurch International Airport (sub. 21) advocated that both countries take further steps to liberalise access to their respective markets, particularly through the removal of restrictions on fifth freedom rights:

> Giving international airlines the option of travelling to Australia and New Zealand in one air service will incentivise more international airlines to service both territories. This will increase passenger and freight movements and so benefit the trans-Tasman economy as a whole. (p. 6)

Australia and New Zealand should reaffirm their commitment to pursuing reciprocal open skies agreements, which grant all air freedoms, including cabotage where appropriate. Where bilateral partners do not seek open skies, efforts should be made to secure the most open package of air services agreements possible, including negotiating additional freedoms and capacity ahead of demand. This would potentially have benefits for trans-Tasman routes, by enabling greater access by third country carriers; domestic routes in each country (should cabotage rights be agreed); as well as the broader international air services market for both economies.

Further liberalisation will reduce constraints on market entry and the controls on the rights of airlines to service particular routes. This should enhance economic efficiency by placing competitive pressure on the cost of air travel; provide consumers with greater choice, particularly in terms of the range of services offered; and encourage innovation and cost minimisation by airlines, including through more efficient operation of their networks.

Designation requirements and ownership restrictions

As discussed above, both countries have committed to adopting a designation criteria of 'incorporation and principal place of business' into their bilateral agreements wherever possible. In practice, however, this has not always been executed in agreements with other bilateral partners (though in some cases this is due to the negotiating position of the bilateral partner). For example, according to Hocking (2011) the Australian Government has more recently negotiated new agreements with substantial ownership and effective control clauses with Turkey (2010), Mexico (2010), Brazil (2010) and the United States (2008).

Alongside a revision of designation requirements, the appropriateness of current foreign ownership restrictions for national airlines, including for Qantas and Air New Zealand, could also be reviewed.

In Australia, total foreign investment in Australian international airlines is limited to 49 percent. Additionally, for Qantas, a single foreign investor is limited to 25 percent ownership and aggregate ownership by foreign airlines is limited to 35 percent. The Australian Government has indicated it will remove the 25 and 35 percent secondary ownership restrictions on Qantas (DITRDLG 2009, p. 7).

In New Zealand, foreign ownership of New Zealand international airlines (including Air New Zealand) is currently limited to 49 percent, with any single foreign airline interest limited to 25 percent and no more than 35 percent in total to be owned by foreign airline interests (MoT 2012a, p. 20). The New Zealand Government has recently announced that, for airlines other than Air New Zealand, it will remove the 25 and 35 percent secondary ownership limits. The ownership of Air New Zealand is being considered separately in the context of implementing a mixed government/private ownership model (MoT 2012b, p. 2).

Restrictions on access to regional markets

Since 1996, the proportion of passengers travelling to smaller airports in Australia and New Zealand has increased (BITRE 2012).

In 1999, the Australian Government moved to allow foreign airlines unlimited access to secondary Australian airports (all Australian designated international airports with the exception of Sydney, Melbourne, Brisbane and Perth) and more access to major gateways when services are linked to regional airports (DITRDLG 2009). However, there may be further opportunities to remove regulatory impediments to the use of regional airports in Australia and New

Zealand. Christchurch International Airport (sub. 21, p. 9) suggested New Zealand adopt an approach similar to Australia's:

> Open regional air access policies compensate smaller regional economies for the disproportionate economic prejudice they face as a result of the reciprocity and flight restrictions contained in national ASAs. This disproportionate prejudice largely results from the fact that regional economies are distant from key aviation hubs and major gateways are often the designated points in national ASAs.

The Tourism and Transport Forum (sub. 25, p. 8) has suggested that several of Australia's secondary airports, such as Canberra, Hamilton Island and Hobart could support direct trans-Tasman flights, but are deterred by the costs involved.

The Australian Commission has previously found that restrictions in ASAs can make it costly for foreign airlines to land at secondary gateways, with implications for tourism and economic development in regional areas (PC 1998a). Enabling foreign airlines to serve a wider range of destinations (including through codeshare) could encourage a wider range of routes, better services provision in secondary gateways and tourism growth (PC 1998a). Even so, it is worth noting that a range of other non-regulatory barriers also may exist, preventing regional airports from operating international services, including a lack of infrastructure and capabilities, low demand from travellers, and high costs for airlines.

Benefits from multilateral liberalisation of air services

Although the specific characteristics of the bilateral system mean that it is not necessarily in Australia's or New Zealand's interests to liberalise unilaterally (box B.6), the two countries may be able to cooperate and encourage other governments to liberalise as part of a broader multilateral framework, such as through the WTO or International Civil Aviation Organisation. Ultimately, a liberal multilateral agreement under the WTO that covers all or most countries would allow international air services to develop in response to market changes and pressures. Efficient carriers would replace inefficient carriers and the removal of regulatory barriers to entry would enhance competition. A multilateral system would also be easier to administer and comply with than the current bilateral system (PC 1998a).

In the first instance, Australia and New Zealand could pursue strategic multilateral arrangements, such as full open skies agreements with the European Union or ASEAN, while encouraging further multilateral reform at the WTO level.

Box B.6 Unilateral liberalisation: an option for air services?

As small countries with limited bargaining power, it has generally been in Australia's and New Zealand's interests to liberalise goods and services trade unilaterally. However, air services have certain characteristics that make them different from other goods and services.

Under the entrenched bilateral system, one country alone cannot produce international air services. They require inputs from both the origin and destination countries in the form of infrastructure and rights to exercise various freedoms of the air. Therefore, unilateral liberalisation would not ensure that competition and the quantity and quality of air services would increase, or that airfares would fall. Other countries could still restrict entry and capacity.

The Australian Commission concluded in 1998 that as long as the rest of the world remains committed to the bilateral system, a policy of unilateral open skies could make Australia worse off.

Source: PC (1998a).

In summary, further removal of barriers to competition in the air services market should facilitate competition, keep downward pressure on airfares and provide opportunities for an expanded range of services, and therefore the Australian and New Zealand Governments should continue to progress appropriate reform. In particular, the Governments should focus on:

- ensuring that the objective of air services policy and legislation is explicitly directed at promoting net benefits for the community
- pursuing reciprocal open skies agreements including the granting of all air freedoms and cabotage where appropriate
- where open skies agreements are not possible, ensuring air services agreements provide for capacity well in advance of demand
- revising designation and ownership requirements
- removing any remaining restrictions on airlines' access to secondary/regional airports
- pursuing plurilateral and multilateral air services agreements
- encouraging multilateral reform of air services, through the WTO or International Civil Aviation Organisation.

B.2 Passenger movement charge

Introduced in July 1995 to replace the Departure Tax, the Australian Passenger Movement Charge (PMC) forms part of the cost of the ticket of a person departing Australia for another country. It was intended as a cost recovery measure to recoup the cost of customs, immigration and quarantine processing of inward and outward passengers and the cost of issuing short-term visitor visas. As of 1 July 2012, the PMC is A$55 per passenger. The PMC is expected to generate A$794 million in revenue in 2012-13 (with around 8 percent from trans-Tasman travel), rising to over A$1 billion in 2015-16 (AGD 2012).

There has been significant debate over the PMC in the last five years (box B.7). During the course of this study, participants have called for its removal or reduction on the Australia-New Zealand route, arguing that true integration would see trans-Tasman travel akin to a domestic flight, and highlighting the potentially disproportionate impact the charge has on trans-Tasman travel as a short and otherwise low price route.

The impact on air travel

The PMC can comprise a significant part of the price for air travel between Australia and New Zealand, typically representing around 15–20 percent of the low-cost airfare category and 2 percent of the average business class airfare (though it has been suggested it can make up as much as 30 percent of the cost of a sale fare). This cost is borne by Australians, New Zealanders and others travelling between the two countries.

While it would be expected that removal of the PMC would lower airfares, the extent to which it would increase passenger movement across the Tasman is less certain. Although there are only a few studies on price elasticity for the trans-Tasman route, the evidence suggests that demand for trans-Tasman travel, and particularly business travel, appears to be relatively inelastic (BTCE 1995; Gillen et al. 2003; Tourism Research Australia 2011). As a result, any increase in airfares will generally decrease demand for flights by less than the proportional price increase. In part, this is because a range of factors enter into a traveller's decision-making when purchasing flights, including their income and exchange rates.

Box B.7 **Views on Australia's passenger movement charge**

In a 2008 inquiry by the Standing Committee on Legal and Constitutional Affairs into the Passenger Movement Charge Amendment Bill 2008, a range of participants argued there was a lack of transparency in relation to the PMC. In particular, they argued that the PMC is a tax rather than a cost recovery charge, and questioned whether the PMC 'over-collects' for its stated purpose (SSC LCA 2008). These concerns were reiterated during the Senate hearings for the 2012 Bill to increase the PMC (SSC LCA 2012).

In a submission to the 2011 Tax Forum in Australia, the Tourism and Transport Forum (TTF) stated that the PMC undermines the competitiveness of Australia's tourism industry and is inconsistent with the government's stated goal of growing international visitation. According to the TTF, if the PMC is to be retained, there needs to be flexibility in the charging mechanism in relation to priority international source markets and to stimulate demand for travel to regional Australian destinations (TTF 2011).

The TTF also recommended a restructure for short-haul markets where the PMC comprises a large proportion of the total ticket price:

> On popular New Zealand routes, the PMC often comprises up to 30 percent of the ticket price, and TTF believes a reduction in the departure tax would stimulate growth in visitation, which would offset the reduction in revenue collected. Given the government's commitment to simplifying trans-Tasman border formalities, TTF believes New Zealand should be used as a test case for PMC reduction, due to its status as the single largest market for inbound visitors (TTF 2011, p. 4).

The Department of Resources, Energy and Tourism commissioned a study (Forsyth et al. 2011) on the impact of raising the PMC by 20 percent. The study found that although the tourism industry unambiguously loses from the PMC, it would provide a net benefit to the Australian economy overall.

In submissions to the Commissions' study, Christchurch International Airport (sub. 21, p. 13) and the TTF (sub. 25, p. 5) identified the PMC as a disincentive for travel between Australia and New Zealand. Additionally, the Australia New Zealand Leadership Forum (sub. 15, p. 3) recommended reducing the PMC to align it with actual costs to encourage more trans-Tasman travel and tourism.

Source: Forsyth et al. (2011); SSC LCA (2008; 2012); TTF (2011).

The PMC is a general tax not a user charge

Legally, the PMC is a tax, levied under the *Passenger Movement Charge Act 1978* and collected under the *Passenger Movement Charge Collection Act 1978*. Despite its original objective as a cost recovery measure, the revenue raised through the PMC is not hypothecated to border services and forms part of the Government's consolidated revenue.

The PMC lacks transparency as currently configured. It has been found to have been over-collected and under-collected at different times. Initially, the Australian National Audit Office (ANAO) estimated that the A$27 charge over-collected the costs of providing border services, as the cost of processing passengers turned out to be lower than expected and the rate of growth in the number of departures was higher than expected (ANAO 1996). However, the Australian Commission (2005a) found that the PMC had under-recovered costs from 2000-01 to 2002-03. This shortfall in revenue compared to the cost of service delivery resulted in a benefit to the tourism industry of A$11 million in 2000-01, A$1 million in 2001-02 and A$3 million in 2002-03. The revenue raised by the PMC was broadly in line with the costs to Government in 2005 (PC 2005a).

The ANAO audit in 2000-01 found that with the decision to increase the PMC from A$27 to A$30 per passenger, a policy shift had taken place:

> The PMC is levied under Commonwealth taxing powers and is now applied partly as a general revenue raising source. As a consequence, the PMC is no longer solely linked to cost recovery of Customs, Immigration and Quarantine services. (p. 13)

Several inquiry participants to an Australian Commission review of cost recovery in 2001 supported this view, arguing that the PMC had come to be regarded purely as a source of taxation revenue. This was confirmed in the 2009 Henry Review of Australia's Future Tax System, which concluded that the PMC does not recover all the costs of border services and does not reflect specific costs (Commonwealth of Australia 2009).

Moreover, at times the revenue raised by the PMC has also been used for other measures such as tourism marketing, as well as to partially offset the costs of national aviation security initiatives (2008) (SSC LCLA 2012). As part of the 2012-13 PMC increase, revenue will be allocated to a new Asia Marketing Fund to support the promotion of Australia to growing markets in Asia, as well as a new Tourism Industry Regional Development Fund (Swan et al. 2012).

Reconfiguring the PMC as a user charge

In its current form, the PMC does not fulfil its original objective as a cost recovery mechanism for border services. In particular, it does not provide a transparent indication of the costs of providing border services (Commonwealth of Australia 2009). As a tax levied on a narrow base, it is a higher cost method of raising revenue than broader-based taxes.

Given the issues associated with the PMC, it would be appropriate for the Australian Government to consider reconfiguring the PMC as a genuine cost recovery mechanism for border services as originally intended. Also, the New Zealand Government could review whether the current arrangements for funding passenger clearance services are appropriate (box B.8).

Box B.8 **New Zealand funding of passenger clearance services**

In 1998, the New Zealand Government announced that it had decided to fully recover the cost of clearing passengers, aircraft and sea vessels at the New Zealand border. A user charge would cover the cost of clearance services provided by the Ministry of Agriculture and Forestry's Quarantine Service, Customs Service and Immigration Service, through a charge on each port (MPI 1998b). This decision was made on the basis of the following considerations:

- international passengers arriving in New Zealand expose the community and environment to a range of biosecurity risks, and also some international travellers presented other risks
- increasing visitor arrivals were placing greater demands on existing border services
- a need to increase the efficiency, effectiveness and equity of border services
- service users should pay for border services, rather than New Zealand taxpayers (MPI 1998a).

However, this user charge was never introduced. In 2004, changes to funding of passenger clearance services were announced: the costs of aviation security services were to be met by the airline industry, and the costs of biosecurity and customs passenger clearance processing services were to be met by the Government at established international airports (Carter 2010). This was expected to result in a split of costs of around 50:50 between the Government and industry.

Meanwhile, full cost recovery of clearance services for cargo proceeded. The charge for cargo clearance was based on a framework for cost recovery developed by the New Zealand Treasury, and were the subject of consultation with industry.

A further issue to have arisen is whether passenger clearance services at new airports should be subject to cost recovery. Extension of existing Government funding for these services at new airports would be consistent with the regime for existing airports, but may result in the commencement of international services from some regional airports where the economic costs exceed the benefits.

Further legislation is currently being debated in Parliament regarding the funding method for new (and re-starting) airports.

Source: Carter (2010); MPI (1998a, b).

A genuine user charge (box B.9) would have the advantage of:

- providing greater transparency in the cost of border services, through requiring border agencies to articulate clearly their broad objectives and explain how their activities and approach to the user charge contribute to those objectives (DoFA 2005)

- providing a mechanism to signal the underlying cost of the provision of border services
- enhancing equity, by ensuring that those who use the services pay for their provision.

Some analysis would be required to determine the appropriate design of a user charge. However, if designed correctly, it would ensure that those who use border services pay a cost that reflects their provision (Commonwealth of Australia 2009).

Box B.9 **Cost recovery and user charges**

Cost recovery differs from general taxation which raises revenue to fund a wide range of government activities or products. Cost recovery recovers some or all of the costs of a particular government activity or product. Examples of cost recovery include the costs of aviation safety regulation through the Civil Aviation Safety Authority in Australia, and road user charges in both Australia and New Zealand.

A user charge is one form of cost recovery. It is a charge for the provision of a specific good or service to an individual user, generally related to the quantity consumed. Less direct forms include special levies or earmarked taxes to fund a specific government activity. The link between the revenue raised and the funding of a specific activity distinguishes taxes imposed for cost recovery from general taxation.

Cost recovery can provide an important means of improving the efficiency with which government services are produced and consumed, as well as transparency in the cost of their provision. Charges for goods and services can also provide signals to users or their customers about the costs of the resources involved.

Benefits will be greatest where cost recovery charges can be linked as closely as possible to the costs of activities or products. Where this is not possible, specific taxation measures such as levies may be appropriate, but only where the basis of collection is closely linked to the costs involved.

The Australian and New Zealand Governments have both developed principles and guidelines for cost recovery.

Source: PC (2001).

B.3 Other potential air services issues

There are several other air services regulatory issues that were raised during the study, including:

- Occupational licensing. Although pilot licences are covered under the trans-Tasman Mutual Recognition Arrangement, a study roundtable participant indicated that there are barriers to the mutual recognition of pilot licensing in the SAM.
- Competition regime issues have arisen from time to time regarding airline services. The Trans-Tasman Outcomes Implementation Group has been working to progress reforms which will result in firms operating in both markets facing the same consequences for anti-competitive conduct and enhanced cooperation between regulators in Australia and New Zealand (TTOIG 2012).
- A frequent complaint relating to trans-Tasman air travel is not related to the air services themselves, but the relatively high cost of taxi travel to and from airports, as well as the opportunity cost of the time spent at airports because of international security requirements. For instance, taxi fares to and from airports can represent a significant cost for travellers. Unlike New Zealand, taxi services throughout Australia remain highly regulated, through a combination of supply restrictions (licensing), price setting and service standards (box B.10). There would be significant benefits to the Australian community overall from the removal of restrictive regulation, as well as benefits to international visitors, including those from New Zealand.

Box B.10 **Taxi regulation in Australia and New Zealand**

The Australian and New Zealand taxi industries operate within substantially different regulatory regimes. In New Zealand, the industry was deregulated in 1989, removing quantitative entry restrictions for taxis and limousines, and removing fare controls (maximum fares are required to be pre-registered and approved). After some initial instability and the introduction of service quality measures, deregulation has produced significant benefits for New Zealand (Taxi Industry Inquiry 2012).

In comparison, the taxi industry in Australia operates within a highly regulated environment governed by each state and territory. The 2012 draft report of the Victorian Taxi Industry Inquiry found:

> …the causes of the taxi industry's poor performance are longstanding and deeply entrenched. Most of the industry's problems stem from the complex and highly restrictive regulatory framework within which it operates — a framework that constrains competition, stifles innovation and directs much of the revenue generated by the industry away from those providing 'on the ground' services. (p. 20)

International studies have reported similar outcomes. A study from the OECD (2007) concluded:

- Restrictions on taxi numbers constitute an unjustified restriction on competition. These restrictions can lead to large transfers from consumers to producers, economic distortions and associated deadweight losses.
- Increasing numbers of OECD countries have removed or loosened supply restrictions on taxis. The results of these reforms have been strongly positive, with reduced waiting times, increased consumer satisfaction and, in many cases, falling prices.
- Removing entry restrictions does not imply removing quality based regulation. Indeed, appropriate regulation (which might address a range of vehicle and driver standards and which seeks to ensure passenger safety and minimum service standards) is a precondition for fully achieving the potential benefits of adopting an open entry policy. That said, remaining regulatory arrangements must not unduly inhibit the development of innovative service offers and industry models.

Sources: OECD (2007); Taxi Industry Inquiry (2012).

B.4 Sea freight

International container shipping

Currently, ocean liners have immunity from key parts of Australian and New Zealand competition legislation (box B.11) allowing them to form agreements on prices, capacities and schedules for the supply of liner cargo shipping services to exporters and importers (box B.12).

Box B.11 **Exemptions for liner shipping from competition law**

In Australia, Part X of the *Competition and Consumer Act 2010* (CCA) exempts ocean carriers from key parts of the CCA relating to anti-competitive conduct. This allows carriers to make agreements to: fix prices; pool or apportion earnings, losses or traffic; or regulate capacity. To gain an exemption, carriers must register their agreements with the Registrar of Liner Shipping.

In New Zealand, there are automatic exemptions from the *Commerce Act 1986* 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 countries, 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.

Source: NZ PC (2012).

These exemptions reflect a view that allowing collusive agreements between ocean carriers is necessary because the sector's characteristics (high fixed costs, and the existence of economies of scale and scope) mean that carriers on a route need an ability to fix prices and/or capacity and pool revenue to ensure reliable freight shipping services. The public benefits of the agreements were presumed to so clearly outweigh any anti-competitive detriments such that there should be no onus on carriers to prove that this was the case.

Box B.12 **Collaborative agreements in international sea freight**

Liner shipping operators use various types of collaborative agreements to coordinate rates, capacity, routes, frequency and other matters. Agreements can generally be divided into ‘ratemaking’ agreements and ‘non-ratemaking’ agreements. The defining characteristic of ratemaking agreements is that they set freight rates and/or to limit capacity in order to raise rates above what they would be in the absence of the agreement.

Ratemaking agreements

- Conference agreement: an agreement between a group of ocean carriers to set rates and manage capacity on a specific trade route. The carriers might also agree to limit capacity.
- Rate discussion agreement: an agreement between a group of ocean carriers to discuss advised rates and capacity management for a specific trade route.

Non-ratemaking agreements

- Alliance agreement: an agreement between a group of ocean carriers to jointly operate a network of vessel services.
- Cooperative working agreement: an agreement between two or more carriers regarding joint services.
- Equipment interchange agreement: an agreement between a group of ocean carriers to jointly use and manage a pool of equipment.
- Non-rate discussion agreement: an agreement between a group of ocean carriers to discuss service-related and capacity-management matters.
- Sailing agreement: an agreement between ocean carriers regarding coordinated sailings.
- Vessel sharing agreement: an agreement between two or more ocean carriers regarding sharing of vessel space.

Source: NZ PC (2012).

Recent review findings

Both the Australian Commission and the New Zealand Commission have previously reviewed these exemptions and concluded that there is little rationale for maintaining them in their current form. In Australia, the Commission (2005c, p. XXXVIII) concluded:

> the existence of Part X was based on the judgment that so few agreements would fail a net public benefit test that the added costs of individual authorisation were not warranted. At best, this judgment is now untested. As the analysis of market share indicates, there are a number of agreements currently operating which are unlikely to

> provide a net public benefit. The Commission finds that, in this sense, Part X as currently structured, no longer meets its primary purpose and that evaluation of agreements is needed to ensure that registration is provided only to agreements that are likely to provide a net public benefit.

The New Zealand Commission (NZ PC 2012, p. 6) found:

> There now seems to be little evidence to suggest that reliable shipping services are so dependent on the ability to have ratemaking agreements that such agreements should be automatically presumed to be in New Zealand's best interest.

International reviews also indicate that exempting ratemaking agreements from competition legislation does not provide a net benefit to the community. For example, the 2002 OECD review of Competition Policy in Liner Shipping concluded that it 'had not found convincing evidence that the practice of discussing and/or fixing rates and surcharges among competing carriers offers more benefits than costs to shippers and consumers' (OECD 2002, p. 5).

The presumption that these agreements provide a net public benefit also runs counter to the general provisions in the competition acts of both countries, where those seeking exemptions for anticompetitive behaviour are required to demonstrate a net public benefit before such exemptions are provided. It also runs counter to the usual approach in competition policy where the onus of proof is placed on those seeking the retention of anticompetitive arrangements to make the case and present the supporting evidence.

Market conditions have changed significantly over the last 15 years. International reforms, most notably in the United States and European Union, have seen a marked shift towards contract carriage and individual service contracts, and away from ratemaking agreements, suggesting they are not necessary for the stable and efficient operation of liner shipping (NZ PC 2012).

Useful parallels can be drawn between shipping and other transport industries such as airlines and some road and rail freight. In many countries, these industries were formally accorded special treatment under competition laws or subject to industry-specific regulation. Deregulation of these industries has occurred without evidence of unacceptable market instability. In fact, deregulation, with regulatory approval for operational agreements, has generally been associated with improved service provision and lower prices (PC 2005c).

Reforms in both Australia and New Zealand are warranted

For these reasons, it would be appropriate to reform requirements for international liner shipping in both Australia and New Zealand. In the first instance, the exclusion for ratemaking agreements under the competition acts in both Australia and New Zealand should be removed. This is consistent with the recent New Zealand Productivity Commission recommendation, which the New Zealand Government is currently considering.

Removing exemptions for ratemaking agreements should increase the level of competition in international liner services, leading to better and lower priced services, which in turn should reduce the costs of international trade (including trans-Tasman trade). This change would not mean that beneficial agreements could not be made. It would simply place the onus on carriers to demonstrate that an agreement is in the public interest.

That said, the benefits of removing the exemption are unlikely to be large for the Australian and New Zealand economies, given the low reliance on such agreements. Nevertheless, removal will reduce the likelihood of future carrier collusion.

As highlighted in the New Zealand Commission's report (2012), there may be potential benefits from Australia and New Zealand coordinating the proposed change in order to reduce any potential costs from removing the exemptions. In a submission to this study, the New Zealand Shippers Council (sub. 46, p. 5) supported Australia and New Zealand working together on this issue:

> Both countries share characteristics like distance to markets. Each country is a significant trading partner with the other. So it makes logical sense that both have standardised shipping regulation …

At this stage, it is suggested that the exemption for non-ratemaking agreements be retained based on the potential risk that authorisation requirements may deter the making of productivity enhancing non-ratemaking agreements. In the future, however, it would be appropriate for the Australian and New Zealand governments to examine the potential costs and benefits of further action, particularly in light of ongoing changes in international practices.

Coastal shipping

Australian cabotage restrictions currently require vessels to obtain a licence and employ Australian crew under Australian conditions and rates of pay while in Australian waters.

Prior to 1 January 2011, however, the responsible Minister could issue single or continuous (lasting up to 3 months) voyage permits in cases where licensed ships could not meet all coastal shipping demand, which allowed foreign vessels to operate without having to satisfy cabotage requirements. Since 1999, the tonnage carried under these permits increased from 7 to 25 percent of the market (DIT 2011b, PC 2005b). During the same period, the number of Australian registered trading vessels fell from 55 to 22 and employment fell from 2400 to 1300 people (DIT 2011b). The growth of permits coincided with a marked reduction in sea freight rates — for example, shipping rates from the east coast to Perth fell by more than a third in real terms (PC 2006, p. 26).

Box B.13 **Australia and New Zealand's coastal shipping task**

Coastal shipping is responsible for around 25 percent of Australia's domestic freight task on a tonne-kilometre basis (DIT 2011a). In 2009-10, 104.8 million tonnes of coastal cargo passed through Australian ports. Measured in tonnes per kilometre terms, the total coastal freight task was 114.8 billion tonne-kilometres in 2009-10 (BITRE 2011a).

Bulk cargo represents the majority of coastal cargo — approximately 85 percent by weight in 2009-10. Dry bulk cargo makes up the largest proportion of shipped products. 66 percent of coastal shipping is the movement of non-fuel crude materials, such as bauxite and iron ore. Liquid bulk, such as fuels, represents around 20 percent of the shipping task, with container and non-bulk cargo making up the remaining (BITRE 2011a).

In 2009-10, Weipa was the largest port in Australia for total loaded coastal cargo (13.2 million tonnes of dry bulk cargo), followed by Port Hedland and Gladstone (both also largely dry bulk cargo). In 2009-10, Gladstone was the largest port in terms of total unloaded coastal freight (14.3 million tonnes), followed by Port Kembla, with both ports predominantly unloading dry bulk freight cargo (BITRE 2011a).

In New Zealand, coastal shipping accounts for 15 percent of all freight movements on a tonne-kilometre basis. Total movements by coastal shipping is estimated at about 4.2 million tonnes annually, of which almost half (47 percent) is the movement of fuel, 28 percent is the movement of cement and 24 percent the movement of general cargo. By weight, over half the coastal shipping task in New Zealand in 2006-07 was loaded at Northland Port, Marsden Point, while Canterbury and Auckland were the largest destinations for coastal freight (RPC 2008).

Sources: BITRE (2011a); DIT (2011a); RPC (2008).

Recent restrictive changes in Australia

During the 2010 Federal election campaign the Minister for Infrastructure and Transport announced that a 're-elected Gillard Government will introduce measures to strengthen Australia's shipping industry for our economy and our environment' (DIT 2011a). As of 1 January 2011, wage rates on foreign-flagged vessels operating coastal trade under permits were no longer set by the International Transport Federation (ITF) market rate. Instead, wage rates on these vessels are now set in accordance with the *Fair Work Act 2009* — under the Seagoing Industry Awards.[3] A further package of changes, which commenced 1 July 2012, abolishes single and continuous voyage permits for foreign-flagged vessels. It also provides a range of tax concessions to Australian registered ships and establishes a new licensing system to protect the domestic shipping industry (box B.14).

The main reasons put forward to support cabotage are to prevent Australian vessels from 'unfair' competition from subsidised foreign-flagged vessels, and support jobs for Australian seafarers, as well as to maintain the industry for other strategic purposes (such as supporting national security and defence):

> There has been a decline in the Australian shipping fleet and industry over recent decades, as regulatory drift has allowed a concurrent increase in the number of foreign registered ships and the proportion of coastal trade they carry has increased. As a consequence investment in Australian registered shipping has fallen substantially and is predicted to lead to a situation where there are very few Australian ships within a few years as the aging fleet is retired from service. The strategic consequences of a decline in the domestic maritime industry could be significant for a trading nation such as Australia, particularly for the viability and longevity of its maritime skills base. (DIT 2011a, p. 78)

3 Wages on Australian licensed vessels are now determined by the Seagoing Industry Award (SIA) Part A or enterprise bargaining agreements. Wages for foreign vessels operating in Australian waters are now determined under SIA Part B. Part B provides more generous wages rates compared to the ITF market rates and improved conditions relating to working weekends and leave entitlements (total cost estimated to be almost double the ITF market rate). Part A has similar daily wage rates to part B but more generous conditions, including approximately one day leave for every day worked and allowances for handling, disturbed sleep, meal and study (total cost is estimated to be more than 60 percent higher than Part B rates) (ELC 2012, p. 30).

Box B.14 **Support for the Australian shipping industry**

A new licensing regime: A licence can be issued in one of three categories:

- a general licence allows unrestricted access to the coastal trade for Australian registered vessels for up to five years
- a temporary licence allows foreign-flagged vessels to operate in the coastal trade for up to 12 months, subject to time, trade and voyage restrictions. It is expected that temporary licences will cover less constant or unpredictable trade
  - applications will be made available to general licence operators to provide an indication of their ability to carry the trade. The Government will reject an application if it believes an Australian registered operator can carry the trade on reasonable commercial terms
- an emergency licence can be granted for cargo or passenger movements in emergency situations such as natural disasters.

Tax concessions: Companies operating qualifying ships on Australia's primary or international shipping registers[4] will be able to access:

- an income tax exemption for operators of Australian registered eligible vessels on qualifying shipping income
- accelerated depreciation and rollover relief for owners of Australian registered eligible vessels
- a refundable tax offset for employers who employ eligible Australian seafarers
- an exemption of Royalty Withholding Tax arrangements, where vessels are leased by an Australian company from foreign owners under a demise or bareboat charter (the chartering of a ship where no crew or provisions are included).

Productivity compact: In exchange for strengthening cabotage, maritime unions and the Australian shipping industry have agreed to a compact to deliver productivity gains including: improving work practices; the development of a process to review minimum manning levels; and the introduction of riding gangs on board vessels to undertake additional maintenance at terms and conditions of employment established under the *Fair Work Act 2009.*

Sources: DIT (2011a, b); Albanese (2011).

4 The Australian International Shipping Register will register Australian owned or operated vessels provided they: employ a minimum of two Australian citizens (preferably the Master and Chief Engineer); meet training obligations (a requirement to access tax concessions); and be covered by the *Fair Work Act 2009* and associated laws when in Australian coastal waters (exempted when in international waters).

New Zealand has liberalised coastal shipping

The experience in New Zealand reaffirms that while Australian cabotage can directly benefit local ship owners and maritime workers, it does so at the expense of the wider community.[5]

The New Zealand Government largely removed its cabotage regime in 1994. Coastal trade is not fully open. The *Maritime Transport Act 1994* (s. 198) only allows international operators to compete on coastal routes against domestic operators, as part of an international voyage and if they do not operate in New Zealand for longer than a continuous period of 28 days (NZ PC 2012).

After cabotage was removed, the number of New Zealand flagged freight vessels declined. International ships now carry around 70 percent of coastal cargo in New Zealand, both in full domestic cargo and repositioned empty containers (Rockpoint 2009). However, freight rates have fallen substantially and volumes have risen:

- coastal shipping rates dropped between 25–50 percent, depending on the route
- volumes shipped increased by up to 100 percent on some routes.

The removal of cabotage has since been found to have provided a net benefit to the community (Cavana 2004).

The New Zealand Commission recently reviewed the case for cabotage as part of its International Freight Transport Inquiry:

> The Commission does not support the reintroduction of cabotage. International shipping services carry significant volumes of container cargo around the New Zealand coast, much of it at low marginal cost and low prices. They also reposition thousands of empty containers each year. These services are valuable to New Zealand shippers. Reintroducing cabotage would likely increase prices. (NZ PC 2012, pp. 6–7)

This is consistent with findings of other reviews in Australia and overseas. For example, the Australian Commission has examined cabotage in a number of inquiries (see, for example, IAC 1988; PC 2005b, 2010). In the first of these it said:

> The Commission's assessment of the arguments for cabotage … indicates that, while many have intuitive appeal, they also imply the acceptance of high cost imposts upon the wider community for, at best, uncertain benefits. Hence, from a national

5 Under the recent package of changes, the Australian Government has proposed that the costs of cabotage will be offset by productivity improvements agreed between industry and unions under the productivity compact.

perspective, the Commission is unable to identify any worthwhile reasons for retaining cabotage. (IAC 1988, p. 130)

The OECD (2001, p. 41) questioned the effectiveness of cabotage in preserving employment and national fleets and called for member countries to remove it:

> Overall, cabotage laws attract considerable domestic attention, and generally are jealously guarded by domestic shipping lines. However, the reality seems to be that they probably do not protect a country's shipping "capability", but may simply act to increase the costs of domestic shippers.

The Australian regime should be assessed within a broad cost-benefit framework

On balance, protection of domestic shipping serves to encourage the sale of maritime transport and labour services at the expense of the sale of goods and employment creation elsewhere in the economy. Although the coastal trade is small relative to international trade, the negative impact is likely to be material, particularly for industries (such as the minerals and manufacturing industries) that rely on coastal shipping.

From a trans-Tasman perspective, the ability for international carriers to combine services both within and between Australia and New Zealand may provide better utilisation of container capacity, increased competition and lower prices.

The application of different policy approaches to coastal shipping in Australia and New Zealand provides an opportunity, in due course, for a comparative review of the impacts of the two approaches on each economy and on trans-Tasman trade.

B.5 Ports

Governments play numerous roles in relation to ports: in many cases as owners, planners and regulators of port infrastructure. Governments can facilitate the efficient operation of ports by:

- ensuring the appropriate regulatory frameworks are in place for port access, pricing and employment relations
- facilitating competition for port services
- providing the right governance and planning structures.

Performance has improved

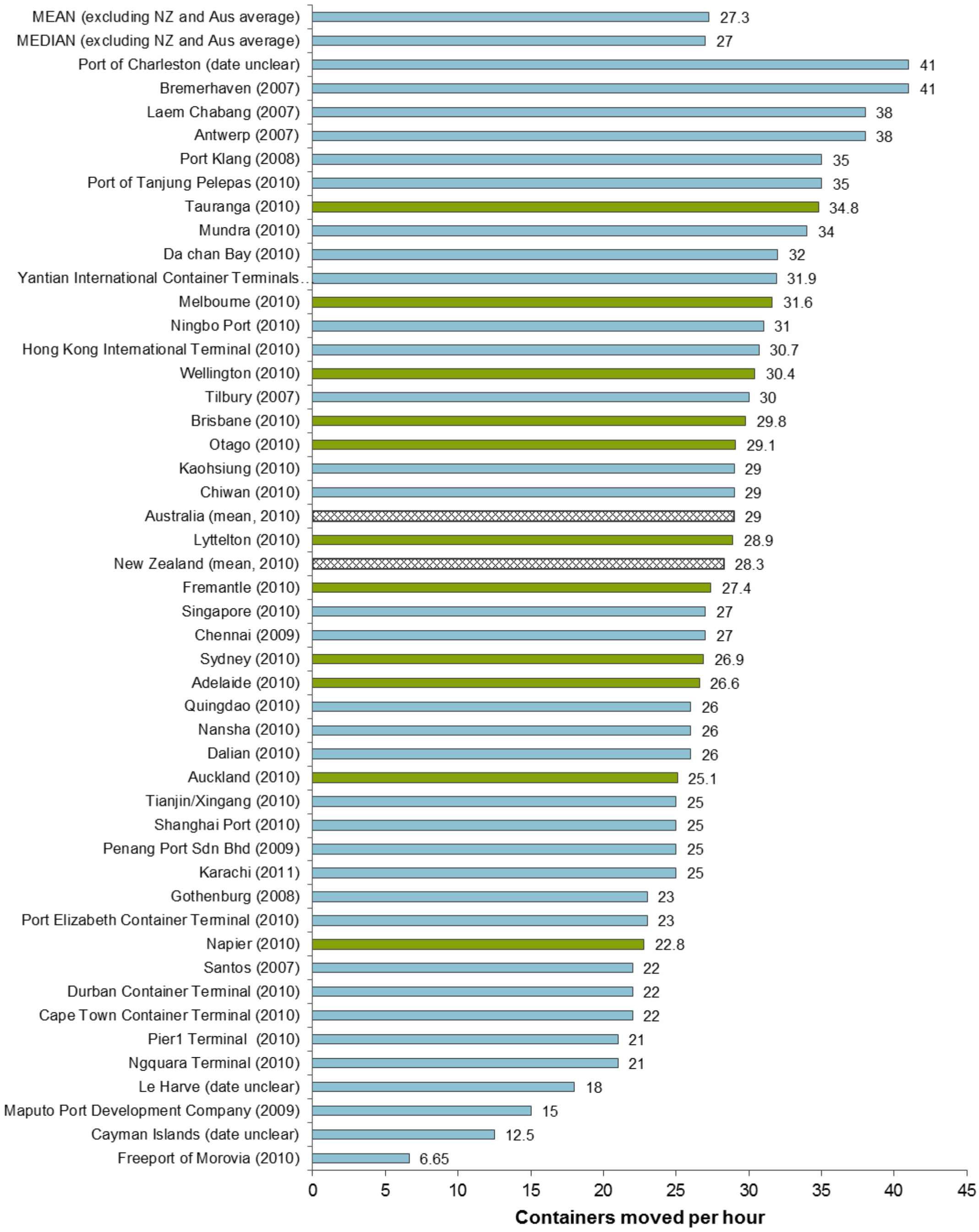
The performance of Australian and New Zealand container ports has improved significantly since the late 1990s. There has been progress in bridging the productivity gap with overseas counterparts, despite relatively small trade volumes at Australian and New Zealand terminals. Improvements are due to a number of factors, and notably more flexible labour arrangements (ACCC 2011; PC 1998b, 2003).

During this time, governments have undertaken a range of initiatives to improve the framework in which ports operate, for example, competitive tendering to encourage greater competition for stevedoring services and the review of port access regulation under the COAG Reform Agenda. Recently, the Australian Government released a National Ports Strategy, which aims to drive the development of efficient and sustainable ports that meet the community's needs (IA 2010).

Scope for further gains

However, further improvements can be made. While Australia and New Zealand now compare favourably with overseas ports with respect to crane rates (figure B.2), they are still below world's best practice. And across both Australia and New Zealand there is notable variation across ports (figure B.3). In many cases, productivity at New Zealand ports, as measured by crane rates, is similar to that at Australian ports despite significantly lower container volumes. For example, the Port of Tauranga in New Zealand has been able to deliver higher productivity and lower charges than its Australian counterparts, despite lower volumes (PC 2003; NZ PC 2012). This difference is particularly pertinent given the potential to capture benefits from economies of scale that come from the operation of port services at larger ports (ACCC 2011).

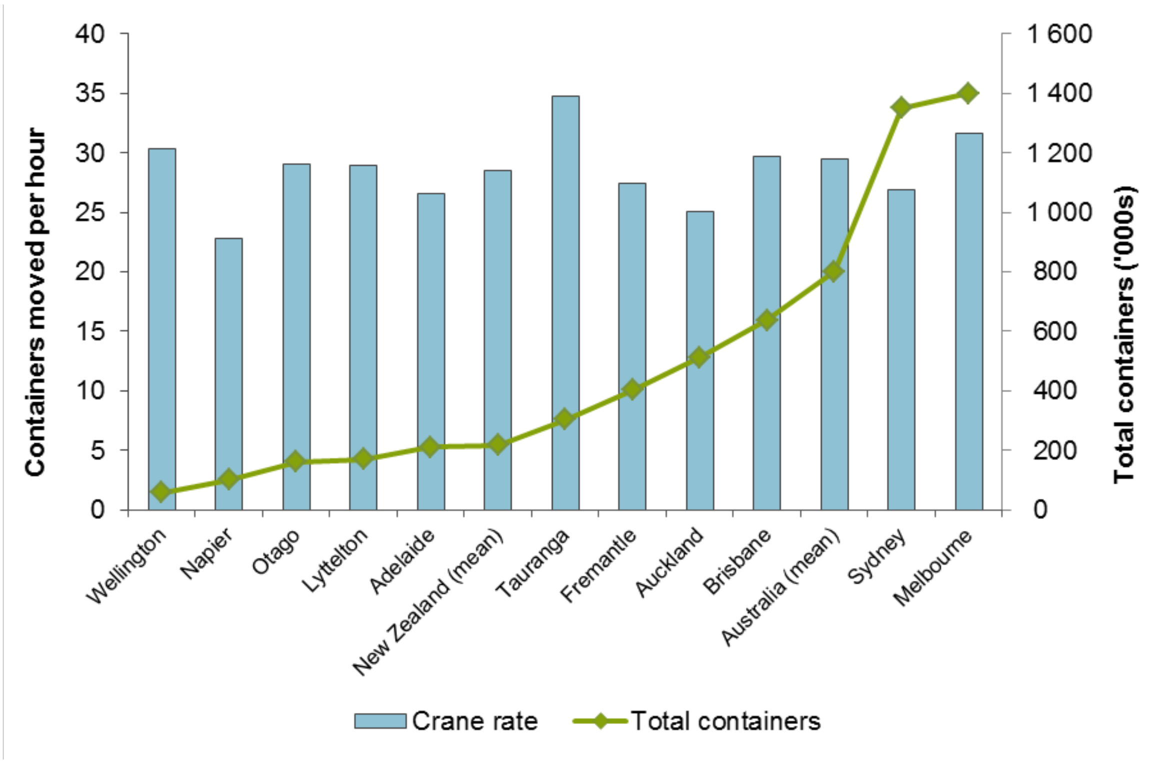
Figure B.2 **Crane rates at selected international ports, 2007–2011**



[a] Data does not reflect difference in port scale. For example, the size of vessels that are serviced at a port, as well as the type of crane used will affect a port's crane rate. Crane rates measure the number of containers a crane lifts on and off in an hour. Original data is from a range of sources, and as a result there may be inconsistencies in calculations.

Data sources: MoT (2011); NZ PC (2012).

Figure B.3 **Container productivity at ports in Australia and New Zealand, 2010**



[a] Crane rates are typically used to measure port productivity, even though other measures, such as ship and vessel rates can also be used. Crane rates measure the number of containers a crane lifts on and off in an hour. Total containers are the total number of containers lifted on/off fully cellular ships in a given period (as distinct from the measure of 'twenty foot equivalent' containers) (BITRE 2011b).

Data sources: BITRE (2011b), NZ PC (2012).

Ensuring an appropriate framework

While competition is possible between ports, particularly in New Zealand, evidence suggests that competition between the major Australian capital city ports is insufficient to provide a significant constraint on prices for container port services (ESC 2009). Where competition between ports is lacking, the main opportunities to increase efficiency at ports come from improving service delivery within ports; promoting competition for port services, particularly stevedoring; and improving labour productivity and the interface with the land transport system.

Competition for port services, particularly stevedoring

The limited number of competitors in stevedoring services at ports in Australia and New Zealand would appear not to provide sufficient incentives to drive productivity growth (ACCC 2011). Stevedoring services in Australia have traditionally been held by a duopoly of providers. The ACCC monitoring program indicates that performance has improved since 1998-99 (for example in 2010-11 there was a small shift in business between the two operators, reflecting some degree of competition in the current market for stevedoring services), but that challenges remain (ACCC 2011).

Actions by state Governments in Queensland and New South Wales to reduce artificial barriers to entry — through the tendering out of new terminal leases and restructuring long-term terminal leases to improve the incentives of the stevedores to undertake certain investments — have had some success (ACCC 2011). A third operator, Hutchison Port Holdings is set to commence operations in Brisbane and Sydney from 2013. A new entrant would be expected to increase the pressure on the existing stevedores to improve productivity in order to retain current customers and attract new ones.

In New Zealand, there is greater choice of stevedoring and marshalling services for bulk and break-bulk cargos (which are handled largely by third parties) than there is for container cargo (which is handled largely by port companies or their subsidiaries). The Port of Tauranga, the largest port in New Zealand in terms of gross volume of freight, has the greatest number of competing stevedoring and marshalling service providers. Other ports have fewer service providers operating, though changes are underway. For example, the Port of Auckland has announced an intention to introduce competitive stevedoring at its Fergusson and Bledisloe Container Terminals in order to enhance port performance (Quay Shipping 2012).

Workplace relations

Workplace relations have been a longstanding issue at both Australian and New Zealand ports, with considerable implications for port productivity through determining the extent to which ports are able to respond to fluctuations in activity.

The New Zealand Commission found in its recent inquiry that there appear to be work practices and behaviours in some ports that are impeding productivity and innovation, which may also be jeopardising progress towards improved health and safety standards and increased workforce diversity. These practices include limited work hours, inflexible scheduling of rostered days off, work extending practices and restrictions on output (NZ PC 2012). Likewise Australian ports have also faced constraints, such as inefficient work practices and industrial action that have led to reduced port operations (ACCC 2011; PC 1998b).

Improving governance, planning and investment

Poor governance, planning and investment can hamper the efficient operation of ports. For example: a number of Australia's and New Zealand's major ports are unable to accept fully laden ships of the highest tonnage; constraints on ship loading facilities have resulted in long queues of ships at some bulk ports in Australia; and several reports have highlighted quay-side and land-side congestion at some container ports in Australia (ACCC 2011; EIT 2005).

Planning and investment issues can arise for a number of reasons.

- The characteristics of the market may hinder investment. Investment at ports tends to be large and lumpy, demand is uncertain and there are multiple interdependent decision makers through the supply chain.
- Economic regulation of access and port charges may not be efficient.
- Stevedores may lack the right incentives to invest in capacity.
- Port governance arrangements may not facilitate efficient investment in infrastructure.
- There may be environmental constraints on port development.

Having effective frameworks and processes in place should assist in enhancing port performance. The New Zealand Commission (2012) found that governments can improve planning and investment decision-making by facilitating better coordination between different levels of government.

The New Zealand Commission (2012) also found the strengthening of governance and/or ownership arrangements to be an important factor in improving port performance. It found that 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 (box B.15).

Box B.15 The New Zealand Commission's findings on governance

The New Zealand Commission found 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. The Commission concluded:

- The principal objective of council-controlled port companies should be: 'to be a successful business as profitable and efficient as comparable businesses that are privately owned'. (p. 187)
- To manage conflicts of interest, elected representatives and council staff should be precluded from being a director of port companies (increasing separation between commercial and wider council objectives).
- Port companies should regularly publish economic value-added figures in order to improve reporting, transparency and efficiency.
- Councils should consider landlord port models in which land ownership is separated from terminal operations, enabling control to be maintained over port land use, but efficiency improvements resulting from increased private involvement in port operations.

Source: NZ PC (2012).

What next?

Port reform is an ongoing and complex task. Both Governments should continue to focus on providing an appropriate framework for ports to improve productivity. This would include providing the right governance and regulation of ports and opportunities for competition, as well as ensuring the broader workplace relations framework is effective.

An initial step that Governments can make to help identify best practice performance is through better data collection and monitoring. While both countries currently collect data and monitor ports (for example, the Bureau of Infrastructure, Transport and Regional Economics *Waterline* series and the Australian Competition and Consumer Commission stevedoring monitoring program), there may be merit in establishing a formal dialogue between Australia and New Zealand to compare productivity across the full set of container and bulk ports. It may be possible to extend data collection to a broader range of information from a larger number of Australian and New Zealand ports. For example, the New Zealand Commission recommended improving the monitoring of bulk handling productivity (NZ PC 2012, p. 61). Enhanced information could be of benefit for preparing for and responding to future market changes and for policymakers in designing and evaluating policies and regulations.

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