SUBMISSION TO

Ministry of Transport

On the

DRAFT NATIONAL RAIL STRATEGY TO 2014

By

New Zealand Forest Owners Association (Inc)

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1. Introduction

1.1 The NZ Forest Owners Association (Inc) welcomes the opportunity to comment on the Draft National Rail Strategy to 2014.

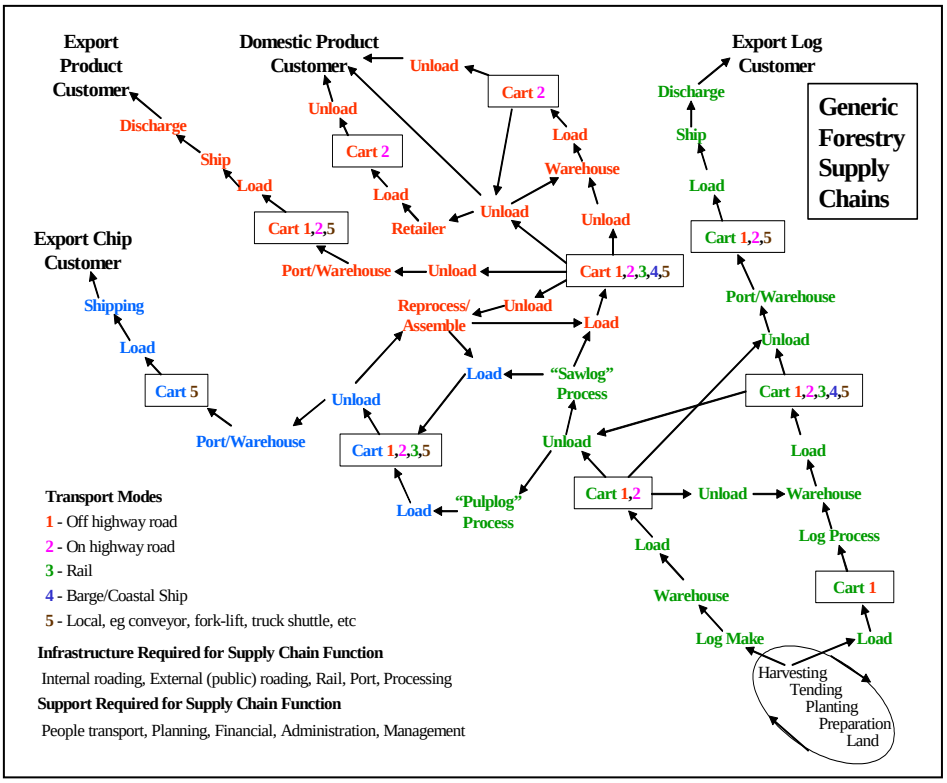
1.2 The NZ Forest Owners' Association (NZFOA) is a voluntary organisation representing the interests of commercial forest growers. The Association has 260 members whose forest holdings represent approximately 85% of New Zealand's commercial forest estate. The members include all the major forest corporates, the majority of medium sized forest companies, many forest syndicates, and a number of farm foresters.

1.3 Last year about 20 million cubic metres of trees were harvested from New Zealand's planted forests. This volume was manufactured into logs and transported to processing plants (approximately 9 million m3) pulp and panel mills (5 million m3) and export wharves (6 million m3).

1.4 The annual harvest is equivalent to around 740,000 truckloads. In 10 years time the harvest could top 30 million cubic metres, around 1.1 million truckload equivalent.

1.5 Logs to New Zealand processing, pulp and panel plants are manufactured into other products – sawn timber, posts and poles, plywood, etc. Processing of logs generates residues and by-products – roughly half the log volume will end up as wood chip, sawdust and bark, often transported substantial distances to pulp and paper mills, MDF plants etc. Manufactured products and residues are transported to warehouses, wholesale outlets, retail outlets, ports, processing plants (for remanufacture or assembly into products such as mouldings, furniture, paper) and to the final consumers.

1.6 The combination of logs, products, residues and by-products forms a complex transport and logistics task as is shown by the generic forestry supply chains in the simplified diagram below.



2 Forest Industry Transport Trends

2.1 Growth

Forestry is a growth industry – the significant increase in harvest over the last 10 years (about 10 million cubic metres) is matched by a predicted large increase over the next decade. Manufacturing growth is also occurring, entailing an increase in demand for container, residue and general freight transport on New Zealand roads.

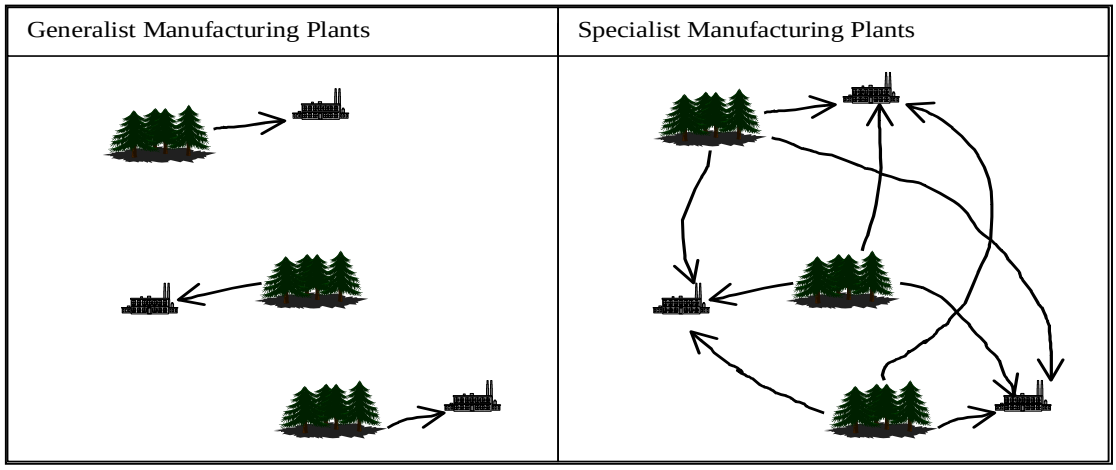
2.2 Regional Distribution

The traditional "power house" regions generating New Zealand's harvest have been the Central North Island, Nelson, and Otago. While these continue to be significant, other regions are emerging and will grow substantially over the next decade including Northland, East Coast, Hawkes Bay, southern North Island and Marlborough. Some of the emerging harvest regions, notably Northland and East Coast, are typified by poorly developed regional transport infrastructure and relatively low levels of manufacturing investment.

2.3 Manufacturing Specialisation

A perception exists that logs are very homogeneous products, able to be stored for very long periods without any value loss, with one log completely substitutable for another. The reality is quite different. The "shelf life" for logs varies enormously – from days for pruned logs, weeks for sawlogs and months for some grades of pulplogs. Specific markets and manufacturing processes have specific needs for specific log characteristics.

Many manufacturing plants have moved from being generalist processors of most log grades to specialist processors of a few. Processing and logistics economics have forced the specialisation; most manufacturers have realised that they cannot survive as "Jacks of all trades". The impact has been to increase complexity of the transport task as well as lead distance as can be seen in the simplistic example below.



The trend toward further specialisation continues with research projects under way to better understand wood quality characteristics and match these to end markets.

2.4 Increase in Scattered Forest Estates

The concentrated, large scale plantings in the Central North Island provided the opportunity for development of off-highway (private) roading networks within contiguous estates and large scale linkages to rail. A substantial proportion of the CNI harvest is transported off public highways and by rail. The situation in other parts of New Zealand is quite different with the resource often scattered in terms of ownership and geography. Reliance on public roading networks is greater with a limited ability to develop off-highway transport systems. Much of the growth in harvest over the next decade will come from the scattered estate, entailing an inevitable increase in the use of public roads by logging trucks.

2.5 Lead Distance

As a result of other trends, eg mill specialisation, and also due to a move to harvest forests in peripheral and emerging regions, the lead distance for logs from forest to destination is increasing. In turn this increases the demand for logging trucks.

2.6 Regional Transport Infrastructure

The development of infrastructure in the emerging harvest areas to enable the wood grown over the last 25 to 35 years to be harvested and transported to market is an important issue for the industry and for district councils. The private road infrastructure within the forest is not at issue but the upgrading and funding of the public regional and district road infrastructure is a key concern.

Forestry establishment since the 1970s has largely been a "back-blocks" activity, pushed out to steeper and poorer quality land partly as a result of restrictions under the old Town and Country planning legislation and partly due to the cost of land and competing land uses. It has gravitated to regions such as Northland and East Coast where land was readily available and forestry encouraged, especially on eroding Gisborne farmland.

3 Importance of Transport Sector to Forestry

3.1 An efficient land transport system is essential to enable forestry to shift its vital production to further processing centres and to ports for export, and to source competitively priced inputs for its production processes. An efficient transport system is an essential component of New Zealand's current international competitiveness.

The forest industry is a major user of sea, rail and road transport modes within New Zealand. Choice of transport mode in the forest industry depends on a number of interacting factors:

3.2 Type and value of product

Generally forest industry products are bulky and of low unit value favouring road, rail or sea modes, rarely air.

3.3 Availability of modes

Parts of New Zealand are well served by road, rail and sea modes while the choice in other regions is restricted. Rail, for instance, does not exist in a number of regions, e.g. Nelson.

3.4 Lead distance

A general rule is the shorter the lead distance from source to destination, the more road transport economics are favoured. In Sweden, log transport by rail is considered seriously when the lead distance exceeds 100 km. The majority of New Zealand log transport leads are less than 100 km. Into and out of the port of Antwerp container transport by rail is seen as economic for distances over 400 km and road transport favoured for shorter distances.

3.5 Customer requirements and expectations

Leaner margins, tougher competition and, in some cases, lack of storage space has seen inventory move from the customers to the producers along the supply chain and overall reductions in inventory. As a consequence, processed product customers are demanding smaller, more frequent stock replenishments which tend to favour the road transport mode. By and large trucks can provide a more flexible, responsive service than other modes and for processed forestry product deliveries have operated at over 90% in full, on time performance, whereas rail has only recently pulled its performance up to 80%.

3.6 Total logistics/systems costs

Modal transport decisions should take into account the whole set of costs along the supply chain, including transfer, inventory management and "hidden" costs. It is not just

a simple comparison of transport leg costs. Warehousing needs and costs associated with transport modes can be a major deciding factor, especially where transferring from one mode to another.

3.7 The first transport leg for virtually all logs harvested from New Zealand's forests involves a truck, generally starting on private forestry roads and often moving onto public roads. A decision to transfer from road to rail or sea (barging) modes takes into account availability of transfer facilities, costs of deviation to transfer points, transfer operation costs, off-loading, distribution and transfer costs and facilities at destination, and "hidden" costs such as handling damage, order tracking complexity, administration, degrade, etc.

3.8 A similar set of factors need to be considered for processed product transport mode decisions where the availability of rail sidings at manufacturing plant and destination points may be an important, additional factor. For logs, the melding of a continuous, and fluid trucking mode from the forest into a rigidly scheduled, batch process needed for rail is complex, requiring storage facilities and tight inventory and scheduling management.

3.9 Complexity of transport task

Experience suggests that the more complex the transport task (eg number of drop-offs, number of stock keeping units per order, small order size, etc), the more road transport is favoured. Rail and sea transport modes have their place in more simple point to point transport tasks for large or bundled (eg containerised) consignments. Numerous break-bulk orders for rail involves expensive (and unsafe) shunting operations.

3.10 Source and destination locations relative to mode

Obviously location of forests, manufacturing plants and customers relative to transport modes is a key factor in modal choice. Suggestions that the Gisborne–Napier rail line will be critical for logs out of Gisborne's forests, most of which are situated to the north of Gisborne do not make commercial sense. Net returns to the forest growers reduce by around $15 per tonne by railing export logs to Napier **past** the port of Gisborne.

3.11 Operational scale

Operational scale is a critical factor interacting with virtually all other factors. Very clearly capital and operating costs differ considerably amongst modes – the higher these costs, the greater the need for scale to cover them. Operational scale is significantly more important in shipping and rail than it is for truck transport. Operational scale is considerably easier to achieve in the large, contiguous estates of the Central North Island, which aids the major use of rail there. Scattered forest estate, under multiple ownership, disperses the scale that enables the economic transfer of logs from road to rail.

3.12 Social and environmental considerations

Social and environmental considerations do influence modal decision making. Certainly the social consequences of shifting large volumes, for instance, from rail onto public road are taken into consideration by the major forestry organisations.

However, the forest industry's view is that individual forest growers and manufacturers need to make their own decisions based on the range of factors specific to their own needs and circumstances. The Association does not believe that that Government should dictate the use of a particular mode and therefore does not support a Government move to return to the days of protected rail transport via restrictions on road transport.

4 General Comments on the Draft Strategy

4.1 While the Association does not object to the development of a National Rail Strategy, it has long been the Association's view that if the pricing signals are correct the market will determine the most effective and efficient manner of moving people and freight. Interventions based on non commercial and non economic considerations about the appropriate mix of transport modes are likely to create inefficiencies and to depress economic growth by adding to the cost of doing business, both directly via increased transport costs, and indirectly via increased taxation imposts.

4.2 The Association considers the NZ Transport Strategy (NZTS) to be flawed in that it fails to recognise the positive role transport plays in facilitating economic growth and is instead seemingly focused on encouraging a reduction of transport use, particularly on the roads.

4.3 The Transport Strategy is now directly influencing the direction of transport policy and legislation, such as the Land Transport Management Act and most recently the Transport Legislation Bill. The Association considers it absolutely essential that the government transport agencies undertake cost benefit analysis and ensure benefits always exceed costs before any decisions are made.

Considering the flavour of the NZTS, the Association is disappointed but not surprised to find that the Draft National Rail Strategy is designed to encourage modal shifts in both passenger and freight transport – that is, to get freight off trucks and onto trains.

4.4 The Association is not anti-rail and nor is it opposed to modal shift per se. Rail has an important role to play in an integrated transport system, particularly for the transport of large volumes of people and freight over long distances.

4.5 The problem is that rail cannot always compete because the vast majority of the total passenger and freight transport tasks cannot be carried by rail. For example, origins and destinations might not be served by rail lines, freight might be poorly suited for rail, or the distances might simply be too short and the distances too small to allow people or freight to be moved efficiently by rail. Road is almost always the only door-to-door option and changes in mode mean multiple handling, which can dramatically increase costs and the likelihood of damage.

4.6 For these reasons, only a small proportion of freight is ever likely to be contestable between road and rail. Therefore a National Rail Strategy, taxpayer funding of rail

infrastructure, and increased operating subsidies are unlikely to significantly alter the mode share – but could significantly increase transport costs.

5 Specific Comments on draft National Rail Strategy

The Association will confine its specific comments on the draft National Rail Strategy to two of the National Rail Objectives:

Assisting Economic Development

5.1 The Association notes that the objective is to "enhance rail's contribution to sustainable economic development".

5.2 As discussed above, the Association agrees that rail has an important role to play in assisting economic development, but we submit that the draft Strategy's emphasis on actively encouraging a shift in modes would not help achieve such an outcome. Such policies will, on balance, be likely to stifle economic development if the shift in mode involved increased resources (costs, and/or taxpayer/ratepayer funds) compared to that which would have occurred without such "encouragement".

5.3 According to the draft Strategy document, rail has around 14% of all domestic freight. At first glance this does not appear to be a high proportion, but the share is not surprising considering the generally short distances between origins and destinations in a country of New Zealand's geographic size, topography, and population density. The draft Strategy document also points out that in the year to June 2003, the amount of freight carried on Toll Rail increased by 27% over 1998. This increase in volume would not indicate that rail needs an activist National Rail Strategy for it to have a sustainable future.

5.4 The Government's decisions to purchase the rail network and commit $200 million to upgrading rail infrastructure were key initiatives made in the name of assisting economic development. The Association remains concerned about these initiatives, particularly the risk to the taxpayer. While we accept that there is a case for upgrading the rail network (particularly given the backlog of deferred maintenance), we submit that the users of the rail network should meet the costs of infrastructure development (e.g. through access charges), not the taxpayer or the road user as is proposed.

5.5 The Association is concerned about the Government's investment in developing the rail network being directed to projects that might be uneconomic or having benefit-cost ratios that are significantly lower than comparable roading projects. It is also undesirable for business investment decisions to be made on the basis of the availability of a subsidy.

5.6 The Association is also concerned by the comment that Transfund and the New Zealand Railways Corporation "… will be required to promote the use of rail where practicable, including the development of intermodal links". This is a strong steer and one that would presumably require Transfund to place a higher funding priority for rail

infrastructure projects with low benefit cost ratios than road infrastructure projects with high benefit cost ratios. We fear that this will result in outcomes that will be neither effective nor efficient.

5.7 The draft Strategy document refers to the *Surface Transport Costs and Charges Study*. The Association is aware that this study was undertaken and completed last year, but has not been publicly released despite requests from various organisations under the Official Information Act 1982. It is surprising that a draft strategy has been released for public comment without the ability for submitters to consider the findings of this important study. We urge the Government to release the study as soon as possible, prior to decisions being made on a National Rail Strategy.

Ensuring Environmental Sustainability

5.8 The draft Strategy document argues that rail transport's environmental impacts are 'small' compared to the impacts of road transport on the environment. However, the draft Strategy provides little analysis to back up this statement. It is this section of the document that is most enthusiastic about modal shift from road to rail, with it explicitly stating that "the Government will encourage the transfer of freight from road to rail, where appropriate".

5.9 Although the term 'where appropriate' is an important recognition that modal shift would in the vast majority of cases not be worth considering, the questions that immediately arise is who will make these decisions to 'encourage' modal shift, under what circumstances would such 'encouragement' be deemed ' appropriate', and in what forms will such 'encouragement' take?

5.10 The document states that the Government's $200 million investment in upgrading the rail network and the changes to the funding mechanism for land transport infrastructure will encourage modal shift, but what will happen if these initiatives do not result in a significant change in modal share? Will the Government consider more intrusive options? The comment further in this section about incorporating the costs of environmental externalities suggests that it would. The result would be an increase in the price of road freight transport, an increase which would need to be substantial to achieve any significant change in behaviour given the relatively low elasticity of demand for fuel.

5.11 Again, the lack of any information from the Surface Transport Costs and Charges Study is disappointing. The Association considers it very important for submitters to be fully informed on the degree to which charging for environmental externalities would increase transport costs in the context of a National Rail Strategy.

5.12 In the absence of any credible analysis from the Surface Transport Costs and Charges Study, and in the knowledge that this year close to $700 of road user funds will be diverted into the Crown Account, and up to a further $255 million of road users funds will be diverted away from roads and used to subsidise other modes of transport, it is

difficult to accept the conclusions made in the draft Strategy that road transport is not meeting its fair share of costs compared to other modes.

6 Conclusion

6.1 New Zealand needs an integrated transport system that provides forest industry users reasonable access to all modes for the transport of their products.

6.2 The choice of transport mode should be in the hands of users based on the range of decision factors specific to each user.

6.3 The national and regional land transport network, ie roads and rail lines, should be in public ownership to enable reasonable and neutral access by users, and to ensure objective and sustainable planning, development, maintenance, renewal and funding decisions at national and regional levels.

6.4 Subsidies (or penalties) to encourage or discourage use of particular transport modes are considered distortionary and are generally not supported by the industry. In special cases, where Government decides to apply subsidies, there should be complete transparency.

6.5 Any decisions to impose additional costs on any particular transport mode for social or environmental reasons should be based on rigorous analysis, and robust science and should be imposed only after wide public consultation.

6.6 Ownership and operation of transport services that utilise networks should be open to competition amongst appropriately licensed and qualified operators. Where monopoly provision of transport services on certain modes, or in certain regions, is unavoidable, the initial selection of provider should be in a competitive basis.

6.7 For the above reasons, the NZ Forest Owners Association recommends that the foundation of the National Rail Strategy should be to ensure that individuals and firms receive accurate pricing signals so that the most efficient and effective transport modes are used. A Strategy that encourages rail use where and when it would not be the most optimal mode on a fair competitive basis would depress economic growth.