

29 October 2013

Inquiry into Regulatory Institutions and Practices  
New Zealand Productivity Commission  
PO Box 8036  
The Terrace  
WELLINGTON 6143

Dear Murray

The Ministry of Transport welcomes the Productivity Commission's Inquiry into Regulatory Institutions and Practices. Improving the quality of regulation is an important part of how we can collectively lift economic, social and environmental outcomes in New Zealand.

I am keen to share with the Commission the experience and insights we have gained in leading the development of better quality transport regulation. In my view the transport portfolio provides a rich case-study that will be valuable to your Inquiry.

To share that experience with you this submission provides an overview of:

- the transport regulatory framework and gains achieved
- the problems with the current regulatory framework and some specific examples of regulatory failure
- the steps we have taken to improve the effectiveness and efficiency of transport regulation.

Ministry staff are available to meet with the Commission if you would like more detail.

### **The transport regulatory framework**

The overarching goal of transport regulation is to maximise the economic and social benefits from the use of transport while minimising harm. To help achieve this goal, the transport legislation provides a two-tiered regulatory framework with the mode specific primary Acts, and secondary legislation in the form of rules and regulations. The modes covered are road, rail, aviation and maritime.

Broadly speaking the transport regulatory framework is characterised by:

- the Minister of Transport having the bulk of the decision-making power and this is effected largely through the making of transport rules. Rules contain requirements, detailed technical standards, and procedures governing the construction, operation and maintenance of vessels, vehicles and aircraft, as well as the licensing of those who operate them.
- its regulations primarily being limited to offences and fees and charges
- the transport regulators have relatively few powers to make tertiary level regulation such as issuing guidelines.

The transport sector is regulated by 21 Acts and 250 rules and regulations. I would characterise this regulation, and specifically the rules, as being extensive and principally prescriptive. For example, the rule set for aviation has approximately 47 parts covering, to a high level of technical detail, almost every aspect of the aviation system.

As you mention in your Issues Paper, much of New Zealand regulation derives from decisions of international 'regulators'. We estimate that in aviation around 60-70 percent of rules result from New Zealand giving effect to international conventions. In maritime the proportion is higher at around 80 percent.

In terms of the roles and responsibilities of agencies, the Ministry is the principal adviser on the regulatory settings. The role of transport regulator is carried out by the Transport Crown Entities on a modal basis. However, the Ministry is the regulator in a few instances such as the regulation of international air services.

### **The current regulatory framework has brought gains**

The current regulatory framework was established in the 1990s. It was put in place largely in reaction to the previous system that was dominated by regulation and a plethora of tertiary instruments made by the various Transport Directors of the Ministry of Transport. The issues the new framework sought to address were primarily the:

- lack of transparency and accountability with the regulator having too much "in house" decision-making
- inflexibility and complexity of transport regulation
- difficulty in securing regulatory change in an efficient and timely manner, particularly for implementing changes to international standards.

Of these issues the current framework has improved transparency and accountability. The rule making processes provide for stakeholder consultation, and the Minister of Transport can be held to account politically for decisions made on the content of rules.

In terms of outcomes achieved the prescriptive approach has been successful in improving safety across the modes. In civil aviation a high level of prescription has delivered a safe system through a generally conservative approach where what is acceptable is clearly defined, allowing the Civil Aviation Authority to relatively easily fulfil its monitoring and enforcement roles.

Similarly in road safety, prescriptive legislation coupled with public information and effective enforcement has, since the 1990s, played a key role in reducing the level of road deaths and serious injuries.

### **But the problems of inefficiency, complexity and inflexibility remain**

However, the current regulatory framework has not solved the problems of inefficiency, complexity and inflexibility. The general consensus across government and industry is that rules take too long to make, they do not keep pace with changing circumstances, and they discourage efficiency-enhancing innovation.

The length of time and level of resources that it takes to secure change, coupled with the prescriptive nature of most transport rules and regulation has in some circumstances led to:

- Rules becoming out of date and irrelevant as circumstances change. For example, one of the civil aviation rules bans sole means Global Navigation Satellite System (GNSS) navigation. This is because the rule was implemented many years ago when GNSS navigation was not reliable.
- The risk of a loss in safety, economic and environmental gains as the introduction of cheaper or improved beneficial technologies has been delayed or put off altogether. This in turn brings the risk of New Zealand becoming out of step with international best practice. Following on from the example directly above, international best practice is for air traffic controllers to use GNSS-derived distances for applying longitudinal separation between aircraft. However the existing rule provides only for the use of dated distance measuring equipment.
- The risk of reduced international confidence in New Zealand as a safe, responsive and efficient jurisdiction if we fall behind in implementing changes to requirements and standards under international conventions to which we are party.
- An increase in regulatory compliance and administration costs as increased use of 'work-arounds' are required. For example, civil aviation requirements specify that pilots must pass a flight test with an examiner who holds a civil flight licence. However, qualified pilots from the military, looking to enter civil aviation, have already satisfied a stricter flight test which is not recognised under civil aviation rules. Although the Civil Aviation Authority allows an exemption as a 'work-around', this comes at a cost of \$800 per application.
- Rules that inhibit the regulators implementing more efficient and effective business processes that would have otherwise reduced government administration and business compliance costs. For instance, the Driver Licensing Rule specifies the exact forms of proof of identity that people must produce in applying for a new or renewed licence. This currently prevents people from proving their identity on-line, which in turn stops a move to on-line license renewal.
- Fees and charges that can not quickly adjust to reflect business costs. For example, the fee for renewing a driver's license was until recently subsidising the costs of other licensing services such as the rescheduling of licensing tests.

The above problems come with the current approach to making regulation. These are in addition to problems that come from weak regulatory design. Examples of the latter type of regulatory failure are set out in the Appendix.

In summary, the transport regulatory framework is still not agile and flexible enough to support the types of economic, social and environmental gains New Zealanders expect from their transport system.

### **We are taking action to improve efficiency and effectiveness**

This has posed a significant challenge for the Ministry because when the transport reforms were put in place in the 1990s they were leading edge. Initially they did deliver a regulatory system that was reasonably flexible and efficient. Through time, however, circumstances and public expectations have changed.

The Ministry is working with the transport regulators to improve transport regulation. Collectively we are aiming to ensure that the transport regulatory system remains fit for purpose and continues to improve outcomes in a world that is constantly changing.

### *The Regulatory Reform Programme*

In 2010 the Ministry established the Regulatory Reform Programme in collaboration with the transport agencies. It has three main elements:

- Identifying any opportunities for reform that will deliver substantial improvements to the transport regulatory system. The changes to the Warrant of Fitness system are an example
- Improving business process to make sure the way we develop policy advice and implement regulatory change contributes to an increase in regulatory efficiency and effectiveness
- Providing better coordination and oversight of the regular regulatory programming and scanning to identify and address requirements that are out-of-date, ineffective or excessively costly.

Our strongest achievement to date has been the Vehicle Licensing Reform. This reform identified opportunities to reduce the regulatory burden of four vehicle licensing systems, including the Warrant of Fitness system, while ensuring the safety of the overall road transport system.

The Ministry and the New Zealand Transport Agency have been working to realise an estimated \$1.8 billion dollars of benefits, to motorists and businesses, over the next 30 years from changes to the Warrant of Fitness system. Changing the Certificate of Fitness system will realise at least an extra \$330 million dollars over the next 30 years.

### *Transport Rules Redesign Project*

Within the Regulatory Reform Programme, the Transport Rules Redesign project sought to find practical ways to improve the quality of rules, and to reduce delay in the delivery of the annual transport rules programme.

A key issue identified was that rules were too often put on the annual rules programme prematurely, prior to adequate problem definition and consideration of policy alternatives. This contributed to false performance expectations, resulted in the inefficient use of staff resources, and slowed the rules development process.

To help address these issues the project developed the following cross-agency guidance material:

- the Transport Regulatory Policy Statement that establishes clear and consistent expectations for best practice regulatory development and implementation. It is available at: <http://www.transport.govt.nz/ourwork/betterqualityregulation/>
- the Regulatory Development and Rules Production Handbook to assist staff develop best practice regulatory interventions. It also standardises the rule development process across agencies and clarifies roles. It is available at: <http://www.transport.govt.nz/ourwork/betterqualityregulation/>

### *Addressing regulation that hinders the efficient operation of markets*

Alongside improving the process of making regulation, we are also focused on addressing instances of where transport regulation is unnecessarily preventing, or reducing, the effective operation of markets.

As a first step we have contracted NZIER to do a research project (called 'Regulatory Efficiency in the Transport Sector') to help identify where regulations, or their application, may be exacerbating market inefficiencies. This could be by preventing the effective flow of information, or creating barriers to entry, or inadvertently creating regional or national monopolies.

The research is scheduled for completion in March 2014. The key deliverables of the research include:

- a framework to identify a short list of areas for exploration
- a process to assess the market effect of regulation
- a review of four to five specific areas of legislation with analysis of the effects of that legislation on the relevant markets.

### **We are also looking at the possibility of more fundamental reform**

Building on these improvements, we are undertaking greenfields reviews of the regulatory framework where there is a good case for change. We are currently assessing how 'fit for purpose' the civil aviation regulatory regime is as part of the Civil Aviation Act review. This review will report to Cabinet by March 2014.

Within this work we are mindful that simply moving to a principles-based approach to regulating is not, in and of itself, the answer. The prescriptive versus principles approaches are opposite ends of a regulatory spectrum each with different advantages and disadvantages. Practice shows that securing public policy outcomes is too complex a task for either of these extremes alone.

Where it works well, a principles approach to regulating provides flexibility and choice. It allows firms to adopt least-cost solutions to meet legal obligations and encourages innovation. This approach includes relying on incentives and self-regulation where possible. All these qualities and possibilities can be missing with a prescriptive approach.

However greater flexibility and choice can increase regulatory uncertainty. For small firms, in particular, uncertainty adds significantly to regulatory compliance costs and can discourage long-term investment and growth.

Uncertainty can also make it difficult for the regulator. Principles-based regulation requires highly skilled and competent regulators who can easily decide whether or not a new process, design, or product meets a certain performance requirement.

In this regard the strength of a prescriptive approach is that it can provide certain and stable regulation that is less complex to implement and enforce.

With the civil aviation work we are not opting for any one approach. Rather we are looking to ensure that the regulatory regime allows for a range of fit-for-purpose interventions that can adapt and evolve as circumstances change.

## **Having the right capability and culture are key**

I agree with what the Commission has said in its Issues Paper that organisational capability and culture are critical components of regulatory performance.

### *Capability and culture of the transport regulators*

An issue we notice across the transport regulators is the challenge they face in resourcing themselves with the full range of skills and capabilities needed to be effective and efficient regulators. Core to this is having the requisite technical skills and knowledge, for example in road safety or aviation design. This can be difficult particularly where there are skill shortages in the relevant industry and market salaries are high.

On top of this capability, regulators also require knowledge of all the diverse factors that make for successful regulation, such as market dynamics, industry or public expectations, and business processes that reduce administration and compliance costs. Having this amalgam of very different skill sets can be what matters for regulatory success.

### *Capability and culture of the Ministry*

For the Ministry, our 2013 Performance Improvement Framework review noted that our regulatory reforms have created a sound process for developing regulations and that these improvements were acknowledged and appreciated by stakeholders. However, more needs to be done.

We agree with that assessment. Better transport regulation depends on quality longer-term policy thinking and new ways of thinking about long-standing problems. To create a stronger policy environment for that we have a programme of change in place focused on:

- Lifting our strategic focus
- Improving the quality and consistency of our policy advice
- Engaging more effectively with stakeholders.

This change programme is underpinned by our recently defined purpose and philosophy. We have defined our purpose as *ensuring our transport system helps New Zealand thrive*. We have set our greatest imaginable challenge (GIC) as *creating the environment to double the value from transport initiatives*.

A clear purpose and philosophy helps refocus and re-energise the Ministry to think harder and more creatively about how public policy outcomes can be achieved, especially with less regulation.

I wish you the best with your Inquiry. As I mentioned earlier, if you would like further information on the Ministry's experience please contact us. The contact person for this is Marian Willberg (m.willberg@transport.govt.nz or (04) 439-9290).

Yours sincerely

A handwritten signature in blue ink that reads "Martin Matthews". The signature is written in a cursive style with a large loop at the end of the last name.

Martin Matthews  
**Chief Executive**

## Appendix – Examples of regulatory failure in transport

### Maritime safety – The Safe Ship Management System

Prior to 1998 all commercial vessels were subject to an annual survey and inspection for compliance with technical standards, but vessel operators were not subject to any requirement concerning the safe operation of their vessels.

This system was reformed in 1998 through the introduction of the safe ship management system (SSMS). This change brought New Zealand's domestic regime into line with a global move to apply ongoing safety management obligations to commercial operators. However, the SSMS system had unintended consequences which have compromised safety outcomes.

#### *How the Safe Ship Management System worked*

Under SSMS, all vessels are required to join the safe ship management system of an SSM organisation. SSMS organisations accept vessels into their system on the basis that the vessel meets regulatory safety requirements. The SSM organisations then periodically carry out inspections, surveys and audits to ensure that vessels continue to meet regulatory requirements.

Maritime NZ approves SSMSs and audits organisations and recognises their surveyors (only an SSM company surveyor may survey an SSM vessel). Maritime NZ also issues vessel owners with a SSM certificate for each of their vessels. In effect, Maritime NZ's role under this system is to 'audit the auditor'.

#### *The SSMS has perverse incentives that undermine safety*

The underlying philosophy of SSMS is that safety improvements are most likely to be achieved when those in industry take responsibility for safety. However, the commercial nature of SSMS companies' interactions with industry has resulted in perverse incentives that compromise safety.

SSMS companies and SSMS surveyors intent on ensuring compliance with regulatory requirements risk losing business to other SSMS companies. Exiting unsafe vessels and operators from the SSMS means reduced revenue for SSMS companies.

As well Maritime NZ has been strongly reliant on SSMS companies for the regulatory functions they perform, and their direct relationships with industry. The regulatory model distances Maritime NZ from vessel operators that, together with poor information from SSMS companies, has hindered its ability to keep up with maritime safety issues and concerns and to effectively target its own regulatory efforts.

The consensus view is that Maritime NZ has taken too much of a 'hands off' approach under SSMS, and that the commercially competitive market that resulted has not been conducive to achieving the necessary improvements in maritime safety that government was seeking.

The SSMS will be replaced next year by the new Marine Operator Safety System, which discontinues the requirement for vessels to belong to an SSMS. Maritime operators become directly responsible for producing a safety plan for their operation, and Maritime NZ becomes directly responsible for the oversight and audits of the operator safety system. Ship surveys will continue to be provided commercially by external providers, establishing a clear separation between the commercial service and regulatory oversight.

## **Road safety - The certificate of fitness system**

The certificate of fitness system contributes to road safety by checking the safety of New Zealand's commercial vehicle fleet – heavy commercial vehicles, taxis and rental vehicles. The certificate of fitness inspection market is regulated by the NZ Transport Agency through a series of policies developed under the framework of a Land Transport Rule.

The NZ Transport Agency's operational practice has resulted in a limited number of certificate of fitness inspection providers as part of a national coverage model. The principle operated is that no vehicle operator should have to travel more than 30 minutes (or more than 40 kilometres) to reach an inspection site. The operational practice has also used independence (separation of inspection and repair services) as a way of ensuring robust inspection outcomes, for example, removing the incentive for repairers to generate work.

The result of this approach has been a market that is restricted to a small number of providers that do not undertake repair work and have their own inspection sites.

However, this separation had the unintended consequence of reducing productivity for transport operators because their vehicles spend longer out of service. An estimated \$20 million in time is spent annually by vehicle owners getting a certificate of fitness.

The NZ Transport Agency's policies are currently being reviewed to enable greater choice for vehicle owners about where vehicles can be tested and by whom. This includes the option to bundle repair and inspection together in order to reduce the time it takes to get a certificate of fitness, saving costs.

## **Transport fees and charges**

The transport sector agencies collect over \$190 million a year in third party revenue through 75 different funding streams (fees, levies and charges not including fuel excise tax and road user charges).

The Office of the Auditor-General's guide on charging fees suggests they should be reviewed every three years, which would require 25 funding streams reviewed each year.

Apart from the capability issue, the fees, charges and levies are set by regulation and require Cabinet approval to change – either increase or decrease. While that is appropriate, the current guidelines for setting fees have two rules that make it inevitable that there will be a frequent need to seek Cabinet approval.

The current guidelines require fees to be set at the minimum level to recover costs, and do not allow the transfer of revenue between funding streams. The point of the first rule is to keep pressure on the Crown agencies to deliver value for money. While this is a critical goal the rule creates a problem for transport fees that are demand based. When there is a significant rise in users typically there is a surplus in fee revenue, and similarly a revenue deficit when the number of users declines.

As some costs for the delivery of services are fixed the guidelines make it difficult to deal with revenue fluctuations. If revenue could be transferred between funding streams the agencies would be able to manage this pressure. However as transfers are not allowed it is inevitable that there are frequent papers to Cabinet seeking variations to fees. Where fees are not changed the pressure to deliver value for money is undermined or service levels diminish as resources are denuded.

For example, the Aviation Security Service (Avsec) has had many funding reviews over the last few years, prompted by a continuous cycle of over and under recovery.

There are solutions to allow this to be better managed for example memorandum accounts, but we think it might also be possible to develop other models of fee setting that will maintain incentives for value for money while still allowing some movement of fees.