

Increased trade with France: what are the potential benefits and barriers?

Summary report
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1 Objectives of the study

This study provides an independent analysis of the potential benefits of, and barriers to, increased trade between Jersey and France. The present report summarises the main findings of a technical report.¹ It is largely an economic/commercial analysis, but issues of culture and non-economic/commercial objectives that might be pursued by the Government of Jersey should not be ignored in an analysis of this sort. In particular, the concentration in this study on the business case should not be seen as implying that these wider issues should not form part of any policy decisions that the Jersey Government might take with respect to its relationships (including economic relationships) with France.

The focus of the study is to answer two main questions.

- Are there significant economic advantages to Jersey as a whole from increasing trade with France?
- If there were, are there reasons or evidence to suggest that the market would not automatically respond to reap these advantages?

The study has been undertaken using theoretical analysis, modelling and interviews in Jersey, the UK and France. Central to the study has been an examination of the interaction between trading patterns, the freight ferry network and the overall benefit to the Island's economy. It should, however, be emphasised that this study is not a 'feasibility analysis' for any new ferry service. The study is more general, and examines the public policy implications of what increased trade with France might mean.

¹ Oxera (2006), 'Increased trade with France: what are the potential benefits and barriers?: Technical Report', June, available at www.gov.je.

2 Conclusions and policy implications

The overall conclusions from this analysis are as follows.²

- Increasing trade with France is unlikely to deliver *significant overall* economic benefits to the Island. It is not a panacea that would deal with the relatively high prices on the Island, the relatively high cost of freight transport, or any more general competition issues that might exist in Jersey.
- This does not imply that there are no economic benefits, just that they are more likely to take the form of significant benefits for individual importers or exporters that can take advantage of a more frequent freight ferry service to France (provided the service were priced at a level that reflected reasonably high capacity utilisation.)
- There may be some market failures relating to the start-up problems of creating a new, frequent, freight service to France, but these are unlikely to be severe. If there are significant economic benefits from increasing trade with France, the market should be willing to provide the freight services required. Targeted and time-limited intervention may be justifiable to overcome the start-up problems, but permanent intervention is unlikely to be economically efficient, and may actually make the Island worse off.
- It may be that the existing trading flows are optimal, even if there are some potential market failures in the provision of a frequent freight service to France. Under these circumstances the market will not provide such a service, but this is the most efficient outcome for the Island (although not necessarily for all individuals in Jersey).
- Policies designed to increase trade with France could result in the Island having a stable, but (slightly) less efficient, transport network. However, the maximum potential level of inefficiency is quite small. The risks involved in seeking to overcome any start-up market failures are therefore minimal, but with the caveat that such an approach may well be unsuccessful (in terms of creating a sustainable freight ferry service).

Lack of information on the *potential* opportunities for increasing trade to or from France appears to be one of the limiting factors of the existing trade, even within the current freight transport services. Ensuring that the potential benefits are understood will help create a market where the private sector could both exploit those opportunities and help minimise the ‘chicken-and-egg’ problem that currently exists with regard to any new ferry service to France (discussed below).

In addition, there are strong reasons to believe that the potential to increase trade with France is limited, at least in the short to medium term. The factors that lead to this conclusion include:

- the UK retail focus, particularly with respect to national chains (eg, Boots, Marks & Spencer, etc), where Jersey is essentially a (slightly) remote extension of the UK supply chain—these retail outlets are unlikely to switch to France as a sourcing location. To alter sourcing patterns in this part of the market would require changing the retail outlet (to a French chain);

² The analysis presented in this study has made some simplifying assumptions throughout. The configurations modelled also focused on the current links to St Malo, rather than any future links to Cherbourg, which might change the analysis. In theory, the unit freight costs would be higher in transition, since Cherbourg is further from Jersey than St Malo, which affects both fuel costs and the flexibility of scheduling. However, a new Cherbourg service might involve the redirection of a portion of UK-origin freight, and so may overcome some of the additional barriers posed by UK distribution hubs.

- the spillover effects from UK targeted advertising which includes Jersey consumers—national newspapers, magazines, national TV and radio. The same spillover effects do not arise with respect to national French advertising;
- the issues of language and labelling (and instructions), which tie Jersey consumption into UK-based distributions systems and which may make French-sourced alternatives less than perfect substitutes, even when the underlying product is identical;
- economies of scale in sourcing for retailers, which may limit the advantages that Jersey retailers could obtain from tapping into French-sourced material if they continue to have a UK sourcing capability as well (which is likely, given the other market conditions).

These conclusions have a number of implications for the development of economic policy.

- Any intervention on overall economic grounds needs to be well targeted at specific market failures. These include potential information and coordination failures with respect to the possibility for increased trade with France and the short-term problem of obtaining a critical mass of users of any service.
- The tools available to mitigate these potential market failures include the provision of information to potential traders and acting as the coordinator of the private sector demand to tackle coordination failures. The Maison de Jersey, based in Caen, and the French networking organisation Oxera spoke to have been instrumental in reducing barriers relating to information and coordination. The States of Jersey could work more closely with such businesses to provide more comprehensive information on the Jersey market, and to explore partnering opportunities in the Island.
- There is no general economic case for government intervention to sustain a freight ferry service to France. If any market failures exist in the provision of the ferry, they exist only in the time-limited start-up phase.
- There may be some justification for more direct intervention in relation to overcoming the critical mass problem with a new freight ferry service, particularly if there is a threat of strategic entry by a competitor once the critical mass of users has been built up. However, while a time-limited subsidy would be one option for overcoming the strategic entry problem, granting a time-limited monopoly for any new frequent service would be a less-interventionist alternative.
- Demonstrating that there are sufficient potential benefits from increasing trade with France to make a new frequent freight service viable may also be a more effective way of overcoming the need to demonstrate reliability and long-term commitment to the route where potential users are reluctant to commit their own investment to change their trading patterns. Government subsidy under these circumstances is potentially a double-edged sword, as it may just re-enforce the view that the service will cease once the subsidy is withdrawn, rather than demonstrate long-term commitment to the service.
- If the route is only just viable after the start-up phase, there is likely to be a more definitive need for a direct subsidy. However, in such circumstances, the economic benefits of increased trade with France are themselves likely to be minimal at best, and there is therefore a significant risk that such intervention will be unsuccessful.
- Notwithstanding the conclusion on the need for direct intervention, there is minimal risk to the Jersey economy if an external subsidy is provided to facilitate the creation of a new freight service to France, unless large amounts of capacity are to be provided at a sufficiently low price to cause a significant shift away from the existing UK route. Under these circumstances, the economic justification for the existing capacity levels on the route to the UK might come into question and some capacity could be withdrawn. If the service to France is subsequently curtailed when the subsidy is withdrawn, the supply to

the Island may be at risk if the capacity cannot be restored easily to the UK route. However, such an intervention is likely to be expensive and unnecessary to overcome any market failures that might exist. The economics of any new route based on an external subsidy would need to be examined carefully to assess the most likely outcome.

The final implications for policy relate to the issues that have been raised, but which are outside the remit of this analysis. Of particular relevance are a number of the expected benefits from increased trade with France that actually relate to addressing other potential issues in the Jersey economy. The problems identified are mainly in relation to the state of competition in both the retail market and the provision of existing freight ferry services. To the extent that these problems exist, they should be addressed directly and not through policy on trade with France. If this involves removing barriers to entry, it may well help to facilitate more trade with France.

Finally, the lack of a significant economic benefit to increased trade with France does not mean that there may be other, non-economic, benefits. In any final decision on policy, these other factors will need to be taken into account.

3 Current trade patterns and approach to investigating the issue

There is an apparent anomaly with the existing trading patterns of Jersey. Once differences in consumption taxes are taken into account, prices of goods in Jersey are generally higher than in the UK. One explanation is the additional costs incurred in transporting goods from the UK, which are incorporated into Jersey prices. Previous Oxera reports, and the explanation from grocery retailers during the interviews undertaken for this study, indicate that increased transport costs do feed through into higher selling prices.³ Although France is much closer than the UK, and as a result transport costs to France would be expected to be considerably lower, at present over 90% of goods transported into Jersey arrive from (or via) the UK.⁴

In addition, many Jersey residents' direct experience of France as a place to buy food, wine, etc, is that prices are no higher than the UK (and may be lower) and that some goods (wine, cheese, fresh vegetables, etc) are better quality. An obvious conclusion is that by increasing trade with France, the transport costs facing the Island could be reduced, quality might improve and prices in the shops might fall.

However, the underlying economics of Jersey's trading patterns are more complicated than this. In particular, there is a complex interaction between trading patterns and the transport infrastructure. As would be expected, the current split of freight traffic of 90% from the UK and 10% from France is underpinned by the frequent (twice a day) and regular (six days per week) conventional freight ferry services between the UK and the Channel Islands. By contrast, France is also served by a weekly conventional freight ferry service and a more frequent fast ferry passenger service, which carries only small amounts of light freight.⁵ As a result, it may be that the trade flows are determined by the existing ferry transport network rather than the transport network responding to the underlying economic demands of the Island. In particular, in this vision of the Jersey economy, there is a demand for frequent freight services from France and, if these services were provided, the Jersey economy could tap into the better quality, lower-priced goods that are apparently available in France (as well as potentially increasing its exports to France) and reduce the transport costs of its imports (and exports).

If this is the case then aligning the transport network to the underlying needs of the Island would provide economic benefits.

However, an alternative view is that the transport network does actually reflect the underlying demand patterns of the economy and that, although there may be specific individual opportunities for benefits to arise from increased trade with France, there are no (or few) overall benefits that would arise from a different trading pattern. In this view of the economy there are good economic reasons why the trading pattern is as it is and which go beyond the direct impact of the current transport network. In other words, the lack of a *frequent* freight ferry service to France arises because even the total *potential* demand is insufficient to make such a service economically viable.

³ Oxera (2001), 'Fuel Prices in Jersey: A Report to the Industries Committee of the States of Jersey, October; Oxera (2002), Industries Committee of the States of Jersey Fuel Prices: Updated Analysis, March; and Experian (2005), 'Assessment of Jersey's Retail Sector', June, p. 100.

⁴ Information from Condor Ferries.

⁵ Until recently, two operators provided this service. In May 2006, the Emeraude service was officially discontinued.

3.1 Approach to investigating the issue

To explore this issue in detail and to establish the boundaries of the likely benefits (and, indeed, costs), Oxera has:

- constructed a number of hypothetical outcomes of increased trade with France using data where available and assumptions where not. This has focused on examining the unit ferry costs of increasing services to France and the impact on the price of goods, and the costs of sourcing goods from France compared with the UK;⁶
- examined, through a series of interviews, the practical opportunities from, and barriers to, potential increased trade. In total, Oxera spoke to more than 30 stakeholders, including eight businesses in Jersey, three ferry companies, ten businesses in Normandy, three Chambers of Commerce, political representatives on the Island and in France, and others. Overall, 90 people in total were consulted in undertaking this research.

The objective is to establish how economic benefits to the Island would arise, the maximum theoretical benefits that might arise, and the practical limits to these benefits once other characteristics of the Island are taken into account.

3.2 Jersey's economy and trade flows

Jersey is a relatively small island economy, which is highly specialised. International banking services make up a large part of the economy, and are the main export. As these exports are services, their demand for freight ferry services is minimal. There are some exports of goods—in particular, potatoes and shellfish—but their volume is relatively limited. In contrast, the Island has only a small manufacturing sector and its agricultural base for on-Island consumption is also limited. Imports of goods, including fresh food, are high. As a result, Jersey has an asymmetric flow of freight, almost all of which is into the Island.

This pattern of asymmetric flow is unlikely to change, at least over the short to medium term. As a result, the total level of demand for freight ferry services will be determined by the total level of consumption in Jersey.⁷ This consumption level is likely to rise with any growth of the economy, but it is unlikely that increasing the volume of trade with France would lead on its own to a significant escalation in the total volume of imports per se; however, if it generated a modest cost saving, it would still be conducive to economic growth.⁸ It is therefore likely that any *increase* in the volume of trade with France would involve, at least in part, a corresponding *reduction* in the volume of trade with the UK.

In the first approximation and in a static world, the Island of Jersey has fixed total demand for ferry freight services. As a simplification, the main implication of this is that significant *increases* in trade with France would result in a corresponding *reduction* in trade with the UK. In economic terms, trade with France is largely a substitute for trade with the UK, not a complement.

In addition, the total costs of the freight services are likely to be paid for within the Jersey economy. Prices of imports to Jersey are likely to reflect the additional costs of transport to

⁶ These assumptions are based on extensive interviews with those directly involved in the provision and use of freight ferry services (between the UK and Jersey, and between France and Jersey) where data is unavailable.

⁷ There is some impact on the total level of demand from the fulfilment industry, which in general imports material in bulk for immediate export in small packets. However, the assumption has been made that this industry will not require a significant amount of additional freight ferry capacity to be provided. For more information, see Oxera (2006), 'Increased trade with France: what are the potential benefits and barriers?: Technical Report', June, available at www.gov.je.

⁸ For example, if an additional 20% of all goods were imported from France (increasing the total trade volume share to around 30%) and these goods were 10% cheaper, and if the money saved were spent on more goods, the total increase in import volumes would be only 2%. If the goods are the same price, but better quality, there is no increase in volumes.

the Island, and exports tend to compete with non-Jersey-based alternatives, so the price paid by exporters does not vary if Jersey-specific transport costs change.⁹ As a result, the total freight ferry costs that the economy pays for will approximate the total cost of all the freight ferry costs incurred in supplying the Island. If increasing trade with France involves increasing the total costs of freight ferry services—for example, by requiring the use of an additional ferry—the total that Jersey residents have to pay will increase. If the advantage that the Island gains from increased trade with France is greater than any increase in transport costs, Jersey will be better off, notwithstanding that total transport costs will be higher.

Increasing trade with France is, therefore, not necessarily a costless exercise. If the benefits *do not* outweigh any additional ferry costs, the Island could face higher total costs for imports.

⁹ Exporters of Jersey goods (eg, shellfish or potatoes) will tend to be price-takers, not price-setters.

4 Principal potential benefits from increased trade with France

Within this framework, the main *economic* benefits that could arise from increased trade with France are a reduction in transport costs, reflecting the difference in distance, and a reduction in sourcing costs (or increase in quality at the same price), if these exist. Many of the interviews reflected these two sources of potential benefit, although interviewees saw the prices they are charged for freight services as being the issue, rather than the costs facing the ferry companies. (This issue of prices, rather than costs, is explored in more detail below, as it raises questions as to whether some of the problems perceived with the current transport network arise owing to the origin—France versus the UK—or from the underlying cost structure of providing freight ferry services to the Island.)

The interviewees cited the following principal potential benefits from increased trade with France:

- more opportunities to source from both France and the European markets more generally (including dealing directly with manufacturers and point-to-point trade);
- lower perceived prices;
- higher perceived quality, and the further export opportunities that might be forthcoming (such as recycled waste and export of shellfish).

This study focuses primarily on two principal potential benefits of switching trade to France that can be readily quantified:

- *unit ferry freight costs*—the unit costs of transporting to the Island (ie, the ferry costs per trailer volumes of freight carried) may be cheaper because France is nearer. Ultimately, it is changes in these unit ferry freight costs that will be reflected in the prices that residents pay;
- *France sourcing costs*—sourcing of goods in France may be cheaper, which might be revealed through lower wholesale costs/prices (or retail costs/prices as a proxy).

4.1 Ferry costs¹⁰

The current ferry freight transport network achieves a twice-daily service to the UK and a weekly service to France essentially using two boats. A pattern that reversed this flow—twice a day to France and once a week to the UK—would provide the same overall capacity for the Island, and could be undertaken with the same number of boats. Because France is closer, it may also be possible to provide the same transport capacity with one, rather than two, boats.

Analysing these hypothetical patterns isolates the impact of the differences in distances between the UK and France. Based on an analysis of data and simplifying assumptions, in the extreme reversal of trade flows with the UK representing only 10% of volume and France taking 90% (a UK 10/France 90 scenario), there may be savings in freight ferry costs of between 15% (£2m pa) and 44% (£5m pa) to the Jersey economy, relative to the current situation. These savings arise from:

- the direct effects of distance on freight ferry costs (in terms of fuel savings);

¹⁰ The full analysis of the likely changes in total ferry freight costs is set out in the technical report.

- the indirect effects, in terms of scheduling and a reduction in the number of boats required. These are likely to be more important factors in achieving potential savings.

However, the maximum estimated amount of possible savings, of £5m, is based on an absolute minimum cost solution and potentially increases the disruption risks facing the Island as only one boat is involved in taking the roll-on, roll-off (RO-RO) freight between both the UK and France. In practice, a breakdown of the ferry could cause problems very rapidly. Moreover, notwithstanding the distance advantage of France, it is not entirely clear that a single-boat frequent France service could serve the Island at these high levels of trade flow to France.

If the single-boat operation is not possible, or represents an outcome with too high a potential disruption risk to the Island, the maximum ferry freight cost savings from switching trade to France become more limited—to around £2m per annum savings from fuel costs. Although any level of savings is potentially of benefit to the Jersey economy, it is limited compared with the size of the overall economy, and savings of this magnitude are unlikely to have significant second-round effects on the economy.

The total level of savings is limited because the costs of operating the ferries are only partly dependent on the distance. Table 4.1 sets out the main cost categories and their approximate magnitude for switching operations between the UK and France.

Table 4.1 Frequent freight ferry costs for UK–Jersey versus France–Jersey routes (£m cost pa and % of total cost)

Cost category	Channel Islands– Portsmouth		Channel Islands– St Malo		Difference between UK and France		
	Scenario	Two-boat operation	Two-boat operation	Two boats Portsmouth versus two boats St Malo			
Operating cost and periodic maintenance		4.1	37%	4.1	44%	0	
Capital costs		2.7	22%	2.7	29%	0	
Voyage cost—port cost		1.4	13%	1.4	15%	0	
Voyage cost—fuel cost		2.9	26%	1.2	13%	1.7	59%
Total cost		11.1	100%	9.4	100%	1.7	15%

Note: Figures may not add up due to rounding.

Source: Industry source for generic cost information on operating a ship from St Malo; Oxera calculations.

As can be seen, the level of cost savings that arise if two boats continue to be necessary is rather modest—around 15%—from a complete switching of the freight ferry transport network. In addition, ferry costs account for only a small portion of the total cost of goods on the current UK route. The overall reduction in the price of ferry-imported goods and hence the benefit to the Jersey economy might only be 1%, or a maximum of 2% if one boat can be used.

4.2 Sourcing costs

As even the maximum savings in ferry transport costs arising from increasing trade with France are likely to be modest, if significant advantages are to be gained these will need to

arise outside the difference in ferry transport costs. The other main area of cost savings is sourcing costs (wholesale prices plus the non-ferry costs incurred by the retailer).¹¹

Sourcing costs can be cheaper in France if the wholesale price of the required goods is lower or if the transaction costs incurred by the (Jersey) retailer are lower.

However, the evidence on whether sourcing prices in France are lower than in the UK is mixed. Studies of supplier prices tend to be beset with difficulties regarding finding like-for-like products, particularly for branded products.

- The UK Competition Commission concluded that there was little evidence of wholesale prices being systematically higher in the UK than elsewhere in Europe, and that exchange rate fluctuations between pounds sterling and the euro strongly influenced any comparisons.¹²
- Even for basic products, such as cement, direct price comparisons can be difficult because of differences in standards.¹³
- European Commission data shows that fruit and vegetable producer prices in France are lower than in the UK.¹⁴
- A recent publication by Gardiner & Theobald shows that supplier prices for a variety of building materials are actually higher in France than in the UK.¹⁵
- Retail price comparisons and higher-level price indices provide a second-best to sourcing cost information. These reveal that France may be cheaper than the UK by up to 10%; however, based on the evidence reviewed, the actual figure is likely to be lower than this.¹⁶

Thus, in total, the overall hypothetical savings to the Jersey economy stemming from totally switching the current demand pattern such that most trade is undertaken with France might be up to 10%, although the average figure across any significant range of goods is likely to be lower, and is dependent on the £/€ exchange rate

In addition, a considerable proportion of goods currently demanded in Jersey, such as branded goods, are not equally available through the French wholesale distribution system, although they may share the basic characteristics. An example is electrical goods where the basic product may be identical, but the plug and possibly instruction on the French version may be different from that from the UK distribution system.

As a result, the maximum savings available from switching the transport network to focus on France are likely to be rather modest, notwithstanding that this pattern would minimise total

¹¹ For the purposes of this Summary Report, the concept of 'cost savings' in sourcing includes the outcome where the wholesale prices are the same, or even higher, but quality is higher, such that, from the retail customer's perspective, value for money is higher.

¹² Competition Commission (2000), 'Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom', October.

¹³ Source: Interview with building supplies business.

¹⁴ Directorate-General for Agriculture; Oxera calculations.

¹⁵ Gardiner & Theobald, 'International Construction Cost Survey', data for 2004. See: <http://www.gardiner.com/Economics/images/IntCst04gbp.pdf>

¹⁶ Competition Commission (2000), 'Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom', October. ACNielsen (2005), 'Breaking news press release for Euro Price Barometer', September; Oxera calculations. ACNielsen (2000), 'A Report into International Price Comparisons', prepared for the Department of Trade and Industry, February, and Oxera analysis of data published in the report. Economist Intelligence Unit (2001), 'International price comparisons, A survey of branded consumer goods in France, Germany, Sweden, the UK and the US', a report for the UK Department of Trade and Industry and the Swedish Ministry for Foreign Affairs. Eurostat (2004), 'Eating, drinking, smoking—comparative price levels in EU, EFTA and Candidate Countries for 2003', 30.

ferry transport costs. In addition, for reasons set out in more detail below, this level of switching in underlying demand may not be feasible. More realistically, therefore, the maximum switching of trade to France is likely to be considerably short of 90%. What happens under these circumstances is explored next.

4.3 What happens when trade patterns only alter ‘slightly’?

The *maximum* level of savings from transport costs (of £5m) is only possible if the trade patterns completely reverse, but this is unlikely to be achievable in practice.

Moreover, in the intermediate positions (eg, 70/30 or 50/50), the total transport costs facing the Island would, in most conceivable instances, be higher than at present. This arises because in the intermediate transport network position it is likely that more than two RO–RO ferries will be required to meet the required capacity on both the French and the UK routes. Notwithstanding this higher total ferry transport cost, the Island would still be better off if the benefits—in essence, the sourcing benefits—outweigh the additional total transport costs.

This raises two potential concerns:

- at the point at which the benefits from sourcing advantages are exhausted, the increase in total ferry transport costs is higher than the overall benefit from sourcing—so the Island as a whole is worse off. It is possible that the transport network might remain in such a position and not shift back to the previous position;
- there are overall benefits to be gained, so sourcing benefits outweigh additional ferry transport costs. However, market forces do not automatically provide the incentives and rewards for the transport network to provide the required ferry service for these benefits to be realised.

The potential for the above to occur is discussed in the next section.

5 Why might freight patterns not shift automatically?

In the presence of potential advantages to be gained from increasing trade with France and in the absence of 'market failures', market forces would be expected to result in an automatic adjustment of the freight ferry network to move towards the UK 10/France 90 position, and enable any potential benefits to be realised. However, two major factors that may impede this, in transition, are the nature of demand and the cost structure of freight ferry services.

5.1 Nature of demand

A regular weekly service to France is already available. If sourcing costs were significantly cheaper *and* the nature of the produce meant that a weekly frequency of delivery was efficient, there is no obvious transport problem that would need to be overcome for the Island to benefit from the lower sourcing costs. As a result, if further sourcing cost advantages are to be realised, it is likely that they would have to come from produce that requires either a frequent (eg, daily) service, or where retailers require an immediate response to any need for additional goods (eg, just-in-time supply chains). Both demand profiles can be met by a frequent and regular service.

The evidence available on the overall differences in sourcing costs suggests that sourcing cost advantages will vary through time (if for no other reason than changes in the £/€ exchange rate), and will apply to a limited range of goods. The maximum theoretical advantage that the Island could gain from differences in sourcing costs would be through selective sourcing of goods in the wholesale market.

However, even with such a ferry service, this selective sourcing may not be realistic, at least for many Jersey retailers. The current sourcing supply networks (and freight ferry services that underpin them) enable many Jersey businesses to source reliably, at regular intervals, a large range, in either small or large quantities, of UK-standard and UK-market-oriented goods. Retailers have supply systems which are themselves integrated back into UK-based systems. In extremis, the Jersey outlets of UK chains are essentially offshore extensions of a completely integrated UK-based supply infrastructure, and these outlets may not be able to source independently from France, no matter how advantageous the sourcing costs. Even where retailers do have a choice, those benefiting from existing UK distribution hubs and long-term relationships are unlikely to selectively source more from France, even if a frequent ferry service were offered. If they did, they could lose supply stability, or forgo economies of scale in sourcing enjoyed through buyer representation.

In addition, the ability of individual importers to source selectively from both the UK and France may be limited by their own cost structure and the nature of their relationships with their (current) UK supplier(s). Some may face an all-or-nothing decision, which means that even if some goods are cheaper in France, Jersey retailers may not be able to exploit these opportunities because they would also have to source other goods that may be no cheaper, or even more expensive, than the UK. Any significant realisable sourcing cost advantage may need to come from an overall cost differential, not from selective price differences on individual items.

In practice, a significant proportion of demand in Jersey may be tied to a single wholesale hub, which would have to be either in France or in the UK. The ability to split demand between the two countries in order to exploit wholesale price differentials may, therefore, be limited. The implication of this is that the maximum *realisable* wholesale cost savings for the Island may be significantly below the theoretical maximum, even if there were frequent ferry services to both the UK and France.

5.2 Nature of freight ferry costs¹⁷

In most situations, the addition of a frequent freight ferry to France will require the use of at least one additional boat. If the split of the total trade were close to 50/50 between France and the UK, it might just be possible to operate the transport structure with two boats—one on each route. Similarly, in the complete reversal—10/90—again only two boats (and possibly even only one) would be required (but there would not be a frequent freight ferry service from the UK).

Even with balanced flows to the UK and France, two boats might not be enough to provide the resilience of service required by Jersey businesses. For the reasons outlined above, trade flows on an individual-business basis are likely to be either specialised (selective sourcing) or each retailer may have a single supply arrangement covering all, or most, of their requirements. In either case, from the retailer's perspective, the freight routes to the UK and France may not be substitutable in the short term. Hence when there is disruption of the route (for example, mechanical breakdown of the ferry), the continued operation of the service on the other route may not provide retailers with any real resilience. In the very short term, they could not obtain substitute goods from the other country.

In general, therefore, in all positions between 10/90 and 90/10, more than two ferries would be required—at least three, and possibly four—to enable high levels of service resilience on both routes. Most outcomes therefore result in higher total ferry transport costs for the Island.

In addition, because the initiation of a new service to France is likely to require a frequent service to tap into new demand (as the current weekly service is generally not full), the new operation is likely to have fairly high fixed costs right from the start. Unit costs, and therefore sustainable unit prices, will depend on capacity utilisation. In the early stages of such a service, capacity utilisation may be low because even if there are substantial sourcing cost savings to be gained, it may take time for Jersey retailers to switch. As a result, it may be difficult for a new entrant to build up demand incrementally. This presents a chicken-and-egg problem to potential users of the service. No one user would want to be the first to use the new service unless their own demand was particularly high. There is a further problem that a potential ferry operator might face: even if there is demand, if existing Jersey retailers would incur some *additional* costs in making the change from UK to French sourcing, they may be reluctant to change if they have any concerns that the service might be short-lived. Should the service cease after they have incurred the switching costs, they would face an additional round of costs in switching back to UK sourcing. If this prospect makes a sufficiently large number of potential users hold back, even if only to see whether the service looks like it will remain in business, then its failure may become a self-fulfilling prophecy.

The entrant may, therefore, face a problem of attracting a critical mass of users over a sufficiently short period of time to be able to demonstrate the long-term viability of the service, even if the economic conditions to create a sufficient underlying demand are present. Nevertheless:

- the greater the sourcing cost savings that are available, and the greater the ferry cost savings that could be achieved in the extreme position of UK 10/France 90, the lower the additional costs that the Jersey economy would have to incur in the transition;
- the greater the sourcing cost savings, the smaller the quantity of trade that needs to source from France to make the new service viable. In essence, with large sourcing cost

¹⁷ To meet any demand, it is likely that any new ferry service would need to be frequent. A weekly service to St Malo already exists, which is not full and has the benefit of having its fixed costs largely paid for by the frequent UK service. This suggests that there is no significant unmet demand for infrequent services to France. Many importers and retailers in Jersey import perishables, use just-in-time supply chain management, or value flexibility. On pure cost grounds, since most of the costs of operating a freight ferry service are fixed per week, it may make sense for a new operator to run a frequent service.

savings, the new service to France could charge relatively high prices, which would cover its costs even at relatively low capacity utilisation;

- a one-boat, one-rotation service is likely to be used on the France route while demand picks up, and this will help to abate the critical mass problem;
- most flows are currently one-way, into Jersey, and a more frequent link with France might provide opportunities for more exports from Jersey, reducing unit costs (and hence prices).

5.2.1 Additional mitigating factors

The analysis of the structure of freight ferry transport costs has been carried out on the basis that the type of vessel used is similar to those used on the northern route to the UK. The two vessels used are, in essence, the largest possible given the limitations of St Helier's harbour. As long as capacity utilisation is adequate, using larger boats produces a lower unit cost outcome. However, where capacity utilisation is low there are (limited) cost savings to be made by using a smaller boat (and hence increasing the capacity utilisation of that boat).

In particular during any start-up phase, the capacity utilisation of a frequent freight service to France using a boat of a similar size to that used on the route to the UK is likely to be low. Within the capacity constraint of any smaller boat, the impact of using a smaller boat is to reduce (slightly) the total additional freight ferry costs that have to be paid for by the Island, and to reduce (slightly) the critical mass of users needed to achieve an economically sustainable service. As a result, the problems that relate to the initial start-up phase are reduced slightly.

5.2.2 Stuck in the middle

The economic interests of individual retailers/importers in Jersey with respect to where to source their imports and the total costs facing the Island (as a result of the totality of sourcing costs and the totality of freight ferry costs) are not necessarily aligned, even if the transitional problems of critical mass outlined above are overcome. This arises because the choice of the individual retailer to, say, switch their sourcing from the UK to France has the unintended consequence that the unit costs for those continuing to use the UK route would increase, while the average unit costs on the France route would fall. If the cost savings for the switcher are small, it may be that these savings are insufficient to cover the increased costs faced by those who do not switch.

Although this outcome may be unlikely if freight ferry services are left to the market, there is more of a possibility of this outcome if there is a period of subsidy of the service to France which results in switching to France under conditions where there is little, or no, sourcing cost advantage.¹⁸ When the subsidy is withdrawn, switching back to the UK does not take place (as there is little advantage in terms of sourcing costs) and the Island may get 'stuck' in a stable, but inefficient, freight ferry network.

Although a theoretical outcome, this stable, but inefficient, condition depends on the precise balance of ferry costs, ferry prices made available to importers (and exporters), the level and pattern of sourcing cost differentials, and the extent to which substitution of sourcing locations can take place. While possible, it is unlikely that the underlying demand pattern and constraints of Jersey would conform to these precise conditions.

Absent these precise conditions, the operation of a frequent service to France is likely to be viable only if the savings to the Island are positive. If viable, the service will stabilise at a level

¹⁸ Indeed, if anything, the opposite will be the case—the transport network does not adjust to enable real cost savings to be made.

reflecting the economic advantages of increased trade with France, and if not viable, it will cease and trade will return to its current pattern. Apart from the potential disruption costs facing the users in the transition (see below), the economy would settle back into its former transport pattern.

5.3 Practical issues: further potential barriers

The analysis set out above has been based on a rather simplistic view of what would determine freight flows: essentially sourcing costs and ferry costs. However, in reality there are likely to be a number of additional, and quite complex, barriers that may restrict the total volume of increased trade with France, even if, on paper, there are apparent economic benefits arising from lower transport or sourcing costs. These are likely to restrict the maximum proportion of total trade that could be sourced directly from France (or the rest of Europe excluding the UK). The factors considered significant by interviewees, include the following.

- *Culture*—Jersey leans heavily towards UK influences, limiting the potential for increasing the demand for French goods. There are complex interactions between the Island’s modern history, its language, its culture (including UK-influenced business practices), and its core demand profile (which in turn is affected by UK advertising). Marketing costs, in particular with respect to outlets of UK chains, to reach potential Jersey customers may be close to zero for national magazine and newspaper advertising. A French chain with an outlet in Jersey and advertised in the French national newspapers or magazines would not benefit in the same way, because readership of these publications in Jersey would be significantly lower. The same kind of effect could arise with respect to manufacturing brand advertising where specific promotions are concerned, as these are likely to be coordinated through the supply chain.
- *Standards and labelling*—although standards (and to a lesser extent, labelling) are tending to converge throughout Europe, there are still differences between countries. The UK version may not be exactly the same as the French version, and labelling may only be easily available in the source country’s language. These issues may not affect all goods sourced; for example, a number of respondents suggested that labelling and standards would be less of a problem for basic goods, fresh produce, niche products and capital equipment. However, if the French sourcing of these goods required either the sourcing of UK-standard goods or the re-labelling of goods with English labels, this would tend to reduce any apparent sourcing cost advantages.
- *Distribution hubs*—as has already been described, one of the main barriers to increasing trade with France, even in the presence of apparently lower sourcing costs for some goods, concerns the *distribution hubs* of the main wholesalers and manufacturers serving the Island, which may lock Jersey retailers into the UK distribution structure. In addition, some manufacturers may treat Jersey as an extension of the mainland distribution system such that the additional transport costs to Jersey are absorbed in a UK-wide uniform wholesale price. Although sourcing cost differentials would still make an impact, under these circumstances lower transport costs would not feature in the decisions of the Jersey-based retailer.
- *Working relationships (and language)*—relationships up and down the supply chain tend to be more complex than simple buying and selling of goods. These relationships tend to be valued, and *information flows* facilitated by these relationships are seen as providing a useful service. Reproducing these relationships in the French supply chain is possible (and has been done by Jersey retailers), but the lack of a common language and business cultural background may inhibit the development of such relationships. In turn, this may restrict the number of Jersey businesses that would be willing to substitute a UK supply chain with a French one, even if sourcing costs were lower.

- *Exchange rate risk*—from the point of view of Jersey businesses, depending on the £/€ exchange rate, the relative competitiveness of goods imported from the UK and France may vary considerably. While Jersey businesses may protect themselves against exchange rate risks by hedging their currency exposure, overall hedging measures add to the cost of conducting business. Thus, conducting business within the sterling common currency trading area is likely to offer financial benefits for Jersey businesses, which would need to be offset by (additional) sourcing or transport cost benefits.
- *Chicken and egg*—the chicken-and-egg problem arises not only in relation to the nature of ferry costs, but also *information*. In the presence of uncertainty, users want to see a service prior to committing to use it, whereas an operator wants to see the demand. No consensus emerged on which should come first.
- *Limited demand from larger businesses*—Oxera asked companies whether they would source more if a frequent service from France were provided. While medium to large retailers might not significantly increase trade with France if a frequent service were launched, smaller businesses, with more flexibility, might, although the extent to which they would do so is unclear. French businesses in Normandy were also interviewed, but these were at a very early stage in assessing the possibility of exporting to Jersey.

All these factors suggest that, even if there were no difference in the price and frequency of freight services to the UK and France, there is a limit on how much trade would switch, even in the presence of sourcing cost advantages. In practice, therefore, not all sourcing cost advantages are likely to be realised, even under the best conditions. This is likely to reduce the total economic advantage that is, in practice, available to the Island from increasing trade with France.

The interviews reveal that, given the many additional barriers to trade (cultural factors, demand, distribution hubs, etc), *switching trade such that 90% of this occurs with France is unrealistic—indeed, 50% may be unrealistic within plausible wholesale cost differentials.*¹⁹ Therefore, the point at which no additional trade switches to France is likely to involve (at least) three boats in total (two on the UK route and one on the France route). Even if it were feasible for Condor to reduce its service to one UK boat, this would be unlikely to occur before the 50% point. Thus, rather counter-intuitively, although France is considerably closer to Jersey than the UK, any practical form of increased trade with France is likely to *increase* total expenditure on freight ferry services, rather than *reduce* it.

¹⁹ If UK wholesale prices were very much higher than those in France, this would induce increased trade from France to the UK, which would then come into Jersey through Southampton.

6 Further considerations

6.1 Can sourcing costs overcome the freight cost barrier?

Thus, whether Jersey is worse off depends crucially on whether sourcing costs are lower in France, and the extent to which these savings outweigh increased ferry costs, and on the exact point at which no additional trade switches to France due to the presence of the other barriers revealed in the interviews. In general, the higher the potential sourcing savings, the less amount of trade that needs to switch to France in order for Jersey to be better off.

The analysis undertaken suggests that sourcing prices over a reasonable range of products could be up to 10% lower in France than in the UK. Assuming that, for a reasonably utilised service, freight ferry costs are a small component of total goods costs and that a frequent France service could adopt a one-boat operation (such that Jersey were served by two UK boats and one France boat), trade with France would need to increase from just less than 10% (at present) to around 30% in order for Jersey to be better off. This would involve switching to France around 20% of the trade that currently goes to the UK.

Since the critical mass point for an entrant establishing a new frequent service from France may be fairly low, there may not be a particular problem in respect of market forces facilitating increased trade with France, provided that a few key players used the service to begin with.

Realistically, the maximum savings that the Island could gain is around 2%²⁰ to 4%²¹ of total imported goods costs, if trade with France increases to 50%. However, as noted above, the point at which trade no longer switches due to the additional barriers is likely to arise before this.

As indicated above, Jersey could become locked into a freight ferry network that is stable, but represents a worse position than the current 90/10 network. As indicated, the conditions under which this outcome arises are rather narrow. However, if it did arise, the disadvantage to Jersey would be quite small—the costs of an additional boat would be incurred, but this would be offset somewhat by sourcing cost advantages. Overall, the cost of this outcome would be around 1% of the costs of ferry-imported goods if trade with France stalled at 20% of total trade. This limited downside suggests that there would appear to be few risks, in terms of the overall unit costs to Jersey, in permitting a frequent service to France to be launched.

6.2 Temporary transitional factors

The above analysis concentrated on the issue of frequent freight ferry transport links to France, and what, if anything, might inhibit their provision by the market if the real economic demand made such a transport link viable. The overall conclusion of the analysis is that if there are market failures in the provision of such services, they are limited. However, in conducting the research for this project, it became apparent that, in addition to issues of transport links, a number of other barriers would need to be overcome if any benefits from increasing trade with France were to be realised. These issues have been touched upon with

²⁰ This assumes that 50% of goods are available in France at a discount of 10% to their UK price, and that three boats are required at this point.

²¹ This assumes that 50% of goods are available in France at a discount of 10% to their UK price, and that one boat undertaking one rotation on each route provides sufficient security of supply for the Island at this point (ie, that Condor would be able to reduce its UK service to one boat).

respect to the demand for transport services, but they also exist outside that direct framework.

In particular, there appears to be a significant lack of relevant information with respect to the *potential* demand in Jersey for what France could offer, both at a general level and with respect to specific opportunities for certain French suppliers or Jersey importers. The information on what might be possible seemed to be rather lacking, although some of the initiatives currently being undertaken by both Jersey and France were helping in this regard.

In addition, some issues outlined in the section on other potential barriers *could* also be temporary. This would apply particularly with respect to factors such language barriers and understanding the processes needed to successfully trade with France. Again, some of the existing initiatives are addressing these kinds of issue.

In addition, if the economic conditions with respect to sourcing costs are met, it would be expected that individuals in either France or Jersey would have the skills or knowledge to mitigate these more general problems. Given that only a relatively small number of parties need these characteristics to be able to exploit the market opportunities, competition should then ensure that the available economic advantages are met.

6.3 Jersey, Guernsey and the Channel Islands

The analysis set out above of the economics of freight ferry services has been based on the assumption that the service to the UK is continued in conjunction with services between the UK and Guernsey. This is how the service is currently operated, and Jersey and Guernsey each have a service-level agreement that includes aspects of this freight service. The weekly service to France (St Malo) is also run as a joint service between both Guernsey and Jersey and France.

The analysis of the potential frequent service to France has also been based on the assumption that it is a joint service serving both Jersey and Guernsey. The assumption has been made that conditions are sufficiently similar in Jersey and Guernsey to mean that if a frequent service to France were to be operated, it would operate as a triangle service.

However, it could be envisaged that a frequent service to France might be launched that served only Jersey. This would have a number of implications.

- To obtain the same level of capacity utilisation only from Jersey traffic would require higher proportions of trade to be switched. As Guernsey has a population of approximately two-thirds of Jersey, at a first approximation, trade switching would need to be scaled up by a factor of 1.75 to reach the same level of demand (eg, 30% of combined traffic is broadly equivalent to 50% of Jersey-only traffic).
- The route distance would be shorter, so the distance-variable costs of running the service would be lower. However, as this is a relatively small part of total costs, the impact on potential transport cost savings would be limited.
- It would be relatively easy to run one boat with two rotations just between Jersey and France.

7 Increasing trade with France and competition

The interviews, particularly in Jersey, revealed that some of the expectations of the advantages of increased trade with France arose from the expected impact on competition within the Island economy, rather than from increased trade with France per se. There were two areas where this kind of benefit was expected: competition in freight ferry transport and competition at the retail level in the Island.

It is beyond the scope of this study to establish whether there are competition problems at either the retail level or within the existing freight ferry transport network. However, even if these problems exist, measures to increase competition do not necessarily include changing the structure of trade, and policies designed to increase trade with France may not be the optimal way to tackle them. In particular:

- for the reasons set out above, it is unlikely that the majority of the trade flows to the UK would be displaced. Hence, if there are currently competition problems on that ferry route, these might well continue even if a frequent freight service to France becomes established and is sustainable. Direct intervention to address the issues on the route to the UK may be more likely to deliver improvements on that route;
- the level of competition in the local retail market is subject to many factors other than the non-existence of a frequent freight service to France. Existing land-use controls and controls on the establishment and operation of businesses may be having a significant impact on the level of competition. If they are then attempting to increase trade with France will not address these issues. However, if these issues were addressed, any competition benefits that arise would be likely irrespective of whether there is increased trade with France.

In addressing these issues, increased trade with France is neither a sufficient, nor a necessary, condition for improving competition at the retail level in Jersey or within the existing freight ferry transport network. Under these circumstances, directly addressing any underlying competition problems is likely to be more effective and may also help to encourage trade with France if it removes barriers to entry.

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