Oxera

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

Technical report prepared for The States of Jersey

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Executive summary

Objectives of the study

This study provides an independent analysis of the potential benefits of, and barriers to, increased trade between Jersey and France. 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.

Conclusions and policy implications

The overall conclusions from this analysis are as follows.[1]

– 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 in Jersey, 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

[1] 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.

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);

– 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.

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.[2] 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.[3]

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 a more frequent fast ferry passenger service, which carried only small amounts of light freight.[4] 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.

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:

[2] 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.

[3] Information from Condor Ferries.

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

– 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;[5]

– 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 in Jersey and in France, and others. Overall, Oxera has spoken to around 90 people in total 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.

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.[6] 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.[7] 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 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.[8] 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

[5] 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.

[6] 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.

[7] 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.

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

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.

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).

Ferry costs

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);

– 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 1 sets out the main cost categories and their approximate magnitude for switching operations between the UK and France.

Table 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.

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).[9]

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.[10]

– Even for basic products, such as cement, direct price comparisons can be difficult because of differences in standards.[11]

– European Commission data shows that fruit and vegetable producer prices in France are lower than in the UK. [12]

– 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.[13]

– 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. [14]

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 ferry transport costs. In addition, for reasons set out in more detail below, this level of

[9] For the purposes of this 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.

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

[11] Source: Interview with building supplies business.

[12] Directorate-General for Agriculture; Oxera calculations.

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

[14] Competition Commission (2000), op. cit. 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 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.

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.

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.

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.

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.

Nature of freight ferry costs[15]

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

[15] 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.

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 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).

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.

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.[16] 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 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.

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

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

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.[17] 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.

Further considerations

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%[18] to 4%[19] 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.

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

[17] 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.

[18] 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.

[19] 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).

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 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.

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.

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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1 Introduction

This study provides an independent analysis of the potential benefits of, and barriers to, increased trade with France. Since a large majority of goods are transported to Jersey via sea routes, and air transport is comparatively expensive for the majority of products, the focus in this study is solely on sea transport. However, 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.

The focus of this study is on the underlying costs of both ferry services and the sourcing of goods for the Jersey market. The reason for the focus on costs and not prices is that, in the long run, the economy of Jersey will have to pay for the costs of operating the ferry services that supply it, and the off-Island costs of the goods it consumes, if the economy is to be sustainable over the long term. As a result it is changes in the total of these costs that benefit (or not) the Island as a whole. In a competitive market, prices are set with respect to costs, so the overall change in prices as a result of changes in costs is captured, but without the complication of needing to take account of changes in the price structure. In addition, by concentrating on the underlying costs, it is possible to separate out the effects of ferry and sourcing cost changes from any competition issues which, if significant, may be more efficiently tackled in a different way.

At present, the vast majority of goods transported into Jersey arrive from (or via) the UK. The way in which existing trade patterns have emerged is a legacy of history—the trade links with the UK have been cemented over the centuries. A critical question is, therefore, whether this pattern of trade is optimal for the Jersey economy.

This technical report initially explores, from a commercial/economic perspective, what the benefits to Jersey of increased trade with France might be. Two obvious potential sources of benefit are that France is much nearer to Jersey than the UK, which might reduce freight ferry costs, and that it may also be cheaper to source goods from France than from the UK.

The report then considers how the nature of demand for freight ferry services, and the structure of ferry costs, might serve as a barrier to the realisation of such hypothetical benefits. Following this, other potential opportunities for increased trade with France, and other potential barriers, are examined. The latter include culture, language, standards, UK-oriented demand for goods, and the distribution hubs of businesses.

In exploring these issues, Oxera has undertaken extensive interviews in Jersey, in the UK and in France, speaking to more than 30 stakeholders, including eight businesses in Jersey, three ferry companies, ten businesses in Normandy, three Chambers of Commerce, political representatives in Jersey and in France, and others. Overall, 90 people in total were consulted in undertaking this research. These interviews have been invaluable for putting together a framework to explore whether market failures are likely to occur, and in obtaining a further understanding of the current situation and the main perceived opportunities and barriers (including whether businesses would use a frequent freight service to France if it were offered). Oxera is very grateful for the cooperation received.

1.1 Structure of the analysis

This technical report is structured as follows.

– Section 2 summarises current trade patterns between Jersey and the UK and France.

- Section 3 outlines the approach used in this study.

- Section 4 examines the benefits of increased trade with France given the available data, and presents a framework for examining whether market failures are likely to occur:

  - Section 4.1 explores the supply chain in serving Jersey, to explore where cost savings in sourcing from France versus the UK might emerge;

  - Having examined the cost characteristics of ferry services, section 4.2 focuses on potential savings associated with increased trade with or via France in respect of freight ferry costs, given the available data;

  - Section 4.3 then looks at what the available data reveals about the benefits associated with increased trade with or via France in respect of product sourcing costs;

  - Section 4.4 analyses the market failures that might arise in realising the potential benefits of increased trade with France *purely* from the perspective of freight ferry costs (assuming that sourcing costs between the UK and France are equal);

  - Section 4.5 considers how this picture of market failures changes when both the structure of freight ferry costs and potential sourcing cost savings are taken into account. **Some indications are provided regarding whether the States of Jersey needs to intervene in order to correct the market outcome**.

- Section 5 examines in more detail the lessons from the interviews and discussions undertaken for the study in Jersey, France and the UK with various parties.

  - Section 5.1 summarises the potential advantages of increased trade with France, as revealed in the interviews;

  - Section 5.2 sets out the reasons provided for the current balance of trade, and the perceived barriers to increasing trade with France;

  - Section 5.3 explores in more detail the sourcing patterns and frequency requirements of Jersey businesses, and how this affects the perceived balance between the potential opportunities to increase trade with France versus the barriers. Case studies are drawn upon, given the experiences of Jersey businesses. Cases of projects that, if they go ahead, could lead to increased trade with France, are also examined, including a proposed freight link to Cherbourg and the possible establishment of a French supermarket in Jersey;

  - Section 5.4 draws some conclusions on the limits to increased trade with France.

- Taking into account all the above lessons, section 6 then provides an assessment of the potential benefits of increased trade with France and whether market failures (or other barriers) impede this. **It provides some conclusions on whether, on balance, intervention by the States of Jersey could be justified on purely economic grounds**.

2 Current trade patterns and freight services: a summary

At present, over 90% of freight transported to Jersey comes from or via the UK, using the regular conventional freight ferry services from Portsmouth. The remainder comes from or via France, using the weekly conventional freight ferry service, and fast ferry passenger services (which carry only small amounts of light freight) services from St Malo. In 2004, approximately 7% of freight (and less than 10% of RO–RO freight) transported to Jersey arrived from or via France (see Table 2.1).[20]

Table 2.1 France imports and exports, 2004 (2004 prices)

Category	Imports (£)	Exports (£)
Building materials	2,614,731	
Alcohol	3,597,438	
Clothes	463,060	
Newsprint	657,317	
Furniture	236,974	
Agricultural & horticultural[1]	341,433	176,808
Dairy products	443,487	
Meat etc	600,210	
Fruit & vegetables	132,557	18,300
Fish & shellfish	143,243	2,838,648
Other food	689,835	
Water	118,926	
Perfume & pharmaceuticals	232,190	
Vehicles	1,159,599	
Scrap metal	–	99,150
Miscellaneous	1,300,703	29,941
Total	**12,731,703**	**3,162,847**

Notes: [1] The agricultural and horticultural category comprise cut flowers, flower bulbs and Jersey Royal potatoes.
Source: States of Jersey.

As shown in Table 2.1, as an island economy, Jersey imports far more from France than it exports to France (as is the case for the UK). With the exception of shellfish, exports to France are spread unevenly over the year. Single bulky consignments can also affect the figures significantly. It should be noted that imports from France are not necessarily sourced from France (similarly, products arriving from the UK are not necessarily sourced from the UK, and a portion of these are sourced from France). In addition, imports via France have decreased in recent years—total imports for 2004 were 19% lower than in 2002, and total exports were 24% lower.

The majority of freight is transported to Jersey via Condor Ferries' freight services, in particular its conventional RO–RO services (see Table 2.2).

[20] Source: Based on Condor Ferries figures. The 7% figure includes RO–RO and lift-on, lift-off (LO–LO) freight on the Northern (UK) route, and RO–RO and fast-ferry freight on the Southern (France) route.

Table 2.2 Freight ferry services to Jersey, 2005

Service operator	Origin–destination	Frequency	Type and carrying characteristics
Condor	Portsmouth–Jersey (and Guernsey)	6 times per week, twice a day	Conventional RO–RO slow ferry. Mainly driver-unaccompanied trailers (capacity for a few trucks with drivers), including temperature-controlled. Some LO–LO freight
Huelin Renouf	Portsmouth–Jersey (and Guernsey)	Three times a week	LO–LO slow freight ferry, excluding temperature controlled. Includes containers
Condor	St Malo–Jersey (and Guernsey)	Once a week (Sat.). Fitted around UK service	As per UK service
Condor	St Malo–Jersey (and Guernsey)	Daily	Fast catamaran. Mainly passenger service. Capacity to carry light freight only (eg, in vans and in small pods)
Emeraude[1]	St Malo–Jersey (and Guernsey)	Daily	Fast catamaran. Mainly passenger service. Capacity to carry light freight only (eg, in vans and in small pods)

Note: [1] This service was officially discontinued in May 2006.
Source: Portsmouth Harbour, Condor Ferries, Huelin Renouf, and Emeraude websites, and discussions with interviewees.

Condor carries the vast majority of freight. As shown in the table, while the Condor RO–RO and Huelin Renouf LO–LO services can carry heavy freight, the fast ferry services from France are predominantly passenger services, capable of carrying only light freight, including that transported by vans (either by owner-drivers or logistics companies) and small pods for perishables (handled by logistics companies). However, the Emeraude fast ferry services are capable of carrying somewhat heavier freight than the Condor fast ferry services. The nature of ferry services serving Jersey has changed over time. For example, Emeraude used to provide a more frequent RO–RO freight service from France.

Condor's RO–RO services operate six days per week, carrying mainly driver-unaccompanied freight (perishables and non-perishables) from the UK. Two boats are used, 12 hours apart, which serve the Channel Islands as a whole in a triangle (UK–Guernsey–Jersey–UK). One of the boats (Commodore Goodwill) travels every Saturday to St Malo, providing a weekly RO–RO service to France. For those requiring a frequent heavy freight service from France, Condor offers, through an agreement with Brittany Ferries, the option of importing to Portsmouth, and then using Condor's frequent RO–RO services to complete the remainder of the journey to Jersey. The Huelin Renoulf LO–LO service from Portsmouth operates three times a week, carrying approximately the same composition of freight as Condor, with the exception of temperature-controlled freight.

Serving Jersey (or rather the Channel Islands as a whole) poses particular logistical issues, which are discussed further in this report. Logistics companies forward, load and handle most freight on Condor's services. Condor Logistics, a subsidiary of Condor Group, operates on the Northern route, as does Ferryspeed, an independent logistics company. Morvan Fils, which is based in St Malo and is owned by Condor, operates on the Southern route.

3 Methodology

Before examining the potential benefits of increased trade with France, the approach used in this study is explained.

3.1 Demand for freight ferry services

The first step is to understand the overall (simplified) demand framework within which the potential benefits of switching trade from the UK to France can be analysed. Two factors have important implications for examining these potential benefits.

– Demand for freight ferry services in Jersey is ultimately dependent on the consumption of imported goods in Jersey and the export of goods from Jersey. The demand for goods in Jersey is linked to a number of factors,[21] but is linked most closely to the population of the Island, which, in turn, is growing only modestly over time. Thus, the overall demand for freight ferry services to Jersey is unlikely to grow significantly over time. General growth of the economy will tend to increase the total *value* of demand for imported goods, but its impact on the *volume* of demand is likely to be lower if consumers switch their expenditure to high quality goods, rather than higher volumes of the same quality. Therefore, if there is significant increased use of freight ferry services to France to import goods, this is likely to result in an offsetting reduction in the use of freight ferry services to and from the UK.[22]

– From the perspective of a company selling goods to the Island, or a freight operator, Jersey represents a small market, posing particular logistical issues. Relating to this, it is unlikely that a freight ferry company would choose to serve Jersey and not Guernsey, or vice versa.[23]

Given these two factors, in the initial economic analysis developed for this study, some simplifying assumptions have been made. First, it is assumed that overall demand in Jersey (and thus freight volumes) is fixed, and that importers' decisions may lead to a reallocation of these existing volumes between the UK and France routes. Second, it is assumed that freight flows are one-way (into Jersey), and freight operators choose to serve both Jersey and Guernsey. The focus is also on the main RO–RO services serving Jersey. In practice, there are complexities, discussed throughout the report, which may affect the analysis, and the implications of these are drawn out in the discussion.

3.2 Potential benefits of increased trade with France

This study focuses on two main potential benefits of switching trade to France.[24]

– *Unit ferry freight costs*—the unit costs of transporting to Jersey (ferry costs per trailer volumes of freight carried) may be cheaper because France is nearer; and

[21] For example, demand per head of population generally increases as people become wealthier. Also, in certain sectors (such as construction), demand has grown faster than in the Jersey economy as a whole. Summer demand is also generally greater than winter demand, due to the impact of tourism.

[22] This is not to say that there could not be an overall increase in the demand for freight ferry services on the import side through organic growth, or potentially increased export opportunities to France that might be stimulated by a new France service, but these flows are likely to be a small component of overall demand for freight ferry services.

[23] Indeed, discussions with ferry companies indicate that, given the size of the individual markets, although Jersey and Guernsey are separate political entities, a freight service ideally needs to serve both to be viable.

[24] Unit freight ferry and sourcing costs are initially explored in this study, as they are the main *economic* benefits of increased trade per se, and are the most readily quantifiable.

– *France sourcing costs*—sourcing of goods in France may be cheaper, which might be revealed through lower wholesale costs (or retail costs as a proxy).

If one or both of these conditions holds, Jersey residents could be expected to benefit from reduced prices in Jersey for imported goods. In the absence of either of these two effects, the *economic* benefits from increased *trade* with France (and reduced trade with the UK) are likely to be small. There may be other benefits, but it is unlikely that Jersey residents would experience lower retail prices for their imports. In order to examine these issues, a number of scenarios have been constructed to examine what might happen to freight ferry and sourcing costs, and thus the unit costs to the Jersey economy as a whole, if most existing demand switched to France, effectively with a reversal of the current UK 90/France 10 pattern.

3.2.1 Potential market failures

If the advantages of lower transport costs and/or lower sourcing costs exist, it would be expected that market forces would result in an automatic adjustment of the freight ferry network to enable these advantages to be realised, and hence to reduce prices in Jersey. Assuming that these benefits do exist, the question addressed in this study is whether there impediments, or market failures,[25] that prevent this from occurring?

Two major factors that may prevent such an adjustment are the nature of demand and the inherent cost structure of freight ferry services. The initial analysis focuses exclusively on this. To explore whether market failures exist, three hypothetical scenarios are considered: 10% of trade is undertaken with France (ie, the status quo); 50%; and 90%. The unit costs of the UK and France routes, and total unit costs, are considered. In many instances, the 50/50 position may result in higher unit ferry costs in total to Jersey than the two extreme positions.[26] Furthermore, in such situations, the critical mass of volume that an entrant might need to attain to move towards the (potential) lower-cost France-oriented point might be high, such that it is not possible for incremental demand alone to lead to increased trade with France.

However, these initial scenarios make the assumption that freight ferry unit costs play an important role in importers' decision-making, and that sourcing costs in the UK and France are *equal*. As noted above, the demand for ferry services is ultimately derived from the demand for products. Hence these assumptions are relaxed by considering how changing the importance of freight ferry costs in sourced goods costs affects the analysis and, crucially, what potential sourcing savings would be required to overcome any market failures.

Other factors may also hinder the development of increased trade with France, including cultural differences, language, standards, current distribution hub configurations, networking relationships, experience goods, market structure/competition, and differences in working patterns. These additional, more qualitative, factors are then explored, building on the valuable insights gained from the interviews with interested parties. The impact of these is considered prior to reaching conclusions on the issues.

[25] In economics parlance, a market failure exists where the free operation of the market, left to its own devices, does not bring about the optimal outcome.

[26] This induces a 'hump' in the total freight ferry unit cost function.

4 Potential benefits and market failures: quantitative and theoretical analysis

This section considers the key quantifiable potential benefits as well the major potential market failures of increasing trade with France.

4.1 Where may savings occur?

There are a number of areas in which savings might arise from increased trade with France.[27] In this study the average cost that arises along the supply chain up and including to the point when goods are loaded onto the ferry is assumed to be the same for both the UK and France as sourcing destinations. Thus, the analysis of the potential benefits of switching trade to France looks at on the potential differences in costs arising due to differences in:

– ferry transport costs (including the percentage of costs accounted for by ferry transport costs), as discussed in section 4.2; and

– differences in sourcing prices, as discussed in section 4.3.

4.2 Reduced freight ferry costs: potential benefits

The benefits that might emerge in respect of freight ferry transport costs are explored below by developing a scenario of more trade via France, considering:

– *the cost structure of operating freight ferry services*—using generic cost information from an industry source, an initial indication of the potential benefits is provided;

– *the importance or otherwise of ferry costs*—the proportion of final goods prices accounted for by ferry transport costs is examined, to provide an idea of how important (or otherwise) differences in freight ferry costs may be to Jersey businesses' decision-making.

4.2.1 Ferry cost characteristics[28]

Critically, with the *exception* of voyage costs (such as fuel costs and port charges), **ferry costs are largely fixed in nature**. They are incurred regardless of the origin and destination harbour, and are to a large extent independent of volumes carried or distance travelled.

Hence, if it is assumed that the same type of vessel would operate on the Channel Islands–St Malo and the Channel Islands–Portsmouth routes, a key difference in costs if the current frequent service from the UK were instead operated from St Malo would be expected to arise in voyage costs. This is due to the relative proximity of St Malo to the Channel Islands compared with Portsmouth.[29]

A cost scenario analysis of alternative ferry routes is undertaken below to provide an indication of the potential benefits of increased trade with France *relative* to the UK, rather

[27] The supply chain is examined in more detail in Appendix 1.1.

[28] Examined further in Appendix 1.2.

[29] Also, as will be discussed further, potential efficiencies in scheduling arising from distance might, hypothetically, also lead to savings in fixed costs (such as ship capital costs and crewing costs) on the St Malo route relative to the UK route.

than the absolute level of cost differences.[30] The analysis considers what the change in costs might be if the current frequent service from the UK, facilitating just over 90% of volumes (excluding LO–LO) transported to Jersey, were switched to France, with the trade pattern switching at the same time.[31]

Most of the Channel Islands demand for goods is currently satisfied by a two-ship operation from Portsmouth. Hypothetically, there are two principal savings of operating a frequent service on the St Malo versus the UK route, stemming from the direct and indirect effects of distance on costs:

– *direct effect*—the shorter distance between St Malo and the Channel Islands compared with Portsmouth and the Channel Islands means that there are savings in fuel costs, a key element of voyage costs. However, the effect of distance is muted to a degree. Because it is assumed that any service would serve the Channel Islands as a whole, rather than just Jersey, a round trip to Jersey will always involve a fixed component of distance to be covered in navigating between the islands;

– *indirect effect*—the shorter distance means that a more flexible service schedule might be operated from St Malo, with one boat undertaking two daily rotations, while still being able to clear any trailers from St Helier, instead of two boats undertaking one daily rotation each. This would reduce operating, maintenance and capital costs. The realisation of this benefit would depend on whether, at high volume levels, such a service would be capable of serving Channel Islands demand, and whether it could clear empty trailers from the Channel Islands in time. If the service carried a higher proportion of driver-accompanied freight than the UK service, this may assist in realising scheduling benefits, although other logistical issues might arise.

Therefore, to examine the difference in freight ferry costs stemming from a hypothetical switch of the majority of demand from the UK to France, the following comparisons have been undertaken:

– *two boats UK*—the costs arising from two-boat operation (one rotation each per day) on the Channel Islands–Portsmouth route;

– *two boats France*—the costs arising from two-boat operation (one rotation each per day) on the Channel Islands–St Malo route; and

– *one boat France*—the costs arising from a single-boat operation (undertaking two rotations per day) on the Channel Islands–St Malo route.

A number of assumptions are made in the calculations.[32] The scenarios focus solely on the frequent (six days per week) service in the UK 90/France 10 or UK 10/France 90 scenarios, and abstract from the current weekly service to St Malo.[33] Table 4.1 summarises the findings.

[30] The analysis is based on costs provided by an industry source for a hypothetical frequent service from St Malo. For the purposes of this study, the data has been extrapolated to compare the potential costs for a frequent service from St Malo with that from Portsmouth.

[31] At this stage, the focus is on the main frequent service operated in the UK 90/France 10 case or an alternative UK 10/France 90 scenario, rather than considering the costs of any parallel weekly services (section 4.4 considers these costs in more detail).

[32] Ferry logistics costs are not explicitly included in the analysis. A more complete list of the assumptions underlying the analysis is provided in Appendix 3, which explores potential market failures in more detail. The calculations assume a distance on a single Portsmouth–Channel Islands roundtrip of 290 miles, whereas that of a St Malo–Channel Islands roundtrip is 120 miles. It is also assumed that fuel consumption is directly proportional to distance (a doubling in distance leads to a doubling of fuel costs). In practice, a less than proportional fuel cost increase can be expected with a doubling in distance, since the rate of fuel consumption during vessel acceleration is higher than voyage fuel consumption. Port charges are assumed to be approximately the same in Portsmouth and St Malo. The scenarios modelled involve the same total volumes of freight carried.

[33] Scenarios that model the 50/50 situation, or include the impact of an additional weekly service, are investigated further in section 4.4.

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.

Table 4.1 reveals that switching the bulk of trade to France would significantly lower fuel costs (from £2.9m to £1.2m pa, or 59%), and reduce the share of fuel costs in total freight ferry costs. However, it also shows that most of the costs of freight ferry operations are not directly related to fuel (and thus distance). The result is that **the total freight ferry cost savings available from switching trade to France are limited**, and most benefits that could arise only do so if a one-boat operation from St Malo were possible (the indirect distance effect). Under these circumstances the maximum benefit to Jersey would be around £5m pa (a fall in freight ferry costs of 44%). If, however, a two boat operation is required, the benefit is likely to be less than £2m pa (a fall in freight ferry costs of only 15%). As noted above and discussed further in section 4.4, this depends on whether a single boat operation on the St Malo route is feasible.

4.2.2 How much do transport costs add to the price of goods in Jersey?

To put these potential benefits into perspective, it is necessary to consider whether the potential freight ferry cost savings are important in terms of the final prices of goods. This will determine whether any savings would be of material benefit to Jersey consumers, and whether such differences could be important to Jersey businesses' decision-making.[34]

This depends on the percentage of final goods costs accounted for by the additional ferry (and logistics) costs involved in serving Jersey. Table 4.2 below provides an overview of figures available on the share in the value of imported goods that is attributable to both ferry transport *and* logistics costs, which is assumed to apply to the freight currently sourced from or via the UK.

[34] The percentage of goods accounted for by ferry transport-related costs also affects the degree to which market failures might be expected to occur (see section 4.4).

Table 4.2 Transport costs

Source	Transport cost from UK as % of final price	Basis of valuation[1]
1. Condor Logistics	5	Value of all goods transported from the UK to Channel Islands via Condor Logistics
2. Independent retailer	1	Distribution and logistics cost in high-value electrical goods
3. Independent retailer	6	Distribution and logistics cost in low-value electrical goods
4. Experian	<10	Transport cost element in food retail price
5. Jersey Competition Regulatory Authority	5–8	Transport cost element in food retail price

Note: [1] Due to the way in which the 5% figure has been calculated, the term 'value' cannot be uniquely interpreted as either the supplier (wholesale or manufacturer) price or retail price, since different customers declare their values on a different basis. 'Value' therefore refers to a mix of retail and supplier prices, and can be taken as an approximation of the overall share of transport costs in retail prices. *Row 1*: as this figure includes a wide selection of goods, it can be regarded as the approximate average value of overall transport cost in the value of imports. However, the mix of goods is not entirely representative of *all* goods imported; other logistics companies focus more on fresh produce imports. Since their importation tends to be more expensive, an overall representative figure may be somewhat greater than 5%. *Rows 2–5* are not representative of the full mix of imported goods.
Source: 1. Interview with Condor Logistics; 2. and 3. Interview with independent retailer; 4. Experian (2005), 'Assessment of Jersey's Retail Sector', June. 5. Jersey Competition Regulatory Authority (2005), 'Comparison of Food Prices in Jersey and the United Kingdom', October.

The table illustrates that, on average, the transport cost element in the value of goods is less than 10%, falling to as low as 1% for certain, high-value (electrical) goods. **Overall, for all goods imported into Jersey, it might be assumed that the additional transport costs in serving Jersey are around 5% of the value of goods, since this figure is based on a broadly representative selection of imported goods into Jersey**.[35]

As noted above, the analysis of the benefits of switching trade to France in this study assumes that the ferry logistics costs in France and the UK are the same. To explore these benefits, it would therefore be useful to have an estimate of *ferry costs* as a percentage of the value of goods, rather than (as presented above) an estimate of the overall transport (combined ferry and logistics) costs as a percentage of the value of goods. However, the interviews revealed that such figures are not readily available. Oxera understands that Jersey businesses typically receive an overall logistics price quote from logistics operators, which includes the ferry costs.

To circumvent this problem, two alternative assumptions have been made:

– freight ferry transport costs incurred in serving Jersey from the UK or France are 5% of the overall cost of goods. This indicates the maximum potential benefit from increased trade with France from ferry cost savings per se;

– freight ferry transport costs are 50% of overall transport and logistics costs, such that they are 2.5% of the overall cost of goods. This may lower the potential benefit of increased trade with France.

The analysis summarised in Table 4.1 shows that ferry costs might be 15% or 44% lower if trade switched to France, depending on whether two or one boats are used on the France route. Table 4.3 below combines these findings with the information provided in Table 4.2, to

[35] The figure is based on the Channel Islands overall. It is therefore assumed that the type of goods shipped to Jersey and Guernsey is the same.

examine the impact on the final cost of goods. In each case, it is assumed that either all transport costs are comprised of ferry costs (ie, other logistics costs are assumed to be negligible), or that ferry transport costs are only 50% of overall transport and logistics costs (with other logistics costs making up the remainder).

Table 4.3 Contribution of ferry costs (transport hub exit point to Jersey) to the cost of Jersey imports (%)

	Channel Islands–Portsmouth UK 90/France 10	Channel Islands–St Malo UK 10/France 90	
	Two boats and 100%/50% assumption	One boat and 100%/50% assumption	Two boats and 100%/50% assumption
Type of freight			
1. Average freight	5/3	3/1	4/2
2. High-value electrical goods	1/1	1/0	1/0
3. Low-value electrical goods	6/3	3/2	5/3
4. Food	10/5	6/3	8/4
5. Food	5–8/3–4	3–5/1–2	4–7/2–3
Range	**1–10/1–5**	**1–6/0–3**	**1–8/0–4**
Average (ie, row 1)	**5/3**	**3/1**	**4/2**

Note: *Row 1*: As this figure includes a representative selection of goods, it can be regarded as the approximate average value of overall transport cost in the value of imports. *Rows 2–5* are not representative of the mix of imported goods and thus should not be used to calculate the *overall* potential savings from using a lower-cost transportation route, but can be regarded as the saving for the specific subsection of goods. Figures are rounded to full percentages.
Source: See Table 4.2. Derived from 1. Interview with Condor Logistics; 2. & 3. Interview with independent retailer; 4. Experian; 5. JCRA.

The summary figures presented in the last two rows in the table assume that the overall costs of transport and logistics in transporting the 90% of goods from or via the UK are 5% of the value of these goods. The table reveals that, if the bulk of trade were switched, such that 90% of volumes came from France, the resulting fall in ferry costs might then reduce the proportion of goods costs accounted for by freight ferry costs—ie, the overall cost of goods may fall. This may fall by a maximum of 2 percentage points (from 5% to 3%), assuming that a one-boat two-rotation operation is possible from France (ie, indirect scheduling benefits are realisable at high volume levels), and that freight ferry costs are a major component of overall transport and logistics costs. If only a two-boat operation is possible from France, and ferry costs are only 50% of overall transport and logistics costs, the benefit of switching trade to France falls to 1 percentage point (from 3% to 2%).

The maximum savings in freight ferry costs from switching demand to France, of 44%, may only translate into very modest savings in the overall price of goods, of up to 2%.

Crucially, the above calculations assume that the value of goods (and hence sourcing prices) are identical in the UK and France. Whether this assumption holds in practice is investigated in section 4.3.

4.3 Reduced sourcing costs: potential benefits

By focusing on freight ferry costs, the analysis of the preceding sections has implicitly assumed that product sourcing costs in the UK and France are identical. However, one the sources of price differences along the supply chain, as discussed above, is that suppliers may charge relatively lower prices in one sourcing destination relative to another. If prices for a given good were considerably lower in France than the UK, and other factors influencing prices, such as transport costs from the supplier to the transport hub exit point (ie, St Malo or Portsmouth), were no higher in France, the cost of living in Jersey could fall.

This is important since, ultimately, the demand for ferry freight links is derived from the demand for products. Given that sourcing costs for most products represent the main single component of final goods prices, if sourcing costs were genuinely cheaper in France than in the UK, these might be expected to dominate any effects on ferry costs of sourcing destination.[36]

The differences in prices between Jersey and the UK are well established—the States of Jersey Statistics Unit publishes annual reports containing detailed investigations of the differences price levels and their rates of change. For example, they show that, in June 2005, average meat, fish and vegetable prices were 20% and fruit prices 25% higher in Jersey than in the UK.[37] However, this comparison is only indirectly relevant for this study as the impact of higher costs incurred in Jersey and higher transport costs will also be incurred if goods are sourced from France. As the difference in *transport* costs between France and the UK is relatively small, retail price differentials between Jersey and France of anything less than the UK/Jersey differential would imply that this price differential could easily be explained by the Jersey-specific costs that would continue to be incurred even if the goods were sourced from France. Under these circumstances any savings to be made from trading with France may not materialise, notwithstanding the difference in current retail prices.[38]

This section therefore brings together evidence from a variety of sources on whether prices are *lower in France than in the UK*. The section also highlights that there are a number of complexities in carrying out international price comparisons. To establish whether significance differences exist in the price level of goods, several possible types of price information are examined below.

4.3.1 Supplier price comparisons

Supplier price comparisons[39] (ie, comparing sourcing costs of Jersey businesses from producers, distribution centres or wholesalers in the UK and France) provide the most useful insights since they abstract from other costs that arise along the supply chain (eg, transport costs to transportation hub exit point).[40] Such comparisons therefore allow a direct comparison of the sourcing costs for Jersey businesses. Given that not all products imported through France ports are sourced from France, the ideal analysis would compare the sourcing prices by point of origin. However, comprehensive comparisons may be difficult.[41]

[36] As will be discussed in sections 2.4 and 2.5, savings in sourcing costs are also particularly relevant to exploring whether market failures are likely to occur, stemming from the demand for, and cost structure of, ferry services, in facilitating increased trade with France.

[37] States of Jersey Statistics Unit, 'Comparison of consumer prices in Jersey and the UK: June 2005'.

[38] If retail costs in France are significantly *higher* than in the UK, savings could still be made from sourcing in France, even if the price differential between Jersey and France were smaller than that between the UK and Jersey.

[39] Throughout this section, supplier price, wholesale price and producer price are used interchangeably.

[40] Potential reasons for higher food prices in Jersey than in the UK are discussed in Jersey Competition Regulatory Authority (2005), 'Comparison of Food Prices in Jersey and the United Kingdom', 2005. However, such costs arise in Jersey, and would therefore apply to sourcing from the UK, France, or elsewhere.

[41] Several interviewees raised the possibility of sourcing goods not only from France but *via* France at lower prices than are currently available from the UK, if more frequent, reliable and cheaper freight transport capacity existed between Jersey and

A fundamental issue is to determine which products can be *validly* compared and to define the *scope* of the price comparison exercise. Relevant and robust price comparisons can only be carried out if a product from the UK can be matched with a very similar or identical product in France.[42] For similar or identical goods that are available in both the UK and France, price comparisons would provide useful insights as to whether goods could be more cheaply sourced from one destination compared with another *if* identical transport links existed from both locations.

In practice, however, comparing supplier prices in the UK and France is very difficult.[43]

– The UK Competition Commission 2000 investigation into supermarket prices examined differences in wholesale prices of goods sold in supermarkets in the UK and other European countries, including France.[44] The investigation highlighted that finding similar or identical products in two or more countries is not straightforward. Nevertheless, the Commission concluded that **there was little evidence of prices being systematically higher in the UK than elsewhere in Europe, and that exchange-rate fluctuations over time played a major role in affecting the comparisons**.

– This study has examined whether other forms of supplier price comparisons might provide insights. Again, however, there are significant obstacles. For example, many Jersey retail outlets are UK high-street stores that have integrated distribution chains, and no representation in France. Even if data *were* available on UK sourcing prices for these brands, comparable data is unlikely to be available in France. Even for basic products such as cement, direct price comparisons might be difficult because of differences in standards.

– As regards basic products, a number of data sources might enable a comparison of fresh produce wholesale prices in the UK and France (eg, the Rungis international wholesale produce market in Paris, versus UK New Covent Garden). Even here, however, due to differences in the varieties sold and packaging practices, robust and representative wholesale price comparisons have not been possible. Nonetheless, annual data from the European Commission on producer prices tends to show that **fruit and vegetable prices in France are lower than in the UK**. This may be partly due to the higher levels of farming subsidies in France. A recent publication by the DTI shows that **supplier prices for a variety of building materials in France, including cement, aggregates, sand and bricks, are actually higher in France than in the UK**.[45]

Even where wholesale or producer price comparisons *are possible* and relatively lower prices are identified in France, these comparisons may not be an accurate reflection of the prices that Jersey businesses would actually pay were they to switch suppliers. A Jersey businesses importing food ingredients from both France and the UK stated that, as part of a cooperative, it had buying power with suppliers in both locations, giving it access to bulk discounts. This meant that it was sourcing produce from *both* locations depending on which provided the better price. In addition, businesses may have established relationships with existing suppliers, allowing them to negotiate special prices or favourable pricing, or other

France. Relevant price comparisons could therefore also be carried out between goods currently sourced from the UK and those that could be imported via France at cheaper prices. To establish whether these would be *overall* lower prices compared with the UK would require a detailed costing exercise with quoted prices from suppliers and an estimate of total transport costs from the sourcing country.

[42] In this context the terms 'similar' and 'identical' refer to physical attributes such as pack size of product, composition of products and quality.

[43] Appendix 2 provides more detail on the Competition Commission investigation in 2000, the other potential data sources discussed below, and the difficulties in undertaking comparisons.

[44] Competition Commission (2000), op. cit.

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

business arrangements with established partners that may be severed as a result of a large shift in trade patterns (see section 5).

Thus, a tentative conclusion from the available evidence is that, while **there is some limited indication that, for some products, supplier (wholesale/manufacturer) prices are lower in France**, like-for-like comparisons are difficult, **and any price differences are very sensitive to movements in exchange rates**.

4.3.2 Retail price comparisons

Retail price comparisons (ie, of how much consumers in the UK and France pay for given goods) may provide an indication of the differences in the cost of sourcing for Jersey businesses. However, such comparisons have the disadvantage of including costs relating to running retail outlets (eg, rents, utility bills, labour costs, and taxes) and may also capture differences in competitive conditions between the UK and France at the retail level, rather than just at the wholesale level. Retail price comparisons are therefore likely to provide a distorted picture of the differences in sourcing cost to Jersey businesses (rather than consumers) from sourcing from France and the UK.[46] Such comparisons may therefore present only an approximate picture of the differences in sourcing costs to Jersey businesses from sourcing from France versus the UK.

These studies, which are explained further in Appendix 2, yield the following main insights.

– *Food and drink*—a very recent investigation of grocery retail price differences reveals 11% lower prices in France compared with the UK.[47] Similarly, the investigation by the UK Competition Commission in 2000 revealed that supermarket grocery prices were, in 1999, around 11% lower in France than in the UK.

– *Branded consumer goods*—an investigation into differences in consumer goods prices showed that, for a quarter of goods, there were no price differences between France and the UK.[48] For around two-thirds of the goods examined, prices were statistically different between the UK and France. In 60% of these cases, prices were cheaper in France, but in 40%, prices were cheaper in the UK, although this gap widened when comparing prices net of VAT. In a separate survey by the EIU in 2001, for one-third of goods, no price differences were found.[49] As regards the remainder, around 90% of goods were cheaper in France. On average, prices were 16% lower in France.

The above indicates that **retail prices in France are lower, for staple products and consumer goods, than in the UK**. Insofar as this captures differences in sourcing costs, these may also be lower in France. Nonetheless, care should be taken in interpreting the above findings. **The Competition Commission noted that its result was strongly affected by the appreciation of sterling in the period prior to its price investigation**. As regards the studies undertaken in 2000 and 2001, sterling has since weakened against the euro.[50]

[46] As will be described further in section 3, anecdotal accounts were provided during the interviews which indicated that, at the retail level, goods tend to be cheaper in France than in Jersey.

[47] ACNielsen (2005), op. cit.

[48] ACNielsen (2000), op. cit.

[49] Economist Intelligence Unit (2001), op. cit.

[50] Appendix 2 presents an illustration of the sensitivity of the findings of the 2001 EIU study to different exchange-rate assumptions.

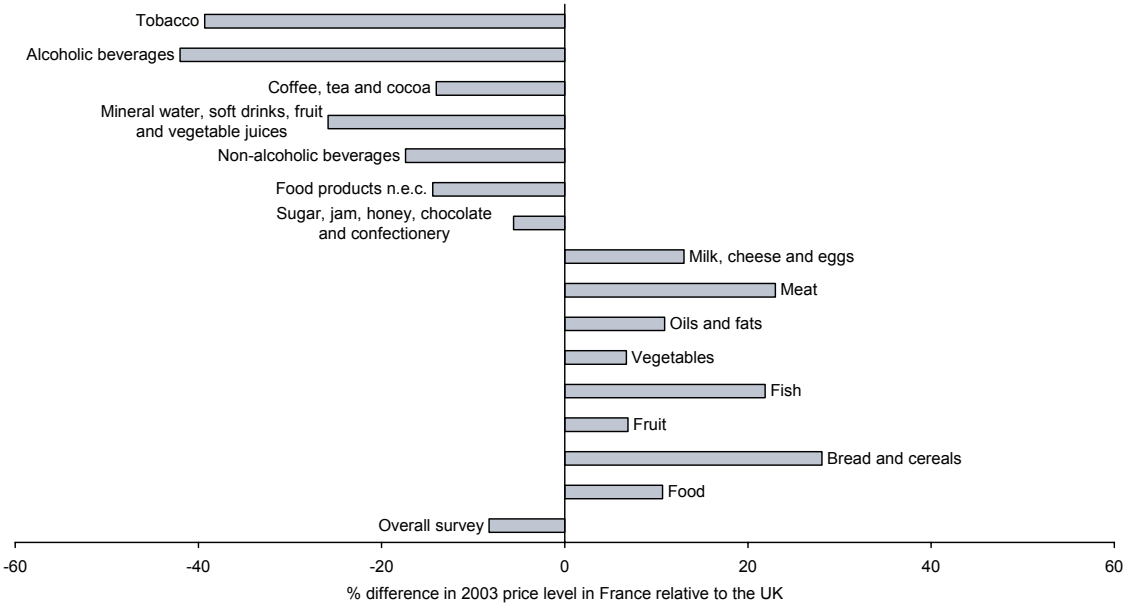
4.3.3 Price-level comparisons

EU national statistical institutes regularly carry out price surveys, which are used in the assembly of national accounts. These surveys are used by Eurostat to construct price indices for comparable 'baskets of goods' containing food, beverages and tobacco.[51]

Although Eurostat recommends a cautious approach in using its data to carry out comparisons between individual countries, based on its recommended use of data, it is highly likely that the price level of the measured basket of goods is lower (by around 8% overall) in France than in the UK.[52]

For illustrative purposes, Figure 4.1 provides a breakdown of the elements of the overall price index. This demonstrates that, **while, overall, the price level is lower in France than in the UK, the price level of comparable food products is higher in France**. In contrast, the price level of non-alcoholic beverages, alcoholic beverages and tobacco is considerably lower in France than in UK. Since the baskets of goods consist of prices paid by end consumers, **these large price differences are likely to be due to differences in national regulations, excise duties and other taxes**. Furthermore, since the relative weight given to each expenditure category is chosen to represent the respective national expenditure pattern, and consumption patterns are likely to differ between France and the UK, there are further uncertainties regarding the accuracy of the comparisons.

Figure 4.1 Food, beverage and tobacco price levels in the UK and France



Source: Eurostat (2004); Oxera calculations.

4.3.4 Overall potential benefit from increased sourcing from France

The insights gained can be used to construct an indicative range of the potential benefits of hypothetically switching trade and freight links such that 90% of goods are sourced from France rather than the UK. The above analysis has assumed that trade flows can *readily* be

[51] Eurostat (2004), op. cit. The price indices are calculated as the ratio between purchasing power parities (PPP)—ie, an estimate of what it would cost to purchase a comparable basket of goods—and the exchange rate. There are a number of issues concerning the construction of PPP measures, and Eurostat advises that findings from price-level index comparisons be interpreted with care since observed differences may not be statistically or economically different. In particular, Eurostat advises that, rather than basing comparisons on individual countries, the focus should be on groups of countries. The UK is in the highest price group, with price levels in excess of 120% of the EU average. France is in the second-highest group, with prices greater than, or equal to, the EU average but less than 120% of the EU average.

[52] Source: Eurostat (2004), op. cit.; Oxera calculations.

switched from the UK to France, and ignores any other barriers that may exist in practice, which may prevent switching (see sections 4.4, 4.5 and 5). Since these figures abstract from several highly relevant real-world features, they cannot be interpreted as actual potential savings, but should only be understood as the maximum savings in the absence of any barriers. Table 4.4 provides an overview of the potential savings in terms of ferry freight costs and sourcing cost differences.

Table 4.4 Potential maximum savings from importing from France

	Current route (Channel Islands–Portsmouth)	Channel Islands–St Malo (two boats/one boat)	% difference between UK 90/France 10 and UK 10/France 90 scenarios
Share of ferry cost in value of imports			
Maximum (all transport costs are ferry costs)	5	4/3	1–2
50% of transport costs are ferry costs	3	2/1	1–2
Sourcing cost			
Supplier price comparison	Evidence on overall difference in wholesale price levels is not available. The limited evidence available on branded groceries suggests that differences, if any, are driven by exchange-rate movements		Low
Retail price comparison	Evidence on overall difference in retail price levels not available. Retail prices are not an accurate representation of sourcing costs to Jersey business since they are affected by other factors. Available evidence on groceries, branded consumer goods prices and price levels suggests differences of around 10%. Differences are also likely to be driven by exchange-rate movements		10
Overall potential maximum saving in terms of the value of imports			**Potentially up to 10%, but probably lower**

Source: See sources in sections 4.1, 4.2 and 4.3; Oxera.

An accurate like-for-like quantification of the **savings to Jersey** from switching to the potentially lower-cost trade configuration via France is not possible. However, **an indicative range lies between 0 and10%, with the probable figure somewhat less than 10%**. Considering that the above calculations ignore other barriers (further discussed in sections 4 and 5), the overall savings to Jersey from increased trade with France may be lower in economic terms.

This does not mean that savings are unavailable from increasing trade with France on certain ranges of goods—as evidenced by the existing goods trade patterns between Jersey and France, which would be unlikely to exist if equivalent goods could be imported at a lower cost from the UK. The above analysis has also ignored the additional benefits that might result from increasing exports from Jersey to France (and elsewhere in Europe). This will underestimate the potential advantage flowing from the provision of a frequent freight ferry service to France. However, given the existing weekly service, and the limitations in the areas where Jersey is likely to have a competitive advantage in the provision of exportable goods, significantly better export opportunities into France (or the rest of Europe) compared with the UK are unlikely at the economy-wide level.[53]

[53] A potential trade-off arises here between the advantages that are likely to be available from *importing* from France and the likely benefits available from *exporting* to France. If wholesale prices are generally lower in France than in the UK, this will make

4.4 Potential market failures: Freight ferry service costs

Although there may be hypothetical benefits of switching 90% of trade to France, there may be problems in transition.

– there may be higher total costs to the Jersey economy than at present; and, relating to the first point
– a new entrant launching a frequent service may find it difficult to secure a critical mass of users.

To illustrate this:

– using generic cost data (taken from Table 4.1), sections 4.4.2 to 4.4.4 develop a simplified theoretical model of how market failures, arising solely from ferry freight demand characteristics and its cost structure, might occur in launching a new freight ferry service;[54]

– section 4.4.5 shows how relaxing the assumption that sourcing costs are identical in the UK and France (and other assumptions) might be expected to reduce the extent to which market failures occur;

– section 4.4.6 looks briefly at the effects of other aspects of the potential barriers to increasing trade with France (such as reliability, distribution hubs and language).

4.4.1 Context for a simplified model

First, it useful to recap on the particular issues involved in operating freight ferry services to Jersey, since this has an important bearing on the unit costs of any transition point

The Jersey freight market can be summarised as follows:

– demand for freight volumes in Jersey is reasonably finite;
– Jersey and Guernsey tend to be treated as a single market;
– the Island requires small boats (which do not achieve the scale economies of larger boats in terms of crewing and fuel unit costs), because of the size of the St Helier port;
– most freight carried is driver-unaccompanied because of lorry restrictions in Jersey (and the particular logistics involved in serving the Island);
– as a result of the above factor, more logistics and handling is involved than on a driver-accompanied service, which means that empty trailers are left on the docks in Jersey;
– Condor operates two boats per day from the UK, in part to pick up these empty trailers, because of the limited space at the Jersey docks;
– because the Island imports far more goods than it exports, the vast majority of trailers returned to the UK are empty, and this leg needs to be largely paid for by those importing goods to the Island.
– many of the costs of operating a freight ferry service are fixed—unit costs therefore fall the more a boat is used. Nonetheless, due to savings in fuel costs and potential scheduling benefits, the unit costs on a fully utilised France to Jersey route might be lower than on the Portsmouth to Jersey route.

What has been ignored thus far, however, are the additional costs of the current weekly service operated by Condor to St Malo on the Southern route. This is essentially fitted in alongside the main frequent UK service on the Northern route. Therefore, the fixed capital and operating costs of the St Malo service are already, in large part, paid for by the UK

it more difficult to sell into the French market. However, this does not rule out the possibility that, for certain products (eg, fresh-farmed shellfish), the export market to France is more attractive than that to the UK.

[54] The analysis focuses on unit costs since these are more informative here.

service, and the incremental costs relate mainly to fuel. Thus, the economics of Condor operating a weekly service from France are fundamentally different to that which an entrant might face in seeking to launch such a weekly service on a stand-alone basis. The entrant would face the full burden of the fixed capital and operating costs.

4.4.2 Nature of demand and frequency

As noted, any significant increased trade with France would, in the main, involve a reallocation of existing demand. The question then is what a new service from France might look like to have a chance of reallocating this demand. There are a number of considerations which, when taken together, mean that any new service would probably need to be a frequent one (see Appendix A5.3 for a discussion). As such, in the model developed below, there is an inherent assumption that any new service to France would be six days a week. Given this assumption, two hypothetical questions can be explored:

– how do the *total unit costs* to the Jersey economy of a service based on a 50/50 split of volumes sourced from or via the UK and France compare with a 10/90, or a 90/10 split? It is demonstrated below that the unit costs of 50/50 are generally higher than at the two extremes; and

– might there be a *chicken-and-egg problem* for an operator seeking to increase services to France? It will be shown that, given the presence of fixed costs, an operator would need to divert a critical mass of volumes from the UK route, to make its unit costs at least comparable to the UK route in transition.

4.4.3 Total ferry freight unit costs to Jersey

Using the generic cost information in section 4.2 illustrative costs have been derived for some hypothetical Jersey–UK and Jersey–France service configurations (see Table 4.5 Table 4.5).[55]

Table 4.5 Service assumptions

Service	France–Channel Islands service (Southern route)	UK–Channel Islands service (Northern route)
Weekly	**A weekly St Malo service, as an addition to a current frequent UK service**	A weekly Portsmouth service, as an addition to a frequent France service
Weekly	A weekly St Malo service, on a stand-alone basis	A weekly Portsmouth service, on a stand-alone basis
Frequent	Two frequent St Malo boats undertaking one rotation each per day	**Two frequent Portsmouth boats undertaking one rotation each per day**
Frequent	A frequent St Malo service, using one boat undertaking two rotations per day	A frequent Portsmouth service, using one boat undertaking two rotations per day
Frequent	A frequent St Malo service, using one boat undertaking one rotation per day	A frequent Portsmouth service, using one boat undertaking one rotation per day

Note: The existing service configurations are highlighted in bold. All costs and unit costs derived for each of the service combinations are based on generic data. Not all service configurations may be possible in practice.
Source: Oxera.

The assumptions used in the following analysis are detailed in Table A3.1 of Appendix 3. Given that the demand for freight ferry services is derived from the demand for goods, sourcing costs play a crucial role. The assumption adopted—that sourcing costs are *identical*

[55] As discussed, data was provided by an industry source to characterise what the costs of a stand-alone frequent (300 days a year) service to St Malo might be, using one boat and one rotation per day. Starting from this point, in the current section the costs of other service configurations have been derived. A key difference in the analysis in the present section versus section 4.2 is that the costs of operating the weekly service are also taken into account.

in the UK and France—is important, since it enables the focus to be *solely* on the nature of demand and ferry costs in leading to potential market failures.

One frequent France boat undertakes two rotations per day

Based on the assumptions in Appendix A3.1, the unit costs of the 90/10 UK/France, 10/90 France/UK and 50/50 UK/France scenarios have been compared. Assuming that the current weekly St Malo service has no additional fixed costs, or that a weekly UK service would also have no additional fixed costs (ie, they would be run by the operator of the frequent service), and that the reduced distance to St Malo means that only one frequent boat is required from France to fulfil a twice-daily service each day (providing additional savings in the fixed weekly capital and crewing costs),[56] the unit costs of the UK–Channel Islands and France–Channel Islands services are as presented in Table 4.6.

Table 4.6 One frequent France boat undertakes two rotations per day (£/lane metre used)

	Number of boats	UK–Channel Islands	France–Channel Islands	Total
UK 90/Fr 10	2	26.3	7.2	**25.1**
UK 10/Fr 90 (weekly stand-alone)	2	132.9	14.8[1]	**22.7**
UK 10/Fr 90 (weekly integral)	1	11.9	14.8[1]	**14.6**[2]
UK 50/Fr 50	3	49.2	27.7	**38.4**

Note: [1] This unit cost corresponds to the £6.2m cost in Table 4.1. [2] This total unit cost to Jersey compared with the 25.1 figure in this column (which takes into account the weekly service if provided on an integral basis) roughly translates into a 42% saving in unit costs in the UK 10/France 90 scenario compared with the UK 90/France 10 scenario. A more direct comparison can be made with Table 4.1 by comparing the unit cost figure of 14.8 in the middle column of this table with the unit cost figure of 26.3 in the first column of the table. This takes into account the unit costs of the frequent service only, and illustrates a saving of 44% in the UK 10/France 90 scenario compared with the UK 90/France 10 scenario. This corresponds to the percentage saving when comparing the £6.2m and £11.1m figures in Table 4.1.
Source: Oxera analysis using generic cost data.

In Table 4.6, it can be seen that, consistent with section 4.2, the UK 10/France 90 scenario is a lower unit cost point in serving the Channel Islands (and thus, by approximation, Jersey) than the UK 90/France 10 scenario, due to:

– the direct effect of distance on fuel costs;[57]
– the indirect distance effect of being able to use only one boat for the frequent service to France.

Table 4.6 illustrates that the degree to which this *indirect* distance benefit lowers the UK 10/France 90 unit cost point depends on whether the weekly service is stand-alone or integral.[58]

Two frequent France boats undertake one rotation each per day

The above scenario assumes that the service, in the UK 10/France 90 case, would have sufficient time to clear trailers from the docks at St Helier as a consequence of the distance saving. As noted in section 4.2, this might be less of a constraint if more of the freight carried

[56] Appendix 3.2 illustrates the unit costs when two boats (each undertaking one rotation) are required.

[57] As discussed in section 2.2, the distance savings that might be achieved in serving Jersey from France are not in direct proportion to the distance from St Malo to Jersey versus the UK to Jersey. This is because a round trip to the Channel Islands will always involve a fixed amount of distance to be covered in navigating between the islands. Moreover, because many of the costs involved in freight ferry operations do not relate to fuel, the effect of fuel cost savings on unit costs is relatively minor.

[58] If the service is stand-alone, the fixed capital costs saved by removing a boat and crew on the frequent France service are simply duplicated on the weekly service. (The total unit cost of 22.7 in Table 4.6, and its components can be compared against the total unit cost figure of 21.6 in Table A3.2). An integral weekly service, by contrast, lowers the total unit cost to 14.6 in the UK 10/France 90 scenario.

on the France service were driver-accompanied (in this situation, there would be fewer trailers to clear),[59] although this may itself pose other logistical issues. However, if it is not possible for a frequent France service to benefit from indirect distance benefits at high volume levels, and two France boats are required, the picture changes, as illustrated in Table 4.7 and Appendix A3.2.[60]

Table 4.7 Two frequent France boats undertake one rotation each per day (£/lane metre used)

	Number of boats	UK–Channel Islands	France–Channel Islands	Total
UK 90/Fr 10	2	26.3	7.2	**25.1**[2]
UK 10/Fr 90 (weekly integral)	2	11.9	22.3[1]	**21.6**[2]
UK 50/Fr 50	4	49.2	41.6	**45.4**

Note: [1] This unit cost figure corresponds to the cost of £9.4m in Table 4.1. [2] The total unit costs to Jersey of 21.6 against 25.1 (which takes into account the weekly service if provided on an integral basis) roughly translate into a 14% saving in unit costs in the UK 10/France 90 scenario compared with the UK 90/France 10 scenario.
Source: Oxera analysis using generic cost data.

General observations (one or two boats)

Tables 4.6 and 4.7 illustrate that the total unit costs of the 50/50 scenario are higher than the total unit costs of the extremes. This finding can be explained as follows: in either of the extreme situations, the frequent service offered is well utilised and either the weekly service has fixed costs that have been paid for already by the frequent service, or, at the very least, the weekly service uses only one boat and, because it is run less often than a frequent service, saves on fuel. In the 50/50 case, the frequent services operated duplicate fixed costs (including boat and crewing costs), while each service is less used than in the extreme situations (since the finite total volume is split between the France and UK routes.) Furthermore, more fuel is used in total in the 50/50 situation than in either of the two extreme cases.

It is the combination of these factors that can generate a 'hump' effect in respect of the total unit costs of serving the Channel Islands and, therefore, Jersey. In the framework described thus far, any transition to significant increased trade with France would involve higher total freight ferry unit costs for a period. Though a related concept, this does not in itself represent a market failure in a strict sense: it is the phase through which total unit costs to Jersey might go through in the transition to increased trade with France.[61] In the framework developed, whether a market failure occurs is dependent on whether incremental ferry services can arise which enable a movement over the hump.[62] Based on Table 4.6, Figure 4.2 illustrates the total unit cost function for the Jersey economy.[63]

[59] Logistics costs for driver-unaccompanied freight are not modelled explicitly in this analysis.

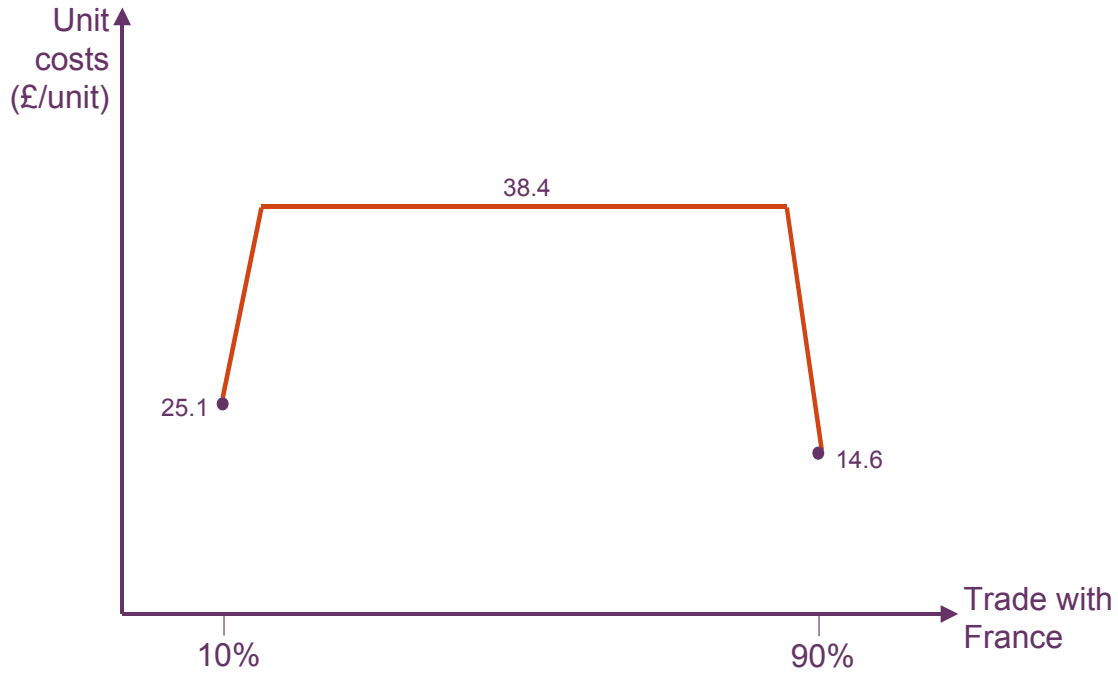
[60] If two France boats are required in the 50/50 scenario (potentially meaning four boats in total), the hump in transition is significantly increased. If two France boats are required in the 10/90 scenario, the benefits of significantly increased trade with France are reduced. This issue of 'critical mass' will be examined later.

[61] However, if trade stopped at the higher cost point, this might be regarded as a market failure because of the suboptimal outcome for Jersey.

[62] This abstracts for the time being from other factors (such as reliability issues, distribution hubs, culture, etc) that may prevent a movement over the hump.

[63] In this simplified framework, unit costs remain constant in between the two extremes. Fuel costs might be expected to vary with volumes or weight carried. If, for example, these were taken into account, total unit costs might vary between the two extremes, providing a more rounded total unit cost function.

Figure 4.2 Total unit freight ferry costs to Jersey (£/lane metre used)



Source: Oxera. These figures are not to scale, and are purely illustrative.

One frequent France boat undertakes one rotation per day

At the limit, it is possible to envisage a frequent France service using only one boat with one daily rotation. Table 4.8 shows that this would lower the UK 10/France 90 low cost point further (to 11.8), and would further reduce the total unit cost hump (to 35.5).[64] However, in practice, such a service might only be able to satisfy lower levels of demand.

Table 4.8 One frequent France boat undertakes one rotation per day (£/lane metre used)

	Number of boats	UK–Channel Islands	France–Channel Islands	Total
UK 90/Fr 10	2	26.3	7.2	**25.1**
UK 10/Fr 90 (weekly stand-alone)	2	132.9	11.7	**19.8**
UK 10/Fr 90 (weekly integral)	1	11.9	11.7	**11.8**
UK 50/Fr 50	3	49.2	21.9	**35.5**

Source: Oxera analysis using generic cost data.

One frequent France boat undertakes one rotation per day with one UK boat

The scenario also assumes that the UK service would remain at two boats undertaking one rotation each per day. If the UK service were reduced to one boat per day—for example, if the incumbent withdrew a boat in reaction to higher unit costs—this would change the 50/50 point.[65] Table 4.9 shows how the further reduced duplication of fixed capital and crew costs lowers the unit costs to the Jersey economy in transition, to 23.8, which is itself lower than the total unit costs in the UK 90/France 10 case. However, it is not clear that the UK service could reduce its service to one boat per day, given the distance disadvantage relative to the

[64] Table 4.7 assumes that one frequent boat from France, plus a weekly service from the UK, would be sufficient to fulfil total Channel Islands (and, by approximation, Jersey) demand. It is not entirely clear that this is the case. It is also not clear whether the weekly service could be operated as integral to the frequent service in this scenario.

[65] Table 4.8 assumes that the withdrawn UK boat could be sold at the full value (here, equivalent to the annual financing cost).

France route, and that most of the freight carried is driver-unaccompanied. One boat may not be sufficient to clear in time the volumes of trailers from the port of St Helier. Even if this were feasible at *some point*, it is not clear that this would be at the 50/50 point, or somewhat beyond this.

Table 4.9 UK service reduced to one boat undertaking one daily rotation (£/lane metre used)

	Number of boats	UK–Channel Islands	France–Channel Islands	Total
UK 50/Fr 50	2	25.7	21.9	**23.8**

Source: Oxera analysis using generic cost data.

Summary

The above discussion illustrates the following.

– *Extreme points*—the UK 10/France 90 point may be a lower total unit cost point than the UK 90/France 10 point, but the savings are not significant (see also section 4.2).

– *The total costs 'hump'*—capacity utilisation is key. In most scenarios, the UK 90/France 10 and UK 10/France 90 points are lower-cost than the UK 50/France 50 transition point. In the 50/50 case, the frequent services operated duplicate fixed costs, while being run at significantly less than capacity, giving rise to a total unit cost 'hump'.

– *Weekly service*—whether the weekly service is stand-alone or integral to the frequent service affects both the lower unit cost points and the hump.

– *Fixed cost reduction*—the more the frequent France service is able to strip out fixed costs, as an indirect consequence of the relative proximity of France to Jersey, the lower are both the UK 10/France 90 equilibrium, and the total unit costs hump. The extent to which this is possible depends on whether Jersey's needs could be met with such a service.

– *Condor's reaction*—there may, however, be three low-cost points. If, in the 50/50 scenario, one boat is withdrawn from the UK frequent service, the total unit costs hump is eliminated. However, the extent to which this is possible depends on whether Jersey's needs could be met with such a service.

In essence, much depends on the number of boats required in the scenarios considered. In the UK 90/France 10 and UK 10/France 90 scenarios, in which the weekly service is integral to the frequent service, only two boats (and possibly even just one boat) are used. In the 50/50 situation, it is not clear how many boats would be required. If, in total, four boats are required in the 50/50 situation, this significantly increases total unit costs relative to the current position. If only three boats are required (due to potential scheduling advantages on the France route), total unit costs are higher than at present, but to a lesser extent. If, in the 50/50 situation, Condor withdraws a boat such that only two boats are used, total unit costs to Jersey may fall relative to the current position. However, given the need to clear trailers from St Helier, it is not clear that Condor could reduce its service or, if it could, that this would be possible at the 50/50 point.

4.4.4 Unit costs and the chicken-and–egg problem: the decision to launch a new ferry service

The above illustrated how the overall unit costs to the Jersey economy might be affected by different freight ferry service combinations. However, whether, on unit cost grounds alone, a

new frequent service to France would be launched has not yet been discussed. This decision is examined in Appendix A3.3 and a summary is provided below.

An examination of the decision on whether to launch a ferry service highlights the following.

– *Incumbent's incentive*—Condor may not have an incentive to move towards a more frequent service to France, particularly if this means investing in a new freight ferry, in the absence of a significant increase in volumes on the France route.

– *Entrant's incentive*—an entrant may not launch a new frequent service at the margins since, on the grounds of unit costs alone, given that it would eventually need to price at (or above) average unit cost, the critical mass point at which the entrant's unit costs are equal to those of Condor's may be fairly high (assuming that UK and France sourcing costs are identical). However, the more that UK 10/France 90 represents a lower unit cost point, and the more that a new frequent service from France is able to remove fixed costs (due, for example, indirectly to the proximity of France to Jersey), the lower the critical mass point, and thus the less likely it is that market failures will occur.

– *Many possible outcomes*—the situation is not completely clear. It all depends on what a new service would look like, what is possible in terms of serving the Channel Islands, and the plausible reactions of the incumbent.

The scenarios discussed above might not be strictly like-for-like in terms of the potential quality of service, or security of supply, to the Channel Islands, particularly if the UK service were reduced to one boat, or if the France service uses only one boat.[66] It is also not clear if normal Channel Islands demand could be satisfied using one frequent France boat undertaking one rotation per day coupled with a weekly service to the UK. (As noted, this may only be sufficient at low demand levels.)

4.4.5 Factors abating the critical mass problem

A number of simplifying assumptions in the above analysis could *overstate* the degree to which market failures might impede the development of increased trade with France. In some respects, the critical mass point for a new entrant may have been overstated. In particular, the following have not been taken into account in the analysis:

– *satisfying lower levels of demand*—the existence of the Huelin Renouf freight ferry service, operated from the UK, and/or the potential for incremental demand to be serviced through a one-rotation service to begin with, or a smaller ferry;

– *further opportunities to reduce costs*—by spreading fixed costs, or moreover reducing unit costs, on the France route;

– *competition effects*—rather than pure cost effects; and

– *ferry versus sourcing costs*—the percentage of overall goods costs accounted for by ferry freight costs, and sourcing prices in France versus the UK.

These factors, including whether they fundamentally change the analysis, are discussed in Appendix 3 and 4, and are returned to in section 5. The potential for lower levels of demand to be satisfied using one boat with one rotation at first may reduce the critical mass point, although two rotations would be required at some point. Further opportunities to reduce

[66] In respect of quality of service, if a freight ferry customer at Portsmouth fails to transport its goods using its desired Condor service, the user will have only a 12-hour wait until the next service. This wait would be extended to 24 hours with a one-per-day service (as envisaged in some of the UK 10/France 90 scenarios discussed). Furthermore, if the France (or indeed UK) service uses only one boat, and this broke down, greater security of supply problems might ensue than if two boats were used.

costs, facilitated, for example, by using a second-hand ferry, or the increased potential for two-way flows from greater trade with France (most flows are currently one-way) may also reduce the critical mass point. Any sourcing cost savings in France will have a major impact on the picture (see section 4.5).

The focus of the above analysis has been on unit costs, rather than on revenues or margins. Average unit costs form the bedrock for sustainable competition. The possibility that a new service would increase competition in ferry services does not change the analysis. Indeed, this may serve to increase the critical mass point for an entrant. Thus, if a new frequent service from France has significantly lower unit costs than the existing service from the UK, this may both produce benefits for Jersey and assist the entrant to enter the market. If, however, a new frequent service simply served to increase competition (significantly) on the routes, while of potential benefit to Jersey in the short term, this could reduce the desirability of entry.

4.4.6 Other factors hindering increased trade with France

In addition to the above factors, which may serve to abate the critical mass problem, there are factors not taken into account in the simplified analysis that may hinder the development of increased trade with France.

Section 5 sets out the multitude of factors uncovered, which have emerged from discussions with various parties. These include cultural differences, language, standards, differences in working styles, current distribution hub configurations, networking relationships, reliability issues ('experience goods'), information (eg, market opportunities), and potential market structure/competition concerns. Some of these factors might be regarded as additional market failures, exacerbating the chicken-and-egg problem. However, a number of these are simply inherent factors that will limit the amount of potential trade with France.

4.5 The interaction of ferry costs and sourcing costs

Section 4.3 identified that there might be potential savings in overall sourcing costs in the UK 10/France 90 scenario, of up to 10%. However, the market failure analysis presented in section 4.4 has ignored this. It assumed that all that matters to the marginal decisions of importers (whether to import from the UK or France) is the unit ferry costs—ie, the price that they would have to pay to sustain the ferry service. At low freight volumes, ferry costs will always represent a fairly high proportion of total goods costs for any new service. However, if sourcing costs of the particular goods being sought are *significantly* lower in France than in the UK, and ferry costs are generally (for a reasonably well-utilised service) not a high proportion of the overall cost of goods, the structure of ferry costs matters much less. The reasons are:

– *reduced market failures in transition*—there should be fewer market failures for an entrant seeking to secure a critical mass of customers. Even if, in transition, an entrant on the France route has higher unit freight ferry costs than the incumbent (on the UK route), the overall unit costs of goods when importing from France will, at an earlier point, be lower than the unit costs of importing the same goods from the UK;

– *lower overall unit costs to Jersey in transition*—the overall total unit costs for goods transported to Jersey (from both the UK and France) should fall as the percentage of trade undertaken with France increases. The overall final goods unit costs to the Jersey economy may be more of a downwards-diagonal line, rather than a pronounced hump.

Put another way, in transition, the benefits of the savings in sourcing costs from increased trade with France may outweigh the higher unit transport costs. This may even hold if, rather than across the generality of goods and services, there are more specific opportunities for lowering the costs of goods by importing from or via France—so long as there are *sufficient*

opportunities to achieve reasonable capacity utilisation.[67] The effects of the percentage of goods costs accounted for by ferry freight costs are somewhat paradoxical. While the lower the proportion of ferry freight costs in total goods costs, the less the extent to which the UK 10/France 90 point represents a lower cost equilibrium (since the benefits of ferry cost savings are muted), reaching the new UK 10/France 90 point equilibrium is easier.

These issues are now explored in more detail, extending the framework developed in section 4.4 to consider overall unit costs (including both ferry and sourcing costs[68]). For ease of exposition, the overall unit costs of the main UK–Jersey route in the current UK 90/France 10 scenario have been re-indexed to 100. Unit costs for the France–Jersey route, and for all other scenarios, have been expressed relative to this index.[69]

Four potential situations are examined in detail in Appendix A4.2, reflecting potential differences in the balance between ferry and sourcing costs.

Situation A Freight ferry costs are **5%** of goods costs on the current UK route, and there are **no differences** in UK versus France sourcing costs

Situation B Freight ferry costs are **5%** of goods costs on the current UK route, and France sourcing costs are **10%** cheaper than UK sourcing costs

Situation C Freight ferry costs are **15%** of goods costs on the current UK route, and France sourcing costs are **4.5%** cheaper than UK sourcing costs

Situation D Freight ferry costs are **5%** of goods costs on the current UK route, and France sourcing costs are **15%**cheaper than UK sourcing costs

In each instance, consideration is given to:

– *the total benefits to Jersey*—of significant increased trade with France (in the UK 10/France 90 scenario);

– *the total unit costs to Jersey in transition*—combining the overall unit costs for the UK and France routes; and

– *importers' marginal decisions*—choosing between importing from the UK or France, taking into account both transport and sourcing costs. In particular, the critical mass point for a new service is considered, which may be regarded as the minimum sustainable volume from France.

In the current section, a number of the key results are extracted from these analyses. The underlying economic interaction between the potential advantage of lower ferry costs and lower sourcing costs and market failures is as follows.

– *Non-interdependence in realising sourcing cost savings*—network effects do not influence sourcing savings. In respect of importers' decisions, the sourcing cost advantages available to any one importer do not depend on the availability of sourcing cost advantages to other importers. There is no 'hump effect' in transition (in terms of the overall costs to Jersey) in realising sourcing savings.

– *Interdependence of ferry costs*—in contrast, 'network effects' influence ferry costs. Whether there is a total ferry cost advantage to Jersey of increased trade with France

[67] Section 3 shows how interviewees have highlighted a number of potential opportunities for lower sourcing costs (for example, the direct importation of kitchens, bathroom fittings, etc).

[68] Sourcing costs are implicitly assumed to cover the point up to delivery to the port in question (Portsmouth or St Malo). The scenarios abstract from Jersey retailers' own costs or margins, and assume that they pass on any increases or reductions in ferry and sourcing costs to consumers.

[69] Appendix 4.1 provides more detail on the calculations.

depends on the split of *total demand* between the UK and France routes (and, in many cases, increasing the proportion of trade with France raises total ferry costs). Similarly, in respect of individual importers' marginal decisions, the relative price of the UK versus France ferry services depends on how many other importers are also using the service (ie, the total demand on each route).

– *Importers' overall decisions*—whether a particular importer will have a demand for increased ferry services to France depends on the combined effect of the sourcing cost advantage to them (not prone to network effects), and the relative prices of ferry services between the UK and France (prone to network effects). The point at which importers prefer to import via a frequent France service is the critical mass point (or minimum sustainable volume from France).

– *Overall costs to Jersey*—Jersey is better off if the total of all ferry costs (which is likely to be higher except in the extreme position of 90% of trade with France) is more than offset than by the lower total sourcing costs of all goods in France and the UK.

The results of these interactions are as follows:

– *Sourcing savings and critical mass*—the greater the sourcing cost savings available in France relative to the UK, the lower the share of the freight flows that need to be captured by the France service for it to be economically viable (or, to put it the other way round, the higher the price the France route can charge and still be sustainable) and for Jersey to be better off. Nonetheless, the point at which the France service becomes sustainable is generally before the point at which there is an overall benefit to Jersey.

– *Percentage of goods costs accounted for by ferry costs*—goods with a low proportion of freight ferry costs in the final selling price require a lower percentage sourcing cost differential to make sourcing from France viable, and hence provide a source of the demand for the French ferry service.

– *Potential ferry cost savings*—the lower the initial fixed costs of setting up the new frequent service to France, the lower the sourcing cost advantage required to make the service viable and (potentially) to provide an overall benefit to Jersey.

4.5.1 Summary results of the analysis

As regards the last of the above points, each of the situations developed in Appendix A4.2 considers how the picture changes when the number of boats and rotations required to provide the France service changes, and what the additional impact might be if the UK service were reduced to one rotation.

In reality, it is possible that the introduction of frequent France services would be staged, as trade with France increases. This affects the *total* number of boats used (on the UK and France routes) as trade with France increases, and thus the total unit ferry costs to Jersey (see also section 4.4).

– *Two boats at 90/10*—the current UK 90/France10 position involves using **two boats**, each undertaking one rotation.

– *Three boats as trade with France increases*—incremental demand, up to 20–25% (or, at the limit, perhaps 30%) trade with France, might be facilitated by one France boat undertaking one rotation. However, demand beyond this might require one France boat undertaking two rotations. **Satisfying initial volumes is nonetheless likely to involve three boats in total** (two on the UK route and one on the France route).

– *What happens at the 50/50 point is unclear*—three or four boats in total may be required. However, Condor may react and reduce its UK service at this point to one boat

undertaking one rotation. **The 50/50 point may therefore be characterised by two, three or even four boats in total**.

– *One boat or two boats at 10/90*—if the proportion of trade with France increased further and edged towards the UK 10/France 90 point, **one France boat undertaking two rotations might be sufficient**. However, if the indirect distance effect cannot be realised at this point due to the volumes carried, **two France boats undertaking one rotation each might be required instead**. In addition, only one boat on the France route could expose the Island to considerable vulnerability to mechanical or other failure of the boat, as the vast majority of ferry freight would be carried by this one boat.

These considerations are reflected in the summary tables below. Each column of the table provides the following.

– *Current costs*—the current overall costs to Jersey in the UK 90/France 10 situation, with two boats, assuming that the weekly service to France is integral to the frequent service.

– *Costs with complete switch*—the overall costs to Jersey with a complete switch (UK 10/France 90). In general, the 'best outcome' assumes that only one France boat is required (undertaking two rotations), whereas the 'more likely' outcome assumes that two France boats would be required (each undertaking one rotation).

– *The minimum sustainable volume point*—this is the critical mass point for the France service, or the point at which overall unit costs (including goods and ferry costs) to importers using the France service are equal to the overall unit costs of using the UK service. If this is sufficiently low (less than, say, 25%), it is assumed that one France boat undertaking one rotation is sufficient at initial volume levels. Otherwise, while the 'best outcome' assumes that one France boat undertaking one rotation is sufficient, the 'more likely' outcome assumes that one France boat undertaking two rotations is required.

– *Costs at minimum sustainable volume point*—the overall costs to Jersey at the critical mass point are provided. These are generally higher than the current costs in the UK 90/France 10 situation, but the degree to which this is the case varies by situation. Once the critical mass point has been attained, the market should lead to further increased trade with France, up to the point where other barriers not considered thus far in the analysis (such as cultural factors, distribution hubs and so on) prevent this.

– *Minimum volumes that provide an overall benefit to Jersey*—this is important. While a frequent France service might attain critical mass, the concern would be if increased trade with France after this point then stopped before reaching the position at which Jersey is actually better off. As noted above, this might arise due to the impact of other barriers not considered in the analysis. As shown below, when sourcing savings are significant, the point at which Jersey is better off arrives sooner. In other instances, Jersey is only better off if the UK 10/France 90 position is reached, or if Condor reduces its UK service to one boat in the 50/50 scenario—either of which may not be feasible.

Table 4.10 Situation A: freight ferry costs are 5% of goods costs on the current UK route, and there are no differences in UK versus France sourcing costs

	Current costs: 90/10 (index)[1]	Costs with complete switch: 10/90 (index)[2]	Minimum sustainable volume to France [3]	Costs at minimum sustainable volume (index)	Minimum volume that provides an overall benefit to Jersey[4]
Best possible outcome[5]	99.8	97.8	31%	101.7	~50%
More likely outcome[6]	99.8	99.1	36%	102.3	90%

Notes: [1] Unit costs are set to 100 on the UK route—10% of freight is with France, so has a lower transport cost component; as a result average unit costs are slightly below 100 with the current transport pattern. If there are additional sourcing savings in France, this number would be even lower (see other situations below). [2] Complete reversal, assuming the UK service is integral to the France service. [3] The critical mass point, at which the unit cost (ie, price) of the service to France is the same as the unit cost of the UK service. The UK unit cost has *risen* from the current position. [4] The point at which total costs (sourcing plus ferry) across all imports is the same as the current position. [5] In the 'best possible' outcome, a *maximum* of three boats are used at any point. In the current UK 90/France 10 situation, two boats are used. At the minimum sustainable volume point for a France service, one France boat undertaking one rotation is used (hence three boats in total). Where the split is approximately 50/50, it may be that only two boats are used, since Condor may withdraw a boat. However, this would increase the critical mass point for the entrant to beyond that shown in the table. Where the complete switch has happened (10/90), only one boat is required on the France route, undertaking two rotations per day. [6] In the 'more likely' outcome, aside from in the 90/10 or 10/90 positions, a *minimum* of three boats in total are required. At 90/10 or 10/90, two boats in total are required, each making one rotation. At the minimum sustainable volume point, one France boat undertaking two rotations is required (thus three boats in total). 50/50 still requires three boats, if not four (two boats on each route, each undertaking one rotation).
Source: Oxera.

Table 4.11 Situation B: freight ferry costs are 5% of goods costs on the current UK route, and France sourcing costs are 10% cheaper than UK sourcing costs

	Current costs: 90/10 (index)[1]	Costs with complete switch: 10/90 (index)[2]	Minimum sustainable volume to France [3]	Costs at minimum sustainable volume (index)	Minimum volume that provides an overall benefit to Jersey[4]
Best possible outcome[5]	99.1	88.9	14%	100.4	28%[8]
More likely outcome[6]	99.1	90.2	14%[7]	100.4	33%[9]

Notes: 1–6 see notes to Table 4.10. [7] This is the same as the best possible outcome because at this level of switching one France boat undertaking one rotation per day is more likely to be possible (three boats in total). If two rotations are needed, the minimum sustainable volume rises to around 17%. [8] Here, it is assumed that one France boat undertaking one rotation is used (three boats in total). [9] Here, it is assumed that one France boat undertakes two rotations (three boats in total).
Source: Oxera.

Table 4.12 Situation C: freight ferry costs are 15% of goods costs on the current UK route, and France sourcing costs are 2.5% cheaper than UK sourcing costs

	Current costs: 90/10 (index)[1]	Costs with complete switch: 10/90 (index)[2]	Minimum sustainable volume to France [3]	Costs at minimum sustainable volume (index)	Minimum volume that provides an overall benefit to Jersey[4]
Best possible outcome[5]	99.1	91.4	29%	104.6	~50%
More likely outcome[6]	99.1	95.3	34%	106.2	90%

Notes: 1-6 see notes to Table 4.10 above.

Table 4.13 Situation D: freight ferry costs are 5% of goods costs on the current UK route, and France sourcing costs are 15% cheaper than UK sourcing costs

	Current costs: 90/10 (index)[1]	Costs with complete switch: 10/90 (index)[2]	Minimum sustainable volume to France [3]	Costs at minimum sustainable volume (index)	Minimum volume that provides an overall benefit to Jersey[4]
Best possible outcome[5]	98.8	84.5	11%	100.2	20%[8]
More likely outcome[6]	98.8	85.8	11%[7]	100.2	20%[8]

Notes: 1–6 see notes to Table 4.10 above. [7] This is the same as the best possible outcome because, at this level of switching, one France boat undertaking one rotation per day is more likely to be possible (three boats in total). If two rotations are needed, the minimum sustainable volume rises to around 13%. [8] Here, it is assumed that one France boat undertakes one rotation (three boats in total).

The implications of the way sourcing costs and ferry costs interact can be summarised as follows.

– *Few potential benefits means little case for intervention*—where ferry costs are a significant proportion of final selling costs, and sourcing cost savings in France are modest (for example, Situations A and C), the benefits to Jersey only arise when the trade flows have more or less switched completely. This arises because, in the transition period, more boats are required, the total ferry costs that have to be sustained by the Jersey economy increase, and there are few offsetting effects from sourcing cost savings. If a complete switch of routes were not achieved, the transport pattern could stabilise into a new position that would leave Jersey worse off overall. However, even if such a switch were hypothetically possible, it is unlikely that the market would deliver it because of the relatively high shift of trade required to make a regular France service sustainable (ie, the high critical mass point). Thus, the risks of intervention are high—the intervention could make the Island worse off—but the need to intervene is higher if the savings can, in practice, be realised. Even then, the potential savings to Jersey in the 10/90 situation are somewhat less than in the case where more pronounced sourcing savings exist.

– *More potential benefits also means little case for intervention*—where the main advantage of switching trade to France arises from lower sourcing costs (for example, Situations B and C), then, if these are significant, the risks from intervention are lower. Even if the transport pattern does stabilise in a relatively more expensive position (because of the need to use more boats), the total additional costs to Jersey are small. In addition, the proportion of freight that needs to switch to make a regular France service sustainable is lower, as is the proportion that needs to switch before Jersey is better off. By the same token, the *need* to intervene is also reduced, as the market failure is much more limited.

Sections 4.2 and 4.3 highlighted that the evidence on the proportion of overall goods costs accounted for by Jersey ferry costs, and the potential sourcing savings available in France versus the UK, is mixed. **However, the results of section 4.3 indicate that Situation B, which assumes that ferry costs are around 5% of the cost of goods on a reasonably well-utilised service, and that sourcing costs in France are 10% lower than in the UK, is the most realistic of the situations described above. This does not negate the possibility that there may be certain goods available in France with higher potential sourcing cost savings.**

4.5.2 The impact of other opportunities and barriers

The above analysis of potential situations identified that there were few grounds for intervention by the States on the basis of potential market failures caused by the nature of freight ferry demand and costs per se. However, other potential benefits from increased trade with France, and other potential barriers, might affect the above picture. In these respects, section 5 reviews the insights gained from interviews in Jersey, France and the UK.

In particular, it is shown that there are a number of potential barriers, including cultural factors, distribution hubs, standards and informational issues (such as the demonstrable reliability of ferry services), which may hinder the development of significant further trade with France. In respect of the analysis undertaken, these might mean that trade with France cannot move beyond a certain point. The 10% UK/90% France trade pattern may not be possible, even if it appears to make economic sense. More importantly, the proportion of trade that could be undertaken with France, whatever the apparent economics, may be below the levels that deliver *overall* benefits to Jersey. (The above discussion noted the potential disadvantages if trade with France stabilised at a higher cost point, dependent on the situation). In such a case, there would be even less economic justification for intervention to attempt to shift the trade patterns. Culture may be one such factor.

Section 5 below reports on what these limits to trade with France might be, based on the interviews with interested parties in Jersey, France and the UK.

4.6 Impact of economic growth and a general increase in the demand for freight ferry services

The analysis set out above is based on a static examination of the total demand for freight ferry services. As the economy grows there is likely to be an increase in total expenditure in Jersey, which is likely to translate into some increase in the value of imports and a (somewhat lower) increase in their volume.

If this general increase in the volume of imports (and exports, if this occurs) still leaves the total volume within the existing maximum capacity of the existing boats on the services to the UK, any increase in volume does *not* change the static analysis significantly. It is only when the increase in volume means that the existing capacity constraint is reached that there is an impact on the analysis. This impact is as follows:

– an additional boat is required, irrespective of whether it goes to France or the UK;

– at this point, the diversion of demand to France does not cause any additional fixed costs to be incurred;

– the reduction in variable (ie, distance-related) costs would become an unambiguous net gain to the Jersey economy, at least in the short term;

– if demand on the UK route continues to grow and an additional boat is required on that route, the analysis reverts to the static analysis set out earlier, only now the trade-off is between three boats if only the UK route is served with a high-frequency service and a minimum of four boats if there are high-frequency services to both the UK and France.

At the point of transition when an additional boat is required, there may also be an enhanced level of flexibility in the route that such a boat could take. If most of the potential demand with respect to France could be met by, say, a service three times a week, splitting the new boat between France and the UK may be an option. This type of approach would reduce the risks faced by the ferry operator, as the marginal costs of the new service to France would be lower than those faced by an operator supplying only the France route.

As a result, the barriers to entry on the provision of a (more limited) frequent service to France are lower at the point where the UK reaches its existing capacity constraint. However, Oxera has been given no indication by the existing ferry companies that the capacity constraint on the UK freight service is being approached.

5 Opportunities and barriers in practice

Oxera undertook interviews with a wide selection of interested parties, in order to obtain a further understanding of:

– the potential advantages of increasing trade with France;

– the reasons for the current trade and freight patterns between Jersey and the UK versus France and the UK, and the perceived barriers to increasing trade with France;

– retailers' current sourcing patterns and frequency requirements; how this affects the balance between the perceived opportunities and barriers discussed above; and whether they would source more from France if a new frequent freight ferry service were operated from France;

– how schemes that could be taken forward in future might seek to make the most of the potential advantages of increased trade with France, while overcoming some of the barriers. In particular, Oxera spoke to parties involved in a potential project to serve Jersey via a frequent freight link from Cherbourg, and a supermarket that might use this link. Nonetheless, there are still issues that these projects would need to address.

Interviews were undertaken with several businesses in Jersey, government representatives and departments in Jersey, ferry operators, and government representatives, businesses and Chambers of Commerce based in Normandy, France. Many of the businesses in Normandy were interested in undertaking trade with Jersey and, although some had direct experience of this, a number had not yet done so. Business links are, at present, stronger with Brittany, which also has the weekly RO–RO (and daily passenger/light freight) services sailing to the Channel Islands. A number of the Normandy businesses interviewed were potentially interested in using a link from Cherbourg, although the project is in its infancy.

There is, therefore, an issue of whether increased trade might occur through the existing links via St Malo (the simplified analysis in section 4 assumed that this was the case), or through a new service from Cherbourg. The possibility of a link from Granville was also raised in some discussions.

The discussion below focuses on the insights gained from the interviews undertaken. More detail, including case studies, is provided in Appendix 5, which illustrates the complex interplay between the opportunities and barriers.

5.1 Opportunities: lessons from interviews

The main opportunities for increased trade with France, which might be facilitated by a frequent freight ferry service, include:

– increased prospects of sourcing from both France and the European markets more generally (including dealing direct with manufacturers and point-to-point trade);

– lower perceived retail prices that might result and lower sourcing costs (although much of this evidence was anecdotal);

– higher perceived quality in some cases;

– more choice for consumers?

– the second-order benefits of competition, in terms of ferry services and competition in Jersey—although relying on these arguments alone as a justification for increased trade with France is problematic;[70] and

– the further export opportunities that might be forthcoming (such as recycled waste and export of shellfish).

Given that interviews were undertaken with businesses and representative bodies, not consumers, it is perhaps not surprising that more choice was not mentioned as a key advantage of trade with France; however, from a consumer's perspective, this is likely to be a key advantage of increased trade with France.

5.2 Barriers: lessons from interviews

The interviews revealed that there were also many barriers, beyond the nature of freight ferry costs. All may restrict a move towards increased trade with France even if, on paper, there are apparent benefits.

5.2.1 UK influences and culture

Jersey leans heavily towards *UK influences*. 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).

5.2.2 Standards and labelling

Standards and labelling, which have been influenced by these factors, are then also key barriers, at least in respect of core demand (for example, branded goods, electrical products, and produced foods). This is not purely a legal issue, but concerns how consumers perceive products and what happens at the point of use. These are less of an issue for niche goods (eg, crème fraîche), unbranded basic products (such as vegetables and cement), and one-off purchases (eg, capital equipment). However, even for basic products such as cement, there may be issues concerning differences in norms.

5.2.3 Distribution hubs, 'locked-in' relationships and information flows

The main barrier is likely to concern the networks that have been built up over time around historical trade patterns. The *distribution hubs* of the main manufacturers serving Jersey, the *relationships* formed between Jersey retailers and others in the supply chain that are valued (including representation by buyer groups in the UK, wholesalers/distributors and agents in Portsmouth), and *information flows* facilitated by these relationships, all serve to lock trade into the current UK-oriented pattern. Manufacturers treat Jersey as an extension of the UK market for UK-specification goods. Given the size of the Jersey market, they may not be prepared to redirect volumes via St Malo at an earlier stage of the process.

Any apparent cost advantage of sourcing from France would also need to be over a wide range of goods, and to persist over time. In this regard, the current networks (and freight ferry services) enable many Jersey businesses to source reliably, at regular intervals, small or large quantities of UK-standard and UK-market-oriented goods. Those benefiting from these hubs and long-term relationships are unlikely to source more from France, even if a frequent service were offered (see below). They could lose supply stability, or forgo economies of scale in sourcing enjoyed through buyer representation. The price benefits identified from the higher-level comparisons in section 4.3 may be illusory.

[70] As will be discussed, insofar as there may be competition issues regarding current ferry services (and this is not clear), increased trade with France is only one solution. The introduction of a French supermarket to the Island might increase competition in Jersey, but a UK supermarket might achieve the same outcome.

As regards information flows, while Jersey businesses have good information on the opportunities to trade with the UK, and know what to expect, trade with France directly, for those not currently doing so, is more of an unknown entity. Forming relationships with French suppliers therefore represents a new challenge, in addition to the challenges posed by differences in language and culture. Likewise, businesses in France can face informational problems in seeking out opportunities in Jersey (see section 5.3).

5.2.4 Resistance to change and competitive threats

There may also be resistance to change from Jersey retailers and businesses, given that increased trade might be accompanied by greater competition in Jersey. However, it is far from clear that the current arrangements for securing goods give rise to any competition concerns. It may simply be that the established relationships are the most efficient way of importing goods to the Island.

5.2.5 History

The history of how the current ferry configurations arose (the reduction in freight links over time and the focus on passengers) has also played a role. The lack of a frequent service at present is seen by some in Jersey as a constraint (particularly those involved in perishable imports or shellfish exports, or for importing heavy freight). However, mixed views were obtained on whether the current services were adequate, and whether businesses would necessarily need or use a new frequent service from France. Customs issues (it is more straightforward to go from or via the UK), and port capacity at St Helier, were also seen as constraints.

5.2.6 Uncertainty and experience goods

It became evident during the interviews that the ferry services chicken-and-egg problem not only concerned 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. Many argued that there was not enough demand, and Condor argued that its options for importing freight were both sufficient and scalable (in part, given the degree of redundancy in existing services). Few of those interviewed (including Jersey and French businesses) could provide indicative volumes that they might import or export, with the exception of a shellfish exporter and a French supermarket. Another aspect concerning information relates to 'experience goods': any new service from France would need to be very reliable. The current frequent UK service has a proven reliability record, whereas the *prospective* reliability of a France service is unknown. Here, there is a conflict between a desire to minimise the costs of any new operation and the need to guarantee the quality and reliability of the service.

5.2.7 Structural issues with regard to ferry services

Some identified potential structural and competition issues regarding the current ferry and logistics services provided by Condor, which they perceived as a barrier. It is outside the scope of this research to investigate these concerns, and this could be explored as part of a separate study if required. In any event, if these concerns are valid, increased trade with France and direct ferry competition would be only one solution. Alternatives could include regulation of Condor's prices, further internal separation of roles within Condor, or more complete business separation.

5.3 Potential changes to sourcing behaviour in practice

Discussions with Jersey companies focused on the balance between the perceived benefits and barriers of increased trade with France. The companies were asked whether they would

source more if a frequent service from France were provided. Interviews were also conducted with Normandy businesses.

The general message obtained from interviews with Jersey businesses and logistics experts was that, *if* a new freight ferry service to France were offered, it would need to be frequent, to cater for retailers selling perishable goods and those businesses using 'just-in-time' supply chain methods in Jersey, and to provide flexibility more generally to Jersey businesses.[71]

A key question, however, is whether businesses would then use such a service. UK chains in Jersey are likely to continue to use their existing hubs, as vertically integrated UK entities, and would not change their sourcing patterns. However, it is also unlikely that even medium-to-large *independent* Jersey retailers would switch significant amounts of trade to France (eg, the electrical retailer and general store interviewed), even if there were apparent benefits on paper.[72] A supermarket business interviewed also emphasised that its core demand was UK-based, it had buyer power in the UK to source such products, and that it would not wish to stock a wide range of French-labelled products if consumers might not understand the labelling. Nonetheless, it saw some opportunities for sourcing more niche products and fresh produce from France.

Although smaller retailers might have more flexibility to bypass distribution hubs, many have established relationships with the UK (including agency agreements). Nonetheless, there are small businesses in Jersey who already trade with France, and those who have realised benefits from sourcing directly from manufacturers in Continental Europe (albeit using existing services via Portsmouth or St Malo). The main advantages cited were lower prices in Europe, since this is a larger market, and that dealing directly removes successive mark-ups. The types of good in question were affected less by standards issues. However, these businesses looked less like just-in-time importers, and it was not clear whether they would individually undertake significant increased sourcing if a frequent service to France were offered. As regards export opportunities, a shellfish (perishables) exporter indicated that it would switch its entire consignment to a frequent heavy ferry service if the price were right.

Therefore, while medium-to-large retailers might not significantly increase trade with France, if a frequent service were inaugurated, smaller businesses might, although to what extent is not clear.

The French businesses in Normandy were at a very early stage in assessing the possibility of exporting to Jersey. Their main priority was to gather information on the market, and assess the opportunities for finding a partner with common interests (eg, a French company, an independent Jersey partner, or an independent downstream distributor—all of which would involve bypassing UK hubs and relationships). Many had problems finding information at low cost, given the size of the market. Some pointed out the advantages of sourcing from France versus the UK, although much of this was anecdotal at this stage. Few knew what their potential volumes might be at this stage if, for example, a frequent service were inaugurated between Cherbourg and Jersey. Future initiatives by the networking organisation interviewed in France, and the States of Jersey and its departments, may seek to lower informational barriers that might mask potential opportunities for increased trade. La Maison de Jersey also plays a key role in networking French businesses with potential Jersey partners.

Two projects that might lead to increased trade with France were examined in some detail. These may seek to take advantage of the potential benefits while getting around some of the

[71] Frequency did not appear to be as much of an issue for Normandy companies as Jersey businesses in exploring potential opportunities to trade with Jersey. This may reflect the fact that companies in Jersey (importers) need to source regular supplies from a range of suppliers to carry on their business, whereas, for exporters, Jersey represents an incremental opportunity. As noted below, the Normandy businesses were at a very early stage in their assessment of the potential opportunities.

[72] For example, the electrical retailer was unsure how it might source a diversity of UK-specification products from France, and emphasised that total savings would need to be between 15% and 20% for it to consider using such a service.

barriers. These were a potential freight link to Cherbourg, and the possibility of a French supermarket becoming established in Jersey.

The Cherbourg link may get around demand-side barriers associated with distribution hubs and standards by re-diverting UK freight via Cherbourg and carrying freight for a French supermarket (which may provide an initial base level of demand), facilitating point-to-point trade, and carrying fresh produce. There may also be cost savings on the France route through scheduling benefits and using a second-hand boat. If the service did lead to sourcing and ferry cost savings, these would all serve to lower the critical mass point. However, there are also potential problems: the running costs and reliability of a second-hand boat if used; the distance advantage of Cherbourg being less than St Malo; the logistics of the operation at Cherbourg and Jersey; the potential reaction of Condor to the service; and that Cherbourg's role as a hub has decreased over time (St Malo is more of a hub).

The establishment of a French supermarket might increase competition in Jersey (although a UK supermarket might do the same). This would use its own hubs and buyer arrangements in France. The main potential obstacles concern whether Jersey residents would spend their weekly shop on products aimed mainly at the French market and, crucially, labelling issues.

5.4 Limits to increased trade with France

The discussions with suppliers in both Jersey and France reveal that there are significant barriers to dual sourcing, and that many Jersey retailers are locked into UK distribution systems that do not permit significant switching of trade to France, even if some of the goods they require might, on paper, be cheaper in France. Notwithstanding the integration of European economies, there are still national differences in both demand and supply. These include the language of labelling and technical specifications, as well as more subtle cultural issues. In this regard, Jersey is more like a part of the UK than it is part of France, and the demand for goods reflects this.

Thus, to switch anything like the 90% of trade to France does not seem possible within plausible limits to lower sourcing costs in France. Moreover, if such lower sourcing costs existed, it would be expected that UK importers would exploit this difference and import into the UK from France, which would then flow into Jersey via the UK ferry link. Realistically, therefore, the amount of trade that could be switched from UK sourcing to French sourcing is limited, and this will set a limit on the trade flows to France. This in turn reduces the maximum benefit the Island could obtain from increasing trade from France because any significant increase in trade, particularly as a frequent service is required, will *raise* the total transport costs that the economy of Jersey will need to sustain. On the imports side, the major economic benefits to Jersey from increased trade with France must, therefore, come from lower sourcing costs and not lower transport costs.

6 Overall assessment and conclusions

6.1 Hypothetical economic benefits

Notwithstanding that the coast of France is much closer to Jersey than the UK coast it is highly unlikely that Jersey could realise significant benefits from increasing trade with France just through a reduction in the ferry transport costs incurred by the economy. This conclusion flows from the structure of both ferry costs and demand in Jersey. As a result, if there are to be benefits to the Island, these must generally arise from lower sourcing costs (or higher net export prices) of Jersey products in France, compared with the UK.

In addition, if the Island is to benefit, the aggregate of the lower sourcing costs (or higher export prices) must be greater than the *additional* ferry transport costs that the Island would have to sustain as a result of the *additional* capacity that a frequent service to France would produce. However, such benefits *may* exist, although realising them may not be straightforward.

Within the range of likely differences in sourcing costs between France and the UK across enough of the economy, the potential savings could outweigh the additional total transport costs incurred. A 10% sourcing cost advantage across around 30% of the current freight imported would be likely to result in overall benefits to the Island and is also likely to produce a fairly sustainable, once a day, freight service to France.[73] To be able to realise these advantages, however, importers in Jersey need to be able to be prepared to switch. This may not be easy because many retailers are either tied into UK distribution systems, or manufacturers supplying independent retailers treat Jersey as an extension of the UK market (and thus an extension of their established UK hubs). Switching *part* of their demand to France may not be possible, or may result in loss of economies of scale, making the partial switch uneconomic. Branches of UK chains may not be able to behave in this way at all, even when sourcing from France would be cheaper.

In addition, branches (or franchises) of UK chains may benefit indirectly from the cultural ties with the UK in terms of marketing, advertising and general consumer awareness. The marginal costs of advertising to the Jersey market through UK national media (eg, newspapers) may be very low (or even zero) for these operations.[74] A similar advantage for an equivalent French operation would not arise—the spillover from national French advertising would not occur (or would be much reduced) because the target consumers (ie, Jersey residents) would not watch French TV nor buy French newspapers and magazines.

It has not been possible to quantify the impact of the demand-side limitations to sourcing from France from the interviews. Most interviewees were unable, with accuracy, to estimate what proportion of their demand they could switch to sourcing from France. What is clear is that there are significant limits on the ability to switch, even if sourcing costs in France were lower. In addition, the existence of the weekly Jersey–St Malo boat suggests that sourcing

[73] See Table 2.12. If, as is the case in the 'more likely' outcome, one France boat undertaking two rotations is required to facilitate the freight, the point at which Jersey is better off relative to the current position is at 33% trade with France. In the potential event that one France boat undertaking one rotation would be sufficient, this falls to 28%. The critical mass point for the France service, at which the service becomes sustainable, comes before this point, at 14% trade with France, assuming that a one-rotation service is possible at this demand level.

[74] UK-based firms may still advertise locally, in addition to benefiting from the spillover effects of UK national advertising. French-based firms could also advertise locally, but would not have the additional benefit from equivalent spillover effect. As a result, French-based firms are still at a disadvantage, notwithstanding the fact that both UK- and French-based firms would undertake local advertising.

cost differentials for non-time-critical freight are largely exploited fully within the capacity of this service.

6.2 Market failures

If a significant market failure exists, it must be in the inability of the ferry transport network to respond to considerable sourcing cost advantages (or export price advantages) that are available, and which *could* be realised by importers and exporters if there were a suitable ferry service. The analysis presented in section 4.5 shows that, in the absence of sourcing cost advantages, the pure transport cost advantages to Jersey of increased trade with France arising from distance effects are not likely to be achievable.

Moreover, a common theme throughout this technical report is that demand for ferry services (the costs of which may be subject to market failures) is largely a derived demand, stemming from the available sourcing opportunities (which may not be subject to market failures) that ferry services facilitate. If there are significant sourcing savings in France relative to the UK, the market failures arising from the structure of ferry costs per se in transition to increased trade with France are much reduced. Put another way, because the critical mass point is between 14% and 17%, provided that a few key players use the service to begin with, there should be few problems in market forces leading to increased trade with France.

As a result, the *relevant* potential material market failures are probably limited to the following.

– *Information failures regarding sourcing cost advantages or business opportunities*—the lack of reliable and robust information on the potential sourcing cost advantages available in France (see section 4.3) suggests that, even if they exist, the potential importers in Jersey (and, indeed, exporters from France) may not be aware of them. The interviews with Jersey businesses and companies in Normandy provide further confirmation that informational barriers play a role regarding the opportunities for trade more generally. As a result, even if with a frequent service to France, demand for the service might not materialise, as importers/exporters may be unaware of the potential advantages. The potential savings might, however, become evident as more businesses used the service. A number of independent Jersey businesses were aware of specific sourcing in France or European markets more generally.

– *Information failures regarding the total demand for ferries*—the potential ferry company might not be able to anticipate the level of aggregation of demand that would arise *if* it offered the frequent service to France, and as a result may fail to enter the market (or, in the case of the existing supplier of weekly services, expand its service).

– *Experience good failures*—importers/exporters requiring frequent services may not purchase such services (ie, switch their sourcing patterns) *until* they are confident that the new service from France is reliable and sustainable. They can only do so by observing the operation of the service for a period before they buy. As a result, there may be few users at the beginning, even though there is sufficient demand to make the service viable. The lack of demand in the early stages could cause the service to fail, or the anticipation of the lack of demand at the beginning might mean that entry does not take place.

– *Start-up and strategic entry problems*—the lumpiness of the costs incurred in the provision of the service, and the requirement to start with a frequent service, means that most costs of a new frequent service from France would be incurred from the start. However, building up demand will take time, and losses are likely to occur in the start-up phase. Indeed, this is common in markets characterised by critical mass problems and network effects (see Appendix A3.2). A potential problem for the first-mover is that, once it has overcome the coordination problem and has established a network of users on the

France route, a new supplier might also set up on the route, poaching the established customer base. Not having incurred the start-up costs (ie, start-up losses) in obtaining a critical mass of users prepared to use a frequent France service, the new entrant might be in a position to undercut the first-mover. As a result, the latter might not be able to recover its past losses. The very *threat* of this outcome may deter an entrant from launching a service in the first place.

Most of these problems concern information uncertainty.

The available evidence suggests that if realisable sourcing cost advantages are real, they are likely to be concentrated in particular parts of the economy. Thus, information problems here may be limited, and market research techniques could be used to establish whether the sourcing cost advantages really exist, and to gauge the likely demand for ferry services if they do exist. Any feasibility study for a new ferry service would in any case need to consider these factors. Moreover, in undertaking this particular study, it became clear that French businesses in Normandy which might be interested in undertaking trade with Jersey face informational problems. The Maison de Jersey, based in Caen, and the French networking organisation Oxera spoke to have been instrumental in reducing these barriers. Closer working between the States of Jersey and Normandy, to provide more comprehensive information on the Jersey market and to explore partnering opportunities in Jersey, might help to resolve such issues.

The experience goods problem and the start-up/strategic entry problem impinge on the ferry service itself.

The strategic entry problem can be overcome, at least in theory, by granting a time-limited monopoly for any *new* frequent France service, rather than a direct subsidy.[75] The experience good problem is more difficult to tackle, as it depends on the perception of the potential users. Intervention to underwrite the costs of operation would provide some assurance that the service would be maintained at least until the underwriting ran out. However, a reputation for relying on subsidy could have the opposite effect.

6.3 Implications for policy

Although there are some potential market failures in the ferry transport network, even in their most extreme form they are unlikely to be causing significant damage to the economy. This conclusion arises because it is unlikely that ferry costs are too high as a result of the transport pattern. Thus, if damage to the economy is occurring, it is as a result of sourcing costs being lower in France, which are currently unrealisable because of the lack of a frequent freight ferry service to France.

However, if this is genuinely the case, the *economic* barriers as a result of market failures facing the supplier of a new service to France are low. Section 4.5 showed that, with *large* differences in realisable sourcing costs, relatively little trade needs to switch to France before the ferry service is viable—more significant sourcing savings in France mean less market failures arising from the structure of ferry costs (ie, less of a coordination problem) and, by the same token, less case for intervention.

[75] This may not be the only competition-related concern for any new operator of the France service. Condor's reaction, on its existing frequent UK (or, indeed, weekly France) service, may also play a role in affecting the feasibility of any new frequent service from France. While keeping existing service levels constant (ie, two boats on the UK route), Condor might lower its prices. The degree to which it could do so would depend, to a large extent, on whether the prices it currently charges on either route are too high. As noted in section 3.2, this is far from clear. Moreover, even if this were the case, the entry of a competitor on the France route, and the provision of assistance to such an entrant, would be only one solution. Insofar as any problem did exist, the alternatives would include, for example, the regulation of Condor's prices. If sourcing cost savings by using a frequent France service are significant, any potential for Condor to lower prices on existing services would, in any case, have a muted impact on the entrant.

Realistically, in terms of the *maximum* disbenefit that the Island could *currently* be suffering as a result of market failures associated with ferry costs per se, Jersey may be missing out on savings of around 4% of total ferry-imported goods costs. This assumes, however, 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). If three boats are required at this point, the maximum savings available to the Island are lower, at around 2%.[76] In any event, it is not clear that Jersey policy should seek to motivate Condor to reduce the number of boats on the UK route, given the possible impacts on quality and security of supply.

Furthermore, the benefits may not exist at all, if, even when a new service from France is able to attain critical mass, trade with France is unable to pass the ~30% point.[77] Therefore, intervention to increase trade with France, by providing a direct subsidy for the ferry service, might make the Island permanently *worse* off. *If* the proportion of goods that can realistically be sourced from France is limited by cultural and other non-price factors, the available sourcing costs savings (of 10%) are unlikely to cover the extra costs of the additional boat(s) required.

At the same time, even though the transport pattern could get stuck in this position, the total detriment to Jersey is likely to be limited. For example, the costs to Jersey might be 1% higher than at present if switching of trade to France stops at around 20%. At the same time, the maximum savings to Jersey from increased trade with France, by reaching (say) the 40% point, would be fairly modest, at around 1%.[78] There may nonetheless be certain products, or sourcing methods, that could result in greater savings.

Under these circumstances, intervention for *economic* reasons needs to be very well thought out, and precisely targeted at market failures. As noted, a direct subsidy aimed at targeting market failures associated with ferry costs per se may not be the most efficient intervention, even if intervention is, on balance, likely to produce a net economic benefit.

Moreover, as regards all four of the additional potential market failures outlined above (information on sourcing costs, demand for ferry services, the experience good issue, and start-up issues), it was identified that other less interventionist ways of dealing with these issues are generally available.

While it might be argued that, in light of all these factors (including information issues), the market was unable to price the risks of any new project, from the point of view of public policy, the focus should ultimately be on whether a project generates wider 'spillover' benefits to the Jersey economy that private investors might not price into their projections. The conclusions presented above illustrate that the benefits to Jersey may be modest at best. Again, there is little justification for direct intervention by the States of Jersey on the grounds of project risk per se.

There may, however, be some justification for more direct intervention in relation to overcoming the strategic entry problem described above, and the experience good problem. 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

[76] Assuming that freight ferry costs are 5% of goods costs and France sourcing costs are 10% less than UK sourcing costs (situation B), the UK 90/France 10 point has a total unit cost index of 99.1. If the 50/50 point is characterised by two boats, this falls to 94.8. However, in the three-boat case, this falls to only 97.5 (97.0) if one France boat undertaking one (two) rotations is required. See Tables A4.3 and A4.4 of Appendix A4.2 for more information.

[77] See Table 2.12. The 'more likely' outcome associated with situation B reveals that 33% of volumes would need to be sourced from France for Jersey to be better off than at present.

[78] The first figure assumes one France boat undertaking one rotation, and the second figure one France boat undertaking two rotations (three boats in total in both cases).

less-interventionist alternative. Any potential subsidy to tackle the experience good issue would need to be carefully thought through.

The analysis presented in this study has had to make a number of simplifying assumptions with respect to the transport network and the potential for sourcing cost savings available in France. In particular, the freight ferry configurations modelled have focused on the current links to St Malo, rather than any future links to Cherbourg, or even Granville. A different freight ferry route network could change the analysis. In theory, a Cherbourg link would imply that 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. In addition, the total potential savings in freight ferry costs would be lower if a significant switch did occur, because the variable cost advantage compared with the UK would also be lower. 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.

A connection to Granville would have lower variable costs, as Granville is slightly nearer than St Malo, but could suffer the disadvantage of being a smaller commercial centre compared with St Malo or Cherbourg.

The general conclusion that the total transport cost savings that are potentially available from increasing trade with France are relatively small, and the conclusion that *total* freight ferry costs could rise, at least in the transition, if not permanently, still hold. However, the precise points at which total ferry costs could fall, such that the service to France would become economically viable and the level of sourcing cost reductions needed to make the Island economically better off, would change slightly.

There may be non-economic benefits of increased trade with France, which have not been explored in detail in this study, such as political or cultural reasons why the States of Jersey might support a new freight link.

In addition to the direct issues of increasing trade with France, a significant number of interviewees linked perceived problems with either the Jersey economy, or the current operation of the ferry route to the UK, to the lack of a frequent freight ferry service to France. In particular, increased trade with France was seen as a way of increasing the effective competition in both retailing in Jersey and the provision of ferry services (with their accompanying logistics) to the UK.

It is possible that increasing trade with France could bring about competitive changes in these two markets. However, because these problems, insofar as they exist (and this is not clear), are not directly connected with the level of trade with France, there is no guarantee that increased trade would deliver these benefits. More importantly, if these are the real problems that need to be tackled (and it is beyond the scope of this project to answer this question), there are likely to be more effective and more reliable ways of tackling them that do not require government subsidy or run the risk of permanently increasing the total ferry transport costs that are incurred by the Jersey economy.

Appendix 1 Supply chain and freight ferry cost structure

A1.1 Description of the supply chain

The nature of each stage of the supply chain is discussed in more detail below. Some key observations are as follows.

– *Supplier to transportation hub*—Jersey retailers may deal with manufacturers, distribution centres or wholesalers. In many cases, freight transported into Jersey arrives via established UK distribution hubs, effectively ending at Portsmouth. Jersey represents a small proportion of total volumes carried along these hubs. More trade with France might involve redirecting a portion of Jersey-bound freight at an earlier stage in the supply chain, or more direct sourcing. However, it is not clear that this would be lower cost since the economies of scale and scope achieved via current hubs would not apply, and the functions performed by current hubs would need to be duplicated.

– *Transportation hub to ferry*—most freight being carried into Jersey is driver-unaccompanied and is handled by logistics companies (which store, pack and forward freight).[79] This may be efficient, given the small volumes carried into Jersey, the need to pack freight on the ferries as efficiently as possible, and the need to avoid congestion at the port of St Helier.

– *Harbour to Jersey businesses*—there are restrictions in Jersey which mean that it is not possible to drive large trucks, at least not without a permit.

A1.1.1 Where may differences in cost arise along the supply chain?

There are several stages along the supply chain at which sourcing from (or via) the UK may have different costs to sourcing from or via France. To the extent that lower costs are passed through along the supply chain to the Jersey business, there may be potential benefits in Jersey of sourcing goods from one destination compared which the other. Potential differences, which may be influenced by sourcing location, are as follows:[80]

1) sourcing prices;
2) hub costs;
3) logistics costs;
4) harbour and customs costs—including cost of delays, etc, and additional bureaucracy for example on the French side;
5) freight ferry costs.

In the analysis of potential benefits undertaken in this study, it has been assumed that:

– the average transport costs from suppliers to the main transportation hub exit point (ie, prior to port) are the same in the UK and France, and that there are no additional costs in bypassing or reconfiguring existing UK-oriented distribution hubs (2);
– the efficiency of logistics companies (3) are the same on either side;
– bureaucratic costs and harbour facilities costs (4) are the same on either side.

[79] Condor Logistics, part of the Condor Group, operates on the Jersey–Portsmouth route, as does Ferryspeed. Morvan Fils, a subsidiary of Condor Group, operates on the route between Jersey and St Malo.

[80] Once a ferry arrives in Jersey, it can be assumed that handling/transport costs along the remainder of the supply chain are common for all imports, and are thus not influenced by origin of the ferry.

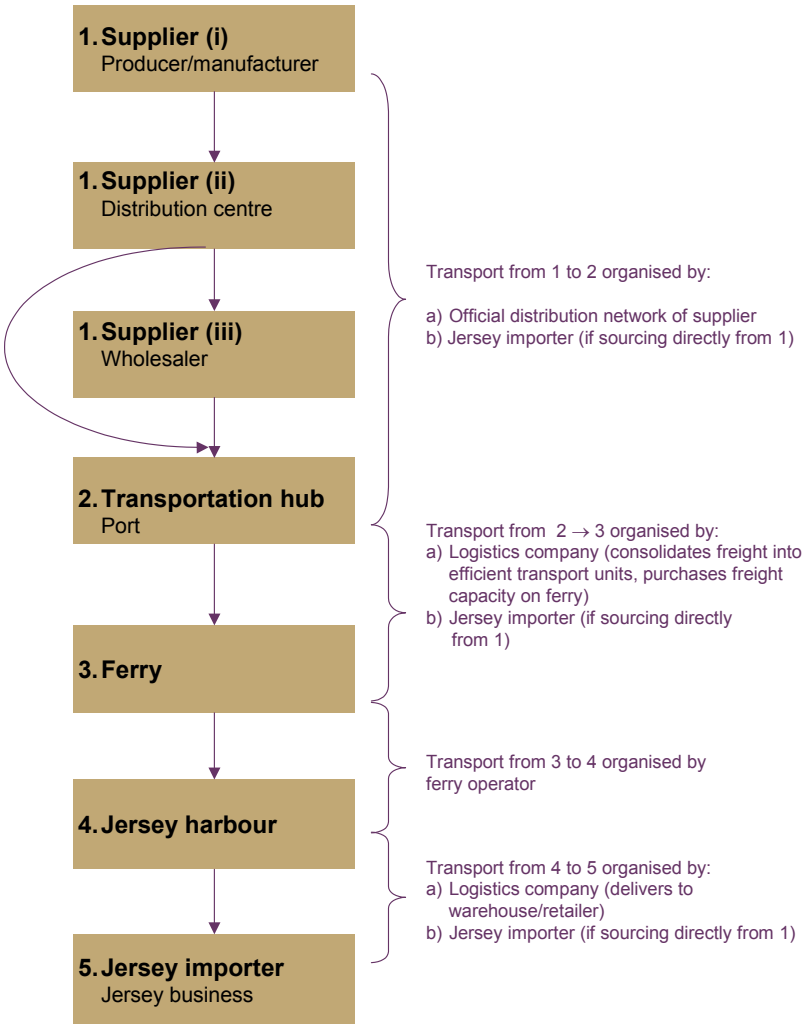
Therefore, the average cost that arises along the supply chain up and including to the point when goods are loaded onto the ferry is assumed to be the same for both the UK and France as sourcing destinations. Thus, the analysis of the potential benefits of switching trade to France focuses on the potential variation in costs arising due to differences in:

– ferry transport costs (including the percentage of costs accounted for by ferry transport costs) (5); and
– differences in sourcing prices (1).

A1.1.2 The stages in the supply chain

Products typically go through several stages between leaving a production facility and arriving at Jersey businesses. Freight ferry costs are one among many other factors. Figure A1.1 provides a generic overview of the stages of the supply chain of Jersey importers. (This description applies to both sea and air transportation routes.)

Figure A1.1 Jersey business supply chain



Source: Oxera.

It is of note that, in serving Jersey, there may be more stages to the supply chain than in serving other parts of Europe. For example, the reloading of goods from a standard trailer in which goods arrive by ferry in Jersey into a smaller trailer designed for circulation in the Island is specific to Jersey (or to the Channel Islands more generally). This handling cost

does not arise elsewhere; it adds to the final price that a Jersey business pays for goods, and is likely to have an impact on the retail price.[81]

From supplier to transportation hub (1→2)

Depending on the type of good, the relevant supplier (1) that deals with retail orders is either (i) the producer/manufacturer directly, (ii) a distribution centre, or (iii) a wholesaler.

Due to the limited size of the Jersey import market, there are only a relatively small number of transport hub exit points (2) (ie, ports, or airports) from which it is possible to access the Island. Since transport capacity is a derived demand (ie, demanded transport capacity depends on the volume of goods that an economy wants to import), and Jersey import demand is finite (although perhaps growing slowly since the fixed population's disposable income rises over time, increasing their demand for imports), commercially viable transport links can only be operated from a small number of transport hubs.

Currently around 90% of goods are shipped by ferry from Portsmouth, with the majority of freight carried by Condor Ferries. Airfreight accounts for a relatively small proportion of light freight.[82]

The transportation of goods to transport hubs tends to follow via established distribution networks of suppliers. For example, when ordering goods from branded manufacturers, the manufacturer will use its own distribution centres. Alternatively, Jersey importers may source goods directly from suppliers and the transport to the transportation hub may be organised by them. In particular, smaller, independent retailers may have more possibilities to rely on direct sourcing (see section 5 and Appendix 5).

From the interviews, it is of note that a large majority of Jersey export volume is currently transported from suppliers to transportation hubs via established distribution networks (see also section 5). Since Jersey businesses tend to import from different suppliers, direct sourcing would require an importer in effect to replicate each of the existing bulk and finer distribution networks. Since the volumes of any one imported good tend to be comparatively small (eg, considerably less than the required amounts for a truck load), the unit cost of doing so may be high in many cases.

For example, most Jersey freight sourced from Continental Europe is carried on cross-channel services alongside bulk consignments of freight bound for the UK market. Jersey volumes represent a small proportion of these total volumes carried, and the marginal costs of carrying the additional Jersey freight will be very low. Following redistribution in the UK (again, in fairly substantive volumes), the freight eventually travels to Jersey via Portsmouth. The alternative to sourcing via these UK distribution hubs would be to redirect a portion of Jersey-bound freight at an earlier stage in the supply chain via a more direct route (for example, via St Malo). It is not clear, however, that this would be lower cost, since the economies of scope and scale achieved via the current hubs would not apply, and the functions performed via the existing hubs would need to be duplicated (again, see section 5 for a further discussion).

From transportation hub to ferry (2→3)

The often relatively small volume of a single consignment good has further implications for the procedures required prior to the shipping of goods to Jersey. To minimise transport costs, freight needs to be packed as efficiently as possible. Charges for ferry freight are often levied on a per-lane-metre (or pallet-equivalent) basis; alternatively, they may be levied according to weight, but even these can be subject to maximum volume limits per tonne. Thus, in

[81] This depends on the degree to which the additional costs of serving Jersey feed through into delivered prices to Jersey. Some interviewees identified that it was possible in some cases to secure goods at delivered-to-UK prices (see Appendix 5).

[82] The unit cost of transportation for airfreight is much higher than for other forms of transport.

general, the more that can be fitted into a lane metre, the lower the unit transport cost. In this regard, logistics companies play an important role.

Logistics companies consolidate the goods of different importers into efficient transport units (eg, trailers or containers) and purchase freight capacity from ferry operators. These companies also take care of handling the required export procedures with custom authorities.

Alternatively, a Jersey business may handle the organisation of shipment and customs procedures itself, although at potentially higher unit transport cost, as it has to replicate the operation of the logistics company, which can spread its costs over a large number of export operations, with consequent economies of scale.

The ferries operated by Condor, which handles most of the freight on the Channel Islands–Portsmouth route, have only limited capacity for driver-accompanied freight (see Appendix 5). Therefore, most freight needs to be handled by a logistics company. An alternative would be to use a large number of driver-accompanied freight with small lorries. However this may itself lead to additional costs, and cause coordination issues at the port concerned. Therefore, the current reliance on driver-unaccompanied freight handled by logistics companies may represent the most efficient method for transporting goods to Jersey. As discussed in section 5 and Appendix 5, however, the interviews revealed differences in views on this issue.

Freight shipping, Jersey Harbour and delivery to Jersey business (3→5)
Following the loading of the ferry, goods are shipped to Jersey by a ferry operator, either directly (eg, daily light vessels from St Malo to Jersey) or via Guernsey (daily freight ferries on the Portsmouth–Guernsey–Jersey route).

A ferry operator's decision to operate a service on a certain route and the frequency of the service depends on transport demand for the route (which, in turn, is derived from the demand for the sourced products). The level of demand also determines the size of the operator's vessel choice. The economics of ferry operators and the choices they face are further explored in section 4.

Upon arrival at the Jersey harbour, the ferry cargo is unloaded and delivered to Jersey businesses in one of three ways:

– *driver-accompanied RO–RO*—if the cargo is on a truck and accompanied by a driver, having gone through the customs procedure, the goods can be delivered to the Jersey businesses;

– *driver-unaccompanied RO–RO*—if the cargo is driver-unaccompanied (eg, on a pod or trailer), the ferry is unloaded by stevedores. Since standard-size trailers from outside the Channel Islands need a special permit to drive in Jersey, as roads are narrower than elsewhere, freight companies have invested in trailers into which cargo from the ferry is reloaded. A logistics company then handles the customs procedure and organises delivery to the individual businesses. Oxera understands that this is the most common procedure for importation;

– *unaccompanied LO*–LO—if the cargo is shipped in a LO–LO vessel (as is the case for nearly all the cargo carried by the Huelin Renouf service from Portsmouth), the cargo is lifted off by stevedores, reloaded into Jersey-specific trailers and, after a logistics company handles the customs procedure, delivered to businesses.

A1.2 Freight ferry cost structure

More detail is provided below on the cost structure of ferry services, as obtained from an academic study and from generic data provided by an industry source.

A1.2.1 Ship cost structure (academic study)

The costs of running a ferry operation can be placed into the following principal categories.[83]

– *Operating costs*—these are incurred in the day-to-day running of a ship and which need to be incurred regardless of the ship's length of voyage, and origin and destination ports. This category includes crew costs, stores and supplies, insurance, overhead costs (administrative and management), and essential repairs.

– *Maintenance costs*—these are the periodically incurred costs of maintaining the ship that go beyond essential repairs. This is an important cost category in particular for older ships.

– *Voyage costs*—these vary by type of activity, and depend on the origin and destination ports and the length of voyage, such as fuel costs and port charges, with fuel costs being the most significant item in voyage costs.

– *Capital costs of purchasing a ship*—including the repayments of principal borrowed to purchase the ship, interest and (potentially) return on equity capital.

Critically, with the *exception* of voyage costs, **the above costs are largely fixed in nature**.

Table A1.1 outlines the cost structure of a Capesize bulk carrier,[84] as described by Stopford (1997). It needs to be emphasised that such freight ships are substantially larger than the conventional freight ferries, with considerably different underlying economics compared with the ferries employed on the Channel Islands–UK route.[85]

Table A1.1 Cost of running a bulk carrier operation (% of total cost per annum)

	% of annual total cost
Operating cost & periodic maintenance	26
Capital cost	39
Voyage cost—port cost	16
Voyage cost—fuel cost	19

Note: Based on an estimated total cost for a ten-year-old bulk carrier of US$8.8m at 1993 prices.
Source: Stopford (1997); Oxera calculations.

Since the availability of ferry cost structure data is very limited, the costs provide a useful comparison of the importance of different elements of operating a ferry service. The table shows that the most important element in the total cost is the cost of purchasing the ship (the capital cost). Even though the trips of bulk carriers tends to be lengthy, only around 20% (fuel costs) of total costs are directly related to the distance travelled, with the remainder of costs being either fixed (capital costs, operating cost and periodic maintenance) or related to the destination port of the ship (port costs).

Stopford (1997) presents an independent check on the cost structures derived from the industry source data, and makes a number of interesting observations that are relevant to the current study.

– *Old versus new ships*—day-to-day operating costs (eg, maintenance and crewing) and voyage costs (eg, fuel) are higher for older ships because they are less reliable and

[83] Stopford, M. (1997), *Maritime Economics*, second edition, Routledge.

[84] A bulk carrier is a single-deck vessel designed to carry homogeneous dry cargoes such as grain, iron ore and coal.

[85] For example, the large dimensions of Capesize bulk carriers mean that only the largest deep-water terminals can handle them.

require more maintenance (and thus also more crew to perform this), they have fewer automated functions (again, resulting in higher crewing costs), and they are less fuel-efficient (due to engine design and hull condition). Thus the cost structure of older vessels is considerably different to that of newer vessels.

– *Fuel costs*—fuel is the most significant item in voyage costs. Thus fuel costs are a significant consideration in weighing up alternative routes.

– *Large versus small ships*—larger ships benefit from economies of scale, and have lower unit costs than smaller ships (for example, the same crew size may be required in both instances, and fuel costs do not rise in direct proportion to boat size). The downside is that larger ships may not be able to enter smaller ports.

The finding of economies of scale in freight ferry operations is particularly important. The economies of scale identified in Stopford (crew, fuel, etc[86]) cannot be exploited on the Jersey route since the maximum length of boat that can enter the harbour is 130m (see below).

A1.2.2 Ferry cost structure (industry source)

The structure of costs outlined in Stopford (1997) provides an independent sense-check on the hypothetical cost structures created by Oxera, using generic data from an industry source.

To provide an idea of the differences in cost structures between the UK 90/France 10 and UK 10/France 90 scenarios, Table A1.2 shows the contribution of the different cost categories to total costs for a ferry on the Portsmouth–Channel Islands and St Malo–Channel Islands, respectively. The table assumes that the capacity of the ships is sufficient to satisfy the majority of the Channel Islands demand, whether with a one-boat operation on the St Malo–Channel Islands route undertaking two trips per day, or a two-boat operation on the Portsmouth–Channel Islands route undertaking one trip each within 24 hours.

Table A1.2 Ferry costs (% of total cost per annum)

	Portsmouth–Channel Islands route UK 90/France 10	St Malo–Channel Islands route UK 10/France 90
Operating cost and periodic maintenance	37	37
Capital costs	24	22
Voyage cost—port cost	13	22
Voyage cost—fuel cost	26	19

Note: Calculations assume a one-ferry operation on the St Malo–Channel Islands route and a two-ferry operation on the Portsmouth–Channel Islands route. Furthermore, the assumption is made that the same type of ship is run on both routes and that port costs are the same for both Portsmouth and St Malo.
Source: Industry source for generic cost information on operating a ferry; Oxera calculations.

A direct comparison between Table A1.1 and Table A1.2 shows that the capital cost of a large bulk carrier takes a greater share in the total annual cost than for either of the ferry operations to the Channel Islands shown in Table A1.2.

Table A1.2 also shows that, due to the greater length of the trip, fuel costs are a more important element in terms of total costs on the Channel Islands–Portsmouth operation (26%) compared with the Channel Islands–St Malo roundtrip (19%).

[86] Operating, voyage and capital costs tend to increase less than proportionately with the size of vessel, such that the unit costs of transporting goods fall with larger vessels.

A1.2.3 Frequency of possible new ferry service

There are a number of considerations which, when taken together, mean that any new service would probably need to be a frequent one.

– A weekly service from St Malo already exists (Condor's), and Oxera's understanding is that this is not currently fully utilised (see Appendix 5). Hence there appears to be little existing unmet demand for an infrequent service to France. The current configuration also benefits from Condor being able to spread its fixed costs between its existing frequent operations and the weekly service. A weekly stand-alone service, introduced by a new entrant, is likely to have higher unit costs than the current service. Thus, on these grounds alone, it would not appear to make sense, in unit cost terms, for a new entrant to launch a weekly service.

– Any new service would most likely need to be aimed at satisfying frequent demand, to attain sufficient volume. It is not necessary for individual customers to each require a daily or six-day-a-week service for a total daily demand profile to be attained. There can be a randomly allocated mixture of demands (for example, six days a week, three times a week, two times a week). When aggregated, this is likely to convert overall into an overlapping daily demand profile.[87]

– Given that many of the costs of operating a freight ferry service are fixed each week (eg, crew and capital costs), it may make sense for an operator to launch a frequent daily service to target this demand, and to spread its fixed costs across this demand. Thus the existence of frequent demand may not in itself hinder the development of a freight ferry service since, even if demand were non-periodic, it would still make sense for a new operator to run its service frequently to spread its fixed costs over an expanded customer base. Capacity utilisation is key, regardless of the nature of demand.

[87] See also section 3, which looks at the requirements of Jersey retailers and importers in respect of perishables, just-in-time and flexibility. Although not all Jersey businesses would require a frequent service, by the same token, for these customers, the existing pattern of services from the UK and France could be adequate. Thus, to pick up this total demand, a new service run once or even twice a week may not attract sufficient additional demand. Although the Huelin Renouf service currently operated from Portsmouth runs three times a week, and this attracts UK demand for the sectors served by the service, this also has secured an established base of customers with particular demand profiles (those not requiring temperature-controlled trailers who are prepared to use a LO–LO service).

Appendix 2 UK and France price comparisons

This appendix provides more detail on the price comparisons discussed in section 4.3.

A2.1 Wholesale price comparisons

A2.1.1 Scope for price comparisons and obstacles

As part of the inquiry into supermarkets in 2000,[88] the UK Competition Commission conducted an investigation into differences in the wholesale prices of goods sold in supermarkets in the UK and other European countries, including France. The Commission asked 57 large suppliers to provide information on their top-five branded product lines that are supplied to large supermarket chains in the UK, France, Germany, Netherlands and Italy. Only eight companies[89] were able to provide detailed comparable data. Among the reasons were that companies did not sell products outside the UK or had no or only limited price information available, but also that products sold under the same brands in the UK and Europe had significant formulation and/or ingredient differences.

The Commission study therefore highlights the problem of finding like-for-like comparisons and raises questions regarding the scope of price comparison between the UK and France in the current study. There is likely to be a range of goods for which like-for-like price comparisons cannot be carried out, since goods are not sold in both France and the UK (and therefore Jersey, which receives over 90% of its imports from or via the UK).

For the purposes of this study, the scope for carrying out price comparisons for the following broad product categories has been examined.

– *High-street brands*—many of Jersey's retail outlets are UK high-street stores, which have no representation in France. Like-for-like comparison products can therefore not be readily identified. Since these stores tend to be highly integrated into the distribution network and supply chain of a UK-wide network of stores, even if some identical products sold in these stores were available from France at lower prices, it is unlikely to be economic to source these via non-UK-oriented supply chains, as this would require duplication of transport and distribution networks.

– *Bulk goods*—ie, building materials (eg, bricks, cement, sand, gravel or timber), fuel, or animal feed. These are likely to be less-constrained existing supply chains and, given data availability, price comparisons could be conducted. However, Jersey largely follows UK building standards, and to the extent that French products do not meet the requirements, Jersey may be limited to importing UK-produced goods (although some interviewees identified that this may be less of a problem going forward as countries converge to EU norms—see section 5 and Appendix 5).

– *Fresh produce*—fresh fruit and vegetables available from wholesale markets in the UK and France may also offer scope for like-for-like price comparisons.[90] France is a large producer of agricultural goods, potentially leading to lower unit production costs due to greater economies of scale than in the UK. France is the largest beneficiary of EU common agricultural policy (CAP) funding, and one of the highest per-capita

[88] Competition Commission (2000), op. cit.

[89] The data analysed by the eight suppliers comprised 34 product lines for which data was available in at least three countries.

[90] Fresh fruit and vegetables may offer sourcing opportunities in particular for UK-based retailers and those which are not highly integrated into a UK-oriented supply chain.

beneficiaries of CAP funding.[91] Compared with the UK, the larger subsidies to food producers in France may lead to overall lower prices for French agricultural output. Oxera has investigated a range of data sources for wholesale price comparisons.[92] While there is some evidence of lower prices, in practice, representative rather than indicative wholesale price comparisons of fresh produce are not straightforward. The lack of a sufficient number of comparable produce in the data sources provides significant obstacles to like-for-like comparisons.[93] The Competition Commission's investigation into wholesale prices also revealed that the fresh produce suppliers in the UK do not sell products to Continental Europe.[94] This further limits the way in which comparable fresh produce data could be collected.

As noted, some comparisons can be made for building supplies and fresh produce. As regards building supplies, Table A2.1 shows that, in most cases, building supplies are more expensive to source in France than in the UK (although this presents a national picture for the countries concerned, and prices may be lower in some regions than in others).

Table A2.1 France versus UK building supplies prices, 2004

Building material	Type	Unit	France	UK	France versus UK (% difference)
Steel rebar	High yield	£/tonne	735	518	+42
Structural	Steel	£/tonne	868	715	+21
Ordinary	Cement	£/tonne	113	108	+5
Concrete	20N/mm^2	£/m^3	74	66	+12
Aggregate	All grades	£/tonne	34	15	+127
Sand	Coarse	£/tonne	34	17	+100
Plaster	–	£/tonne	185	186	–1
Carcassing	Timber	£/m^3	258	247	4
Common	Bricks	£/1000	285	199	+43
Concrete blocks	100mm	£/m^2	2	8	–75
Glass	6mm	£/m^2	23	32	–28

Note: Rates include delivery to site and local discounts, but exclude VAT and local taxes.
Source: International Cost Survey, Gardiner & Theobald.

As regards fresh produce, the European Commission publishes annual producer prices[95] for a limited range of fresh produce. These comparisons can be used to provide some indication of price differences in sourcing nationally produced goods. Producer prices for a comparable 100kg of apples were around 22% lower in France in 2000/01 and 2002/03, around 6% lower in 2003/04, but 9% higher in 2001/02. Similar comparisons show that producer prices for pears were around 25% higher in France in 2000/01 and 2001/02, but lower by 15% and 10% in the years 2002/03 and 2003/04, respectively. For cauliflowers, the European

[91] European Commission (2004), 'Annual report on allocated expenditure, Financial Year 2003'.

[92] The data sources investigated include a survey database from www.todaymarket.com of daily wholesale prices from major wholesale markets in France and the UK, including Rungis (Paris) and New Covent Garden (London). A number of Jersey businesses currently source their fresh fruit and vegetables from New Covent Garden.

[93] Obstacles include the unavailability of same product varieties—eg, the same variety of fruit—and other difficulties such as irreconcilable differences in unit/weight measurements in datasets.

[94] Competition Commission (2000), op. cit.

[95] Although producer prices are synonymous with wholesale prices, the prices apply only to domestically *produced* rather than domestically *sold* produce; hence, further inferences about general differences in prices cannot be made.

Commission figures show that producer prices were lower in the range of 15–28% in the four years since 2000/01.[96]

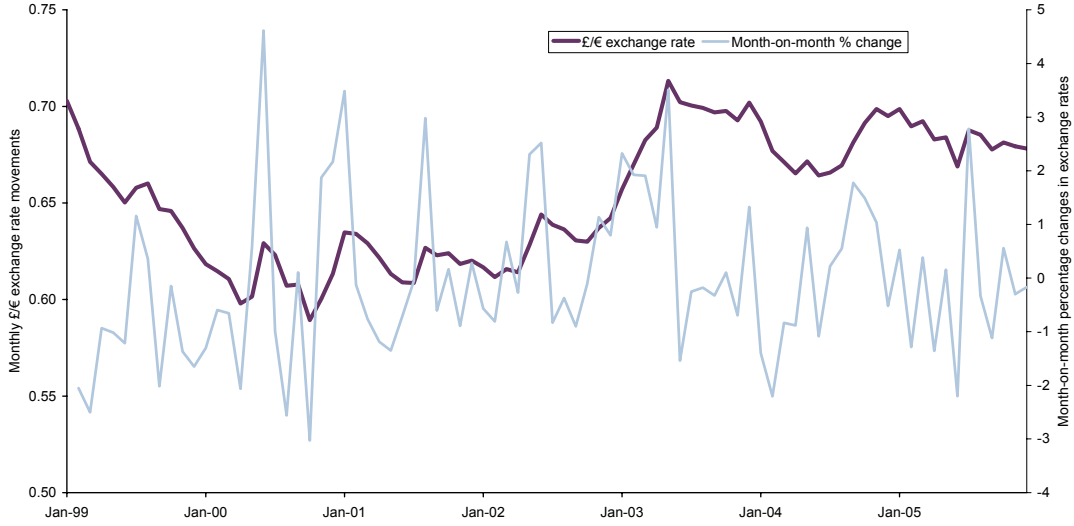
A2.1.2 Results from the Competition Commission inquiry into wholesale prices

The 2000 Competition Commission supermarkets inquiry does not provide a breakdown of wholesale prices that would allow direct comparison between France and UK prices. However, its analysis shows that UK prices were cheapest for nine product lines, most expensive for 11 and joint most expensive for one line. The analysis also revealed that, for some products, the differences between the top four supermarkets within a country exceeded the differences between countries.[97] This indicates that *international* differences in wholesale prices of branded products for certain goods may be less important than *national* differences in wholesale prices. Overall, the Commission noted that 'direct price comparisons of suppliers' prices across Europe are very difficult' and that 'on the limited evidence available, there was little evidence of prices being systematically higher in the UK. Exchange rates appear to be a major factor.'[98]

Indeed, significant exchange-rate movements provide a major obstacle to price comparisons. 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. In times of a weak euro, price comparisons may show large differences such that it would be advantageous to source goods from France or the Eurozone. In times of a strong euro, comparisons may show lower or even higher prices for France compared with the UK. While Jersey businesses may protect themselves against exchange rate risks, hedging measures add to the cost of conducting business and any price differences may decrease. Thus, conducting business within the sterling common currency trading area offers financial benefits for Jersey businesses.

Figure A2.1 shows monthly £/€ exchange-rate movements (left-hand axis) and month-on-month percentage changes in £/€ exchange rates (right-hand axis) since the inception of the euro in January 1999.[99]

Figure A2.1 Monthly £/€ exchange rates movements



Source: European Central Bank, www.ecb.int/stats/exchange/eurofxref/html/index.en.html; Oxera calculations.

[96] Directorate-General for Agriculture; Oxera calculations.

[97] Competition Commission (2000), op. cit., appendix 11.7.

[98] Competition Commission (2000), op. cit., appendix 11.7.

[99] Although the euro was introduced in January 1999, it was introduced as a physical currency only in January 2002.

Figure A2.1 shows a gradual decline in the £/€ exchange rate following an initial value of £/€ 0.7 when it was introduced in 1999, to a low of 0.59 in October 2000. This represents a fall in the value of the euro against pound sterling of 20% over a period of less than two years. Price comparisons conducted during this and subsequent periods of low exchange rates are likely to have shown relatively lower prices in France compared with the UK. From October 2002 to November 2005, the euro remained relatively strong. Price comparisons during times of a stronger euro may still have revealed price differences in favour of France, although these would have been considerably lower than in times of a weaker euro.

Movements in exchange rate tend to be very frequent and therefore add to the uncertainty of conducting business outside the sterling area for Jersey businesses (although, as noted above, the risk can be minimised through hedging). This can be visualised by looking at month-on-month exchange movements (the right-hand axis of the figure), which range from around –3% to 4%.

A2.2 Retail price comparisons

Comparisons of retail prices between the UK and France may provide a very approximate picture of differences in sourcing costs. Recent studies have found the following.

– Retail market research company, ACNielsen, has conducted the most recent investigation into European grocery retail price differences,[100] comparing prices for 160 international branded products within and across the EU15 markets using price observations of all large retailers within each country. Its comparisons show that French international branded products are on average around 11% cheaper than in the UK.

– As part of the 2000 supermarket inquiry, the Competition Commission conducted a comprehensive international retail price comparison exercise.[101] Overall, it was concluded that, in the second half of 1999 (ie, a period during which the euro was gradually declining in value against the pound sterling), supermarket grocery prices were around 11% lower in France than the UK. The Commission noted that the result was 'heavily affected by the appreciation of sterling between 1996 and1999'.[102]

The Commission's figure is very similar to that found by ACNielsen in 2005, which is likely to have calculated its figure of around 11% via a somewhat different methodology to that used by the Commission.

In 2000 and 2001 the UK DTI commissioned two reports on international price comparisons.

– *ACNielsen (2000)*—these comparisons focused on retail price differences for a range of consumer goods sold in a variety of retail outlets (eg, grocery stores) and general outlets (eg, department stores) in the UK, France, Germany and the USA. Of 56 items for which like-for-like comparisons could be made, 31 retail prices were found to be statistically different in the UK and France,[103] around 60% of which are reported to be lower in France and 40% of prices are lower in the UK. When comparing prices net of VAT—which is lower in the UK[104]—27 items were found to be statistically significantly different. Of these, 70% were lower in France and 30% lower in the UK.[105]

– *Economist Intelligence Unit (EIU) (2001)*—these comparisons covered internationally traded branded consumer goods across France, Germany, Sweden, the UK and the

[100] ACNielsen (2005), op. cit., and Oxera calculations.

[101] Competition Commission (2000), op. cit. section 9. The data used in the price comparisons was provided by ACNielsen.

[102] The Commission also found that land and construction costs may have an impact on British grocery retail prices.

[103] In other words, for a quarter of goods examined, no differences in price were found.

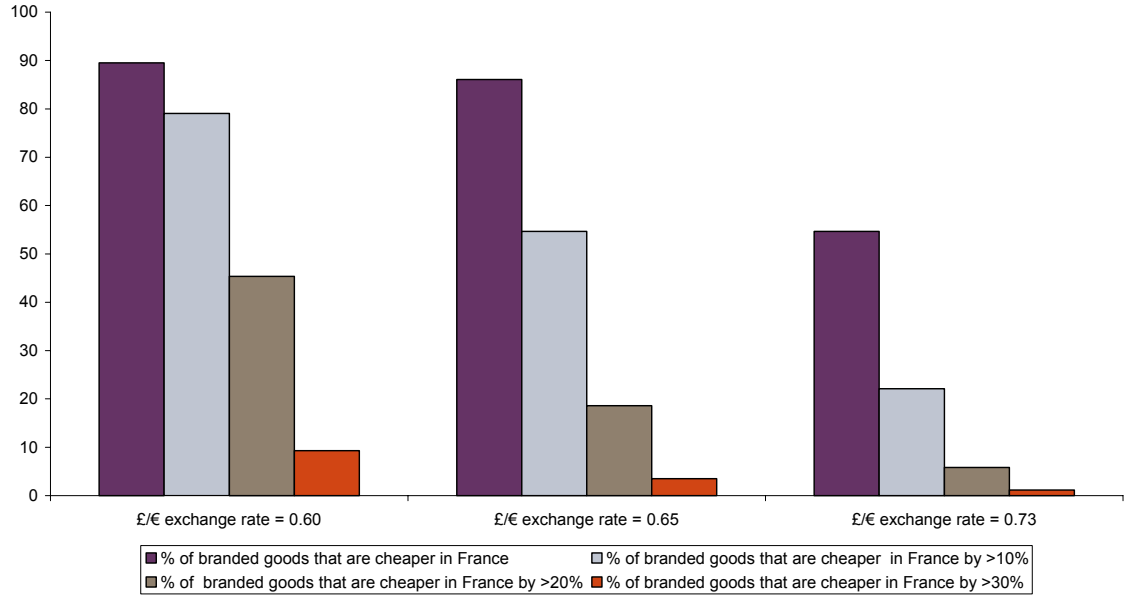
[104] VAT is 0% for food and 17.5% for most non-food items in the UK, and 5.5% on food and 20.6% on non-food items in France.

[105] ACNielsen (2000), op. cit., and Oxera analysis of data published in report.

US.[106] The survey identified 127 goods for which like for like comparisons could be undertaken between the UK and France. The retail prices of 86 products were found to be statistically significant different (ie, one third or prices were the same). At an exchange rate of £/€0.60 at the time of the survey, 90% of the 86 products with statistical differences in price were cheaper in France. Across all products, prices were on average 16% lower in France.[107]

Since the exchange rate at the time of the EIU report was close to the all-time low of the euro, at £/€0.57, it is instructive to test the sensitivity of the price comparisons to movements in the exchange rate (see Figure A2.2). The figure assumes that relative prices between the UK and France stay the same, and that only the exchange rate varies. Using an exchange rate of £/€0.65—the average rate from the introduction of the euro in January 1999 to November 2005—French prices are estimated to be on average around 4% lower. If the maximum value of the exchange rate of £/€0.73 is used, French prices are on average *higher* by around 2%.[108] A similar pattern emerges when comparing prices net of VAT.

Figure A2.2 UK–France branded goods price comparison



Note: £/€0.6 is the rate prevailing at the time of the study. £/€0.65 and £/€0.73 are the average and maximum exchange rates respectively over the period from January 1999 to November 2005.
Source: EIU (2001); Oxera calculations.

[106] Economist Intelligence Unit (2001), op. cit.

[107] This figure refers to the unweighted average price difference across all products. When the size of price differences is taken into account, the price difference falls to around 7%, suggesting that, for more expensive items, price differences tend to be lower or prices tend to be lower in the UK.

[108] Economist Intelligence Unit (2001), op. cit., and Oxera calculations.

Appendix 3 Ferry costs and market failures

This appendix provides more detail in relation to the analysis of ferry costs and market failures, presented in section 4.4. Table A3.1 outlines the assumptions used in the calculations undertaken for the analysis presented in section 4.4

Table A3.1 Unit cost modelling assumptions

Issue	Assumption
Sourcing costs	Sourcing costs (for example, wholesale prices) are identical in the UK and France
Scenarios	90/10 UK/France demand is satisfied through a frequent service to UK, and a weekly service to France 10/90 France/UK demand is satisfied through a frequent service to France, and a weekly service to UK 50/50 scenario can only be satisfied through a frequent service to both the UK and France (in this scenario, no weekly service would be run)
Boats	All boats in the analysis are of the RO–RO conventional type, and are of exactly the same type and size
Weekly services	In the 'stand-alone' case, the weekly service is not operated by the company running the frequent service, whereas in the 'integral' case the weekly service is operated by the company running the frequent service. For weekly services, capital and crew, etc, costs are either fully allocated (stand-alone) or not allocated at all (integral) to the weekly service. This represents two extremes of cost allocation
Direction of flows	All freight is assumed to flow in one direction—ie, a capacity utilisation of 50% is assumed. The costs of transporting empty trailers or trucks back to their destination are reflected in the costs modelled
Fixed capital and operating expenditure	Capital and crew costs represent fixed costs per week, depend on the number of boats used, but are invariant to frequency of use (daily versus weekly). Shore costs do not vary with the number of boats operated. Driver-unaccompanied RO–RO logistics costs are excluded from the analysis (see section 3)
Capacity	Two frequent boats, each undertaking one rotation per day (six days per week), are sufficient to satisfy total Channel Islands demand
Variable operating expenditure (by frequency)	Ships dues and stevedores vary by frequency of service and number of boats, but not by volume or weight (a simplifying proxy)
Variable operating expenditure (by distance)	Fuel costs vary by distance, in direct proportion (ie, the higher costs of acceleration are not taken into account), but fuel costs are not dependent on volumes carried/weight (a simplifying assumption)
Effects of distance	Not only does distance affect fuel costs directly, but may also indirectly affect scheduling (eg, using one boat instead of two)
Joint Channel Islands demand	Jersey and Guernsey are served by the services. Unit costs to Jersey are approximated by the unit costs of serving the Channel Islands as a whole
Northern route and Southern route services	The existing three-day-a-week Huelin Renouf service from the UK (Northern route) and the light ferry services from France (Southern route) have not been taken into account in the analysis

Source: Oxera

A3.1 Calculations in section 4.4

Assuming that the current weekly St Malo service has no additional fixed costs, or that a weekly UK service would also have no additional fixed costs (ie, they would be run by the operator of the frequent service), and that any frequent service operated requires two boats each doing one rotation, the unit costs of the UK–Channel Islands and France–Channel Islands services are as provided in Table A3.2.

Table A3.2 Two daily boats each undertaking one rotation, integral weekly service

	UK–Channel Islands	France–Channel Islands	Total
UK 90/Fr 10	26.3[1]	7.2	**25.1**
UK 10/Fr 90	11.9	22.3[2]	**21.6**
UK 50/Fr 50	49.2	41.6	**45.4**

Note: [1] This unit cost figure corresponds to the cost of £11.1m in Table 4.1, section 4.2. [2] This unit cost figure corresponds to the cost of £9.4m provided in Table 4.1, section 4.2.
Source: Oxera analysis using generic cost data.

If, however, the weekly service is treated as *stand-alone*,[109] the unit costs are as shown in Table A3.3.

Table A3.3 Two daily boats each undertaking one rotation, stand-alone weekly service

	UK–Channel Islands	France–Channel Islands	Total
UK 90/Fr 10	26.3	128.2	**33.1**
UK 10/Fr 90	132.9	22.3	**29.7**
UK 50/Fr 50	49.2	41.6	**45.4**

Source: Oxera analysis using generic cost data.

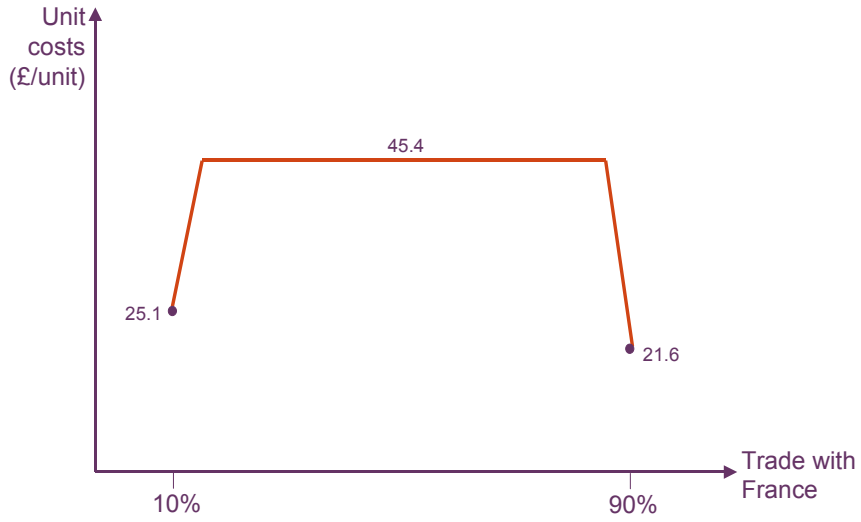
In both Tables A3.2 and A3.3, it can be seen that, consistent with section 4.2, the UK 10/France 90 point is a lower unit cost point in serving the Channel Islands (and thus, by approximation, Jersey) than the UK 90/France 10 situation. This is solely due to the *direct* effect of distance on fuel costs.[110] However, it can also be observed that the total unit costs of the 50/50 situation are higher than the total unit costs of the extremes. If the weekly service becomes stand-alone, rather than integral to the frequent service, this raises the two low-cost points.

That the 50/50 situation has higher overall unit costs is not surprising: in either of the extreme situations, the frequent service offered is well utilised. Furthermore, either the weekly service has fixed costs that have been paid for already by the frequent service (Table A3.2) or, at the very least, the weekly service uses only one boat and, because it is run less often than a frequent service, saves on fuel (Table A3.3). In the 50/50 case, the frequent services operated duplicate fixed costs (including boat and crewing costs), while each service is less utilised than in the extreme situations (since the finite total volume is split between the France and UK routes.) Furthermore, more fuel is used in total in the 50/50 situation than in either of the two extreme cases.

[109] For example, the service in the UK 10/France 90 scenario might be stand-alone if the weekly UK service were operated by a separate company to the frequent France service.
[110] As discussed in section 4.2.1, the distance savings that might be achieved in serving Jersey from France are not in direct proportion to the distance from St Malo to Jersey versus the UK to Jersey. This is because a round trip to the Channel Islands will always involve a fixed distance to be covered in navigating between the islands. Moreover, because many of the costs involved in freight ferry operations do not relate to fuel, the effect of fuel cost savings on unit costs is relatively minor.

It is the combination of these factors that can generate a 'hump' effect in respect of the total unit costs of serving the Channel Islands and, therefore, Jersey. Based on Table A3.2, Figure A3.1 illustrates the total unit cost function for the Jersey economy.[111]

Figure A3.1 Total unit freight ferry costs to Jersey



Note: The figure is not to scale, and is purely illustrative. Only the extreme 10/90 and 90/10 situations, and the 50/50 situation, have been modelled.
Source: Oxera.

A3.2 Unit costs and the chicken-and-egg problem: the decision to launch a new ferry service

The issue of whether, on unit cost grounds alone, a new frequent service to France would be launched can be looked at in terms of the marginal decisions of either Condor, the incumbent, or a new entrant setting up a new service.

Looking first at the marginal decisions of the *incumbent*, the current weekly service to St Malo is incremental for Condor, rather than stand-alone. The fixed capital and crew costs can therefore be spread between the UK and France operations. Moving away from this, towards increased services to France, Condor could either re-route its existing service to serve St Malo more frequently, or lay on an additional service. However, there may be problems in undertaking either at the margin.

– *Re-routing the existing service*—Condor's existing regular triangular six times per week UK–Guernsey–Jersey route, plus the weekly service to St Malo, meet existing Jersey demand (including the frequency requirement). Re-routing this existing service to St Malo, say, twice a week would involve offering a less frequent service to the UK, and a service to France that is still not frequent. A sufficient portion of retailers in Jersey would simultaneously then need to change their frequency patterns, or undertake parallel (duplicated) frequent sourcing from both the UK and France, to satisfy their requirements. This could require coordinated action.[112]

– *Additional service*—alternatively, Condor could launch an additional frequent service from St Malo to the Channel Islands. However, this would require investment in a new

[111] In this simplified framework, unit costs remain constant in between the two extremes. Fuel costs might be expected to vary with volumes or weight carried. If, for example, these were taken into account, total unit costs might vary between the two extremes, providing a more rounded total unit cost function.
[112] In addition, the UK service may be optimally configured to pick up empty trailers from the Channel Islands and return them to the UK. Existing distribution hubs and cultural factors will also play a key role, as discussed in section 3.

boat; moreover, such a service would divert demand away from the UK route. Both would serve to increase the total unit costs to Condor, since the capacity utilisation of each service offered would be lower. Condor would be competing against itself.

Nonetheless, re-routing the existing service is potentially a less problematic way for a more frequent service to France to emerge at the margins, depending on whether sufficient demand existed, and the logistics of reconfiguring the existing service. However, there may be other reasons why Condor might not have an incentive to launch an additional service from St Malo, which do not relate to unit costs per se. These were discussed in section 5 (and are also discussed in Appendix 5).

The issue can also be explored from the perspective of whether an *entrant* would face an incentive to launch a new service. As noted in section 4.4.2, a weekly stand-alone service from France might not be an option, given that such a service already exists and that users in total are likely to demand a frequent service, and given the need for an entrant to capture demand and spread fixed costs.

In the framework described above, once an entrant has launched a frequent service, its own unit costs unambiguously fall as the volume it carries increases (similarly, the unit costs of the frequent service to the UK will increase). Thus, considering solely the unit costs of ferry freight, the problem for an entrant is that, to be competitive, it must be able to capture sufficient demand such that its unit costs are equal to or lower than those of the UK frequent service. Below this critical mass of volume, the situation will return to the UK 90/France 10 equilibrium. Beyond this point, the situation will move towards the UK 10/France 90 equilibrium. This assumes that the ferry companies price at average unit cost, as the 'bedrock' for examining the issues.[113]

In this regard, it is not sufficient for the entrant to build up demand incrementally: 'network effects' exist, because the fares charged to each transport user depend on how many other users are, simultaneously, using the service. Thus, for one user to utilise the service, it would wish to see others using the service. In this situation, no one customer would wish to be the first to switch to the new service (unless their demand was, in itself, particularly high, sufficient in itself to provide the required critical mass). Instead, coordinated action would be required since the effect of incremental customers switching in a piecemeal fashion would not lower unit costs quickly enough.

Thus the market may not, by itself, deliver the solution. Once this critical mass of users had been attained, however, people would continue to switch to the new service, until the new UK 10/France 90 equilibrium had become established. This is, in essence, the chicken-and-egg problem—at least the part of the problem relating solely to unit freight ferry costs.

In a similar vein to how factors reducing the fixity of costs for the French service decrease the overall total unit cost hump (while also lowering the new equilibrium point), these factors also reduce the critical mass of volume the entrant would need in order to achieve similar unit costs to the UK service, and therefore the extent to which market failures might occur. This issue can be examined further by considering the point at which, in the above tables, the unit costs of the frequent France and UK services are equal.[114]

[113] The point at which UK and France ferry freight unit costs are equal is not, strictly, a 'break-even' point, since the focus here is on unit costs, not revenues (which in turn depend on competitive conditions and margins). It simply relates to the bedrock of costs such that, starting from *any given position*, if this is beyond the critical point, the frequent France service has lower unit costs and, if this position is before the critical point, the UK service has lower unit costs. It assumes that the ferry companies price (or would eventually need to price) their fares at average cost. In this framework, if the France service could credibly secure the critical mass of customers required, the situation would move towards the UK 10/France 90 equilibrium. If it were unable to do so, the situation would revert to the UK 90/France 10 equilibrium.

[114] Indeed, at this point, France, UK and total unit costs are all equal. Total unit costs between the UK 90/France 10 and UK 10/France 90 situations are constant in the framework. The effect of linking fuel costs to volumes and port handling to volumes may smooth the hump to a degree.

Table A3.4 Critical mass for France service (solely based on unit costs)

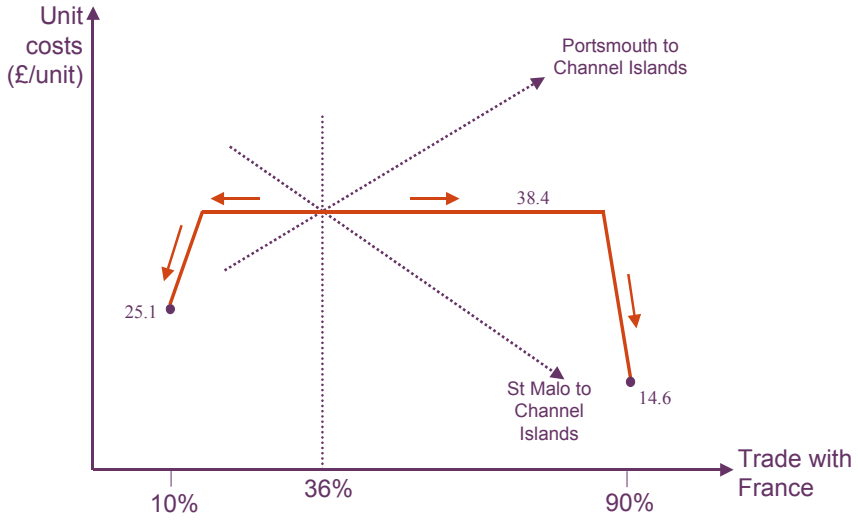
UK 50/France 50	Table	UK–Channel Islands unit cost	France–Channel Islands unit cost	Average unit cost across both routes	Critical mass point (France)
France has two daily boats undertaking one rotation per day	Tables 4.8, A3.2/A3.3 (Appendix A3.2)	49.2	41.6	**45.4**	**46%**
France has one daily boat undertaking two rotations per day	Table 4.7	49.2	27.7	**38.4**	**36%**
France has one boat undertaking one rotation per day	Table 4.9	49.2	21.9	**35.5**	**31%**
UK service reduced to one boat undertaking one rotation per day	Table 4.10	25.7	21.9	**23.8**	**46%**

Source: Oxera analysis using generic cost data.

Table A3.4 shows that, the greater the potential savings from moving to the UK 10/France 90 point, and the more that fixed costs can be stripped out from the France service, the lower the critical mass point. This means that the market failure problem is reduced *if* France is genuinely a lower-cost point.

The scenario in the second row of Table A3.4, in which the frequent France service has one boat undertaking two rotations per day, is further illustrated in Figure A3.2. The individual unit cost functions for the UK and France services are depicted by the dotted arrowed lines. The overall unit cost function to the Jersey economy is then also shown by the bold solid line. The bold arrows above this function illustrate the position the market would move towards if fares reflected average cost. The critical mass point is represented by the vertical dotted line.

Figure A3.2 France has one boat undertaking two rotations per day



Source: Oxera. These figures are not to scale, and are purely illustrative.

Nonetheless, a France service may alternatively undertake one rotation (at least initially), which may reduce the critical mass point to 31% (and lower the overall costs to Jersey in transition to £35.5 per lane metre). Interestingly, it can also be observed from the last row of Table A3.4 that if the UK service reacts by removing a boat from its schedule, this serves to increase the critical mass point for the France service, exacerbating the market failure. This is despite the fact that, in this situation, the overall unit costs to the Jersey economy are reduced in the 50/50 scenario (ie, the overall hump is eliminated in transition).

A3.3 Factors abating the critical mass problem

There may be factors not taken into account in the analysis of section 4.4.4 that may abate the problem of market failures stemming from the nature of freight ferry costs and the demand for such services.

A3.3.1 Satisfying lower levels of incremental demand

An existing service provided by Huelin Renouf sails three times a week from Portsmouth to the Channel Islands. This carries some of the freight on the Northern route. The presence of this service indicates that a service three times a week appears viable, at a level of freight demand significantly less than that carried by Condor. As such, frequency and economies of scale issues may not hinder the development of incremental services to the extent discussed above. The unit cost critical mass point for a new ferry service from France, assuming that the UK 10/France 90 point is a lower unit cost point, could be lower than that discussed.

It is also of note that the viability of the Huelin Renouf service is probably not linked to differences in sourcing costs of users employing this service to transport goods versus Condor's, as both operate from the UK, and Oxera understands that they carry a broadly similar composition of freight.[115] Also, hypothetically, if enough incremental demand surfaced for increased trade with France, Huelin Renouf could start to operate a weekly or twice-weekly service from France using its existing boat. However, Oxera understands that the existing Huelin Renouf service cannot be extended in this way. First, its LO–LO nature means that it needs to spend a day in port followed by a day at sea, which converts into a three-a-week schedule. Second, Oxera understands that the Huelin Renouf service has secured an established base of customers with a certain demand profile.

There is the possibility that incremental demand with France could be satisfied through using one new boat with one rotation at first, building up to two boats as demand picks up. In this instance, the critical mass point may be as shown in the third row of Table A3.4 (31%, with total unit costs of 35.5). However, two rotations may need to be undertaken at some point, to satisfy further demand, and this has a critical mass point of 36%, with total unit costs of 38.4. How Condor reacts to these services will also affect the picture.

Also, initially, a smaller freight ferry than is implicit in the above analysis might be used to satisfy incremental demand, although it is not clear that such freight ferries are still built (see Appendix 5). At the limit, a converted fishing trawler might be used, but this may be better suited to ad hoc orders from France rather than to establish a regular, frequent service.

A3.3.2 Further opportunities to reduce costs

The analysis above also ignored the potential for other ways in which fixed costs might be spread, or costs more generally might be reduced, on the France route. For example:

– *spreading costs*—depending on the ferry type, further opportunities might exist to spread fixed (and variable) costs between passengers and freight carried on the same service (ie, joint costs), although there may also be conflicts between the requirements of the two sectors;

– *driver-accompanied versus driver-unaccompanied*—as noted, if a frequent France service carried more driver-accompanied freight than the existing UK service, this might reduce the trailer clearance problem at St Helier, enabling scheduling benefits to be realised. This might also reduce handling and logistics costs (which would otherwise be charged by logistics companies) for the ferry leg *per se*, relative to a driver-unaccompanied service. The above modelling did not take explicit account of driver-

[115] Except that the Huelin Renouf is LO–LO and, unlike Condor, it does not carry temperature-controlled freight.

unaccompanied logistics costs. If the France service were mainly driver-accompanied, taking into account the logistics costs might increase the unit costs of the UK service and reduce those of the France service. However, the driver-accompanied option may place additional logistics costs on the truck companies;

– *new versus second-hand ferry*—a second-hand ferry might initially be introduced on the France route, rather than a new ferry, and this could reduce fixed costs significantly. However, fuel and crewing unit costs are generally higher for second-hand ferries than for newer ferries; new ferries tend to be faster than older ones and thus can be fitted into a more demanding rotation pattern; and older ferries may be less reliable (which may not be ideal for a frequent service);

– *one-way versus two-way flows*—the above analysis assumed that all flows are into Jersey only, and that fares reflect the costs of transporting empty trailers back to their point of origin (or, more generally, an empty boat). It is of note that, currently, most trade with the UK is one-way. The analysis ignored the further export opportunities that may arise as consequence of a more frequent link to France—for example, transporting shellfish, agricultural produce and waste materials. These would reduce the unit costs of carrying freight.

A3.3.3 Competition effects

The above discussions also focused exclusively on unit costs, rather than on revenues or margins. Intuitively, increased competition brought about by the introduction of a new service could be of benefit to Jersey. However, the degree of competition on the Northern and Southern routes, before and after the introduction of any new France service, would affect price–cost margins and, therefore, the willingness of a potential entrant to launch such a service in the first instance.

The reason for the above focus on average unit costs in defining the critical mass points, and not on revenues or margins, is that it was assumed that these would form the 'bedrock' for competition. For example, to attract critical mass, a new frequent France service might initially price at below average unit cost.[116] This would lead to short-term losses until such a point that the entrant had secured sufficient volumes. However, the entry of a competitor, in particular one with such a low pricing strategy, could generate fierce competition between the new operator on the Southern route and Condor on the Northern route. A potential scenario is that, in reaction to the competition, Condor could lower its prices to or below average unit cost (while pricing above average variable cost, and therefore covering its operating costs).[117]

Fares would eventually need to at least cover average costs and, within the framework outlined above, the operator with the lower average unit costs would end up running the frequent service. If, by this point, the entrant has secured an insufficient mass of customers to lower its unit costs below those of Condor, the situation would soon revert to the UK 90/France 10 equilibrium point. Condor may have more resources to incur short-term losses than an entrant in the event of a price war.

This underlying framework would not change even if Condor, as a consequence of its current high market share on the Northern route, were *currently* pricing significantly above average cost, and were (hypothetically) making supernormal profits. While an entrant—even one with higher average unit costs than the incumbent—might be attracted to the market on the basis of these current prices and margins, it is, as noted above, likely that Condor would react in some way if entry occurred and there was competition.[118] Thus, current prices may not

[116] This is typical in markets characterised by network effects or economies of scale.

[117] In general, if a company is dominant in a market, pricing at below average variable cost is likely to raise competition concerns. Pricing at average variable cost might, however, also raise competition concerns.

[118] The modelling above also showed that Condor might hypothetically withdraw one of its boats, thereby lowering its unit costs.

provide an accurate picture of entry opportunities: the underlying cost characteristics of freight ferry services are a more reliable indicator.[119]

However, what has been ignored thus far is the possibility that the existing Condor service on the Northern route and the new service on the Southern might not compete solely on price (and thus average unit costs). The new service from France might be *differentiated* in some way from the existing Condor service. For example, Condor's Northern route service has only limited driver-accompanied capacity. If the France service were mainly driver-accompanied (and there was an underlying demand for driver-accompanied freight to Jersey), this might provide a means of differentiating the France service, and enable an entrant to earn margins above average unit cost.[120]

In short, if a new frequent service from France has significantly lower unit costs than the existing service from the UK, this may both produce benefits for Jersey and assist the entrant. If, however, a new frequent service simply served to increase competition (significantly) on the routes, while this might benefit Jersey (at least in the short term), it could reduce the desirability of entry.

A3.3.4 Ferry versus sourcing costs

Freight ferry services are essentially a *derived demand*. Most crucially of all, the above analysis has ignored the proportion of final goods costs accounted for by freight ferry costs, and differences in sourcing costs that might exist between the UK and France. These issues are explained in Appendix 4.

[119] Thinking about the entry problem in stages, the entrant's dilemma can be split into its decision to incur fixed costs in purchasing a ferry and to enter the market in stage one, with competition occurring with the incumbent in stage two. The higher the fixed costs (in stage one), the smaller the total market size, and the more intense price competition (in stage two), the less likely it is that the entrant would find it profitable to enter the market. If it did enter the market, it might not be able to recover its average costs (including fixed costs) in stage two.

[120] In economic theory, this argument can be motivated either on the grounds that product differentiation lowers the intensity of price competition in stage two, or that Condor is in effect capacity-constrained in the driver-accompanied market, and cannot therefore retain market share by pricing below average total cost. In either case, entry is made easier since the entrant can earn margins above costs.

Appendix 4 Market failures revisited: interaction of ferry costs and sourcing costs

A4.1 Calculations in section 4.5

Section 4.5 explores whether market failures occur, by using the same framework as that developed in section 4.4, but considering overall unit costs (including both ferry costs and sourcing costs). The overall calculations use the freight ferry transport cost information discussed in sections 4.2 and 4.4, information on the proportion of the cost of goods accounted for by freight ferry costs on the UK–Jersey route in the UK 90/France 10 scenario (section 4.2), and the additional sourcing costs savings that might be present in France relative to the UK (section 4.3).

Section 4.5 assumes that the total cost of goods for the Portsmouth–Jersey route in the UK 90/France 10 scenario is accounted for solely by sourcing costs (including up to delivery to the port in question, or distribution hub exit point) and freight ferry costs to Jersey. It also abstracts from retailers' costs and margins, and assumes that retailers pass on any cost increases or decreases to consumers.

The calculations take as their starting point information on freight ferry unit costs on the Portsmouth–Jersey route in the UK 90/France 10 scenario and the percentage of total goods costs accounted for by freight ferry costs in this instance.

If, for example, in the UK 90/France 10 scenario, unit freight ferry costs are £26.30 and the percentage share of freight ferry costs in the total cost of goods is 5%, the relevant total unit cost of goods, which can be used as a benchmark for other routes and scenarios, is £26.30/0.05 = £526.70. Sourcing costs in this scenario are assumed to be (1 – 0.05)*£526.70 = £500.30 (or, equivalently, £26.30/0.95).

Now:

– for any other route or scenario, an increase in ferry unit costs of 100% will raise the total cost of goods, relative to the UK 90/France 10 scenario, by (0.05)*100% = 5%;

– however, this assumes that sourcing costs are the same for the UK and France. If they are 10% lower in France, this will reduce the total cost of goods by (1 – 0.05)*10% = 9.5%;

– therefore, relative to the UK 90/France 10 scenario, the total unit costs for the route/scenario concerned will be (9.5% – 5%) = 4.5% lower. Equivalently, total unit costs will be £526.70*(1 – 0.045) = £503.

For ease of exposition, and because the focus of the analysis is on relative costs rather than absolute cost levels (the total unit cost figure of £526.70 is merely a construct to undertake the analysis), the overall unit costs of the main UK–Jersey route in the UK 90/France 10 scenario can be re-indexed to 100. The overall unit costs for all other routes (eg, the current weekly service to St Malo in the UK 90/France 10 scenario), and in all other scenarios (eg, the costs of the France service in the UK 50/France 50 scenario) can then been expressed relative to this index.

In the instance outlined above, the total unit cost index would be 100 – 4.5 = 95.5.

The total unit cost indices for the UK–Jersey and France–Jersey routes can then be weighted by their respective volume levels to obtain a 'total unit costs to Jersey' index.

A4.2 Market failures revisited: ferry costs versus sourcing costs

A4.2.1 Developing the four 'situations'

Section 4.3 identified that there might be savings in sourcing costs in the UK 10/France 90 scenario, of up to 10%. Crucially, the market failure analysis presented in section 4.4 ignored this. If sourcing costs are *significantly* lower in France than in the UK, and, for a reasonably well-utilised service, ferry transport costs are not a high proportion of the overall cost of goods, it can be shown that there are:

– *fewer market failures in transition*—an entrant seeking to secure a critical mass of customers should experience fewer market failures. Even if, in transition, an entrant on the France route has higher unit freight ferry costs than the incumbent (on the UK route), the overall unit costs of goods when importing from France will, at an earlier point, be lower than the unit costs of importing the same goods from the UK;

– *lower overall unit costs to Jersey in transition*—the overall total unit costs for goods transported to Jersey (from both the UK and France) should fall as the percentage of trade undertaken with France increases. The overall final goods unit costs to the Jersey economy may be more of a downwards-diagonal line, rather than a pronounced hump.

Put another way, in transition, the benefits of the savings in sourcing costs from increased trade with France may outweigh the higher unit transport costs. Section 4.5 summarised these issues. The analysis of the section built upon the detailed analysis contained in this annex, which extends the framework developed in section 4.4 to consider overall unit costs (including both ferry costs and sourcing costs). For ease of exposition, the overall unit costs of the main UK–Jersey route in the UK 90/France 10 scenario have been re-indexed to 100. Unit costs for the France–Jersey route, and for all other scenarios, have been expressed relative to this index.[121]

Four key potential situations are developed in this appendix.

Situation A	Freight ferry costs are **5%** of goods costs on the current UK route, and there are **no differences** in UK versus France sourcing costs
Situation B	Freight ferry costs are **5%** of goods costs on the current UK route, and France sourcing costs are **10%** cheaper than UK sourcing costs
Situation C	Freight ferry costs are **15%** of goods costs on the current UK route, and France sourcing costs are **4.5%** cheaper than UK sourcing costs
Situation D	Freight ferry costs are **5%** of goods costs on the current UK route, and France sourcing costs are **15%**cheaper than UK sourcing costs

In each instance, consideration is given to:

– *the total benefits to Jersey*—of significant increased trade with France (in the UK 10/France 90 scenario);

– *the total unit costs to Jersey in transition*—combining the overall unit costs for the UK and France routes; and

[121] Sourcing costs are implicitly assumed to cover the point up to delivery to the port in question (Portsmouth or St Malo). The scenarios abstract from Jersey retailers' own costs or margins, and assume that they pass on any increases or reductions in ferry and sourcing costs to consumers.

– *the marginal decisions of importers*—choosing between importing from the UK or France, taking into account both transport and sourcing costs.

In each case, the key implications for Jersey policy are drawn out. The tables indicate how the 'staging' of any new frequent France service (for example, using one boat with one rotation to satisfy initial demand levels, with service levels increased as demand picks up) might affect the picture. These issues are drawn out in the text. However, for simplicity, the (graphical) illustrations developed hold constant the frequent France service configuration as trade with France increases. This also enables comparison with the figures shown in section 4.4.

Situation A

In this situation, freight ferry costs account for a small proportion of goods costs (5% for the UK route in the UK 90/France 10 scenario), and there are no additional savings from sourcing goods from France relative to the UK.

Here, Table A4.1 contrasts the overall unit costs of 90% of trade being undertaken with the UK versus 90% of trade being undertaken with France. For simplicity, it has been assumed that the weekly service operated in these scenarios is 'integral' to the frequent main service. (This also applies to all other 'situation' analysis developed in this section.) Moving down through the rows, the additional reductions in unit costs that may arise if fixed costs are saved in the France service, in the UK 10/France 90 scenario, are then also highlighted.

It can be observed that, because freight ferry costs are only a small proportion of final goods costs, the ferry cost savings in the 10 UK/90 France scenario translate into only modest savings in the overall price of goods (of between 1% and 3%, depending on the nature of the France service).

Table A4.1 Benefits: freight ferry costs are 5% of goods costs on existing UK route, no difference between UK and France sourcing costs

	UK 90/Fr 10 unit costs			UK 10/Fr 90 unit costs		
	UK–Channel Islands	France–Channel Islands	Total	UK–Channel Islands	France–Channel Islands	Total
France has two daily boats undertaking one rotation	100.0	96.4	99.8	97.3	99.2	99.1
France has one daily boat undertaking two rotations per day	100.0	96.4	99.8	97.3	97.8	97.8
France has one boat undertaking one rotation per day	**100.0**	**96.4**	**99.8**	**97.3**	**97.2**	**97.2**

Source: Oxera.

Table A4.2 then provides the overall unit costs for the situation in which 50% of trade is undertaken with the UK and 50% with France. Section 4.4 illustrated that ferry costs might be significantly higher in this scenario than at the two extremes. However, because ferry costs are a small enough proportion of total goods costs, it is shown here that the effect on overall unit costs is muted. For example, in the scenario in which the France service is able to operate using one boat undertaking one rotation, section 4.4 showed that total unit ferry costs in the 50/50 scenario were 41% more expensive than in the UK 90/France 10 scenario.[122] Yet, because freight ferry costs account for a small proportion of total goods

[122] £35.5 per unit in the 50/50 scenario versus £25.1 per unit in the UK 10/France 90 scenario.

costs, the total overall unit costs to Jersey in the 50/50 point here are only 2% higher than in the UK 90/France 10 scenario.[123]

Therefore, in transition to increased trade with France, the overall unit costs to Jersey do not rise significantly; the total overall unit cost 'hump' is much flatter than before. Nonetheless, in theory, the critical mass points, at which the overall unit costs of sourcing from France become equal to the overall unit costs of sourcing from the UK, are the same as those provided in Table 4.10 (of section 4.4). This is because sourcing costs are assumed to be identical in the UK and France, and thus the only factor that affects the marginal decisions of importers are differences in freight ferry unit costs between the UK and France routes. Going through the rows of the table, removing fixed costs from the France service again reduces the hump and the critical mass points.

Table A4.2 Market failures: freight ferry costs are 5% of goods costs on existing UK route, no difference between UK and France sourcing costs

	UK 50/Fr 50 unit costs			Critical mass point (France)	
	UK–Channel Islands	France–Channel Islands	Total	Unit cost	%
France has two daily boats undertaking one rotation	104.3	102.9	103.6	103.6	46
France has one daily boat undertaking two rotations per day	104.3	100.3	102.3	102.3	36
France has one boat undertaking one rotation per day	**104.3**	**99.2**	**101.7**	**101.7**	**31**
UK service reduced to one boat undertaking one daily rotation	99.9	99.2	99.5	99.5	46

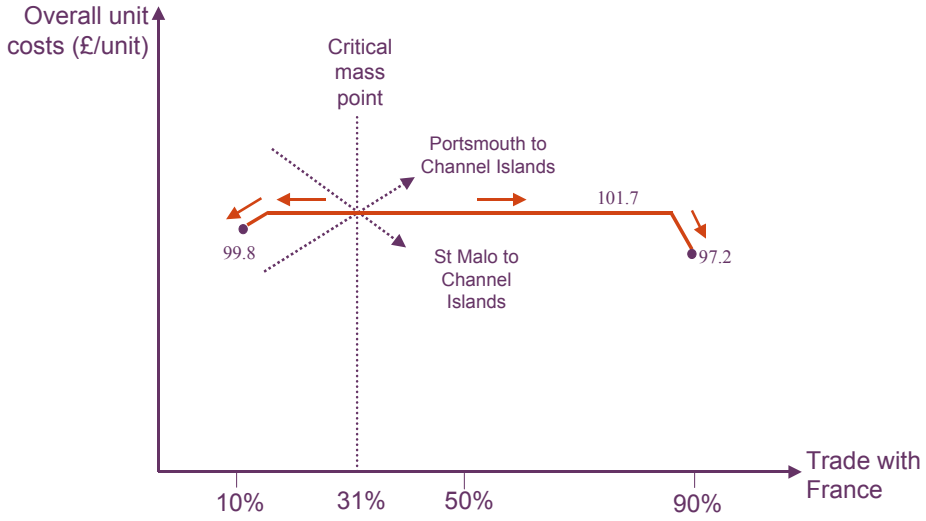
Source: Oxera.

The overall situation for the scenario in which the frequent France service has one boat undertaking one rotation—which is perhaps unrealistic at high demand levels—is provided in Figure A4.1 below. A comparison with the figures presented in section 4.4 reveals how the overall hump is significantly reduced when overall unit costs are considered, rather than just ferry unit costs. However, the hump remains flat since it has not been assumed that there are any sourcing cost savings from increased trade with France.[124]

[123] This may be calculated as (1 – 101.7/99.8)*100%.

[124] In the analysis presented throughout this appendix, only the 90/10, 10/90 and 50/50 scenarios have been modelled explicitly. For all points in between, the service configuration assumed for the 50/50 scenario has been applied.

Figure A4.1 One France boat with one rotation per day (for comparison only)



Source: Oxera.

What would Situation A mean for policy? On economic grounds alone, if the situation is as characterised above, there is little rationale for government intervention by the States of Jersey to significantly increase trade with France by subsidising a service such that it can achieve a critical mass of volumes. This is principally because the benefits to the Jersey economy of the UK 10/France 90 scenario relative to the current configuration are limited (2% at most). Another, less important, point is that the transition to this point involves higher (though not significantly higher) unit costs. In practice, cultural factors, distribution hubs, standards and so on, which have not been taken into account in the above analysis (see section 5), will limit the extent to which it would be possible to move beyond this higher overall unit cost point.

Situation B

Although, as discussed in section 4.3, there is little evidence that wholesale prices in France are lower than in the UK from the available studies, partly due to data issues, there is some evidence that retail price may be lower. *If* it is assumed that differences in UK and France retail prices reflect differences in sourcing costs, the situation changes somewhat.

For example, assume hypothetically that sourcing costs in France are 10% lower than in the UK. Tables A4.3 and A4.4 below outline how the situation changes. The scenario in which the frequent France service uses one boat undertaking *two* rotations, which is potentially more realistic than a boat undertaking only one rotation (since it is more likely to be able to satisfy Jersey demand at higher volume levels), is illustrated in Figure A4.2 below. This assumes that the distance saving also provides sufficient time for any trailers to be cleared from St Helier (which itself might also be assisted if a higher portion of freight carried is driver-accompanied). However, in practice, two boats could be required at high France volume levels.

Table A4.3 Benefits: freight ferry costs are 5% of goods costs on existing UK route, France sourcing costs are 10% less than UK sourcing costs

	UK 90/Fr 10 unit costs			UK 10/Fr 90 unit costs		
	UK–Channel Islands	France–Channel Islands	Total	UK–Channel Islands	France–Channel Islands	Total
France has two daily boats undertaking one rotation	100.0	86.9	99.1	97.3	89.7	90.2
France has one daily boat undertaking two rotations per day	**100.0**	**86.9**	**99.1**	**97.3**	**88.3**	**88.9**
France has one boat undertaking one rotation per day	100.0	86.9	99.1	97.3	87.7	88.4

Source: Oxera.

Table A4.4 Market failures: freight ferry costs are 5% of goods costs on existing UK route, France sourcing costs are 10% less than UK sourcing costs

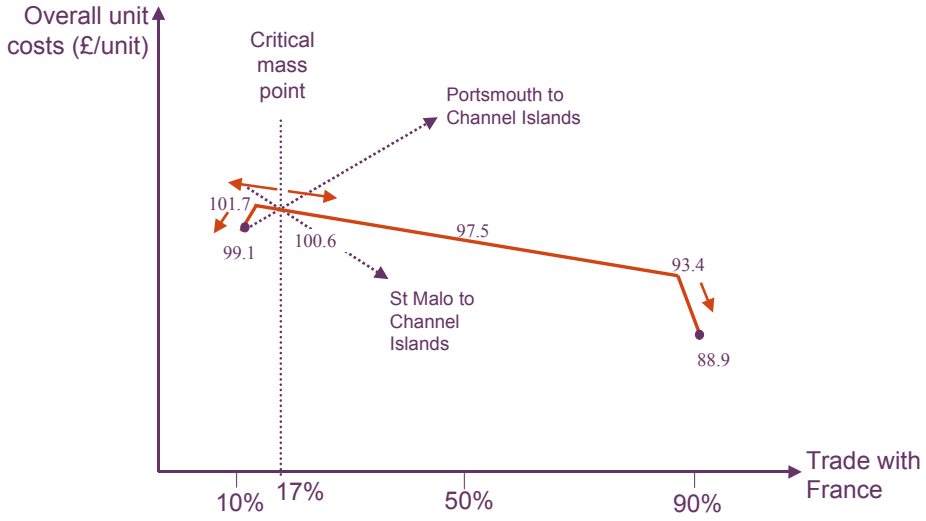
	UK 50/Fr 50 unit costs			Critical mass point (France)	
	UK–Channel Islands	France–Channel Islands	Total	Unit cost	%
France has two daily boats undertaking one rotation	104.3	93.4	98.9	101.2	25
France has one daily boat undertaking two rotations per day	**104.3**	**90.8**	**97.5**	**100.6**	**17**
France has one boat undertaking one rotation per day	104.3	89.7	97.0	100.4	14
UK service reduced to one boat undertaking one daily rotation	99.9	89.7	94.8	97.9	17

Source: Oxera.

Table A4.3 and Figure A4.2 below show how the UK 10/France 90 overall unit cost point is much lower than in Situation A, reflecting the impact of the additional sourcing cost savings from France. Here, the overall savings associated with sourcing 90% of goods from France relative to 90% of goods from the UK are just over 10%.[125]

[125] 100%*(1 – 88.9/99.1)

Figure A4.2 One France boat two rotations



Source: Oxera.

The in-between position has also changed significantly. As shown in Figure A4.2, following an initial increase in total overall unit costs to Jersey in moving away from the current UK 90/France 10 equilibrium, total overall unit costs begin to fall, following the diagonal line illustrated in the figure. This is because, whereas ferry costs represent only a small portion of final goods costs, sourcing cost savings have a pound for pound impact on final goods costs. Thus the increase in overall unit costs on the France route at lower levels of demand, arising from the cost characteristics of ferry services, becomes increasingly offset by the effects of savings in sourcing costs.

Furthermore, the critical mass point (purely in respect of overall unit costs) for a frequent France service falls to 17%. To recap, this is the point at which the overall unit costs for a marginal importer of sourcing from France using a frequent service are equal to the overall unit costs of sourcing using a frequent service from the UK. Beyond this, importers choose to source from France using the frequent service. Thus if a frequent service from France could secure 17% of demand, trade should start to move towards the UK 10/France 90 equilibrium.

Even if trade did not move *all the way* to this new equilibrium, due to factors not taken into account in the above analysis (such as distribution hubs, standards and cultural factors—see section 5), the total overall unit costs to Jersey at the point at which no further trade movements to France take place may not be significantly higher than at present. For example, it can be seen from Figure A4.2, the total overall unit costs in the 50/50 situation (and at some point before this) are lower than in the UK 90/France 10 situation. Section 5 discusses in more detail the issues raised by other barriers to increased trade with France.

Interestingly, section4.4.5 identified that it might be possible for one boat undertaking one rotation to be used at first on the France route, while demand picks up. Table A4.4 below shows that, if this is the case, the critical mass point falls further (to 14%), with a further (though modest) fall in total unit costs to Jersey in the 50/50 case. It can be shown that, where three boats are used in total (two on the UK–Jersey route and one on the France–Jersey route), in Situation B, Jersey is better off than at present when 30–35% of trade occurs with France.[126]

There is a possibility, however, that only two boats might be required. Table A4.4 shows that if Condor removes a boat from the UK route, total unit costs to Jersey in the 50/50 scenario

[126] At these levels of trade with France, overall unit costs to Jersey are around 99.1.

fall by over 4% relative to the current situation.[127] However, it is not clear that this is feasible given the need to clear trailers from St Helier. Even if it were, it is not clear that this would be the case at 50% trade with France, although it may be feasible at some point beyond this.

What would Situation B mean for policy? The overall message is that, if significant benefits exist in undertaking more sourcing from France, and ferry costs are not a large proportion of goods costs, the nature of freight ferry costs should not serve as an obstacle to increased trade with France:

– *there should be fewer market failures in transition*—the critical mass point in situation B is much lower than in situation A. A new operator from France need only secure a core of customers for a dynamic to be established in which trade with France increases;

– *the total overall unit costs to Jersey in transition to increased trade with France are not significantly higher than in the current situation*—thus there are few additional costs to the Jersey economy in transition to increased trade with France;

– *impact of other barriers*—even if trade with France could not reach the UK 10/France 90 point, due to the effects of factors such as culture and distribution hubs (see section 5), this should not imply significantly higher overall unit costs to the Jersey economy.

In this situation, there is again little rationale for intervention by the States of Jersey to subsidise increased trade with France. The potential sourcing savings mean that the market is not significantly impeded in moving towards increased trade with France in terms of the marginal decisions of importers, and there are relatively few dangers to the Jersey economy in respect of the overall unit costs to Jersey in transition.

If Condor were to react, and reduce its UK service to one boat, this may lead to an even lower overall cost point for Jersey than at present—ie, more benefits to the Island. Whether this affects the above conclusions depends on whether a one-boat service from the UK (and from France) is feasible and, if this is the case, whether—due to other barriers—increased trade with France stops before this feasible point. In any event, this may have an impact on the quality of supply and supply security to the Island (see the conclusions to section 4.4.4).

Situation C

The situation changes if sourcing savings from France are much more modest, and ferry costs are a larger proportion of goods costs, than as described in Situation B. Table A4.5 below shows that, assuming that sourcing savings from France are 2.5%, and that ferry transport costs (on the UK route in the UK 90/France 10 scenario) represent 15% of costs, the UK 10/France 90 equilibrium has overall unit costs that are around 8% lower than at present, assuming that the France service uses one boat undertaking two rotations per day.[128] Nonetheless, section 4.2 noted that freight ferry costs as a percentage of goods costs are, on average, around 5%.

[127] 100%*(1 – 94.8/99.1).

[128] 100%*(1 – 91.4/99.1).

Table A4.5 Benefits: freight ferry costs are 15% of goods costs on existing UK route, France sourcing costs are 2.5% less than UK sourcing costs

	UK 90/Fr 10 unit costs			UK 10/Fr 90 unit costs		
	UK–Channel Islands	France–Channel Islands	Total	UK–Channel Islands	France–Channel Islands	Total
France has two daily boats undertaking one rotation	100.0	87.0	99.1	91.8	95.6	95.3
France has one daily boat undertaking two rotations per day	**100.0**	**87.0**	**99.1**	**91.8**	**91.3**	**91.4**
France has one boat undertaking one rotation per day	100.0	87.0	99.1	91.8	89.6	89.7

Source: Oxera.

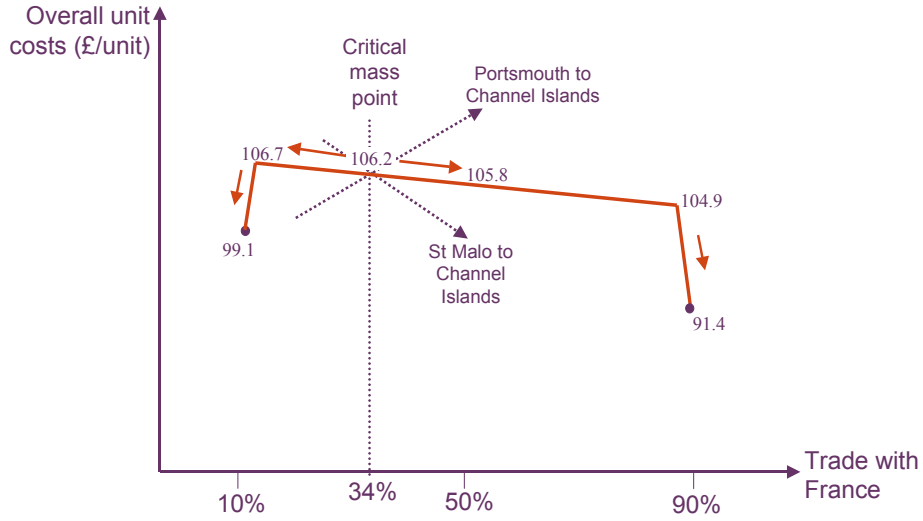
In this situation, the benefits of the France low cost point are mainly due to the impact of ferry costs, rather than sourcing costs. This can lead to problems in transition, as the cost characteristics of freight ferry costs also dominate over the sourcing savings. This is shown in Table A4.6 and Figure A4.3 below.

Table A4.6 Market failures, freight ferry costs are 15% of goods costs on existing UK route, France sourcing costs are 2.5% less than UK sourcing costs

	UK 50/Fr 50 unit costs			Critical mass point (France)	
	UK–Channel Islands	France–Channel Islands	Total	Unit cost	%
France has two daily boats undertaking one rotation	113.0	106.6	109.8	109.9	44
France has one daily boat undertaking two rotations per day	**113.0**	**98.6**	**105.8**	**106.2**	**34**
France has one boat undertaking one rotation per day	113.0	95.4	104.2	104.6	29
UK service reduced to one boat undertaking one daily rotation	99.6	95.4	97.5	97.7	42

Source: Oxera.

Figure A4.3 One France boat two rotations



Source: Oxera.

In this situation, the total overall unit costs to Jersey in transition are *always higher* than in the current situation: The downward effect of sourcing cost savings from France is not enough, in transition, to compensate for the hump effect induced by ferry freight transport costs. Indeed, at the 50/50 point, these total overall unit costs are around 7% higher than in the current UK 90/France 10 scenario[129]. The critical mass point for a new operator is also significantly higher than in Situation B, at 34%.

Therefore, in this instance, even though there are potential benefits of seeking to realise the UK 10/France 90 equilibrium, there are even greater barriers in reaching this point. Again, the potential reaction of Condor may affect the conclusions. Even at 50% trade with France, if Condor is able to withdraw a UK boat at this point, the overall unit costs to Jersey are lower than at present (see Table A4.6), albeit by around 1.5% only.[130] However, the critical mass point for an entrant is also raised significantly. The point at which it might be feasible for Condor to reduce its UK service to one boat *might* need to be considered.

What would Situation C mean for policy? If the market delivered an outcome such that Jersey became stuck at the higher cost point, this might itself be regarded as a market failure in respect of a sub-optimal outcome being achieved by the operation of market forces alone. However, this does not occur in the above framework. In respect of economic policy, the concern in this situation would be if a new service were subsidised by the States of Jersey such that the service could attain a critical mass, but that, due to distribution hubs, cultural factors and other barriers not taken into account in the above analysis, trade with France became stuck at the higher cost point.

In this situation, therefore, there is again little rationale on pure economic grounds for intervention. The Jersey economy could be worse off through such intervention.

The conclusions could again depend on the feasibility of Condor reducing its service to one rotation, at which point this might occur, and whether other barriers halt increased trade with France before this point is reached.

[129] 100%*(1 – 105.8/99.1).
[130] 100%*(1 – 97.5/99.1).

Situation D

In addition to the situations modelled above, to illustrate further the point regarding how savings in sourcing costs in France may significantly outweigh increased freight ferry costs in transition, a situation in which 5% of the cost of goods on the UK–Jersey route in the UK 90/France 10 case are accounted for by ferry costs, and sourcing cost savings in France are 15%, can be considered. Based on the available evidence, these assumptions may be somewhat unrealistic, at least over most products.

Compared with Situation B, this leads to a further decline in the critical mass point, which is exacerbated if the France service is able to strip out fixed costs due to any scheduling advantages. A comparison of Tables A4.7 and Table A4.8 illustrates further that the UK 50/France 50 point has lower overall unit costs than the 90/10 point.

Table A4.7 Benefits: freight ferry costs are 5% of goods costs on existing UK route, France sourcing costs are 15% less than UK sourcing costs

	UK 90/Fr 10 unit costs			UK 10/Fr 90 unit costs		
	UK–Channel Islands	France–Channel Islands	Total	UK–Channel Islands	France–Channel Islands	Total
France has two daily boats undertaking one rotation	100.0	82.1	98.8	97.3	85.0	85.8
France has one daily boat undertaking two rotations per day	**100.0**	**82.1**	**98.8**	**97.3**	**83.6**	**84.5**
France has one boat undertaking one rotation per day	100.0	82.1	98.8	97.3	83.0	83.9

Source: Oxera.

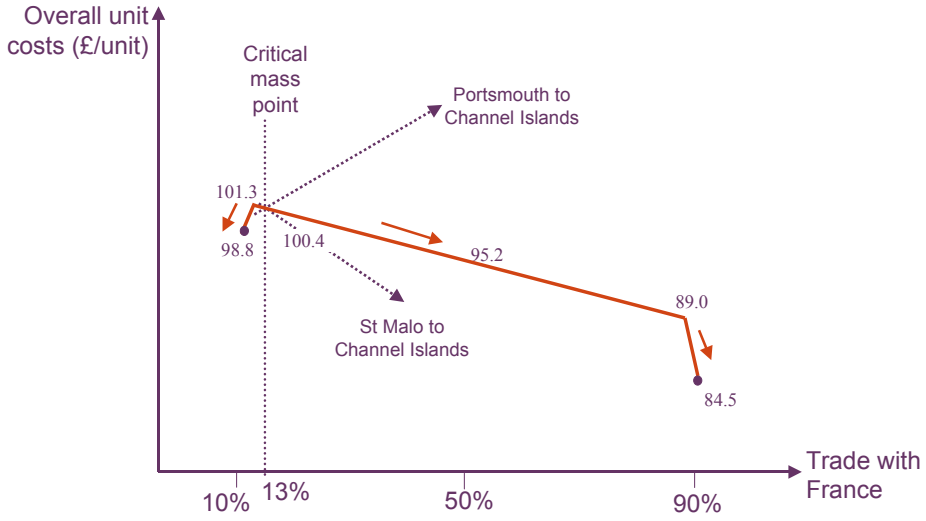
Table A4.8 Market failures: freight ferry costs are 5% of goods costs on existing UK route, France sourcing costs are 15% less than UK sourcing costs

	UK 50/Fr 50 unit costs			Critical mass point (France)	
	UK–Channel Islands	France–Channel Islands	Total	Unit cost	%
France has two daily boats undertaking one rotation	104.3	88.6	96.5	100.8	20
France has one daily boat undertaking two rotations per day	**104.3**	**86.0**	**95.2**	**100.4**	**13**
France has one boat undertaking one rotation per day	104.3	84.9	94.6	100.2	11
UK service reduced to one boat undertaking one daily rotation	99.9	84.9	92.4	97.8	12

Source: Oxera.

Figure A4.4 provides further illustration of the above points.

Figure A4.4 One France boat undertakes two rotations



Source: Oxera.

The impact of other opportunities and barriers

The above analysis of potential situations identified that there were few grounds for intervention by the States on the basis of potential market failures caused by the nature of freight ferry demand and costs per se. However, other potential benefits from increased trade with France, and other potential barriers, might affect the above picture. In particular, there are a number of potential barriers, including cultural factors, distribution hubs, standards and informational issues (such as the demonstrable reliability of ferry services), which may hinder the development of significant further trade with France. In respect of the analysis undertaken, these might mean that trade with France cannot move beyond a certain point—in transition, there may be a vertical line, beyond which increased trade will not occur. Culture may be one such factor.[131]

If trade with France cannot reach or move beyond 50%, scenarios in which Condor reduces its UK service to one boat might be discounted.

[131] Alternatively, such factors may serve to exacerbate any market failure problem that might exist, by making the overall unit cost curve steeper and raising the critical mass point (economies of scale in sourcing may be one such factor), or restricting movement along the curve in transition (information issues and the demonstrated reliability of ferry services may be relevant).

Appendix 5 Results of interviews

This appendix provides more detail on the lessons from interviews conducted by Oxera in Jersey, France and the UK, as summarised in section 5.

A5.1 Potential advantages of increased trade with France

A number of interviewees reported that there were potential advantages of increasing trade with France.

It is clear from discussions that the issue at stake is not simply increased trade with France per se. For example, as regards the current situation, trade already occurs with France, even when goods are not imported through St Malo (products are often sourced from France, but arrive via the UK). So increasing freight links to France may simply mean more direct sourcing of existing trade with France, as well as a net increase in trade with France. In addition, as regards the future situation, increasing links between Jersey and France might not simply mean more trade with France, but could open up further possibilities for accessing (as yet) other unexploited EU markets. It may also result in the diversion of some existing UK freight imported from Portsmouth via France.

Furthermore, the discussions showed clearly that the potential benefits concern not only *trade*, but also *competition*. For example, if a new ferry service were launched from France that competed with Condor, this could increase competition in the freight ferry and freight ferry logistics sectors.[132] Furthermore, bypassing existing UK-oriented distribution hubs might have a knock-on effect of increasing competition in Jersey. For example, direct sourcing of products from France might increase competition with those firms supplying Jersey that have vertical relationships with UK businesses, and the proposals to establish a French supermarket in Jersey might also increase retail competition.

Much of the discussions of the potential benefits of increased trade with France nonetheless centred on anecdotal benefits, although quantified benefits were provided in some cases.[133] For example, most of the French businesses interviewed tended to be at a very early stage in their analysis of the potential opportunities to undertake trade with Jersey, and thus had little hard evidence on how their prices compared with either Jersey prices or (perhaps more importantly) UK prices.

The main benefits of increased trade with France generally cited are discussed below.

A5.1.1 Retail prices, competition and quality

In respect of retail prices, several respondents highlighted that French supermarkets were cheaper than Jersey supermarkets, and that a French supermarket in Jersey would not only bring lower prices, but could also lead to fresher, better quality produce, and better service. This would also serve to increase competition in Jersey. While a UK chain would do the same, a French supermarket might also bring something different to Jersey. A Normandy business potentially interested in exporting meat to the Island noted how its high quality cuts and the traceability of its product were key selling points.

Several interviewees highlighted that, given the current price differentials, many Jersey residents undertake regular shopping trips to supermarkets in St Malo. What should be noted

[132] The issue of competition in freight ferry services was also discussed in section 2.4.5.

[133] Indeed, it is for this reason that sections 2.2 and 2.3 explored the potential benefits using quantitative evidence.

here, however, is that supermarket chains in St Malo will be linked into French distribution hubs, benefiting from economies of scale. The comparisons between Jersey and St Malo prices are not, therefore, like for like. A more relevant comparison would be prices in the UK versus France (see section 4.3).

Oxera also had valuable discussions with a French supermarket interested in potentially setting up in Jersey. The benefits cited were lower sourcing prices, and increased competition in Jersey.

A5.1.2 Sourcing costs, opportunities to source directly from Europe and competition

Some interviewees noted that sourcing costs can be lower in France than in the UK. However, one importer to Jersey noted that this depends very much on the sector concerned, and the quantities ordered. A small independent business in Jersey highlighted that the reason it was able to secure good prices in France was because of the relationships it had formed over many years. An electrical retailer in Jersey highlighted that the relevant price comparison for its business would be manufacturer-delivered prices, but that it was actually unclear what these prices from France would be (given that it was served as an extension to the UK market via manufacturers' distribution hubs).

One interviewee, in the garden furniture sector, highlighted how it had undertaken direct sourcing in France, and had secured lower prices than using an agent in the UK, due to the elimination of intermediary mark-ups and greater perceived competition in European markets (these goods were imported via St Malo). Another in the packaging sector reported how it had sourced directly from the Czech Republic, and had secured cheaper prices than sourcing from the UK (albeit with the goods transported via Portsmouth). An increased link to France might provide further opportunities of this nature.

Some interviewees noted that a new link, with a suitable ship, would enable *more* direct sourcing—in particular point-to-point, driver-accompanied, sourcing from Europe—which had been constrained by the design of the current boats serving Jersey. For example, more direct sourcing of kitchens from Germany, and tiles from Italy, would be possible. Greater access to the fresh vegetable markets in Paris and Normandy would also be possible, as opposed to sourcing from the New Covent Garden market in the UK. Interviewees interested in a potential project for a link from Cherbourg to Jersey highlighted these benefits, as well as the benefits of a French supermarket using the service.

However, there may be limits to the sourcing opportunities. A supermarket in Jersey thought that any increased sourcing from France that it would undertake would only be to serve niche demands, rather than its core demand profile. A Normandy-based furniture maker, who had previously exported to Jersey via St Malo, highlighted that it served a high-quality niche market in Jersey.

Indeed, Oxera interviewed a number of businesses in Normandy which might be interested in exporting to Jersey, including those involved in building supplies and related areas, drinks distribution, furniture (as described above) and meats. A number of these businesses were working with a networking agency in Normandy to explore the possibilities for exporting to the Jersey. The majority of the companies envisaged partnering with an independent distributor/wholesaler or retailer in Jersey, or selling directly to the Island. Many of these businesses sought information on the Jersey market and partnering opportunities. The knock-on effect might be increased competition in Jersey.

Representatives from La Manche thought that the initial increased sourcing from France, and benefits of increased competition on the Island that would result from increased links, would raise awareness of the opportunities available to businesses in Jersey.

A5.1.3 Export opportunities

A number of interviewees highlighted that a frequent link to France might lead to increased export opportunities for Jersey. Most trade with the UK is currently one-way.[134] As will be discussed further, potential opportunities have been identified for increased export of shellfish, agricultural produce, fulfilment goods and waste materials (either recycled or to-be-recycled) to France, if a more frequent freight ferry service were provided from France.

A Normandy-based recycling company highlighted that there is currently relatively little recycling in Jersey and that, while progress was being made, the Island needed to do more to work towards EU norms. The company concerned could recycle many different materials, including paper, cardboard, metal, glass and plastics. It could assist in collecting and compacting materials in Jersey, and what could not be done in the Island could be processed in France. Incineration in Jersey could also be coming to an end soon. It perceived that the advantages of exporting materials to France rather than the UK included greater competition between recycling companies in Continental Europe (and hence lower prices), and proximity.

A5.1.4 Transport costs

Some respondents thought that a new freight ferry service from France would be a good way of increasing competition in these services. The nature of transport costs was also explored with interviewees. Some noted that these would be lower, since France was closer than the UK. However, according to others, distance per se had comparatively less effect on costs, since many were fixed, including handling at each end. Nonetheless, it was noted that fuel costs are rising, and that this may affect the balance of costs. The advantages of distance in respect of allowing more flexible scheduling were also highlighted. These issues were discussed in section 4.2.[135]

An industry source noted that average freight ferry fares (including logistics costs) on the Jersey–St Malo route were cheaper than average fares from Portsmouth to St Malo, which may suggest that distance plays a role in influencing fares. A company using the St Malo service also highlighted that, for heavy freight, the combined freight ferry and logistics costs of importing from St Malo to Jersey were cheaper than importing from Portsmouth to Jersey.

A5.2 Current trade and freight patterns, and perceived barriers

Discussions with interviewees confirmed how overall trade with France in recent years has remained fairly static, while bulk traffic has actually decreased.

Oxera explored the reasons for these patterns with interviewees and, in particular with businesses in Jersey undertaking trade with the UK and/or France, but also French businesses in Normandy who were interested in undertaking trade with Jersey. Interviewees were encouraged to draw upon their own experiences.

The main reasons cited for the current patterns are summarised in Table A5.1 below. Some of these might be regarded as inherent features that do not necessarily relate to the provision of freight ferry services; others relate more closely to the nature of freight ferry services. What is clear, however, is that the factors are largely interdependent.

[134] See section 2.4.5.

[135] Information was also obtained on the percentage of final goods costs accounted for by freight ferry and logistics costs. As discussed in section 2.2.2, at present, ferry freight costs are a small percentage of final goods costs, but this varies by good.

Table A5.1 Reasons for current trade patterns and barriers to increased trade with France

Inherent features	Ferry freight-related issues
History	Logistics in serving Jersey
Culture and language	Lack of frequent service per se
Demand and advertising	Customs and port issues
Standards and labelling	Potential structural and competition issues
Networks and distribution hubs	'Logistics versus market' chicken-and-egg
Potential resistance from Jersey businesses	Reliability and experience goods
Currency risk	

Source: Oxera.

The demand for freight ferry services stems from a derived demand for products. This demand for products and trade has, in turn, been influenced heavily by the history, culture and language of the Island, which have been increasingly oriented towards the UK over the centuries and, in particular, after the Second World War. In more modern times, UK-owned businesses (including UK chains) have set up in Jersey, and manufacturers in the UK, or exporting to the UK, treat Jersey largely as an extension of the UK market (for UK-specification products).

Thus products often arrive at Jersey via Portsmouth, having first gone through the manufacturers' UK distribution hubs. Advertising in Jersey has also been driven by the UK-based culture and demand in Jersey, reinforcing demand for UK-market products. The freight links developed over the last 50 years, and port facilities, have then been focused on carrying this established pattern of trade, largely via Portsmouth.

What this shows is that culture, demand, standards and distribution hubs (which all affect product demand and the derived demand for freight ferry services) are not completely separable—they are inextricably linked, reinforcing characteristics. These inherent features will serve to constrain the degree to which increased trade might be undertaken with France even if, a priori, there are apparent benefits from increased trade. The key question is the degree to which they constrain change, whether they should, and whether there are ways around these constraints.

A5.2.1 Inherent features

This section explores the inherent features that explain current trade patterns, and which may act as barriers to increased trade with France.

History

Jersey has a long-standing cultural relationship with Normandy. Having effectively been part of Normandy, Jersey became part of English Crown in 1204. This started the process of increased cultural and trade links over the centuries with (what was to become) the UK.

The influence of French culture in Jersey nonetheless continued, as can still be observed from the ancestry of many Jersey residents, the place and road names in Jersey, and the cultural and trade links that have been maintained over time. However, links with the UK were reinforced after the Second World War, when many UK (and Irish) people either returned to the Island, or settled there for the first time. Thus, in respect of modern history, the culture of the island, although in itself different to the UK, has been heavily influenced by UK culture.

Culture and language
In an interview with a States representative, attention was drawn to how Jersey residents class themselves, and how this ties in with Jersey culture.

The most recent census, undertaken in 2001, reveals that, of the 87,000 Jersey residents, 53% were born in Jersey and 36% elsewhere in the British Isles (including the Republic of Ireland). Only 1% were born in France (and, indeed, more had originated from Portugal, at 6%).

How people classed themselves also followed this pattern closely, with 51% classing themselves as having a Jersey cultural background, 35% British, 2.6% Irish, 6.4% Portuguese/Madeiran and 1.7% French. 95% spoke English as their first language, and only 0.4% spoke French as their first language (although 17.3% could speak French, either as a main or secondary language).

Therefore, while over half of the population of Jersey class themselves as culturally Jersey rather than British, the combination of over a third of people classing themselves as British, and the vast majority speaking English as a first language, means that Jersey leans more towards an Anglo-Saxon culture rather than a French culture. This influences the demand for products by consumers, the ways in which businesses undertake trade, and individuals' outlook more generally (for example, Jersey students often study in the UK).

In addition, interviewees identified a number of barriers to increased trade with France arising from differences in culture between Jersey and France:

– the way of life, working hours and working patterns are different in Jersey to France;
– French business practices can be more bureaucratic than Anglo-Saxon business practices;
– the finance culture in Jersey, which is crucially important to the Island, is predominantly Anglo-Saxon;
– while there is a high service ethos in France, expectations of service can be high, but expectations of how much service should cost can be low.

It was also identified that Jersey businesses can be quite conservative (more so than UK businesses), can be afraid to talk to French businesses, and that it takes time to change these attitudes in Jersey.

A number of initiatives in recent years have sought to break down these cultural barriers, in particular through re-energising the historical relationships between the Island and Normandy. These have occurred in particular through La Maison de Jersey (based in Normandy) and La Maison de la Normandie (based in Jersey), and links with government departments in Jersey and in France (such as those in La Manche). In 2003, a Working Party group was established in Jersey to promote exchange at a cultural and social level. Over time, these initiatives may reduce the cultural gap.

Cultural issues were discussed with representatives of La Manche and l'Assemblée Nationale in France. It was noted that, to lower barriers, recent education programmes in La Manche had been aimed at improving English language skills. It was also suggested that La Manche could form a common place or 'crossroad' for Jersey, French and other businesses, which would help to bridge cultural gaps, and grow business links. Culturally, La Manche had a similar culture to Brittany, with which Jersey was already undertaking trade. Also, many Jersey residents had properties in the region. As regards business opportunities, given the limited space and infrastructure in Jersey, finance businesses in Jersey could set up back offices in La Manche, and Jersey businesses more generally could take advantage of the

road networks and established information technology assets in the region. Over time, business links between Jersey and La Manche could grow.[136]

The extent to which language forms a barrier was also discussed with Jersey businesses. Many identified this as a key barrier. One interviewee identified his ability to speak business French as being key to securing networking relationships in France. However, mixed views were obtained on the extent to which language *should* form a barrier. One independent Jersey business illustrated how it employed a number of French people, and that, if Jersey businesses perceive language to be a barrier to realising opportunities, there is nothing to stop them from learning French to overcome this.

Demand and advertising

The cultural and language influences discussed above have influenced the demand for products in Jersey. Demand appears to mirror the UK profile of demand, although there are important differences. For example, it was identified in an interview with an importer to Jersey that people are more used to 'seeing' fresh food in Jersey, including meats, vegetables and fish, as opposed to pre-packaged food that has gained influence over the years in the UK. This stems, in part, from the French cultural influence, and the Island's long history of agriculture and fishing. Jersey residents were also used to undertaking frequent shopping trips to France (for example, to shop for food in St Malo). Nonetheless, it was identified that supermarkets in Jersey tended to sell more pre-packed products than would be sold in a typical French supermarket.

As discussed further below, a supermarket interviewed in Jersey classed the demand for its products as being largely UK-based, particularly for branded products such as tinned produce and breakfast cereals, with demand for French products being more niche. However, it was also noted that niche demands can develop over time into a core demand, as has happened with crème fraîche.

Reinforcing the UK-like demand present in Jersey are the UK-based advertising campaigns led by manufacturers, which are aired in Jersey, and the British newspapers and magazines that carry these campaigns. For example, an electrical retailer identified the benefits of Jersey being able to 'free ride' on UK advertising at the right times, given the UK-oriented language and culture: In the run-up to the 2006 World Cup, television manufacturers would be promoting their latest plasma screen models, to the benefit of the retailer. These might not be the same models as those that could be sourced from France. In turn, this has an influence on the retailer's sourcing patterns.

However, the impact of UK-based advertising is likely to vary by product. In niche markets, such advertising has less influence on businesses' sourcing patterns. An independent bakery highlighted how Jersey people had been brought up on better quality (including French-style) bread than the mass-market bread typically sold in the UK. His business did not seek to compete head-to-head with the supermarkets in selling (UK-promoted) mass-market bread. In this case, the barriers to increased trade with France posed by UK-based advertising would be expected to be lower.

Standards and labelling

It is not surprising, given the above, that standards and labelling have developed largely around the UK system. Nonetheless, Jersey does have a separate system of regulations to the UK.

The draft Food (Labelling) (Jersey) Order 2006 aims to reinforce a previous order from 1966 and, while seeking to permit the free movement of goods which can be legally marketed in

[136] An analogy was drawn with Miami, in which businesses and financial institutions in the USA and Latin America needed a common place in which to do business. Miami, while being in the USA, had a Latin culture. By attracting initial business exchange and the interest of financial institutions, Miami grew into an important crossroads between the USA and Latin America. Cultural issues are not, therefore, an insurmountable barrier to trade.

the EU, retains the requirement that information provided on a label must be legible, indelible, clearly visible and in a language readily understood by the intended purchaser.[137] Given that information must be provided both on a label (rather than solely on shelving, for example), and that only 17.3% of Jersey islanders can speak French, this may affect the ability of food importers to sell French-labelled produce, and may serve as a barrier to increased trade. However, this is essentially a legal issue, and some interviewees suggested that the regulations could be modified fairly readily.

Nonetheless, a Jersey supermarket interviewed emphasised that, while French labelling might not be problematic for a niche range of goods, this would not be the case for a wide range of goods fulfilling day-to-day demands (see section A5.3). This was particularly important given the increased attention given to food allergies over recent years. In contrast, a French supermarket did not view the issues posed by labelling as insurmountable (see section A5.4).

In an interview with an electrical retailer, it was emphasised that it would not sell products that were not UK specification. It provided an example of an electrical product, sourced from France. While this had English labelling and the required CE mark, the instructions inside and guarantees were solely in French, and the product had a two-pin, rather than a three-pin, plug. Returns and after-sales service might also be problematic, since a separate servicing agreement would need to be arranged with a business in Jersey. These issues did not arise when sourcing products designed for the UK market through the UK distribution hubs.

The issue of labelling and standards therefore arises as a combination of legal issues per se (which may not be so problematic), and the wariness of how retailers think consumers would react to goods, both at the point of sale, and when they use the products at home.

In an interview, it was identified that these types of barrier were less likely for basic and unbranded products (such as vegetables and cement), or one-off purchases of bulk capital equipment (such as plant). Nonetheless, even in these cases, differences in standards play a role. Jersey building styles, for example, tend to mirror UK building styles, and thus UK construction techniques. As such, bricks, and even sand and cement, can be of a different specification in the UK and France. Building inspections in Jersey are also based on the UK model. These barriers were not, however, insurmountable. For example, joint ventures had been pursued with French companies to undertake construction in Jersey (for example, the apartments on the harbourside in St Helier). Interviews in France with building suppliers also revealed that UK standards were increasingly converging to EU norms, such that this was becoming less of a barrier over time.

Network and distribution hubs

The current trade pattern between Jersey and the UK, versus between Jersey and France, is influenced heavily by the way in which trade networks have been built up over time. In effect, the main networks that facilitate trade patterns have been developed primarily around the UK, although there are relationships with French suppliers. In theoretical terms, a network comprises a number of agents or *components* in a system, and the *links* between these components.[138] In terms of trade with Jersey, the established networks encompass:

– the *distribution hubs* of UK, European and global manufacturers;
– the *relationships* between Jersey retailers and their preferred manufacturers, other suppliers, buyer groups, agencies, wholesalers, warehouse providers, logistics companies and customers; and

[137] See a discussion of the draft Food (Labelling) (Jersey) Order 2006 at http://www.health.gov.je/health_protection/food_matters/food_label.asp

[138] The system itself might be regarded as operating within, for example, a set of rules (such as standards and labelling), the final market, and the business environment/culture.

– the *information flows* that are facilitated by the above relationships, such as trust and market opportunities.

Existing distribution hubs within the UK are an important constraint on the extent to which increased trade might be undertaken with France. The UK-based *retail* chains in Jersey have their own distribution hubs in the UK, which they currently use and are perhaps unlikely to reconfigure to serve Jersey (which is a small market). However, as discussed in the case studies presented below, at the opposite end of the supply chain, branded goods *manufacturers* tend to treat Jersey as an extension of the UK market. Thus even when products are made in France, and are delivered to independent retailers in Jersey, manufacturers will often choose to send these in bulk to the UK (for example, to a centralised warehouse point), with subsequent redistribution to points in the UK (including Portsmouth).

Different manufacturers then have different arrangements and policies for transporting the products from Portsmouth to Jersey. The key point is that this is the preferred way in which the branded manufacturers *choose* to undertake bulk, medium and fine distribution, to minimise costs and/or maximise overall profit. Jersey is a small component of total UK-specification product demand, and it is not clear that a branded goods manufacturer would choose, on cost grounds, to divert at an earlier stage products from its main distribution hub, to serve Jersey from France through a more dedicated supply chain. Even non-branded goods tend to follow this route.

Supply chain relationships more generally influence the prospects for increased trade with France. In particular, the supermarkets in Jersey have buyer power in the UK—for example, the Co-op through membership of the Manchester-based buying group, and CI Traders through its relationship with Nisa. The supermarkets' supply chains have developed as if the stores were an extension of the UK market. Section A5.3 discusses a case study of a Jersey supermarket, its relationships in the UK, and the issues that would occur if more sourcing were undertaken directly from France. An independent electrical retailer also revealed how long-term links with UK suppliers and brand-holders were useful for securing surplus stock at favourable prices, and for promotional activity, and that it would not wish to unduly risk losing these advantages.

A ferry operator noted that the historical relationships facilitated by UK distribution hubs meant that businesses could order a wide range of products regularly, in small or large quantities, including products from manufacturers in Continental Europe. The UK frequent services facilitated this traffic. The St Malo service catered for a demand pattern established through historical relationships with, for example, European wine producers. It was unlikely that the existing demand pattern of both Jersey and Guernsey could be fundamentally shifted to alter the balance of these two very different demand profiles.

However, in theory, those likely to have more flexibility to circumvent existing hubs and form new relationships are small independent retailers in Jersey. However, from interviews, it also became apparent that these can have agreements with buyer agencies in the UK, in order to secure access to a reasonably wide range of products. An interview with an importer revealed that these tended to be based on the type of product or produce sold, rather than the size of the retailer business concerned. An independent retailer, importing from both the UK and France, revealed how it also had long-established business relationships in France, which could not easily be switched on or off. It was these relationships that enabled the retailer to secure good rates. It was not clear whether all businesses in Jersey would be able to secure such good rates. These issues are discussed in more detail in section A5.3.

In totality, retailers' hubs, manufacturers' hubs, and other relationships (buying agencies, supplying agencies) mean that the majority of trade may effectively be 'locked into' the UK. Indeed, the freight ferry part of the supply chain should only be considered as a final leg in the overall chain of distribution. The networks that have formed are potentially a more serious impediment than the existing pattern of freight ferry services to increased trade with France. The main opportunities for increased trade with France would appear to consist of

options in which existing distribution hubs, in particular, can be overcome by Jersey businesses undertaking their sourcing and/or by French businesses seeking to undertake increased trade with Jersey.

However, another issue concerns information flows. Because the majority of trade is currently with the UK, Jersey businesses have good information on the opportunities to trade with the UK, and know what to expect (in part because of language, culture and existing relationships). By contrast, trading with France directly, for those not currently doing so, is more of an unknown entity. Forming relationships with French suppliers therefore represents a new challenge, in addition to the challenges posed by differences in language and culture.

Likewise, businesses in France face informational problems in seeking out opportunities in Jersey. Oxera spoke to a number of businesses in Normandy, and a Normandy networking organisation that the companies had contacted about potentially trading with Jersey. In most cases, the ideas being explored by the businesses were in their infancy. The networking organisation was keen to assist the companies. It was nonetheless clear that there are problems for French businesses seeking to do more trade in Jersey, in respect of these being able to, at reasonable cost, secure information on the Jersey market and opportunities (for example, the different sectors, and the various regulations), and contact with potential partners in Jersey. In particular, the combination of Jersey being a small market, and these fixed transaction costs, may serve to hinder trade. Future initiatives by the networking organisation, the States of Jersey and its departments, may seek to lower these informational barriers. La Maison de Jersey also plays a key role at present in networking French businesses with potential Jersey partners.

Moreover, none of the above factors means that it is too difficult for Jersey businesses to form relationships with networks of French contacts, or vice versa. An interviewee involved in logistics highlighted how the company concerned had formed networks of business contacts in France, although language skills were key to securing this.

Potential resistance from Jersey businesses
Some interviewees argued that, because of the increased competition that further trade with France might facilitate in Jersey, some Jersey businesses might be resistant to change. Indeed, if a French business set up in Jersey, rather than simply selling goods to an existing business, this might directly increase retail competition in Jersey.

The above discussion also highlighted the role of UK distribution hubs and vertical relationships in the supply chain. In general, these appear to offer an efficient means for existing Jersey businesses to source the desired quantities of UK-oriented products. This is consistent with the idea that forming vertical relationships *enhances efficiency* by reducing transaction costs and enabling the consistent stocking of a diversity of consumer goods. However, vertical relationships (or, moreover, 'restraints') can also affect *competition* at different points in the supply chain. In context, some French businesses identified problems in selling to Jersey, in respect of accessing markets. However, this may again simply be because current freight services, distribution hubs, and the relationships formed around these, provide the most effective way of serving the Island. Information issues may also play a role (see above).[139]

Currency risk
Whereas the Jersey currency is linked at parity to the UK Sterling rate, France lies within the Eurozone. Thus, an issue highlighted by some interviewees that served as an impediment to direct trade with France was currency risk, although this was not necessarily a major issue.

[139] It is not clear whether additional competition issues exist, and the purpose of the current study is not to explore in depth such issues (a separate study might explore these).

A5.2.2 Ferry freight-related issues

Logistics in serving Jersey
Section 4 discussed in some detail the logistical issues of serving the Channel Islands (for example, the small market and the restrictions on driving trucks in Jersey). In an interview, it was highlighted that manufacturers often prefer to leave the additional specialist logistics of carrying freight to Jersey to logistics companies, such as Condor Logistics, Ferryspeed and Morvan Fils, which use the existing freight ferry services.[140]

Thus, not only might some manufacturers be reluctant, in certain cases, to disrupt their main distribution hubs in transporting products to the necessary port for serving Jersey (see below); they may in any event prefer to delegate the last leg of the journey to a specialist logistics provider, regardless of the range of freight ferry services offered. This may serve as a barrier to new services from France if they are based on the point-to-point driver-accompanied model. However, others highlighted that there is demand for driver-unaccompanied freight (see, in particular, section A5.4). Moreover, increased frequency services from France need not be based solely on the driver-unaccompanied model.

Lack of a frequent service per se
In contrast, many interviewees argued that the lack of a frequent RO–RO service operating from St Malo places a constraint on the types of trade that can be undertaken with France.

The recent history of how the current service configurations arose was explored with interviewees. A freight-forwarder revealed how he used to work with French logistics companies and, up until the 1990s, used a conventional RO–RO ferry service (Solidor 2) operated daily by Emeraude from St Malo, which was usually full of passengers and cars. However, there would be a freight day twice a week on which it was possible to transport trailers to Jersey. The freight-forwarder would import a variety of goods, including wines, general cargo and electrical products. At the time, Condor (the fright ferry division of which was then known as Commodore) operated a frequent LO–LO service from the UK, and a less frequent service to St Malo.

Since this period, however, the nature of freight links to France has changed.

– Condor adopted a RO–RO ferry in the 1990s, to replace its LO–LO service for heavy freight. This had limited driver-accompanied capacity, which meant that most freight still needed to handled by logistics companies. Condor launched its current frequent RO–RO service to the Channel Islands and its weekly Saturday RO–RO service to St Malo, fitted in alongside its UK service.

– For passengers, Condor launched a high-speed frequent ferry service from the UK to Jersey (carrying light freight), and from St Malo to Guernsey (but not to Jersey). The service could also carry light freight.

– Emeraude then launched its own fast ferry service (Solidor 5), to target the passenger market from St Malo. This contributed to the significant decrease in heavy freight carried from France.

– Following financial problems encountered by Emeraude in 2003, Condor was granted permission by the States to extend its frequent fast passenger service to serve Jersey–St Malo. Emeraude returned to its fast ferry service operations soon after this period.

The way in which both Condor and Emeraude targeted the passenger market in the 1990s therefore appears to have played a role in reducing the freight links to, and the level of trade

[140] As noted in section 2, Condor Logistics and Morvan Fils are owned by Condor Group, which also owns Condor Ferries (which runs the main freight ferry services to the Island). Ferryspeed is an independent logistics provider, which operates on the Northern route.

with, France. In an interview, it was identified that there is an inherent contradiction between passenger and heavy freight services: Today's market is such that passengers wish to reach their destination quickly, but this can mean using smaller faster boats, which are not capable of carrying significant amounts of freight.

The current situation is therefore very much a legacy of the past commercial decisions of the ferry operators and past interventions by the States.

Various views on the adequacy of the resulting services were obtained in interviews.

– Whilst allowing for transportation of heavy freight, the weekly service from St Malo did not cater for frequent (particularly perishable) demand, particularly if there were delays at the quayside. The fact that the service fell on a Saturday did not necessarily encourage exports of fresh shellfish produce, since fewer people work on Saturdays, and fewer people would be available to handle, forward and receive the produce en route to its destination.

– The frequent fast ferry services can only carry limited amounts of light freight—mainly fresh or other limited-shelf-life produce, in vans or pods.

– Nonetheless, those wishing to transport heavy freight more frequently from France could do so via the UK. This option was often chosen (see also the discussion of the logistics versus market 'chicken-and-egg' problem, below).

– Because Condor chose to adopt a RO–RO ship design with limited driver-accompanied capacity, this meant that people needed to use logistics companies, limiting point-to-point driver-accompanied freight, and discouraging owner-drivers.

The key question, however, is whether sufficient additional demand for further trade with France exists to move away from the above legacy, given the cost structure of ferry freight services.

Customs and port issues
In interviews, it was identified that customs requirements may be hindering direct trade with France at present. Whereas goods imported via the UK (including from France) had a straightforward importation procedure, since the UK is part of the EU and Jersey forms part of the UK Crown, importing goods direct from France required more paperwork.

In particular, an exportation document was required to export goods from St Malo. Some problems were identified in obtaining the necessary paperwork, and it was argued that delays had been experienced at St Malo.

In addition, some argued that a more positive outlook had been provided by the port authorities in Cherbourg to the promotion of a potential new frequent freight service than in St Malo.

The shrinking availability of port space available in Jersey was also identified as a potential constraint to increased trade. More space is being devoted to the construction of apartments, rather than developing the port for increased trade.

Potential structural and competition issues
Respondents in some interviews highlighted that the market structure of ferry services and logistics, and the resulting nature of competition, served as a potential barrier to developing further freight links with France.

It is of note that it is not clear whether competition issues do or do not exist, and the purpose of the current study is not, in any event, to explore such issues in depth.[141] Some of those interviewed, however, raised the following concerns, the validity or otherwise of which could be explored further as a separate study.

– *Position on Northern route*—Condor's position in the freight ferry market means that its rates on the UK route are perceived to be high. For example, they are higher than fares for importing freight on cross-channel services from the UK to France (although this may not be a valid comparison).

– *Logistics rates on Southern route*—some have suggested that companies tend to import heavy freight from France via the UK, in part because the rates from Morvan Fils are perceived to be high and/or not stable for heavy freight.

– *Vertical issues*—Condor and its ownership of Morvan Fils might create a conflict of interest. Morvan Fils prices the cost of freight to be carried on the weekly service, including to independent logistics providers, but is in competition with these independent logistics companies for the logistics operation from manufacturer to port. These issues are potentially less of a concern in Portsmouth, which is busier, and in which Ferryspeed is a key competitor to Condor Logistics.

– *Cross-subsidy between markets*—there is the potential for any losses made in Condor's passenger ferry services to be cross-subsidised through any profits made in freight.

– *Lock-in*—Condor's position in the ferry freight market may, more generally, make it difficult to shift trade from its current pattern with the UK.

Insofar as the above genuinely are problems—and it should be emphasised that this is unclear—more trade with France might occur if they were resolved. Oxera has not explored whether excess profits are being made on the routes operated by Condor. However, even if this were an issue, introducing a competing service from France is only one solution. As discussed in section 4.4.5 (and elaborated in Appendix A3.2), given the cost structure of freight ferry services and the size of the market, the increased competition that a new service might introduce could also exacerbate the critical mass problem for any new entrant. Alternative solutions to expanding market competition include regulation of Condor's prices, further internal separation of roles within Condor, or more complete business separation.

It is also of note that there are differences between perceptions and reality regarding the current situation. There is a perception, for example, that the weekly service from St Malo is full, but that further services are not offered. However, Oxera understands from an industry source that, typically, the service is not full (see also the discussion of 'logistics versus market' uncertainty and the chicken-and-egg problem, below). In addition, an independent business importing heavy freight from both the UK and France reported no problems in using Morvan Fils and the weekly service from St Malo. Furthermore, Oxera understands that the average fares for importation from St Malo to Jersey are lower than those for importation from Portsmouth to Jersey.

A5.2.3 'Logistics versus market' uncertainty and the chicken-and-egg problem

The issue of whether there was a chicken-and-egg situation in moving towards an increased frequency service from France was explored with interviewees.

Different views were obtained on these issues, depending on who was asked, as follows.

[141] This report does not discuss compliance with existing competition rules, in respect of the legal issues involved.

– Condor does not have much of an incentive to launch a new service from St Malo since it would adversely affect the operation of the existing UK service, given that the St Malo service is fitted around the current UK schedule.

– If there were sufficient demand (for example, from a supermarket and another large customer), the service would be provided.

– The issue should be approached along the lines that Jersey retailers would consider using a more frequent service if it were offered, and not that Jersey retailers should demonstrate that the demand exists.

– Jersey is a niche market, but French businesses in La Manche want to increase trade with Jersey. The demand exists, but the only problem is in finding a suitable boat to use.

– The chicken-and-egg problem affects all sectors, not just freight ferry services, but trade with France will inevitably increase in any event.

– A service from Cherbourg has not emerged before because the demand has not been there. Now there is demand, such a service has emerged as an option.

It is also of note that the Working Party Report 2004 highlighted that a freight ferry business may be reluctant to launch a new service if there is insufficient demand, or if the new service competes with an existing one.[142]

From some of the responses above, there would appear to be both a critical mass problem per se and an information problem. A potential problem is that current demand patterns are based on the *current* freight ferry service options offered. While most accept that there is a critical mass problem of some kind in securing a frequent service from France, it would appear that an additional part of this problem relates to information[143]: It is difficult to see what level of demand there would be if the new service were offered (ie, the *counterfactual*). Without being sure of what market might be secured, a prospective operator may be reluctant to offer a new service.

Oxera asked Condor if there was a real chicken-and-egg problem. Condor emphasised that it would lay on an additional service if the market dictated, and that this would be the case if there were a real economic advantage of increasing trade with France. At present, however, there was spare capacity on both its frequent fast ferries and on its weekly slow ferry to St Malo. The current services offered are, therefore, scalable, and could fulfil any incremental demand, insofar as it existed. For light freight, there is the option of using additional vans put onto the fast ferry service by Condor Logistics. For heavy freight, people can use the existing weekly service and, if they need a more frequent service, Condor, through an agreement with Brittany Ferries, will transport the freight to Jersey via Portsmouth at the same price.

Huelin Renouf also expressed the view that there was not enough demand to justify a new frequent service from France, and that there was actually not enough demand at present to fill all the freight services sailing to the Channel Islands on the Northern route.

In summary, no clear consensus emerged on the demand for a new service, or the way in which a new service would emerge. Some argued that it was up to a sufficient mass of potential customers to make the case for increased services. Others argued that trade would inevitably increase. Others argued that a service should be put on, and then retailers would decide whether they wanted to use it.

[142] States of Jersey (2004), 'Working Party on Relations between Jersey and France—Report to the Policy and Resources Committee.

[143] The framework developed in section 2.4 is driven by cost and demand characteristics alone, and does not necessarily require information imperfections to motivate the analysis.

A5.2.4 Reliability and experience goods

There was, however, more agreement on the question of how reliable any new service would need to be. Most agreed that the current frequent service operated by Condor from Portsmouth was very reliable.

In relation to any new frequent service from France, it was argued that such a service would need to prove itself reliable, daily and cost-effective *before* people considered using it. The current boats used by Condor were both physically reliable, and the company was in a healthy financial position. A retailer importing from the UK questioned whether a boat from France would necessarily meet both criteria. The potential for industrial action at French ports was also raised as a concern.

What this illustrates is a key further dimension of the chicken-and-egg problem—that of experience goods. Whereas the current service offered by Condor is a 'known', any future service from France is as yet an 'unknown' that would need to prove itself. The reliability of any France service will only become clear once people start to use it. This presents an additional hurdle in persuading people to switch to a new service. The requirement for a reliable service is inherently tied to people's frequency requirements, which are discussed further in section A5.3.

A5.3 Sourcing patterns, frequency requirements, and potential for changing patterns

The general message obtained from interviews with Jersey businesses and logistics experts was that, if a new freight ferry service to France were offered, it would need to be frequent, for several reasons.

– *Perishables*—supermarkets and other retailers selling perishable items need a frequent service capable of carrying temperature-controlled trailers. However, only a small proportion of the total cargo transported to Jersey is strictly 24-hour time-sensitive or short shelf-life.

– *Just-in-time*—many retailers (not just in Jersey) now use 'just-in-time' in order to achieve balance and efficiency in the supply chain. Retailers are averse to having significant amounts of storage space that is not itself earning money, with cash tied up in stock within this storage space. Added to this is the shortage of warehousing space in Jersey. Thus, while not requiring temperature-controlled facilities, just-in-time businesses still require a reasonably frequent service.

– *Flexibility*—even for businesses not requiring regular frequent services, a frequent service helps when problems arise. For example, if a pallet is not put onto a boat at Portsmouth, it can be put onto another boat 12 hours later. Also, if the wrong goods arrive at their destination in Jersey, they can be sent back to the UK fairly quickly. Neither applies in the case of a weekly service. Potentially, all businesses, regardless of their just-in-time nature, would value this.

One interviewee, who used to import goods via the former Emeraude RO–RO service from St Malo, suggested that any new service to France would need to be both reliable and at least three times a week, because of the use of just-in-time in Jersey. (It is also of note that this is the frequency at which the Huelin Renouf LO–LO service, sailing from Portsmouth, operates).[144] Another interviewee suggested that, given the presence of fixed weekly crewing costs, it made sense to run the boat frequently. Another interested party emphasised that the boat would need to be, at a minimum, daily, in order to instil its credibility as a serious

[144] As noted, this service seems to appeal to an established base of customers with a certain demand profile.

alternative service to the UK route. The above issues were reflected in the stylised analysis presented in section 4.4.

Oxera explored with a variety of Jersey businesses their current sourcing patterns and frequency requirements, and how this affected the balance between the potential opportunities and potential barriers of increased trade with France; in particular, looking at whether such businesses would source more from, or export more to, France if there were a new frequent freight ferry service. Interviews were also conducted with Normandy businesses.

A5.3.1 Medium-to-large retailers in Jersey

Two non-food independent retailers (an electrical retailer and a general store) in Jersey and an independent supermarket were interviewed to explore their current sourcing patterns, and to ascertain whether they would undertake more trade directly with France if a new ferry freight service were offered. The issues of distribution hubs, standards and supply chain relationships were all emphasised.

What became clear is that the choices of independent retailers are constrained by manufacturers' decisions. Manufacturers selling to the UK market, which ship across the channel from mainland Europe, tend to send very large quantities of products to the UK in containers. Jersey represents a very small proportion of this load. Therefore, medium-to-large independent Jersey retailers would not necessarily switch significant amounts of trade to France, since manufacturers, even those in France, would not necessarily disrupt their existing preferred bulk transport and redistribution hubs to serve Jersey, in what they see as an extension to the UK market and a very small market.

The retailers concerned also need to source a reasonable diversity of UK-market oriented goods, and the existing hubs are the preferred ways of securing these. Retailers in Jersey also value the relationships formed with others in the supply chain (for example, buying groups, wholesalers/distributors and agents in Portsmouth), along the existing hubs.

Case studies on the two independent non-food retailers are summarised in Box A5.1.

Box A5.1 Case study: medium-to-large retailer

Oxera interviewed an electrical retailer and a general store. Neither currently used the weekly St Malo service, and neither would necessarily change their sourcing patterns if a new frequent service were operated from France. It became clear that geographical averaging occurs in manufacturers' pricing structures. Jersey retailers often obtain 'delivered to UK prices' or 'delivered to UK prices' plus the additional charge for the Portsmouth–Jersey leg.

The electrical retailer had a just-in-time requirement, and was unsure how it might frequently source an array of UK-specification products from France, or what manufacturers' prices might be. Thus, sourcing and transport cost savings would need to be significant (between 15 and 20%) for it to consider undertaking more trade with France. The general store emphasised that exactly how the goods are transported to Jersey was largely the manufacturer's problem, rather than being in the control of the retailer. Its Portsmouth agent received goods from the manufacturer's established distribution network. If the retailer decided to import goods directly through St Malo, it would need to have separate arrangements with manufacturers to transport an offshoot load to St Malo, and then would need a separate agent in St Malo. It was not clear whether this would be realistic.

Box A5.1 illustrates how the UK market for goods and the distribution hubs of manufacturers are inextricable linked. However, this does not rule out that some manufacturers may be

prepared to adjust their distribution hubs if a new frequent service were operated from France to Jersey. In particular, French manufacturers will have large existing hubs in France, through which they might choose to divert some of their existing goods aimed at the UK market. These might, for example, travel alongside France-branded goods to St Malo.

Independent logistics companies might also seek to arrange deals directly with manufacturers in France for UK-branded goods, and Oxera understands that, in the past, even electrical goods were imported via St Malo via this route. More generally, some UK-branded goods may be sourced on the grey market in France (as cars and jeans in the UK have been sourced from the EU on the grey market). However, this may be better suited to one-off purchases than to sourcing a regular and wide range of UK-standard products. Relationships with agents along the supply chain and the use of manufacturers' distribution hubs appear key to securing a regular and wide range of products.

Oxera also spoke to a supermarket in Jersey to ascertain whether it would source more from France if a more frequent service were provided from St Malo. Box A5.2 reports the issues raised.

Box A5.2 Case study: Jersey supermarket

A daily frequency service was important to the supermarket since consumers buy from a supermarket on a daily basis, the business has limited storage space, and just-in-time is used to achieve efficiency in the supply chain.

While the supermarket imported some products from France, it did so via Portsmouth, due to the logistical issues involved in diverting flows via St Malo, and the lack of a regular service. The main bulk of daily demand was UK-based. As regards sourcing these products, the company had buyer power in the UK through its membership of a buying group, and valued relationships with brand-holders. It was unlikely that such products could be sourced in bulk from France or at favourable prices. While the supermarket might source more directly from France, this would probably be modest, limited to niche products (the supermarket did not wish to sell a wide range of French-labelled products if consumers might not understand what the products contained) and fresh fruit and vegetables (although the company did not have a daily presence at French wholesale markets, which it saw as necessary to secure the best prices).

Box A5.2 illustrates that, from the business' perspective, the UK-oriented culture (and language) in Jersey leads to a UK-type daily demand profile in the market concerned. It illustrates the interaction between this demand and labelling issues, the relationships that the business has formed in the UK, its buyer power in the UK, and the use of UK hubs. Although the lack of a frequent service from France constrains what the retailer might import directly from France, the increased sourcing might only be of those products less affected by labelling issues. Changes in sourcing patterns would be incremental, rather than radical.

Not all businesses share the same view of the opportunities for sourcing more food produce directly from France to meet daily demand. Section A5.4 below presents a case study following discussions with a France-based supermarket. It illustrates how the supermarket might overcome some of the barriers discussed in Box A5.2, although the labelling issue would appear to be an important barrier to be overcome. Also, section A5.4 illustrates how a potential freight link to Cherbourg might seek to resolve the problems of lock-in to UK distribution hubs. Moreover, smaller businesses would appear to have more flexibility to undertake more trade directly with France (see below).

A5.3.2 Smaller independent businesses in Jersey

As noted in section A5.2, small businesses would appear to have more flexibility to undertake increased trade with France, in respect of circumventing existing hubs and forming new relationships. Oxera discussed with some smaller businesses their sourcing patterns, the opportunities and barriers regarding trade with France, and whether they would use a more frequent service if it were inaugurated.

An importer of produce from France highlighted that, even for small businesses, agency agreements with buyer agencies in the UK, to secure a reasonably wide range of products, might serve to lessen the opportunities for increased trade with France. These tended to be based on the type of product or produce sold, rather than the size of the retailer business concerned.

An independent retailer, importing from both the UK and France, revealed how it had long-established business relationships in France, which could not easily be switched on or off. It was these relationships that enabled the retailer to secure good rates. It was therefore not clear that all businesses in Jersey would be able to secure such good rates. The retailer highlighted that it might make more use of a frequent conventional freight ferry service from France if this were offered. At present, it mainly imported during quiet periods, using the fast ferry services from the UK and France. Thus, there was the potential for some increased trade with France.

Oxera also spoke to small Jersey businesses that were potentially interested in undertaking increased trade with or via France, on the grounds of cheaper sourcing costs in Europe for certain products. A case study on these businesses is summarised in Box A5.3.

Box A5.3 Case study: small garden furniture business and packaging business

An independent garden supplies company highlighted how it imported both through St Malo and from Portsmouth, on the RO–RO services. It had increased direct trade with France over the past five years, through direct contact with manufacturers, although this was still a low percentage of total sourcing. The company had recently tendered for a particular high-quality product, made in France, which was at least 40% more expensive to source from an agent in the UK compared with buying direct. Direct sourcing removed successive mark-ups by intermediaries, and sourcing costs tended to be lower in mainland Europe than in the UK, since these countries retained a larger manufacturer base. The company experienced no problems importing via St Malo. The current weekly service was sufficient, given the company's on-site storage space, and that its main business contacts were in Brittany and southern France.

Oxera also spoke to a packaging firm that exported to the UK. The company used the Portsmouth–Jersey route for both import and export. Although it did not have detailed knowledge, it perceived problems existing in importing through St Malo. It sourced some tooling equipment directly from a manufacturer in eastern Europe, noting that the buying price could be up to seven times cheaper than buying these from the UK. For some products, Continental Europe provided cheaper sourcing opportunities than the UK due to size of the market and lower margins. To transport the goods, the packaging firm used a logistics company. In principle, if a new service were operated from Cherbourg, this might provide an alternative routing, since the logistics company was likely to have a Paris hub. There were also some potential export opportunities to mainland Europe via Cherbourg. However, Cherbourg was not currently a major hub, which may affect the willingness of logistics companies to use it.

Box A5.3 illustrates that small businesses that currently undertake direct deals with French or manufacturers in Continental Europe *might* consider using a more frequent service from

France, but not necessarily. It was identified that, in certain instances, such markets provided the prospect of cheaper sourcing opportunities. However, since the businesses were not just-in-time in nature, it is unclear that they would undertake significant incremental sourcing from France or Europe more widely if a more frequent service were offered.

It is not clear whether a negative correlation exists more generally between the size of a particular business and the just-in-time characteristics of the business. However, it might be that smaller businesses do not adopt in quite the same way the rigid just-in-time supply-chain methods of larger businesses, and thus might not require a more frequent service. If so, there may be a problem in obtaining sufficient demand for a more frequent service than is currently provided. On the one hand, large businesses may be locked into existing hubs and relationships; on the other hand, smaller businesses may have less need for a frequent service.

Nonetheless, it is not necessary for individual businesses to have frequent demand to lead, in aggregate to a frequent demand profile (see section 4.4.2). Also, there are small businesses with just-in-time characteristics, or which deal in perishables. As regards the latter, according to a business exporting shellfish to France, interviewed by Oxera, the current weekly RO–RO freight service was not ideal as it fell on a Saturday, when fewer people would be available to handle, forward and receive the produce en route to its destination. The business exported daily using vans on a frequent fast ferry service, but would prefer to have a daily service onto which it could drive larger trucks. If necessary, it would seek to obtain a permit to operate these vehicles in Jersey. As such, the business would not necessarily increase its overall volumes exported, but might simply switch its existing volumes to the new service. Nonetheless, this reverse flow might assist a frequent service in gaining critical mass (see also section A5.4).

In discussions, it was highlighted by some that one, potentially currently untapped, market is the point-to-point owner-driver market. In particular, the Cherbourg project might facilitate increased driver-accompanied trade, as discussed in section A5.4 below.

A5.3.3 Businesses in France

A number of businesses in Normandy interviewed were potentially interested in undertaking increased trade with Jersey. In most cases, it was necessary for the businesses to find the right partners. Some perceived difficulties in teaming up with non-independent retailers, distributors or other companies in Jersey. As discussed above, many of the companies needed to know more about both the nature of the Jersey market and the opportunities for forming partnerships. Some examples are as follows.

– *Direct selling and (horizontal) partnering with French companies*—a French pre-fabricated building specialist traded everywhere across the EU, but not in Jersey. It sold directly to customers, often in partnership with a construction company, but was unsure what the opportunities in Jersey might be. In its view, the company had very competitive prices versus the UK, stemming from competition in Continental Europe. The main barrier, however, was finding a partner. While it might attempt to work with a Jersey concessionaire, it would prefer to partner with a French building company with common interests. Its projects would be discrete ‘one-offs’.

– *Direct selling and (horizontal) partnering with Jersey companies*—a small Normandy-based furniture maker who had sold its high-value, niche product to Jersey previously was interested in exploring further opportunities in the Island, and did not perceive there to be many barriers. Its work had stemmed mainly from trade fairs it had attended in Jersey. It wanted to see whether it could partner with others in Jersey in delivering the final product. It preferred to sell directly to the customer, to avoid successive mark-ups, and because it had specialist knowledge of its product.

– *Using existing (downstream) Jersey channels*—a drinks distributor that had previously undertaken trade with Jersey was potentially interested in selling again to the Island. The company would not wish to form its own distribution network in Jersey, given the size of the market, the costs, language issues and the particular logistical issues posed (eg, the need to use small trucks). Rather, it preferred to go through existing channels in Jersey, with people who knew the market. However, the key to this was finding an agent in Jersey to work with, and a reliable distributor.

Although most of the projects were in their infancy, it is of note that the partnering model envisaged varied by business. Most of the companies were, when asked, potentially interested in using a freight ferry link from Cherbourg, although some (in particular, building aggregates companies) preferred Granville, since this was where quarries were located. The companies did not know, at this stage, what their volumes might be. However, frequency did not appear to be as much of a key issue for these companies as for existing businesses in Jersey, and the companies thought that a weekly service might be sufficient at first. This may reflect the fact that Jersey companies (importers) need to source regular supplies from a range of suppliers to undertake their business, whereas, for exporters, Jersey represents an incremental opportunity.[145]

A5.4 Potential projects in France

Oxera has discussed, with a number of parties involved, a potential project in Normandy that would involve providing a new freight frequent ferry service between Cherbourg and the Channel Islands. This could also be timetabled to coincide with an existing cross-channel UK service arriving in Cherbourg, and could therefore lead to some diversion of existing UK freight, currently travelling between Portsmouth and Jersey. These discussions have taken place with parties in France and in Jersey. One business that might use this service is a French supermarket, which may in future establish a presence in Jersey. The benefits to the Island cited by the supermarket included lower sourcing prices, and increased competition in Jersey. The two projects are discussed in turn below.

A5.4.1 The Cherbourg project

Box A5.4 describes the project, the sub-markets to which it is intended to appeal, and how it intends to overcome some of the potential barriers to increased trade with France.

Box A5.4 Case study: the Cherbourg project

Oxera discussed with a range of parties a potential project to operate a new frequent (daily) freight ferry link between Cherbourg, France, and the Channel Islands. This would involve a RO–RO service to Jersey (or both Jersey and Guernsey). It would have more capacity than the current frequent Portsmouth service for driver-accompanied freight. It could be timetabled to link to meet an existing large RO–RO ferry service travelling daily from Portsmouth to Cherbourg, diverting some of the existing freight traffic currently travelling directly between Portsmouth and the Channel Islands.

Since few ships small enough to enter the port of St Helier have recently been built, a small second-hand ship might be used initially. Although a full business plan for the service has yet to be developed, it is not envisaged that the service would divert significant amounts of trade from the existing route, such that it would to a 50/50 spilt with the existing UK services. Large players in Jersey, with established hubs and/or buyer power in the UK, might not use the service. However, it might appeal to a variety of sub-markets, including diversion of UK freight via Cherbourg; France/Continental European trade (unconstrained

[145] As noted in section 2.4.2, on the import side, individual non-frequent demand profiles may, in aggregate, generate a frequent demand profile.

by UK hubs); 'white van' point-to-point sourcing of building supplies, kitchens and bathrooms from Europe; produce sourced from French wholesale markets; a French supermarket; and Jersey exports/reverse flows (such as waste materials, fulfilment industry goods, shellfish and potatoes).

In terms of the factors assisting the project, the new service would appear to seek to get around some of the *demand-side* barriers to increased trade with France. For example, the diversion of trade from the UK via Cherbourg would involve the shipping of the same UK-standard products currently sold in Jersey, would not significantly disrupt existing UK hubs, and the UK–Cherbourg leg itself would not suffer from critical mass issues. Similarly, smaller point-to-point players would not be constrained by the existing hubs. Vegetables from French wholesale markets, and exports of fresh produce and waste from Jersey, would not involve the labelling and standards issues of branded products. The initial UK-diverted and supermarket volumes might provide an starting base level of regular demand. This may assist in overcoming part of the critical mass problem for the service, and provide a 'demonstration effect' for the service. Other components of demand might then follow.

Turning to the *costs* side of the service, there are some features of the potential service that could abate the critical mass problem, reducing unit costs at low volume levels. Cherbourg itself appears to already have all the required port facilities in place to operate a new service. Another feature of the project is that there are factors that seem to reduce the relative fixity of costs, which may abate the critical mass problem, including (potentially) using a second-hand boat and the advantages posed by distance for scheduling (see section 4.4.5). Some parties emphasised that the new service would also increase competition with existing services. Using the UK–Cherbourg (large ferry) service could, for example, represent an arbitrage opportunity (since freight rates are lower than on the UK route), while the Cherbourg–Channel Islands service would be differentiated from the existing services to an extent since it would be driver-accompanied.

However, there are potential hurdles that the project would need to overcome. These factors do not mean that the project is not desirable or possible, but they do need careful consideration. For example, an older boat might cost more to run than a newer vessel, and may not be as reliable. UK flows and the presence of a supermarket appear key to achieving sufficiently low unit costs, but may only be attracted if the service is reliable. The round-trip distance savings on the Cherbourg–Channel Islands route are less than on the St Malo–Channel Islands route (and, relating to this, a service from Cherbourg would probably not be able to achieve a two-per-day rotation using one boat).

In terms of logistics, driver-accompanied freight requires less handling at the port, but does involve an implicit cost in respect of drivers travelling with the cargo. The interface with the existing UK–Cherbourg RO–RO service may also generate more handling than at present, unless the majority of freight carried on the UK service were also driver-accompanied. If trailers were carried on the Cherbourg service, consideration would need to be given to how empty trailers might be cleared from St Helier (the UK service uses two boats for this).

The idea that the service would increase competition in respect of freight services serving Jersey, thereby reducing prices, is intuitive. However, judgements about the current levels of competition based on the freight rates of the current UK–Jersey service as against cross-channel services do not involve comparing like with like. Marginal freight carried by cross-channel services is likely to have very low marginal costs. Such services also carry freight in two directions (rather than one). As noted in section 4.4.5 and Appendix A3.2, while increased competition might be of short-term benefit to Jersey, Condor is likely to react. Intense competition with existing services would reduce the viability of a new service, although its driver-accompanied nature may facilitate some differentiation and reduce the degree of competition on price alone.

Ultimately, it is the nature of the cost structure of ferry services that forms the bedrock for sustainable competition. However, the underlying cost structure of ferry services matters much less for securing a critical volume if sourcing costs in France (or Continental Europe) are significantly lower than in the UK, and transport costs are a low percentage of final goods costs.

Another observation is that, although the port of Cherbourg has the capacity and is well-connected to the UK, the port is currently underutilised and its overall role as a hub has decreased. Thus, while the port of St Malo has less spare capacity than Cherbourg, it is better connected to the European road infrastructure, and Cherbourg may suffer from a coordination problem in establishing the port as a hub for trade.

A5.4.2 French supermarket case study

Box A5.5 describes the potential supermarket project, its potential benefits, and how it seeks to overcome some of the potential barriers to increased trade with France.

Box A5.5 Case study: France supermarket

Oxera spoke to representatives of a French supermarket group about potential plans to establish a presence in Jersey. To explore the demand for a new supermarket, the group undertook an initial price comparison, which revealed that its own prices were cheaper than those of supermarkets in Jersey. The reasons provided for the price disparity were a perceived lack of competition in Jersey, and that the chain could source more cheaply. The supermarket would deliver fresh food and dry stock each day, and hence would only set up in Jersey if a reliable freight ferry service were made available from Cherbourg. It had estimated that the cost of ferry transport might be 1.5–2% of the final cost its goods (by value). To serve Jersey, there would be no change to the company's existing sourcing and distribution channels. Through its sourcing arrangements, the chain had buyer power in France, and its existing warehousing facilities and distribution hubs in France would also be used.

As illustrated in Box A5.5, the supermarket intends to use its existing sourcing patterns and buyer power in France, and its established distribution hubs. Thus trading in Jersey would involve an extension of, rather than alteration to, current flows for the chain. In contrast, distribution hubs would act as a barrier for a UK-oriented supermarket in Jersey to source a wide range of products from France (see Box A5.2). As a larger organisation, the supermarket would also appear to have more resources than smaller players in France to overcome informational barriers and to establish working relationships with Jersey.

There are nonetheless some issues that the supermarket chain might need to overcome. First, transporting produce to Jersey will still represent a more unusual operation, requiring small trucks, with more complex logistics than the company's operations in France. Second, in terms of the products sold, much of the chain's labelling is currently in French. The Jersey food regulations (described in section A5.2) emphasise that the intended customer must, by reading a label affixed to the product, be able to understand its contents. Although the labels could be amended, this requirement would need to be traded off against the possibility that consumers might not be able to readily understand the products' contents. Other options have their costs. Resourcing (outside of current bulk-buying arrangements) or re-labelling would probably increase unit costs. In-store information provision may overcome the information issue at the point of sale, but not the at point of use of the product.

Labelling therefore probably represents one of the main hurdles to the supermarket. Another related hurdle is the potential range of products sold by the supermarket, using existing sourcing channels. While Jersey residents are used to sampling French products, and this demand may grow, whether Jersey residents would spend their weekly shop on products

aimed principally at the French market is so far untested. Box A5.2 provides one view on these issues, as expressed by an existing Jersey supermarket.

In addition, it is not clear that the price comparisons undertaken are completely informative. A more relevant comparison, perhaps, is the difference in prices between the France chain and those charged by a UK supermarket (which might instead set up in Jersey), since this might provide a more accurate picture of the benefits of increased trade with France. Section 4.3 revealed that there is evidence to suggest that French supermarkets may have cheaper prices than UK supermarkets.

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