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Part X of the Trade Practices Act 1974

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Executive Summary

Objectives

This submission provides comments on several issues relating to regulatory regimes for international liner cargo shipping. The comments are based principally on the author's research during the period from 1976 to 1989 and from appointments as professional staff member and consultant to the U.S. House of Representatives, Merchant Marine Subcommittee and the U.S. Federal Maritime Commission in 1977, 1980 and 1986-87.

For the purpose of the current inquiry, many of these comments have an historical context. It is nevertheless important to note that (a) some aspects of the international liner shipping market have not changed and (b) previous legislative errors and omissions should be avoided. The submission also incorporates some recent changes in the international liner shipping market.

The comments relate specifically to four main points:

1. Liner shipping conferences were established nearly one-and-one-quarter centuries ago and have operated continuously since then, except for the First and Second World Wars. During most of that period, the market conduct and performance of liner conferences were affected more by regulations enacted by various governments than by changes within the liner shipping market.

2. Regulatory regimes maintained by various governments were motivated almost entirely by three objectives:

    a. to preserve the "common law duties" of liner shipping operators in providing a service to their respective exporters, in an adequate manner, without unreasonable rates and without discrimination;

    b. to bring international liner shipping regulations into conformity with trade practices legislation applied to the other industries within the nation; and

    c. to ensure that national flag shipping is not adversely affected by the activities of liner shipping conferences.

3. Since 1985 (approximately) the international liner shipping industry has been affected more by market influences than by government regulation.

4. Although some nations have followed regulatory patterns that are similar to the ones adopted by the U.S. Government, little or no effort has been made to devise and implement an internationally consistent set of regulations.

Summary

The principal error that was made in past regulation of liner shipping services, particularly in the U.S., was to impose restrictions on liner conferences that added to their cost of supplying the service and also reduced the capacity of conference members to offset or minimise those costs. In doing that, regulators effectively imposed restraints on global trade (albeit minor ones) with the objective of

protecting their national shippers and carriers against what they perceived to be potentially anti-competitive or discriminatory acts.

The initial legislation almost certainly identified and controlled a number of anti-competitive acts, but diminishing returns set in fairly quickly for that process so that subsequent amendments lack clearly defined benefits in relation to their costs.

An apparent objective with recent amendments is to bring the regulation of international shipping into greater conformity with "mainstream" trade practices legislation. Achieving that objective would undeniably give the appearance of a "level playing field" and make administrative tasks easier for the public sector. However, if the public sector is the only clear beneficiary, then it should not be surprising that the rest of the community remains unimpressed.

Guaranteeing "adequate" levels of an internationally supplied service with an absence of discrimination may be considered a desirable objective, but it has become increasingly less feasible to achieve this through trade practices legislation of individual governments.

There is a need for greater conformity in regulatory regimes among major trading nations. This cannot be achieved by continuing the principal error that was made in the past.

A main objective of the current review of Part X should be to begin the process of determining the type of multilateral regulatory regime that best serves the interests of the nation. Such a determination should obviously be made among those regimes that are more likely to be globally accepted.

This determination should be made before changes to Part X are formally recommended. Otherwise, the risk of lowering the credibility of liner shipping regulation in Australia would be significantly increased.

1. Liner Shipping Regulations and Market Conditions

The first liner shipping conference was formed in 1875 in the U.K.-to-Calcutta trade and was motivated by (a) changes in the prevailing regulatory regime and (b) market conditions that were influenced by technological developments. The specific components in this motivation are as follows (refer to details in "Formation and Development of Liner Conferences"):

- The liberalisation of the Navigation Acts in the U.K. in the 1840s ended the previous, protectionist policies and opened international shipping to other nations. At that time, British shipping interests controlled more than half of the world’s fleet. Mail subsidies to national flag carriers nevertheless continued throughout most of the 19th century.

- The superiority of steamships over sailing ships was apparent by the 1850s with the use of iron and steel hulls in place of wood hulls, and especially with the development of the screw propeller. Vessel productivity increased rapidly as a result.

- The opening of the Suez Canal in 1869 significantly reduced the voyage time from Europe to the Far East.

The combined effect of these influences was to create substantial overtonnaging in all major trades, and that, in turn, motivated a number of aggressive trading practices on the part of ocean carriers. Some of the case law arising from these practices is discussed in "Regulating Ocean Shipping in the U.S.A: Historical Perspective and Current Trends" (referred to hereafter as "ROS"). The formation of shipping conferences was intended, in part, to exert industry control over those more aggressive acts.

The U.S. Shipping Act of 1916 was the first attempt by a national government to exercise control over the conduct of international liner shipping conferences. The Act was clearly influenced by the preceding Sherman Act (1988), Hepburn Bill (1908), Clayton Act (1914) and Federal Trade Act (1914), all of which were initiated as various ways for establishing a more effective control over monopolies.

Supply and demand conditions within the international liner shipping market remained remarkably stable during the period in which the 1916 Act was debated. This occurred despite the introduction of bulk ships (mainly ore-carrying vessels) in 1904. The loyalty agreements of liner conferences, particularly the practice of deferred rebates that required a period of demonstrated loyalty, presumably restricted bulk ship operators to the fortuitous carriage of general cargo consisting mainly of small and irregular consignments.

It happened, however, that American ship owners at that time were engaged extensively in cross-trading activities and tramp operations. The former refers to routes other than to and from the "home" country and the latter implies irregular services without fixed itineraries or sailing schedules. These carriers would normally seek to prevent any form of loyalty arrangement that tied shippers to established liner operators.

In addition, raw materials and agricultural products were the principal items in the U.S. outward trade with Europe. However, after Henry Ford pioneered the mass production of motor cars in 1913, U.S. manufactured goods began to compete in European markets and outward freight rates were viewed more critically in relation to possible discrimination between shippers, commodities and ports.

These factors suggest that the Shipping Act of 1916 was not intended to regulate international liner shipping for the purpose of overcoming a market failure. Rather, the Act, and the way it was administered, conveyed much of the self-interest of U.S. shippers and carriers.

The Shipping Act was not amended until 1961, although a number of court decisions in the interim period significantly changed the regulatory stance of the Act (refer to the discussion of the rulings in ROS section 4). Congress was more concerned, at that time, with the deteriorating position of U.S. exports and the nation’s balance of payments than with antitrust principles. The legislators tried to improve the fairness and equity of the existing regulatory scheme, and that generally entailed a strengthening of administrative powers, the consequences of which were not perceived until later.

In the period immediately before the amendments were passed, inter-carrier co-operation was at a post-war low. This was caused partly by increased pressure from bulk ship operators and tramps, and partly from the widely different levels of operating efficiency among member lines. These pressures were subsequently alleviated through a conversion to container shipping during the 1960s, but in the period of conversion conferences in the U.S. trades increased their vulnerability by

practising illegal rebating and employing various tactics that carried a strong presumption of predatory intent.

Containerisation was initiated in 1960 by two American shipping lines–-Matson Navigation Company on the San Francisco-Honolulu route and American President Line between the West Coast of the United States and the Far East. The full effects of this technological development were of course unknown when the 1961 amendments were passed, but no attempt was made in any of the testimony or reports relating to the amendments to factor in the potential influences of containerisation. Technology and current conditions in the liner shipping market were largely irrelevant to the issues that prompted the amendments.

During the 1960s and 1970s, other nations adopted regulatory regimes in relation to international liner cargo. All of these were less restrictive than regulations in the U.S., though some concordance was reached in declaring specific acts to be illegal and in formally declaring immunity or exemption from trade practices legislation.

Containerisation represented a structural shift to greater capital intensity in loading and discharging operations. This was appropriate to the factor endowments of OECD nations, but it put a stain on the resources of developing countries. A fundamental characteristic of shipping, as with other forms of transport, is that outward capacity exactly matches inward capacity, and the two capacities must be identical in nature. The optimum method for loading and discharging a specific ship cannot be changed in the middle of the ocean. As a consequence, developing countries were forced to adopt the same capital-intensive operations or be content with a slower and less reliable conventional service.

Partly as a reaction to this requirement (and partly from a persisting belief that conference tariffs discriminated against their exports) developing countries succeeded in the adoption of an U.N.C.T.A.D. Code of Conduct for Liner Conferences (refer to ROS section 5). The Code guaranteed the right of every nation to control the ocean transport of at least 40 per cent of its exports and imports. Cargo reservations on a national scale, with market shares allocated to participating carriers, represent a strongly interventionist regulatory regime. Authorities in some of the OECD countries adopted the view that government-to-government negotiations for cargo sharing agreements are necessarily "in the public interest" even if their effects are clearly anti-competitive.

Although the life span of the Code was relatively short, the reactions to it lowered the credibility of many regulatory regimes and had far-reaching implications for the structure of the liner shipping industry.

2. Motivations for Regulatory Regimes

"Common Law Duties"

The phrases "common carriers" and "common law duties" are associated only with U.S. antitrust legislation. They arose from the intention of the U.S. Congress to link the early regulatory acts to common law. Senator Sherman made a statement in 1888, in introducing his regulatory bill, that it was not intended to eliminate monopolies; it merely made illegal those monopolies that were already prohibited by common law. Refer to "Common Carriers and Liner Conferences" (hereafter referred to as "CC") for details.

The label that is applied is less important than the concept underpinning the label. A common carrier performs for-hire transport services for the public, for any one who may apply for carriage within the territory or between the points served by the carrier, so long as it is a type of service and class of commodities the carrier is willing and able to provide for and accommodate, and the service must be provided without interpersonal discrimination in fares or conditions.

This definition closely resembles the requirement contained in section 5(1) of Part X of the Trade Practices Act, except for the addition of anti-competitive effects that clarify the regulatory rationale of the Act:

> An ocean carrier shall not discriminate between shippers requiring similar outwards liner cargo shipping services on a particular trade route (whether the discrimination is in relation to freight rates, levels of shipping services, the provision of equipment and facilities or otherwise) if the discrimination is of such magnitude or such a recurring or systematic character that it has, or is likely to have, the effect of substantially lessening competition in a market for goods and services, being a market in which the shippers supply goods or the ocean carrier supplies outwards liner cargo shipping services.

Section 7 of Part X states further:

> A conference agreement must contain provision specifying the minimum level of outwards liner cargo shipping services to be provided under the agreement.

The intention of these requirements is conveyed in the principal objects of Part X in section 1(1) and, by implication, classifies liner shipping as a "public convenience and necessity":

> a. to ensure that Australian exporters have continued access to liner cargo shipping services of adequate frequency and reliability at freight rates that are internationally competitive;
>
> b. to promote conditions in the international liner cargo shipping industry that encourage stable access to export markets for exporters in all States and Territories; and
>
> c. to ensure that efficient Australian flag shipping is not unreasonably hindered for normal commercial participation in any outwards liner cargo shipping trade.

In complying with the requirement of a "minimum service level" (for conference carriers) or of a service that has "adequate frequency and reliability" (for liner services generally), a carrier must establish a level of capacity that is necessarily fixed in the short term. Demand for that service can vary within the period, and generally does.

In the case of freight services, ex ante assessments of the required capacity must originate from the announced needs of shippers. It is generally recognised that the demand for freight services is a derived demand, in that it depends upon the demand in the destination markets for the goods that are shipped. The latter cannot generally be known in advance for the entire time period within which the level of capacity is fixed.

If failure to meet these service requirements is substantial, as it is under Part X, then the carrier will minimise risks by setting capacity at a point that is closer to the maximum expected demand than to the minimum expected demand. A common carrier service is therefore associated with a tendency toward "built-in" excess capacity (refer to CC section 4 and references cited therein for more detail).

The requirement for non-discrimination "in relation to freight rates, levels of shipping services, the provision of equipment and facilities or otherwise" interferes with the ability of the carriers to use flexible pricing policies for the purpose of reducing the excess capacity. Although section 5 of Part X allows a defence for discrimination between shippers under certain conditions, it is not clear that excess capacity arising from compliance with other requirements of the Act would comprise an acceptable basis for discrimination. If it were so intended, it is reasonable to expect that the Act would specify it.

Common carrier obligations are therefore implicitly contained in Part X, but the capacity of the carriers to meet these obligations is restricted. Earlier legislation in Australia, as well as elsewhere, imparted greater recognition to this regulatory dilemma. The Australian Industries Preservation Act was amended in 1929 to allow deferred rebates and other discounts that were deemed necessary to encourage shipper loyalty and thus to obtain a more secure cargo base. Although deferred rebates and other loyalty arrangements were inadequate as the principal means of eliminating the "built-in" excess capacity, they helped to prevent fluctuations in demand for conference services arising from short-term use of independent carriers.

Part X, as amended, does not specifically prohibit deferred rebates or other forms of tying arrangements. It does, however, change the focus, as compared to the original Act, by stating in section 8 that conference agreements may include only the restrictive trade practices that are specified. The list does not include deferred rebates. The presumed reasons for this change are discussed in the next subsection.

Conformity with Other Trade Practices Legislation

The position of the original Part X in the Trade Practices Act 1966 is, in itself, an indication that the regulation of international liner shipping was viewed as part of the overall regulation of trade practices. The amendments to Part X in 1989 display a further intention of developing a more uniform regulatory approach.

Similar intentions were exhibited elsewhere. For example, in 1977 the U.S. Department of Justice (DOJ) released a report on the regulated ocean shipping industry that challenged the special treatment that was given to ocean carriers. Somewhat to the surprise of the DOJ, and to their supporters, a large number of shippers did not favour the recommendations of greater exposure to the antitrust laws for conference carriers.

In these attempts to achieve conformity, the critical nature of individual markets is frequently overlooked. The demand for liner services as a derived demand was mentioned previously. One of the consequences of if this is a linkage between shippers and carriers that prevents, or precludes, the adversarial status that is typically associated with buyers and sellers. Since perceived inequities in market power, or in the relative bargaining strength of the adversaries, forms the basis for intervention by the state in trade practices matters, it is not surprising that regulators tend to view all market participants in terms of the "good guys" and the "bad guys".

This is not easily maintained, however, for intermediate services since both buyers and sellers are producers (or suppliers) and not final consumers. In the case of liner services, both buyers (shippers) and sellers (ship owners) benefit by enhancing or improving the competitiveness of the freighted items in the final consumers' market. In particular, liner operators cannot gain by pricing their services beyond the point at which the shippers using their services are rationed out of the destination markets. Similarly, shippers as a group cannot gain in the longer term by supporting regulations that add to the cost of providing the service, even if those regulations lead to greater conformity with other trade practices standards.

Compared to more easily accepted co-operative efforts between a producer of a final product and a producer of intermediate inputs to that product, the nature of such efforts between shippers and carriers is more complicated as a result of the carriers' need to include shippers of both outward cargo and inward cargo. Carrier loyalties to specific shippers may therefore be called into question, with the possibility that carriers may intentionally reduce market competitiveness for some shippers, and (presumably) be compensated by other shippers who gain from such actions.

This may be the principal justification for the inclusion in the amended Part X of the a requirement that ocean carriers refrain from discriminatory acts that substantially lessen competition in a market in which the shippers supply goods. If that is the intention, it is certainly not transparent. In any case, the provision implies that carriers have an option to do what Part X prohibits, and the nature of that option is not clear.

National Flag Shipping

The desire to maintain a national fleet stems mainly from concerns that a nation's shippers may be disadvantaged as a result of complete reliance upon foreign ship owners. The same concerns exist, in varying degrees, with other essential services such as telecommunications, banking, broadcasting and the printed media.

Alleviation of the potentially detrimental effects of such dependence through trade practices regulation must necessarily be restricted to the prohibition of discriminatory acts that are designed to drive national flag carriers out of the market. From the point of view of competition policy, all such predatory actions should be treated equally, whether they involve a national flag carrier or a carrier whose beneficial owners are resident of another country.

Protecting Australian citizens and bodies corporate that are "incorporated by or under the law of the Commonwealth or by a State or Territory" is of course a prerogative of, and (some may say) a responsibility of, the relevant governments. Mixing such protection with competition policy nevertheless adds support to the argument that regulatory regimes tend to be discriminatory in their objectives. It also takes intervention by the state an additional step away from the more fundamental task of correcting market imperfections.

3. Liner Shipping Market After 1985

Changes in the Liner Market

Two events within the liner shipping market occurred during the 1980s that cannot be precisely pinned to a particular date. First, the design of containerships in terms

of volume (number of container slots) and deadweight capacity became more standardised. This ended the previous trend of designing containerships to suit the mixture of containers that was typical of each particular trade.

The increased standardisation was motivated mainly by the flexibility it created for fleet managers in allowing ships to be more easily added to trades that were increasing in volume, and removed from trades that were decreasing. A reduction in the level of excess capacity was the ultimate objective, but standardisation also increased the degree of contestability in all trades.

A second event was the increased participation of freight forwarders and non-vessel operating common carriers (NVOCCs). These enterprises booked and paid for a specific number of container slots for some or all sailings of liner vessels. This gave the liner operators a stable cargo base and eliminated some of the uncertainty regarding excess capacity. It comprised a form of quantity discount for large, guaranteed purchases of container space.

The practice also increased the level of competition in most liner trades since the NVOCCs could issue a tariff schedule for the resale of their reserved slots that was different from the tariff schedule used by the operating carriers. Unless, and until, the NVOCCs came under the jurisdiction of the regulatory authority, their tariffs could be inherently discriminatory between shippers, commodities or ports. The NVOCCs could, if they chose, use an auction system to sell their slots on each voyage to the highest bidder.

The NVOCCs did not offer a shipping service as such, they merely acted as agents or consolidators and profited from the activity if they were able to resell the slots at a higher rate, on the average, than that which they contracted to pay. This inspired large shippers to attempt to appropriate an equivalent margin, and they lobbied U.S. Congress to allow contracts between shippers and carriers that specified the number of containers to be shipped, within the contract period, at rates that were to be negotiated outside the normal tariff schedules.

These efforts by the large shippers were successful in the implementation of the U.S. Shipping Act of 1984, and service contracts quickly become the main arrangement for shipper-carrier relations in the U.S. outward trades. Initially, common carrier status was maintained with carriers agreeing to "most favoured shippers" clauses that lowered the contracted rate per container if another shipper of the same freighted item negotiated a lower rate. This practice was relatively short-lived, as large shippers resented the "free rider" effect that flowed from their efforts to achieve a more competitive position in the product markets. The clauses also created severe revenue problems for carriers during periods of slow growth in trade.

Negotiated rates for service contracts in U.S. trades are now treated confidentially by shippers, carriers and the Federal Maritime Commission, thus ending entirely any "free rider" effect. In doing this, however, the "common law duties" of ocean carriers are substantially diluted. Service contracts are inherently discriminatory in relation to freight rates among shippers of the same commodity. Large shippers receive an undeniable advantage over small shippers, and such a change was clearly market determined.

External Market Influences

Following the realignment of currencies, as a result of the Plaza Accord in 1985, producers were confident of an extended period during which exchange rates would remain relatively stable on a global basis. As a result, foreign direct investment from high-wage countries to low-wage countries increased at an extremely rapid rate.

The "out-sourcing" of components for final products began in the 1970s and arose initially from competitive pressures on manufacturers of consumer goods that were standardised in terms of product design and production technology. Setting up manufacturing plants or assembly facilities in other countries nevertheless entailed a number of risks, including the risk of currency devaluation in the "host" country.

Rapid economic growth after 1985, and the growing trend toward reductions in import restrictions by both industrialised and newly industrialising countries, added to a more favourable investment climate on a potentially global scale. The resulting increase in the international mobility of capital and (to a lesser extent) labour, together with the substantial rise in international trade of intermediate products as a per cent of total trade, is generally referred to as globalisation.

The impact of globalisation on the liner shipping market has been substantial. First, a fast and reliable liner service is an essential ingredient in the minimisation of costs in producing consumer goods through "out sourcing" and "just-in-time deliveries". Increased pressures were therefore placed on liner operators by a large number of shippers who are simultaneously importers and exporters in variety of trades.

The so-called seamless and borderless trading activities not only disguise the national identity of most goods that are now carried by liner vessels, they also disturb the traditional view of non-discrimination. Beneficial ownership of Australian exports that have a high percentage of imported components may be attributed solely to the Australian shipper, but the assurance of "stable access to export markets" for those goods also requires an equivalent assurance non-discrimination for the imported components.

Second, and perhaps of greater importance, globalisation has the effect of increasing the elasticity of demand for liner services. An additional consequence of the derived demand is the dependence of the price elasticity of demand for liner services on the price elasticity of demand for the final product. The substantial increase in the number of substitute products that are available in destination markets raised the sensitivity to price differences for final sales of any one product. It follows that the demand for liner services on any specific trade route is also more sensitive to variations in freight rates.

Third, the organisation of liner conferences along specific trade routes is no longer a viable arrangement for minimising the "built-in" excess capacity. It is not surprising, therefore, that major shipping lines are forming strategic alliances in the same way that producers are forming alliances with suppliers of inputs, and airlines are structuring their services as joint-supply arrangements with other air carriers.

Regulating outward shipping never succeeded in influencing all of total shipping capacity, since outward capacity is dependent upon inward capacity. Whatever influence was achieved in the past, the globalisation process reduced it to a relatively small amount.

4. The Need for International Consistency

If, as is suggested above, recent regulatory regimes for liner shipping reflect national self-interests, then they are necessarily ill equipped to seek and to identify fundamental weaknesses in the global liner shipping market. The first step in acquiring the latter is obviously to avoid increasing the former.

Any substantial changes that are made to Part X should bring the regulations into closer conformity with regulations being implemented by our major trading partners. The administration of Part X is particularly important in ensuring that such conformity has a high priority.

The U.S. Shipping Act of 1984 stated in its objectives that the Act was to provide regulation "in so far as possible, in harmony with, and responsive to, international liner shipping practices". It is the first such statement to appear in U.S. regulatory law for liner shipping. Legislative objectives are often intended mainly for the purpose of securing passage and enactment of the relevant bill. Nevertheless, as a statement of policy it indicates a commitment to examine proposed amendments in relation to a potential disharmony with, and a lack of responsiveness to, international liner shipping practices. This comprises a second step.

More "steps" are likely to be needed. International liner shipping services will eventually be examined, on a multilateral basis, as part of the World Trade Organisation's (WTO) review of trade in services. It is impossible to know when this will occur or to know the state of the liner shipping market when it occurs. It is nevertheless important to avoid regulatory changes that are likely to be incompatible with a possible multilateral system of monitoring and control.

Each WTO member must eventually determine the type of multilateral system that would be most advantageous (or least disadvantageous) and consider in advance the enabling legislation that will be required if such a system were agreed upon. Additionally, governments have a responsibility to assist in the development of private sector institutions that are likely to be needed with such a multilateral system. This responsibility arises from previous interventions by the governments that either precluded the formation of similar institutions or influenced the structure of existing ones.

It would seem appropriate that the current review of Part X should comprise the beginning of such a determination and consideration.

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