International Liner Shipping

Submission to the

Productivity Commission Inquiry into

Part X of the *Trade Practices Act 1974*

Department of the Treasury

23 August 1999

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Executive Summary and Recommendations

Key Points

- ***National Competition Policy requires that legislation should not restrict competition unless it can be demonstrated that the benefits of the restriction to the community as a whole outweigh the costs and that the objectives of the legislation can only be achieved by restricting competition.***
- ***This is the first review of Part X under the framework established by the National Competition Policy.***
- ***Part X is an anomaly in the competition policy framework.***
- ***Part X is not necessary to ensure the availability of regular liner shipping services.***
- ***Part X should be repealed and liner shipping subject to standard competition law. The development of an industry code could address concerns about compliance costs, consistency of application across all conferences, and business certainty.***
- ***If Part X were to be retained, significant amendments would be desirable to improve the application of competition law to the industry.***

The Productivity Commission has been requested to inquire into the most appropriate arrangements for the regulation of international liner shipping. The inquiry stems from the Competition Principles Agreement under which all Australian governments have undertaken to review and, if necessary, to reform legislation which restricts competition. This submission is provided in response to the position paper published by the Productivity Commission.

The market for international liner shipping to and from Australia is regulated under Part X of the *Trade Practices Act 1974* (TPA). Part X permits certain forms of anti-competitive behaviour involving liner shipping conferences which may otherwise contravene the competitive conduct rules in Part IV of the TPA.

Part X is an anomaly in the competition policy framework. It is the only part in the TPA that provides an industry specific exemption for most anti-competitive behaviour. While there may have been historical reasons for the granting of these special exemptions, it now needs to be demonstrated that such arrangements are both necessary and beneficial if Part X is not to be repealed. There may be benefits to consumers and the broader economy to be gained by making liner shipping subject to standard competition laws.

The Legislation Review Process

This is the first review of Part X under the legislation review framework established by the National Competition Policy.

Legislative review processes provide an opportunity to establish the case for retaining, modifying or reforming current regulatory arrangements. The guiding principle is that legislation should not restrict competition unless it can be demonstrated that the benefits of the restriction to the community as a whole outweigh the costs and that the objectives of the legislation can only be achieved by restricting competition. Each review is required to identify the costs and benefits of the legislation and the likely consequences of the reform measures proposed.

The Productivity Commission notes (1999, page XXIX) that the authorisation of conference agreements under Part VII of the TPA could achieve similar outcomes to those attained under Part X, since a wide range of liner shipping conduct can be authorised under the TPA. While Part X replicates the exemptions available under Part VII of the TPA, it does so without the requirement that a public benefit be demonstrated before anti-competitive conduct is sanctioned.

Australian Conferences and Regulation

Currently favourable market conditions for Australian shippers are the result of global factors which are not related to Part X. In particular, Australia has benefited significantly from conditions in the global liner shipping market which have been driving global freight rates down over the last decade or more. There has been a strong correlation between global freight rates and Australian freight rates.

Non-conference operators provide competition to conferences in every segment of the Australian market for liner shipping services and they account for a large and growing proportion of Australian liner trade. In almost all significant commodity segments and trade routes, non-conference operators have a significant presence. The available evidence suggests that neither conference agreements nor Part X are necessary to ensure the availability of regular liner shipping services.

An important consideration in reviewing the current regulatory arrangements is the impact which any change in those arrangements may have on regional ports served by regular liner shipping services. Analysis of market shares at regional ports suggests that non-conference operators already provide the majority of liner services to regional ports. Significantly, non-conference operators have been steadily increasing their market share at regional ports and now dominate export tonnage through regional ports. Given this existing propensity for non-conference operators to service regional ports, it appears that services to regional ports would not be significantly affected by the repeal of Part X.

While many of the major western economies have in place special industry specific regulations which afford competition law exemptions to the liner shipping industry, these regulatory regimes are not harmonised in any other sense.

The OECD is considering whether conference agreements that set common rates should continue to benefit from block exemptions, rather than being subject to

specific approval by competition authorities on the basis that a public benefit associated with such collusive behaviour would need to be demonstrated. Consideration is also being given to whether discussion and capacity agreements should be subject to any exemption from competition laws.

It is useful to examine the regulatory arrangements of other industries to ensure consistency of regulation between industries, and to put the relevance of Part X into a general context. The aviation industry shares some similar characteristics with the liner shipping industry, and hence provides a useful benchmark for this purpose. However, unlike liner shipping, potentially anti-competitive conduct on the part of airlines is subject to the normal authorisation provisions of Part VII of the TPA based on a public benefit test.

Competition Policy and Shipping Regulation

In Australia, as in many other countries, government policies seek to promote the use of competitive market forces to improve market efficiency and the ability of the economy to adjust to structural change. National Competition Policy is an important element of this.

A core feature of National Competition Policy is the adoption of a set of principles aimed at ensuring that regulation does not restrict competition unless the restriction can be demonstrated to be in the public interest. New regulatory proposals are therefore subject to increased scrutiny of the public costs and benefits of that regulation, and existing regulations are subject to a systematic review on the same basis. The aim of National Competition Policy in seeking to foster competition between providers of goods and services is to enhance community welfare including through the provision of lower prices to consumers.

It is often argued that liner shipping conferences provide significant benefits to shippers through predictable freight rates and service schedules. It is also argued that there are economies of scale in international shipping which can be exploited through coordinated production, and that the lower cost base can be passed on to shippers through lower freight rates. To facilitate the sharing of these production efficiencies between shippers and shipping operators, shippers are provided with countervailing market powers by Part X. These powers improve their ability to negotiate with shipping conferences on price and service.

The potential for these wider benefits for consumers provides the justification for Part X exempting conferences from the competition provisions of Part IV of the Act. However, it needs to be demonstrated that there is a clear net public benefit flowing from these special exemptions for anti-competitive behaviour if Part X is to be retained. It is not sufficient to state that authorisation under Part VII could achieve similar outcomes to those arising under Part X.

Recommendations

It is recommended that:

- Part X be repealed and liner shipping made subject to general competition law; or

- if Part X is to be retained, significant amendments be considered to improve the application of competition law to the liner shipping industry.

Repeal of Part X

If Part X were to be repealed, the liner shipping industry would no longer have access to special exemptions, and conference agreements would be subject to Part IV of the TPA. The treatment of liner shipping would then be brought into line with other industries. Conferences could then seek the sanctioning of their collusive activities (to the extent that they wished to continue with them) through one of several mechanisms under Part VII of the TPA.

Using the authorisation process to determine the legitimacy of conference agreements has several advantages over Part X. It is a transparent process which is the universal standard for assessing whether anti-competitive behaviour is appropriate. It places the onus on liner operators (and shippers) to justify the public benefit of the collusive arrangements which they wish to undertake.

Concerns have been expressed about compliance costs, consistency of application across all conferences, and business certainty if each conference had to be separately authorised. The industry could address these concerns by agreeing on a code which encompasses the core restrictive practices to be adhered to by all conferences. Individual shipping lines and conferences could gain protection through authorisation of the code but would be free to tailor individual agreements to individual conference needs. Additional provisions in such agreements that contain restrictive practices beyond those already authorised may require separate authorisation.

Such an approach would be consistent with that which applies to other industries and would be transparent. Codes of conduct and collective agreements have been authorised in the past and can be authorised where the benefit of the conduct to the public outweighs the anti-competitive detriment.

Reform of Part X

If Part X were to be retained, consideration should be given to its amendment to enhance the prospect of benefits to consumers and the broader economy from an increased application of competition law to international liner shipping.

- Discussion agreements allow participants to enjoy some of the benefits of conferences without all of the obligations. They increase the extent of collusion in the industry and therefore should be made subject to general competition law.

- Closed conferences restrict market contestability, potentially reducing competition in Australia's liner trades. Closed conferences are no longer allowed under US law. An important amendment to Part X, which would bring Australian regulation of liner shipping into line with that in the US, would be a requirement that conferences be open to the free entry or exit of members.

- The existence of shipowner accords is anti-competitive and therefore should be made subject to the standard authorisation procedures of Part VII of the TPA.

- Inward bound conferences enjoy exemptions under Part X, without the corresponding obligations which are imposed on outward bound conferences. For this reason, there is a strong argument for an approach to the regulation of inward bound conferences based on general competition law.

1. International Liner Shipping

Key Points

- ***Global over-capacity in shipping tonnage has been forcing global freight rates down.***
- ***Australia is benefiting from this global phenomenon through reductions in its freight rates.***
- ***A range of factors are reducing the relevance of conferences.***
- ***Conferences provide relatively more liner services to the major Australian ports, whereas independent liner services are relatively more important for Australia's regional ports.***

THE CHARACTERISTICS OF LINER SHIPPING AND LINER CONFERENCES

Structural Change in Liner Shipping

Over the last few decades, the international liner shipping industry has been characterised by a relatively rapid change in its composition, scope and scale. With the advent of containerisation in the late 1960s and, more recently, modern information technology, shipping companies are evolving from small companies, offering port-to-port services, to large international transportation companies offering world-wide door-to-door services. Shipping operators have also evolved from specialising in single trade routes into global operations, and containers may move from trade to trade.

Containerisation and other technological improvements have led to vessel size emerging as an important factor in reducing operating costs. Larger ships can have lower unit costs and tend to be faster, reducing sailing times on each leg and allowing a faster turn around. Vessels which carried between one hundred and six hundred Twenty-foot Equivalent Unit (TEU) containers, have been replaced in successive generations with 5,000 and 6,000 TEU container vessels. The new generation of vessels will carry around 8,000 TEU containers (OECD 1996, page 5).

To support these large vessels and the necessary cargo flows, companies have invested in land facilities. To operate the global systems, containers must be available in multiples of a minimum of 1½ to 3 times each vessel's capacity in order to maintain a continuous flow of container traffic from inland point to inland point. Over a vessel's long lifetime, several replacement sets of containers may be purchased. These characteristics make liner shipping a capital intensive industry. Capital costs are high and fixed (approximately 80 per cent) and marginal cost can frequently fall below average cost.

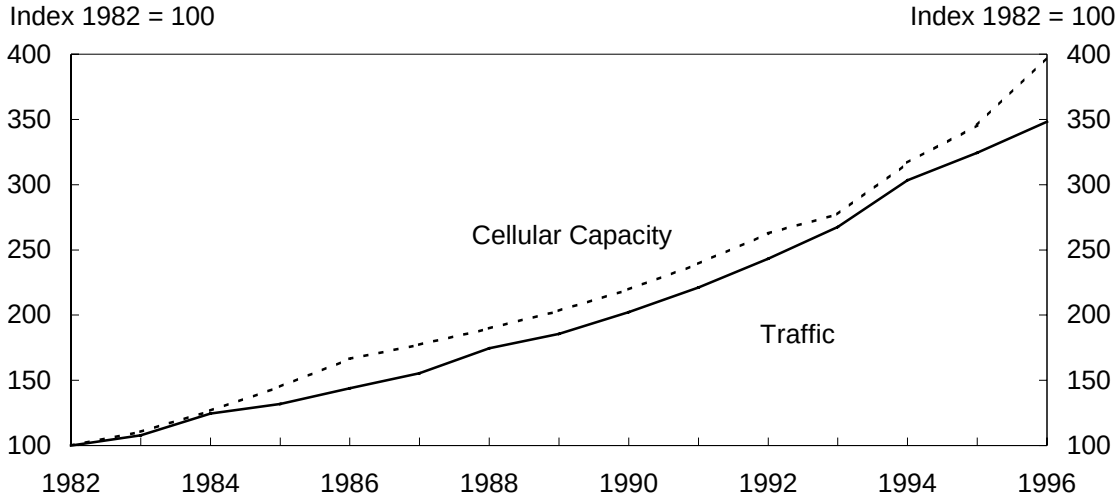
Governments play a significant role in shaping the liner shipping industry. In Asia, for example, there has been rapid growth and expansion in vessel operations and

shipbuilding through the use of low cost labour and government support. Some governments also provide vessel operating subsidies, special taxation provisions relating to investment in shipping, and special taxation treatment for shipping operators.

Government intervention is one factor that has been driving an 'oversupply' of global liner shipping. Another factor is the low rate of scrapping (only 0.5 per cent of the fleet in 1996). As a result, containership capacity grew at an average annual rate of 10.4 per cent between 1982 and 1996 (refer Chart 1). Given that, over the same period, the average annual rate of growth in traffic was only 9.4 per cent, it is clear that the supply capacity of global liner shipping has been exceeding growth in demand. Inevitably this is putting long term downward pressure on freight rates, to the benefit of Australian shippers.

Chart 1: Liner Shipping Capacity and Traffic

Index of Container Capacity and Traffic 1982-96



Source: Containerisation International Yearbook.

Declining Importance of Conferences

The structure of the international liner shipping industry is in transition. Conferences have been the principal form of economic organisation in liner shipping for all of this century. However, their importance seems to be diminishing due to several factors, including the emergence of larger global shipping operators, formed through strategic alliances and formal mergers, the increasing market penetration of independent operators, and the growing importance of hub and spoke networking.

Strategic Alliances

Global strategic alliances are a function of the trend towards the denationalisation of shipping, its globalisation in scope and scale, and its increasing concentration (OECD 1996, page 6).

Alliances in liner shipping appear to be following a similar trend to that evident for international airlines. Features can include the provision of joint capacity, cooperation in purchasing, harmonisation of service schedules, provision of more comprehensive services, and the sharing of facilities, ships and equipment. The

rationale for these joint operations is to improve the service offered and to facilitate significant cost reductions.

Strategic alliances may be reducing the effectiveness of the conference system because the memberships of alliances often clash with the memberships of conferences, and because operators see greater benefits flowing from alliances.

Shipping Company Mergers

There has recently been considerable rationalisation of international shipping companies through formal company mergers. Ten years ago, around 37 per cent of global liner shipping capacity was supplied by the 20 largest operators. By 1998, that figure had increased to about 53 per cent (Crichton 1999, page 8).

This trend is due, at least in part, to strategic alliances and conference arrangements being unable to provide the corporate structures necessary to facilitate significant cost cutting.

Hub and Spoke Networking

Hub and spoke networking is an emerging global trend which may lead to a further reduction in the importance of conferences. Conferences typically provide comprehensive port-to-port services. However, with hub and spoke networking, liner services feed key primary ports (the hubs) from smaller secondary and tertiary ports (the spokes). This can improve efficiency by better matching the vessel size with the trade being serviced, and by achieving economies of scale between hub ports. Hence, there is scope for lower costs and lower freight rates.

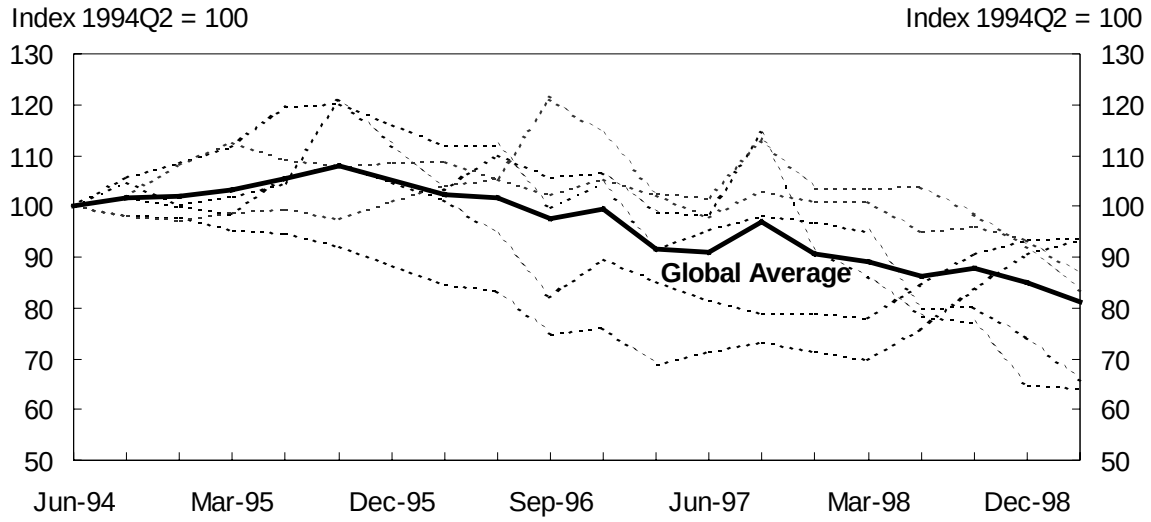
THE GLOBAL MARKET

Freight Rates

As discussed above, the growth in global liner shipping capacity has been exceeding the growth in supply for much of the last decade or more. The inevitable consequence of the resultant reduction in capacity utilisation has been downward pressure on freight rates. As illustrated in Chart 2, global freight rates declined by around 15 to 20 per cent between 1994 and 1998. This decline is consistent with other observations that there have been significant declines in real per unit revenues since the mid-1970s, by as much as 60 per cent (Boyes 1997, page 5).

Chart 2: Global Container Freight Rates

Index of Freight Rates Applying to Key Global Trade Routes 1994-1999[1]



Source: Containerisation International Freight Rate Indicators.

As the Australian liner trades are part of the global liner shipping market, these reductions in global freight rates have flowed on to Australian users of international liner shipping services. The specific Australian experience is discussed in further detail below.

Profitability

Some industry observers and participants have claimed that many liner operators are presently unprofitable due to 'unsustainable' levels of competition in the liner shipping market. However, the performance of liner shipping companies varies considerably from respectable returns on assets in excess of 10 per cent to returns of quite meagre proportions[2] (Fossey 1998, page 59). Despite the competitive market environment, some shipping lines are reported to be earning reasonable rates of return (17 per cent, in the case of Atlantic).

It is apparent that some liner shipping companies are operating efficiently and achieving reasonable rates of return, while other liner shipping companies are having difficulty competing in a market where freight rates have declined.

Competitive markets also produce on-going economic benefits through industry rationalisation. Relatively inefficient firms have to respond to declining freight rates (and rates of return) by extracting greater efficiency from their business operations. Otherwise, they may need to merge with another shipping company, so that the merged business can achieve efficiencies through economy of scale, or face the

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[1] The global freight rates are for the Europe-Asia, US-Asia and Europe-US trade routes, and are in respect of both import and export trades.

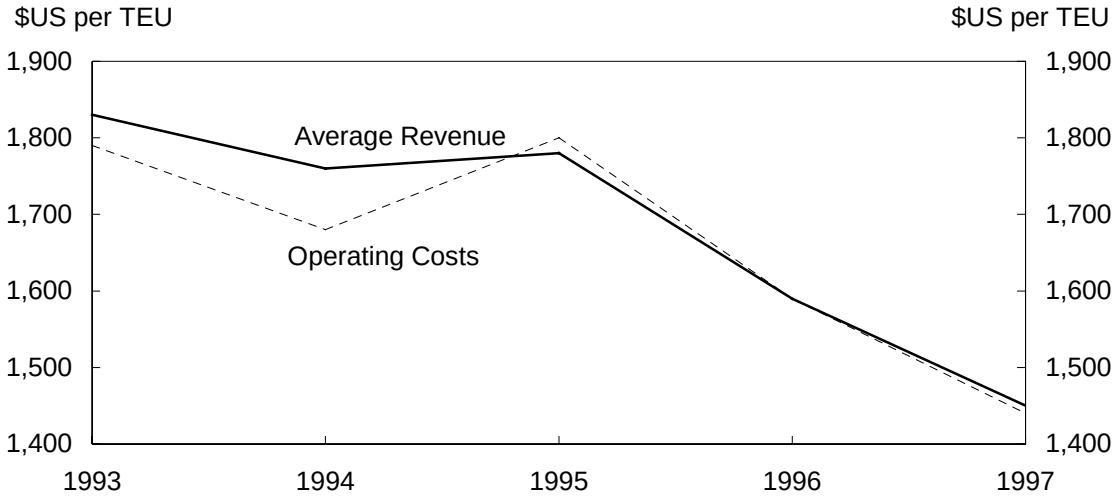
[2] There are, of course, problems in strict comparisons of the profitability of shipping companies because some companies are more diversified than others. For example, some may be pure container liner companies while others may have significant bulk shipping, motor vehicle transport, or intermodal operations. However, companies operating in any industry rarely have strictly comparable businesses, yet comparisons of this type remain useful, bearing the caveats in mind.

possibility of being taken over by a more efficient operator. As an example of these efficiencies, the merger of P&O and Nedlloyd is reported to have resulted in accrued savings of $200 million in annualised terms in the first year of its merged operations (http://www.p-and-o.com, *1997 Results*).

A further example of the dynamic efficiencies being achieved in the liner shipping industry is illustrated in Chart 3. Over the period 1993-1997, Nedlloyd responded to declining freight rates (represented by a 20.8 per cent decrease in average revenue per TEU over the period) by extracting similar levels of operating efficiency from the business (operating costs declined by 19.6 per cent over the period).

Chart 3: Dynamic Efficiencies in International Liner Shipping

Average Revenue and Cost per TEU for Nedlloyd 1993-97



Source: P&O Nedlloyd, 1998 Annual Report.

Had the freight rates faced by Nedlloyd remained steady, the company's profitability over the period would have improved significantly. However, other liner shipping companies have also become more efficient, and able to market their services at lower freight rates. Therefore, competition and improving efficiency are driving continual reductions in operating costs and freight rates.

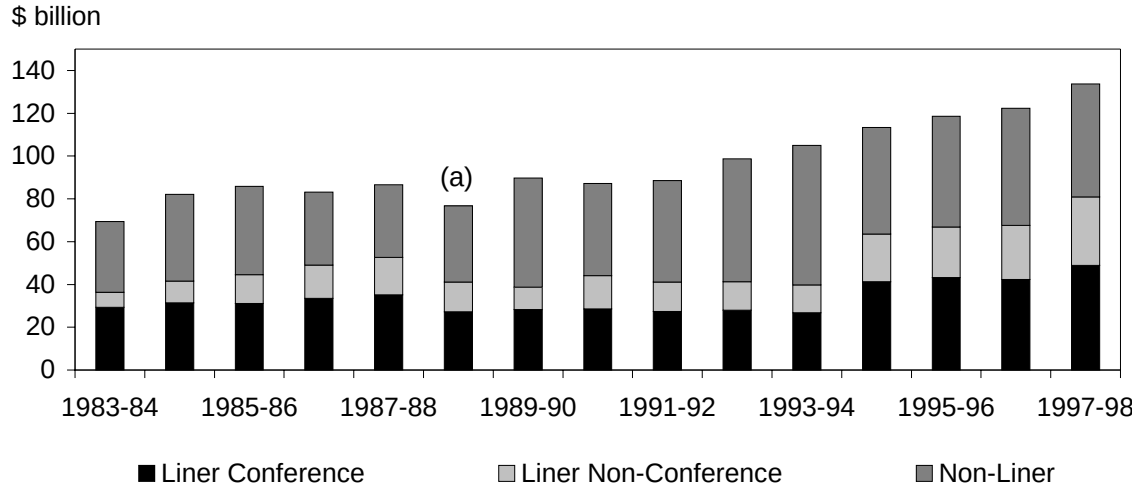
THE AUSTRALIAN MARKET

The Freight Task

Australia's geographic isolation and trade-oriented economy make shipping an important economic function. The availability of timely and efficient liner shipping services is crucial for access to export markets and for ensuring a reliable flow of imported products. As illustrated in Chart 4, liner shipping accounts for over half of the value of Australian seaborne trade. However, bulk carriers dominate some important market segments such as mineral and energy resources.

Chart 4: Australian Seaborne Trade

Total Value Carried



(a) 1998/89 series incomplete

Source: Australian Bureau of Statistics, International Cargo Statistics, unpublished.

In 1997, Australia ranked 15th in the international league of container movements, making Australia a not insignificant player in the world market for liner shipping (Crichton 1999, page 4).

The Australian Market for Liner Shipping Services

Historically, most lines serving Australian ports (including those to and from Europe and the US) have operated direct end-to-end services. However, greater future use of trans-shipment, for example via Singapore, may have the effect of rationalising the number of direct Australian trade routes which are offered.

A long term characteristic of Australia's liner trades has been the imbalance between the shipping requirements of the inwards and outwards legs. For most of the 1990s, volumes of export liner cargo freight were significantly larger than imports. However, in terms of TEUs, Australia is a net exporter of empty containers. This occurs because Australia's exports are heavier per TEU than its imports. The imbalance in trade in containers increases the cost of providing container services to Australia[3].

Independent operators have a strong presence on all trade routes[4] and market segments. In 1997-98, the market for Australia's liner cargo was shared roughly equally between conference and non-conference liner operators (refer Chart 5). Over the last two decades, the trend has been that non-conference operators are capturing significant market share from conference operators. This trend would seem to confirm the view that conferences appear to be of declining relevance, and that the decline seems likely to continue.

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3 However, Australia is not alone in having an imbalance in empty container movements.

4 For further information refer to *Appendix I: Market Share of Seaborne Exports by Liner Conferences on Major Trade Routes (1983-84 to 1997-98)* and *Appendix II: Market Share of Seaborne Imports by Liner Conferences on Major Trade Routes (1983-84 to 1997-98).*

Chart 5: Seaborne Trade Carried by Liner Conferences

Percentage of Total Volume of Trade Carried

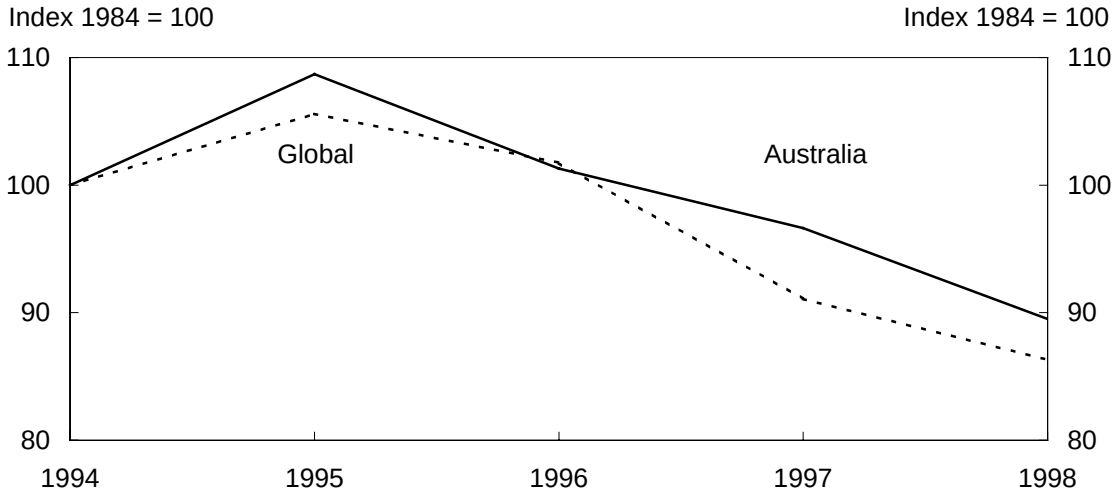
Source: Australian Bureau of Statistics, International Cargo Statistics, unpublished.

Australian Freight Rates

Australia has benefited significantly from conditions in the global liner shipping market which have been driving global freight rates down over the last decade or more. As shown in Chart 6, there is a strong correlation between global freight rates and Australian freight rates.

Chart 6: Container Freight Rates

Index of Average Freight Rates Applying to Key Global and Australian Trade Routes 1994-1998[5]



Source: Containerisation International Freight Rate Indicators; Liner Shipping Services.

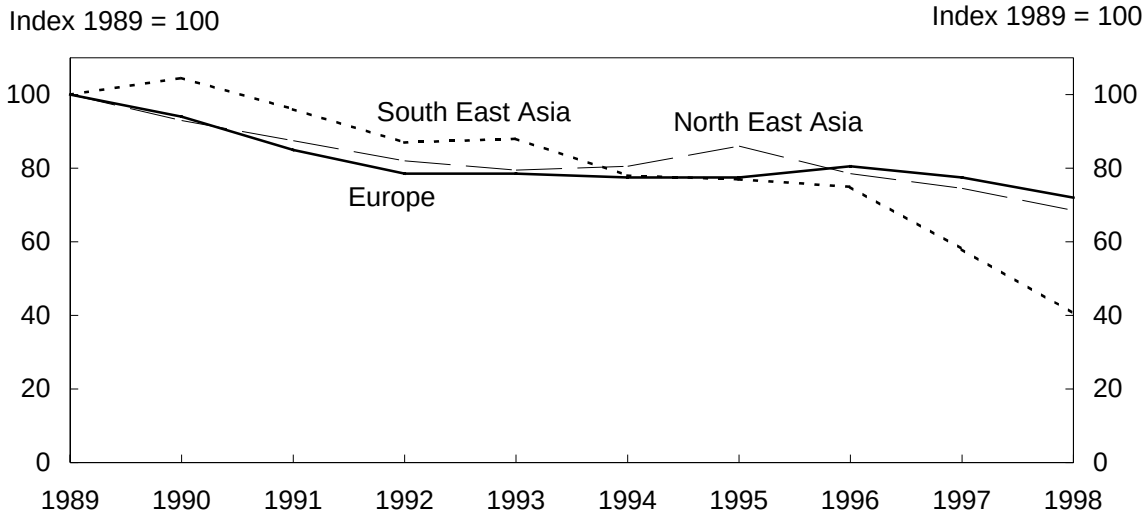
In 1993, the Brazil Review concluded that real freight rates had fallen substantially in the decade to 1993 (Brazil 1993, page 82), although no consideration was given to whether freight rates for liner shipping had been historically high. The downward trend in freight rates continued during the 1990s. Export freight rates for the trade

[5] The global freight rates are the average for Europe-Asia, US-Asia and Europe-US. The Australian freight rates are the average for Australia-Europe and Australia-Northeast Asia.

routes to Europe, North East Asia and South East Asia for the period since 1989 are shown in Chart 7 (import freight rates exhibit very similar characteristics).

Chart 7: Australian Container Freight Rates

Average Export Freight Rates on Key Australian Trade Routes 1989-98



Source: Liner Shipping Services.

During 1994 and 1995 freight rates increased on the North East Asian trade routes, and freight rates to Europe increased during 1995 and 1996. However, the overall trend has clearly been downward. Freight rates to Europe appear to be around 8 per cent lower than they were in 1992. The South East Asian trade route has experienced particular problems with excess capacity, partly as a result of the Asian crisis, and freight rates on that route have declined quite rapidly since 1996. They appear to be around 60 per cent lower than they were in 1989.

Declining freight rates are very beneficial for Australia because transport can be a significant factor of production for exporters and importers. Hence, declining freight rates can make Australian exports more competitive in global markets, lead to lower prices for Australian consumers of imported goods, and result in lower costs of production for domestic producers who rely on imported capital equipment or raw materials.

Although declining freight rates are frequently described as unsustainable, it is not obvious that this is true of the current level of freight rates.

- Low freight rates have been considered unsustainable for a long time (for example, Brazil 1993, page 67). Despite this, freight rates have continued to decline, quite sharply in some trades, and liner shipping companies are still increasing, rather than decreasing, their capacity.

- As discussed above, liner shipping companies have been able to extract substantial efficiencies from their operations in order to remain viable.

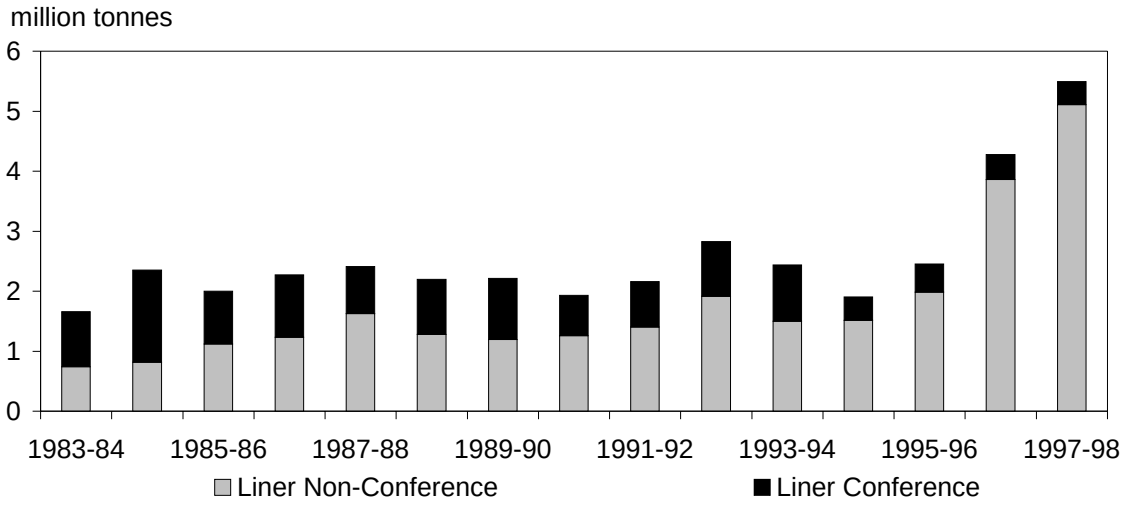
AUSTRALIAN REGIONAL MARKETS FOR LINER SHIPPING SERVICES[6]

Services for Regional Ports

An important consideration in reviewing the current regulatory arrangements is the impact which any change in those arrangements may have on regional ports served by regular liner shipping services. Analysis of market shares at regional ports suggests that independent operators, who are not subject to the regulation of Part X, already provide the majority of liner services to regional ports (refer Chart 8). In 1997-98, their market share was 93 per cent. Significantly, non-conference operators have been steadily increasing their market share at regional ports and now dominate export tonnage through regional ports. Given this existing propensity for non-conference operators to service regional ports, it appears that services to regional ports would not be significantly affected by the repeal of Part X.

Chart 8: Regional Port Exports Carried by Liner Services

Total Volumes Carried by Conference and Non-Conference Liner Services



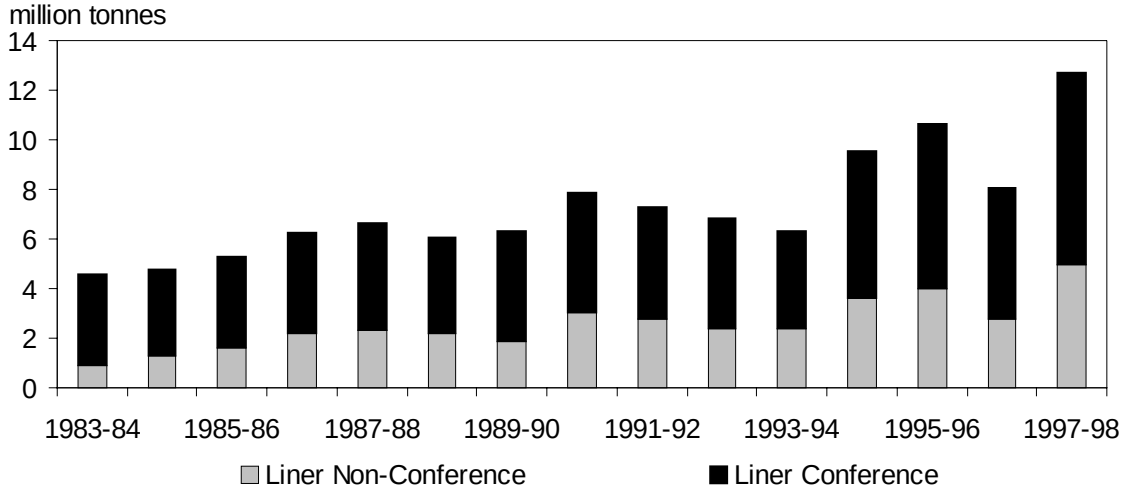
Source: Australian Bureau of Statistics, International Cargo Statistics, unpublished.

In comparison, as illustrated in Chart 9, conferences tend to provide the majority of services at the major ports.

6 Regional ports are all ports other than Sydney, Melbourne, Brisbane, Adelaide and Fremantle.

Chart 9: Major Port Exports Carried by Liner Services

Total Volumes Carried by Conference and Non-Conference Liner Services

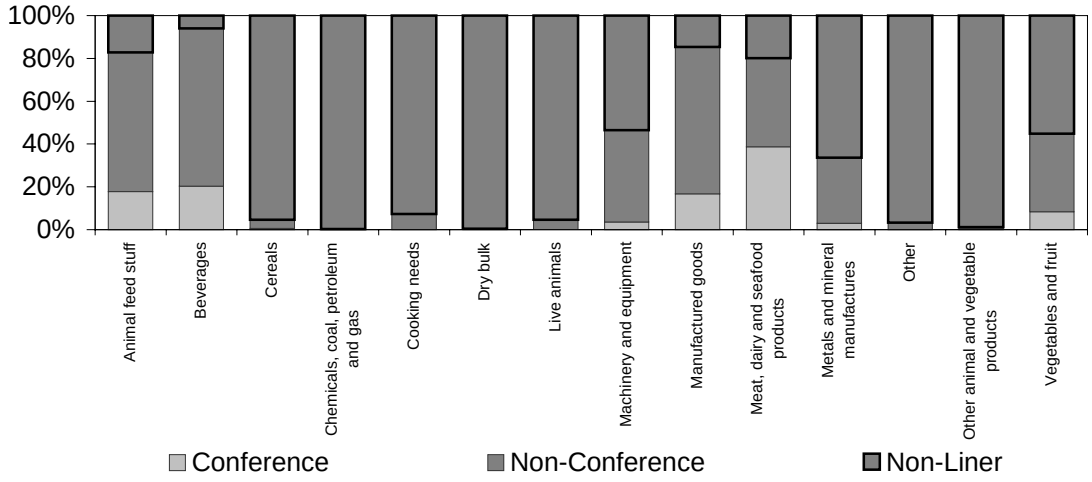


Source: Australian Bureau of Statistics, International Cargo Statistics, unpublished.

As illustrated in Chart 10, of those market segments of regional ports in which liner services are significant, non-conference liner services have a greater market share than conference services in all market segments. Even in the case of time sensitive cargoes such as meat, dairy and seafood products, non-conference operators shipped 30,796 tonnes in 1997-98 compared with conferences which shipped 28,735 tonnes.

Chart 10: Exports Shipped through Regional Ports

Percentage of Exports Carried by Shipping Services in 1997-98

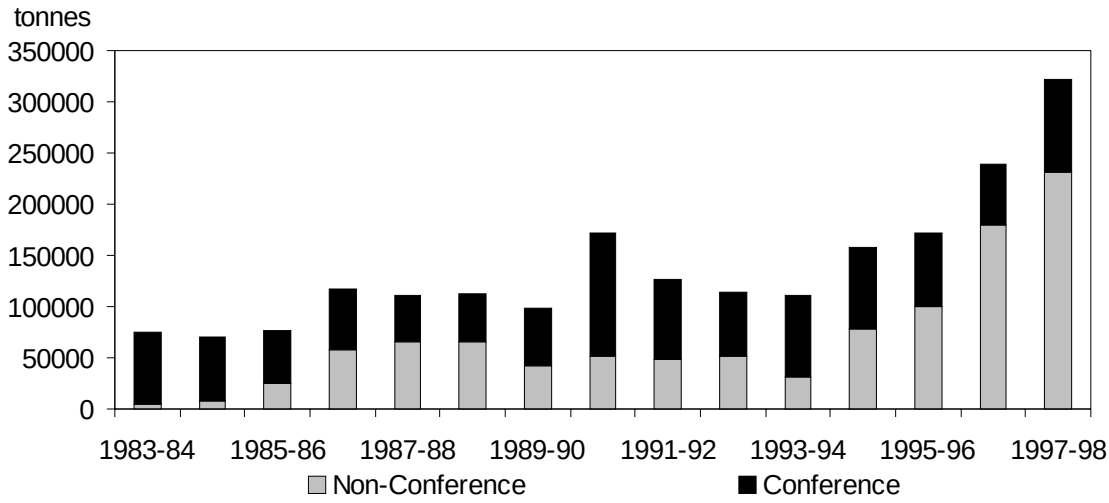


Source: Australian Bureau of Statistics, International Cargo Statistics, unpublished.

It has been suggested that conferences are better equipped to transport time sensitive and perishable commodities requiring high quality and timely services. However, using the refrigerated transport market segment as an indicator of time sensitive freight services, the available evidence suggests that non-conference operators already provide the majority of services in this market for regional ports, and that their market share is still growing (refer Chart 11).

Chart 11: Refrigerated Regional Exports Carried by Liner Services

Total Volumes Carried by Conferences and Non-Conference Liner Services



Source: Australian Bureau of Statistics, International Cargo Statistics, unpublished.

Indeed, the available evidence does not suggest that conference agreements are necessary to ensure high quality and timely shipping services. This then raises the question as to whether Part X is necessary to ensure those services.

AUSTRALIAN CONFERENCES

There are approximately 60 conferences registered under Part X, covering agreements on a range of provisions. Presently, conference operators serve around 50 per cent of the Australian liner freight market, with independents servicing the balance. However, when independent operators participating in discussion agreements are included, the degree of collusion present in the Australian market is somewhat higher.

Australian conferences are closed except for those operating to and from the US, which are required to remain open under US law.

Some of the collusive provisions provided for under Australian conference agreements include:

- fixing of common freight rates;
- provision of minimum service levels;
- arrangements for pooling revenues;
- agreements on the capacity of each member; and
- agreement on conditions for membership to the conference.

Advocates of conference shipping argue that conferences are necessary for two main reasons. The first is to provide adequate and reliable shipping services and stable access to export markets, by allowing a number of operators to act in a coordinated way. It is argued that conferences can supply a greater number of ships than

operators acting independently, thus allowing a greater number of port calls and a better service for customers. Given that conferences now only supply around 50 per cent of Australia's liner services, and that the long term trend is for this to decline, this argument seems questionable. Indeed, with global industry rationalisation and the emergence of liner companies and alliances with global networks and large fleets, this long term decline looks set to further reduce the relevance of conferences in the future.

The second rationale for conferences is that they provide the stability that is required for the lumpy and significant investments that are typical of liner shipping. It is argued that greater competition would lower the returns to ocean carriers to the point where it would no longer be viable for them to call regularly in Australia, with shippers then only being served by transhipment services. However, given the significant and increasing market penetration of non-conference operators, and the potential for improvements in efficiency which may flow from transhipment, this argument does not appear to be supported by the evidence.

In any event, it is important to keep in mind that the Productivity Commission's current inquiry has not been asked to investigate whether conferences are necessary, but rather whether the liner shipping industry should continue to be afforded special exemptions from competition law (i.e. through Part X) that are not provided to other Australian industries.

The current structure of the Australian market for liner shipping services, and developments in the industry globally, do not support the case that there is a continuing need to provide special exemptions from competition law for conference agreements. If, as most shippers claim, competition does exist between conference and non-conference operators, then this necessarily implies that the service offered by non-conference operators is a close substitute for the service offered by conferences. It is difficult to argue on one hand that the market for liner shipping is competitive, and on the other that independents do not offer a viable alternative to conferences. Further, there is no evidence to suggest that any market segments will not be adequately served in the absence of Part X.

2. The Regulation of Liner Shipping

Key Points

- ***World-wide, there is a move away from granting exemptions from competition laws.***
- ***Australia has a comprehensive framework of universal competition laws.***
- ***The regulation of liner shipping is an anomaly in that competition framework.***
- ***There is no formal international harmonisation of liner shipping regulation.***

INTERNATIONAL REGULATION

Historically, liner shipping has typically been exempted from the application of the competition laws of the major western economies, with the extent of those exemptions differing significantly between jurisdictions. Some countries provide exemptions for a broad range of collusive behaviour, while in others, such as the US, there has been a move towards fewer exemptions for anti-competitive behaviour in the shipping industry.

Developments within the liner shipping industry are leading to a less important role for formal conference agreements, and increasingly, even where legal provisions for conference agreements exist, the industry may not necessarily make use of them. The largest shipping lines are increasingly choosing to operate independently while others are opting for formal mergers or strategic alliances over conference agreements. As shown in the previous section of this submission, there has been a steady increase in Australia over the past two decades in the market share of non-conference operators.

United States

In the US, shipping lines are exempt from some competition laws, but face administrative requirements which include making public some aspects of agreements. A feature of US shipping regulation is that conferences must remain open by law, with a requirement that new entrants be admitted to the conference of their choice. Another characteristic of US liner shipping is that pooling of revenue and costs is permitted but is not frequently practised, with the exception of the Mediterranean trade.

New legislation covering shipping, which came into effect on 1 May 1999, weakens the power of conferences by increasing the autonomy of conference members. Under the previous legislation, conferences could prohibit their members from negotiating and entering into individual service contracts, and were allowed to adopt mandatory rules or guidelines for group or individual contracts. Under the new legislation, conferences and other agreements including consortia cannot prohibit a member

from negotiating individual contracts. The member cannot be forced to disclose, to other members, a negotiation of a service contract or the terms and conditions of a confidential service contract, other than the terms which are required, by the law, to be published. Further, conference and other agreements cannot contain mandatory rules for individual service contracts, but conferences can issue voluntary guidelines relating to the terms and procedures for such contracts. Such guidelines must be confidentially submitted to the Federal Maritime Commission.

The effect of these provisions is that US conference arrangements are less rigid and have broader membership than is the case with Australian conferences. The ability of new entrants to join a conference readily, and compete on freight rates with other conference members, would have the effect of placing significant additional pressure on incumbents to pursue productivity gains and to place downward pressure on freight rates. Further, the ease of joining conferences reduces a competitor's entry costs, which heightens competitive pressures.

European Community

In the EC, there are varying competition law exemptions available to liner conferences or consortia. Regulation 4056/86 stipulates certain conditions for the exemption of conferences. However, exempted agreements must meet at least one of four general exemption conditions:

- contribution to improving the production or distribution of goods, or promoting technical or economic progress;
- allowing consumers a fair share of the resulting benefit;
- indispensability of imposed restrictions to achieve benefit; or
- no possibility of eliminating competition in respect of a substantial part of the services in question.

Consortia regulations apply to agreements between carriers concerning the rationalisation of liner shipping services by means of technical and commercial arrangements (except pricing, which falls under conference provisions). In order to qualify for an exemption, consortia must meet at least one of the following conditions:

- preserve effective price competition between their members (e.g. this can be met by demonstrating that independent rate action is permitted);
- preserve competition in terms of the services provided between the consortium members and members of the conference to which the consortium belongs, as a result of the fact that the conference agreement expressly allows consortia to offer their own service arrangements; or
- possess market shares below certain limits.

Other OECD

All OECD member countries grant some form of immunity or exemption from national competition laws for conference activity, although the scope of such regulation differs. The US is alone in demanding that conferences be open. Under some regimes, the right of admission and withdrawal is prescribed and other specific conditions must be met.

Significantly, the OECD is considering whether conference agreements that set common rates should continue to benefit from block exemptions, rather than being subject to specific approval by competition authorities on the basis that a public benefit associated with such collusive behaviour would need to be demonstrated. Consideration is also being given to whether discussion and capacity agreements should be subject to any exemption from competition laws.

AUSTRALIAN REGULATION

In reviewing Part X, it is relevant to note the principles agreed by Heads of Government in establishing the National Competition Policy in 1995. In particular, it was agreed that any changes to competition policy should be consistent with the general thrust of reforms to develop an open, integrated domestic market for goods and services by removing unnecessary barriers to trade and competition.

National Competition Policy targets particular opportunities for governments to encourage competitive outcomes, which should result in the more efficient use of resources. A key component in this approach is the requirement to review and, if necessary, to reform anti-competitive legislation. Importantly, this requires that legislation which restricts competition must not be retained or introduced unless it is demonstrably in the public interest.

Governments therefore have to demonstrate that the benefits of the restriction to the community as a whole outweigh the costs, and that the objectives of the legislation can only be achieved by restricting competition. The means by which public benefit is to be assessed has been broadly defined and includes social, regional and environmental factors.

This is the first review of Part X under the framework established by the National Competition Policy.

As Part X is the only case in the TPA which provides an industry specific blanket exemption from scrutiny in relation to most anti-competitive behaviour, it is a considerable exception to the general approach to competition policy. This provides a *prima facie* rationale for repealing Part X. If Part X is to be retained, it should be demonstrated that affording liner shipping conferences special exemptions from competition law is in the public interest and that Australia's general competition laws are not viable alternatives for regulating liner conferences.

Australian Competition Law

The competitive conduct rules in Part IV of the TPA, and State and Territory application laws, prohibit a broad range of anti-competitive trade practices including anti-competitive agreements, misuse of market power, exclusive dealings, resale price maintenance and some merger activity. The Australian Competition and Consumer Commission (ACCC) can bring civil proceedings in the Federal Court in restrictive trade practices matters seeking monetary penalties, injunctions, divestiture, and other orders for breaches to Part IV and other Parts of the TPA. Private litigants may also seek damages for loss suffered as a result of a contravention of Part IV in addition to seeking injunctions and other orders.

Authorisation

The authorisation provisions in Part VII of the TPA provide the ACCC with power to grant immunity from legal proceedings for some arrangements or conduct that might otherwise breach the restrictive trade practices provisions of the Act. Authorisation is available for:

- anti-competitive agreements and primary boycotts (s45);
- price agreements (s45A);
- anti-competitive covenants (s45B);
- secondary boycotts (ss45D, 45DA and 45DB);
- agreements affecting the supply or acquisition of goods or services (ss45E and 45EA);
- anti-competitive exclusive dealing arrangements and third line forcing (s47);
- resale price maintenance (s48); and
- mergers leading to a substantial lessening of competition in a market (ss50 and 50A).

In considering an application for authorisation, the ACCC is required to apply one of two tests, depending on the conduct in question.

- For agreements that may substantially lessen competition, the applicant must satisfy the ACCC that the agreement results in a benefit to the public that outweighs any anti-competitive effect.
- For primary and secondary boycotts, third line forcing, resale price maintenance and mergers, the applicant must satisfy the ACCC that the conduct results in a benefit to the public such that it should be allowed to occur.

Except for mergers, the ACCC must publish a draft determination and provide the opportunity for a conference of interested parties, before making a final decision whether to grant authorisation.

The immunity conferred by authorisation operates only from the time the ACCC grants authorisation. However, the ACCC may, if it considers it appropriate, grant an interim authorisation to apply while the application is being considered by the ACCC or the Australian Competition Tribunal. Authorisation determinations by the ACCC are reviewable by the Tribunal on application by the original applicant, or anyone else the Tribunal is satisfied has a sufficient interest in the matter.

The ACCC has power to revoke an authorisation where it considers it was granted on the basis of false or misleading evidence or information; where a condition of the authorisation has not been complied with; or where there has been a material change of circumstances since the authorisation was granted. It is the ACCC's practice to grant authorisations for set time periods.

Notification

Part VII of the Act also provides for notification of exclusive dealing conduct. Unlike the authorisation process, immunity from legal proceedings is automatic and immediate from the time notification is made to the ACCC (except for third line forcing, where immunity comes into force 14 days after the ACCC is notified of the conduct). The immunity remains unless revoked by the ACCC.

Before revoking a notification, the ACCC must give interested parties the opportunity to call a conference. Application for review of an ACCC decision on notification may be made to the Australian Competition Tribunal, either by the person who made the initial notification, or anyone else who the Tribunal is satisfied has a sufficient interest in the matter.

Public Register

For both authorisation and notification procedures the ACCC is required to keep a public register of all related documents. However, the ACCC may exclude commercially sensitive material from the register if requested.

Part X

Part X contains regulations specific to international liner cargo shipping to and from Australia. The principal objectives of Part X, as laid out in the Act, are:

- to ensure that Australian exporters have continued access to outwards liner cargo shipping services of adequate frequency and reliability at freight rates that are internationally competitive;

- 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

- to ensure that efficient Australian flag shipping is not unreasonably hindered from normal commercial participation in any outwards liner cargo shipping trade.

Under Part X, conferences are obligated to:

- negotiate with representative shipper bodies;
- include certain minimum standards in the conference agreements; and
- lodge the conference agreements on a public register.

In return for the obligations, Part X provides special exemptions from some provisions of Part IV for conferences. Registered conferences cannot be prosecuted for breaches to sections 45 or 47.

The process of granting exemptions under Part X of the Act is different in nature from the authorisation procedure of Part VII. Anti-competitive practices which would be in breach of Part IV of the Act may be authorised on public benefit grounds by the ACCC. The authorisation process involves the ACCC weighing, on a case-by-case basis and in a transparent way, the anti-competitive effects of the conduct against claimed public benefits. The broad concept of public benefit allows the ACCC to take a wide range of factors into account. However, no such public benefit test is required to register conference agreements under Part X.

International Regulation Harmonisation

A common argument in favour of Part X is that it provides a compatible regulatory regime to that of other countries. While many of the major western countries have in place special industry specific regulations which afford competition law exemptions to the liner shipping industry, these regimes are not necessarily harmonised in any other respects. An example of the significant differences between these regulatory regimes is that conferences operating between Australia and the US are required to be open, in accordance with US legislation, while closed conferences are permitted, in the case of Australia, under Part X. Moreover, while harmonisation of differing competition frameworks between countries is a desirable objective, the first concern is to seek liner shipping regulation which complies with the domestic competition framework.

3. Competition Policy and Shipping Regulation

Key Points

- ***International liner shipping is subject to regulations which may limit the competitiveness, and therefore efficiency, of the market for international sea freight.***
- ***Efficiency in the market for international sea freight may be enhanced by improving the regulation of international liner shipping.***
- ***While it is frequently suggested that non-conference operators provide sufficient competition for conferences to prevent the anti-competitive use of market power, this is not a justification for retaining Part X.***
- ***The aviation industry shares similar characteristics with the liner shipping industry and hence is a useful regulatory benchmark. However, unlike liner shipping, potentially anti-competitive conduct on the part of airlines is subject to the normal authorisation provisions of Part VII of the TPA, based on a public benefit test.***

COMPETITION POLICY REFORM

Over the last decade or so, a range of policy reform measures have been directed at improving economic performance. These reforms have been based on the premise that open and efficient markets for goods and services provide the crucial underpinnings for dynamic high income economies. As a result of these reforms, Australia's productivity performance, which is the main source of sustainable increased living standards, has shown an encouraging upturn in the 1990s. The benefits flowing from economic policy reform are described in detail in Budget Statement 3 (Commonwealth of Australia 1999).

The Hilmer Committee on National Competition Policy reported that:

> *The greatest impediment to enhanced competition in many key sectors of the economy are the restrictions imposed through government regulation – whether in the form of statutes or subordinate legislation – or government ownership.* [7]

Consequently, one core feature of National Competition Policy is the adoption of a set of principles aimed at ensuring that regulation does not restrict competition unless the restriction can be demonstrated to be in the public interest. New regulatory proposals are therefore subject to increased scrutiny of the public costs

[7] Independent Committee of Inquiry 1993, page 14.

and benefits of that regulation, and existing regulations are subject to a systematic review on the same basis.

The regulatory environments of many industries have already been reviewed. Some regulations have been found to be effective and efficient in achieving the Government's objectives. Others have been found to be in need of change. Reasons for ineffective regulation include:

- changing circumstances in the industry mean that the regulation no longer meets the original objectives;
- the public benefits of the regulation are outweighed by the public costs;
- the regulation may conflict with other regulations or government policy; and
- the objectives of the regulations could be more efficiently achieved through other means.

Uniform Competition Laws

National Competition Policy also involves the cooperation of the Commonwealth, States and Territories to ensure that universal and uniformly applied rules of market conduct apply to all markets and all market participants. Businesses and consumers benefit from the uniform protection of consumer and business rights that national competition laws provide. This integrated approach to national competition policy balances economic efficiency and the broader elements of public interest.

Anti-competitive Arrangements

Collusion between producers in an industry, to coordinate supply or price, is often a mechanism designed to increase profits. The extraction of monopoly profits by producers, through higher prices, will reduce consumer welfare with the result that some consumers may withdraw from the market if the increased price exceeds the marginal benefit they derive.

Such collusive behaviour in infrastructure industries may have second order effects on the efficiency of other industries. For example, the demand for transport services is derived from the demand for a good or service in another industry. Shippers demand shipping services as part of their production process (i.e. to transport their goods to market). If collusive behaviour results in increased transport prices to shippers, increased costs of production in the shipper's industry will reduce the industry's efficiency.

This is not to say that some collusive behaviour may not provide economic benefits to offset the efficiency costs. For example, the coordination of supply may lead to improved levels of service for customers, or lower costs of production which may result in lower prices for consumers. For this reason, the general provisions of the TPA specifically provide avenues for the official sanctioning of collusive behaviour in cases where net public benefits can be demonstrated.

ECONOMIC CONCEPTS IN REGULATING LINER SHIPPING

Contestable Markets

Contestability exists in a market where the ability of competitors to freely enter the market (not necessarily the actual presence of competitors) acts as a disincentive to incumbents in acting to lower quality or increase price. The degree of contestability, and therefore the potential for anti-competitive behaviour by market incumbents, is primarily determined by the ease of entry into, and exit from, that market. Barriers to entry include cases where entry and exit are not costless (for example, where there are large sunk costs involved), or where there is strong brand identity or regulatory barriers.

It is often suggested that non-conference operators provide sufficient competition for conferences to prevent the anti-competitive use of market power. However, this is not in itself a justification for retaining Part X.

Revenue and Cost Pooling

Where pooling arrangements exist, they allow the members of individual conference agreements to aggregate and average their costs and revenues. With pooling, it is the range of cost structures within a conference which forms the basis of conference rates. By definition, the less efficient operators with higher marginal costs must raise the average cost (the conference cost) which forms the basis for freight rate negotiations. With pooled costs and revenue, less efficient operators are assured of sufficient returns to ensure their continued viability, and so have less incentive to pursue productivity gains. Similarly, pooling reduces the incentives for more efficient operators to pursue even greater efficiencies because the benefits are not captured solely by the operator concerned, but rather are spread over all members of the cartel. The smaller the benefit, the less likely it is that operators will take active steps to achieve it.

To provide a satisfactory return to all participants, the effect of pooling must be to drive freight rates up above fully competitive levels. Pressure from within the conference to lift the performance of the less efficient members will mainly come in response to competitive pressure on the conference as a whole from non-conference operators.

Discussion Agreements

In addition to formally binding conference agreements, Part X also permits discussion agreements that may involve conference and non-conference operators. These agreements provide for operators involved in trades to discuss and agree on a range of issues which would normally be subject to competition. These discussion agreements between operators have the capacity to limit competition between conference and non-conference operators. For example, in an investigation by the Trade Practices Commission into anti-competitive conduct by conferences in 1991, the Australian Dairy Corporation stated that a discussion agreement on the North American trade reduced competition and limited the ability of exporters to negotiate lower freight rates (Trade Practices Commission 1993, page 46). These collusive

discussions essentially allow discussants to enjoy some of the benefits of conferences without the obligation to pool revenue.

Shipowner Accords

Shipowner accords are arrangements between conference and non-conference operators which limit the capacity which non-conference operators can offer to particular trade routes and which determine the degree to which they may undercut conference freight rates. These accords are inherently anti-competitive.

A COMPARISON OF THE INTERNATIONAL AVIATION AND LINER SHIPPING INDUSTRIES

In considering the relevance of Part X, it is useful to examine the regulatory arrangements of comparable industries to ensure consistency of regulation between industries[8]. The aviation industry shares similar characteristics with the liner shipping industry, and provides a useful benchmark for this purpose. A comparison of the international aviation and liner shipping industries is provided in Appendix III.

A recent legislation review of Australia's system of international air service agreements found that there are inefficiencies imposed on the world aviation industry by the current bilateral system (Productivity Commission 1998, page XXIX). The inefficiencies which flow from the government regulation of capacity and prices in international aviation raise similar questions to the inefficiencies which flow from the regulation, by conferences, of capacity and prices in international liner shipping.

As with liner shipping, many airlines have sought to improve their efficiency and industrial organisation by entering into alliance agreements with potential competitors. The reasons are much the same as those provided by the liner shipping industry, i.e. joint service provision, the sharing of facilities, and joint procurement can reduce the operating costs of airlines and result in flow-on benefits for consumers in terms of reduced airfares and improvements in scheduled services.

However, unlike liner shipping, these potentially anti-competitive airline alliances are subject to the normal authorisation provisions of Part VII of the TPA, based on a strict public benefit test.

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[8] There are problems in any comparison of industries. However, comparisons of this type remain useful, bearing in mind the differences between the industries.

4. Regulatory Options

Key Points

- ***The standard authorisation procedure under Part VII is the appropriate regulatory regime for liner shipping.***
- ***If conferences are concerned about compliance costs under Part VII, these could be addressed through the authorisation of an industry code.***
- ***If Part X were to be retained, then modifications to Part X would be desirable .***

The primary argument advanced in support of Part X is that a conference can provide assurances of a certain capacity of shipping at a scheduled time and price. Implicit in Part X is the assumption that conferences are the best way of ensuring sufficient and regular services, but this would not seem to be the case.

- There does not appear to be evidence that scheduled services would be adversely affected if conferences were no longer granted special exemptions from competition laws. As discussed in Section 1, this appears to be consistent with the declining market share of conferences, the emergence of other forms of industrial organisation which are making conferences less relevant, and the relative concentration of conferences in the major ports rather than regional ports.

- Even if independent operators and the countervailing market power provided by Part X to shippers do provide a limit on the market power of conferences, this is not of itself a justification for granting special exemptions from competition law to conferences.

- Part VII of the TPA allows for conditional authorisation for anti-competitive behaviour in cases where it can be demonstrated that this is in the public interest. It is therefore more transparent than Part X, under which exemptions are granted with minimal obligation and without analysis of whether they are in the public interest.

REPEAL PART X

If Part X were to be repealed, conference agreements would be subject to the full operation of Part IV of the Act, bringing liner shipping into line with all other industries. Conferences could then seek the sanctioning of their collusive activities (to the extent that they wished to continue with them) through one of several transparent mechanisms under Part VII of the TPA.

Authorisation

Using the authorisation process to determine the public benefit of conference agreements has several advantages. It is a highly transparent process and is the universal standard for assessing whether anti-competitive behaviour is appropriate. It also places the onus on conferences to demonstrate the public benefit of the collusive arrangements which they wish to sustain.

The broad concept of public benefit, under which authorisation may be granted, allows the ACCC to make a considered judgement on the basis of a range of factors. Authorisations allow exemptions within a limited framework, such as time or scope, and may be revoked if there is a material change in the circumstances under which the terms of collusion were agreed. In addition, there is the advantage of a formal appeals process if market participants are concerned about the conduct of parties exempted by the authorisation. This is essential for transparency.

Concerns have been expressed about compliance costs, consistency of application across all conferences, and business certainty if each conference had to be separately authorised. The industry could address these concerns by agreeing on a code which encompasses the core restrictive practices to be adhered to by all conferences. Individual shipping lines and conferences could gain protection through authorisation of the code, but would be free to tailor individual agreements to individual conference needs. Additional provisions in such agreements that contain restrictive practices beyond those already authorised may require separate authorisation.

Such an approach would be consistent with that which applies to other industries and would be transparent. Codes of conduct and collective agreements have been authorised in the past and can be authorised where the benefit of the conduct to the public outweighs the anti-competitive detriment.

Notification

The essential difference between the notification and authorisation processes is that authorisation allows for anti-competitive conduct only after an application has been approved by the ACCC, whereas notification permits anti-competitive conduct as soon as it is notified, and it remains in place unless reviewed or revoked by the ACCC.

Transitional Arrangements

A change in the regulatory regime from coverage under Part X to that of Part VII, may create some uncertainty for business operations. However, there are several transitional arrangements which could be considered to minimise this uncertainty.

- The ACCC has the power to grant shipping conferences interim authorisation so as to protect the commercial interests of the shipping companies during the time it takes to finalise a decision on an application for authorisation.

- There is also the possibility that the authorisation process could be finalised before Part X is repealed. For example, the TPA could be amended to provide

for the repeal of Part X in, say, twelve months and to provide authority for the ACCC to authorise conference arrangements in anticipation of the repeal becoming effective.

Financial and Compliance Costs

The application fees for authorisation ($7,500) and notification ($2,500) are higher than for registration under Part X ($570). However, in the case of authorisations, where it is normal practice for an authorisation to be granted for a period of five years, the annual cost would be $1,500 per annum compared with $570 per annum under Part X.

The indirect costs associated with the application would also be greater than registration under Part X. This would be a necessary consequence of moving to a process which must establish whether a net benefit arises from the anti-competitive practice of collusion. In comparison, the information presented in current conference agreements is limited, there is very little opportunity for public scrutiny, and there is no requirement to justify exemptions.

Moreover, industries other than liner shipping have to seek authorisation if they wish to undertake potentially anti-competitive activity, and therefore already face the same compliance costs that the liner shipping industry would face if Part X were to be repealed.

The development and application of an industry code might offer a means of minimising regulatory costs to the industry. It would have the advantage of incorporating the scrutiny of the authorisation process without the administrative requirements of authorising every conference agreement. Shared among industry participants, the application fee for authorisation of the prescribed code would be small, and there would be little in the way of ongoing costs. Provided that individual conference and other agreements complied with the industry code, they would not require separate authorisation.

REFORM OF PART X

Part X is a considerable anomaly in the general approach to competition policy. If Part X is to be retained, it should be demonstrated that affording liner shipping conferences special exemptions from competition law continues to be in the public interest and that Australia's general competition laws are not a viable alternative for regulating liner conferences. If that case can be made, consideration could then be given to the amendment of Part X.

Any amendments to Part X should seek to ensure that users of non-conference shipping do not incur excess costs from the existence of conferences. Related to this objective, there is clearly a need to ensure that non-conference shipping is an effective form of competition.

Discussion Agreements

Discussion agreements seem to be inhibitors of competition. By allowing conference and non-conference operators to collude on a trade, the competitive impact of non-conference operators would appear to be reduced. Discussion agreements should therefore be made subject to the standard authorisation procedures of Part VII of the TPA.

Closed Conferences

Closed conferences place a limit on market contestability, and hence potentially reduce competition in Australia's liner trades. As discussed in Section 2, improved competitiveness, through the removal of a potential barrier to market entry, would appear to be the reason for the US move to open conferences. An amendment to Part X, to require that conferences be open to the free entry or exit of members, would bring Australian regulation of liner shipping into line with that applying in the US.

Shipowner Accords

As discussed in Section 3, shipowner accords are inherently anti-competitive. Under Part X, parties to shipowner accords are entitled to the same exemptions as those available to members of inward conference agreements. This is an exemption from certain conduct prohibited under Australian competition law, without the obligations imposed on outward conferences.

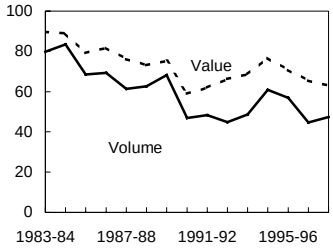
Prohibition of collusion between conference and non-conference shipping under Part IV of the Act could lower the costs faced by users of non-conference shipping and also increase the competitive pressure on conference freight rates from independent operators. This would require that shipowner accords be subject to standard competition law.

Inward Bound Liner Shipping

Inward bound conferences enjoy exemptions under Part X of the Act without the corresponding obligations which are imposed on outward bound conferences. For this reason, there is a strong argument for an approach to the regulation of inward bound conferences based on the principles of Part IV of the Act, with authorisation only available to protect arrangements where a net public benefit can be demonstrated.

APPENDIX I: MARKET SHARE OF SEABORNE EXPORTS BY LINER CONFERENCES ON MAJOR TRADE ROUTES (1983-84 TO 1997-98)[9]

Japan & North Asia ($6.9b)



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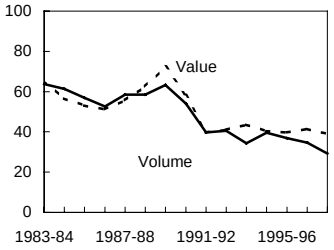

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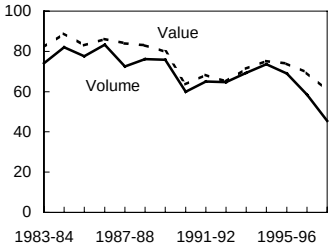
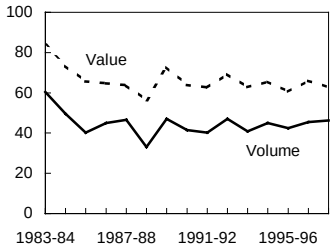
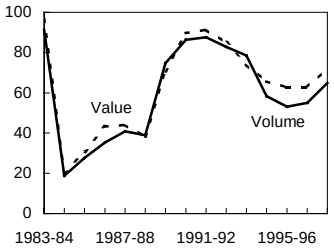


North America ($3.6b)



New Zealand ($2.8b)



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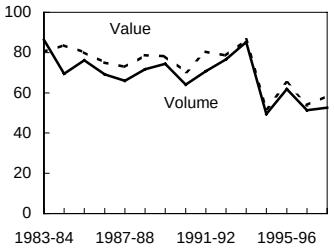
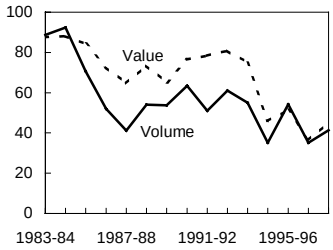


Europe Atlantic ($2.0b)



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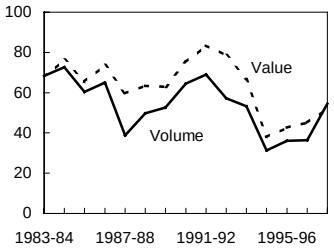

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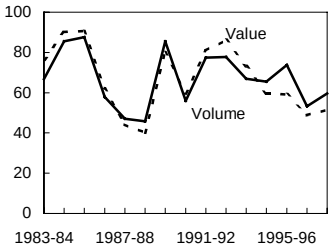

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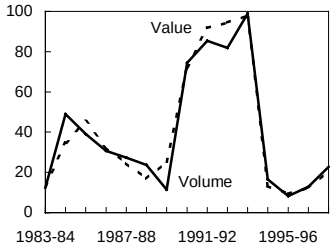

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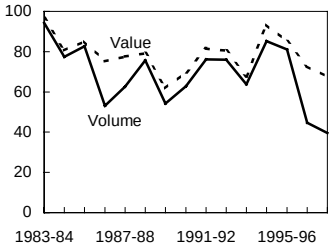

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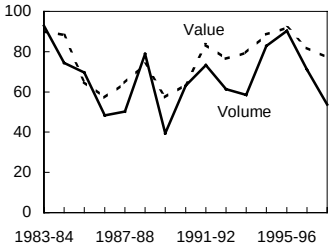
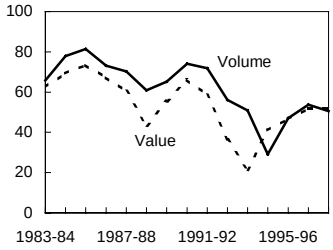
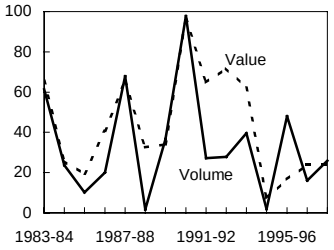


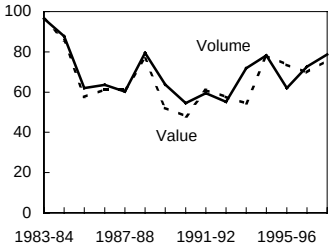
Pacific Islands ($0.6b)



South America ($0.3b)



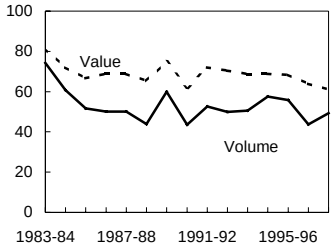
West India ($0.2b)



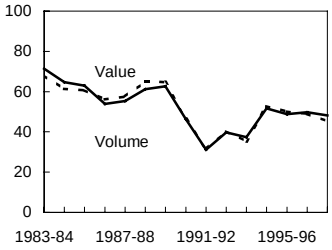
[9] Dollar amounts indicate the value of seaborne exports, for both conference and non-conference liner services, for each trade route in 1997-98. Source: Australian Bureau of Statistics, International Cargo Statistics, unpublished.

APPENDIX II: MARKET SHARE OF SEABORNE IMPORTS BY LINER CONFERENCES ON MAJOR TRADE ROUTES (1983-84 TO 1997-98)[10]

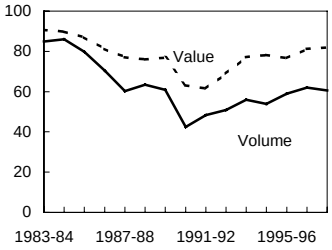
North America ($10.4b)



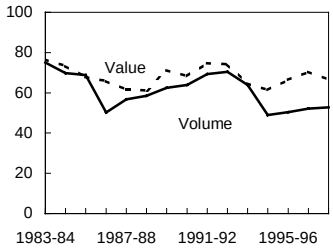
East Asia ($7.5b)



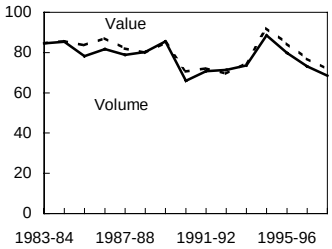
Japan & North Asia ($7.0b)



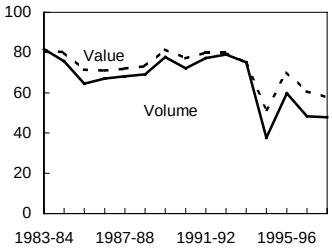
Europe Atlantic ($4.9b)



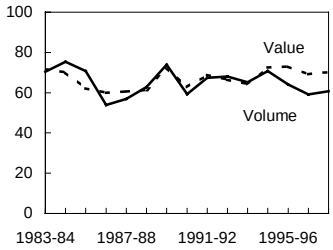
South East Asia ($4.6b)



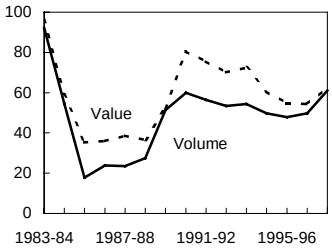
Europe Baltic ($4.1b)



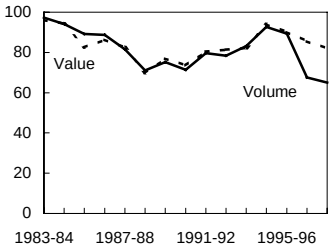
Mediterranean ($4.0b)



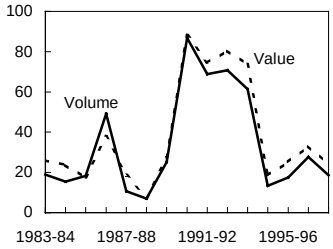
New Zealand ($2.3b)



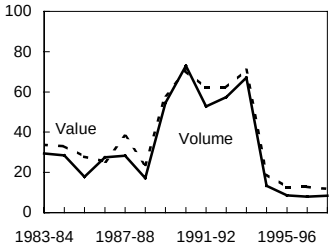
East India ($0.5b)



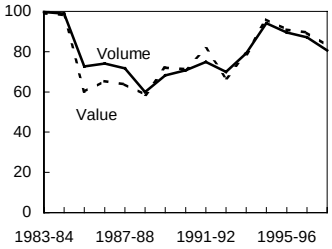
South America ($0.4b)



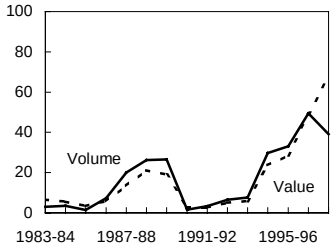
Africa ($0.4b)



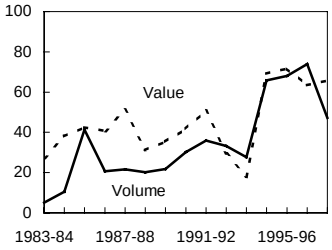
West India ($0.2b)



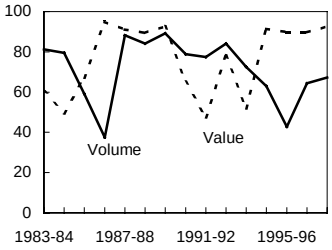
Middle East ($0.2b)



Pacific Islands ($0.2b)



Central America ($0.1b)



[10] Dollar amounts indicate the value of seaborne imports, for both conference and non-conference liner services, for each trade route in 1997-98. Source: Australian Bureau of Statistics, International Cargo Statistics, unpublished.

APPENDIX III: A COMPARISON OF THE INTERNATIONAL AVIATION AND LINER SHIPPING INDUSTRIES

The Characteristics of the Aviation and Liner Shipping Industries

The key features of liner shipping are the service provided (the scheduled transportation of goods between pre-determined international ports of call) and the capital intensive nature of the industry. These are not unique characteristics. The aviation industry has similar characteristics, as illustrated in Table 1.

Table 1: Characteristics of the Aviation and Liner Shipping Industries

	Aviation	*Liner Shipping*
Service Provided		
• international transportation of goods	✔	✔
• international transportation of passengers	✔	✘
• scheduled departures and arrivals	✔	✔
• pre-determined ports of call	✔	✔
• standardised cargo handling	✔	✔
Industry Coordination		
• cooperation agreements	✔	✔
• joint provision of services	✔	✔
• sharing of facilities	✔	✔
Economic Structure		
• capital intensive	✔	✔
• sensitive to business cycle	✔	✔
• low profitability	✔	✔
Economic Regulation		
• general competition law applies to anti-competitive activities	✔	✘

There are two important areas of difference that present some difficulties for a strict comparison of the two industries. However, these differences do not invalidate a broad comparison of the two industries[11] or, in particular, consideration of why different regulatory regimes should apply to similar international transport industries.

- The aviation industry principally exists to transport passengers, with the provision of air freight services being substantially a residual, albeit important, business operation. In contrast, liner shipping exists solely to provide sea freight services.

- International airline capacity is regulated through a complex system of bilateral treaties. However, that system is being liberalised as countries move towards 'open skies' policies.

[11] There are problems in any comparison between industries. However, comparisons of this type remain useful, bearing in mind the differences between the industries.

While conferences have been the traditional method of regulating capacity in international liner shipping, international air service agreements between sovereign nations have been the traditional method of regulating capacity in the international aviation industry. A recent legislation review of Australia's system of international air service agreements found that there are:

> *inefficiencies imposed on the world aviation industry by the current bilateral system [of international air service agreements] and the benefits of more efficient, internationally competitive air services are now apparent.*[12]

The inefficiencies which flow from the government regulation of capacity and prices in international aviation raises similar questions to the inefficiencies which flow from the regulation, by conferences, of capacity and prices in international liner shipping.

Despite the substantial similarities between the aviation and liner shipping industries, the regulation of the two industries is different. Whereas liner shipping is regulated by industry specific legislation (i.e. Part X), affording the sector special exemptions from competition laws, the aviation industry is regulated under the umbrella of Australia's general competition laws.

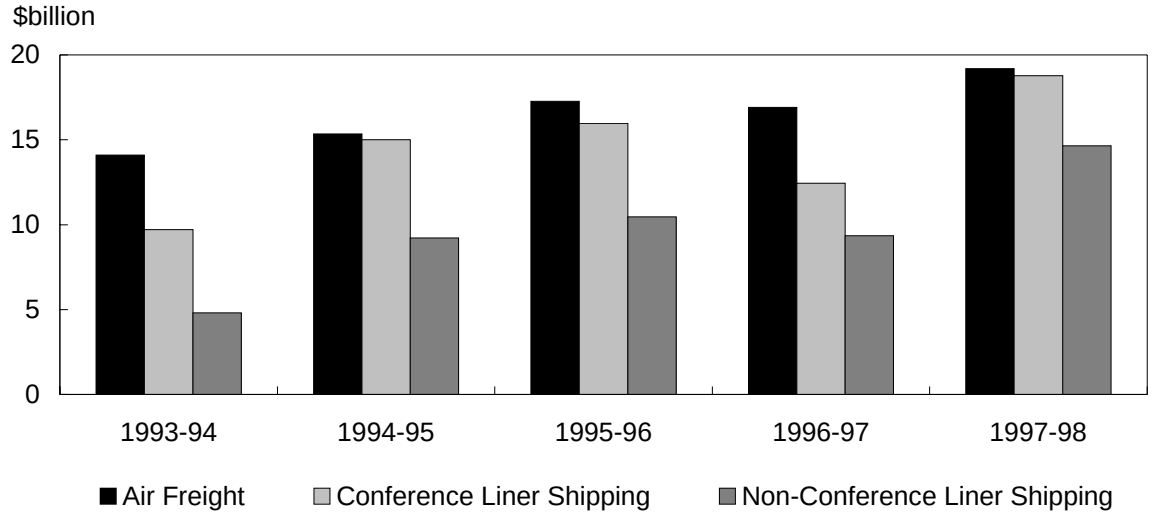
The Markets for Air and Sea Freight

Market Share

The value of exports transported by air is significant, as illustrated in Chart 12.

Chart 12: Exports Carried by Mode of Transport

Total Value Carried



Source: Australian Bureau of Statistics, unpublished.

Typically, more exports (by value) are transported by international air freight than are transported by liner conferences, although in 1997-98 liner shipping in aggregate carried around 50 per cent more exports (by value) than the aviation industry. Of

12 Productivity Commission 1998, page XXIX.

course, the liner shipping industry carries substantially more freight when measured by volume.

The relatively high cost of air transport makes it generally viable only for compact, high value, or time sensitive goods. In comparison, lower value and bulky commodities will generally be transported by sea.

Gold is by far the most valuable export transported by air, followed by information technology equipment, medical and pharmaceutical products, other electronic goods, and professional and scientific apparatus and supplies. As outlined in Section 1 of this submission, meat and other food products, and metals and mineral manufactures are the most valuable exports transported by liner shipping.

A Comparison of Business Operating Characteristics

Service Provision

The nature of the service provision and production process is in many respects similar between the two industries. In liner shipping, port-to-port and, increasingly, door-to-door transportation services are offered at a global level. Likewise, airlines are increasingly offering comprehensive freight services which incorporate door-to-door services.

Furthermore, the mechanics of this delivery are also similar, with standardisation of cargoes practised in both industries using standard size containers and handling wherever possible.

Profitability

It has been argued that the liner shipping industry is characterised by low profitability when compared with other industries[13]. It is also generally considered that, globally, the aviation industry has relatively low rates of profitability. In its recent inquiry into international air services, the Productivity Commission found that:

> *Despite a history of traffic growth, the profitability of the global airline industry has been cyclical but relatively poor on average. In many cases airlines have performed so poorly they are dependent on Government subsidy.* [14]

Cost Structures

The cost structures of aviation and liner shipping are broadly similar. Both are capital intensive with heavy investments in equipment and essential infrastructure. Marginal costs tend to be small in relation to capital costs. Even inputs such as staff and fuel costs, which tend to be marginal costs in most industries, are largely fixed

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13 We note that this point has been made in respect of liner shipping in several submissions to the Productivity Commission's inquiry. A similar finding was expressed in the 1993 Brazil Review. Refer also to Fossey 1998.

14 Productivity Commission 1998, page 33.

costs in both the aviation and liner shipping industries because of the scheduled nature of these industries[15].

One of the arguments in favour of granting conferences special exemptions from competition law, is that shipping is a capital intensive industry, with high fixed costs and low marginal costs. Hence, firms are able to reduce costs (with flow on effects for freight rates) by pooled supply arrangements and improved capacity utilisation. Further, because of the cost structure, it is argued that regular services may be jeopardised if the ability of shipping lines to collude is removed. In its position paper, the Productivity Commission concurred with this argument:

> *…a single shipping line may be loath to commit one or more large vessels (and incur correspondingly large fixed costs) in order to provide a regular scheduled service where demand is uncertain and where that uncertainty is exacerbated by the possibility of* rivals encroaching on the trade. [16]

However, this argument could be applied to many industries, and in particular the aviation industry. Airlines strive to utilise all available capacity on scheduled flights and face the same uncertainty with regard to rivals encroaching on their trade. However, airlines seem able to provide a viable scheduled service without the need for special exemptions from competition law.

The Application of Competition Law

As with liner shipping, some airlines have sought to improve their efficiency and industrial organisation by entering into alliance agreements with potential competitors. The reasons are much the same as those provided by the liner shipping industry, i.e. joint service provision, the sharing of facilities, and joint procurement can reduce operating costs and result in flow-on benefits for consumers in terms of reduced airfares and improvements in scheduled services.

However, unlike liner shipping, these potentially anti-competitive airline alliances are subject to the normal authorisation provisions of Part VII of the TPA, based on a strict public benefit test.

By way of example, the joint services agreement between Qantas and British Airways was subject to a public inquiry undertaken by the ACCC. The Commission found that there was the potential for net public benefits to flow from that agreement, subject to some conditions to ensure that those public benefits materialised, and therefore authorised the agreement for a period of five years.

In comparison, liner shipping conferences can apply for registration and, subject to minimal obligations, are granted automatic exemptions from standard competition laws. No public benefit test is applied to either individual applicants or Part X itself.

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15 Because air services and liner shipping services depart at scheduled intervals regardless of capacity utilisation, costs such as labour and fuel do not tend to vary significantly (at least in the short term) in relation to output, and hence could be thought to be substantially fixed costs.

16 Productivity Commission 1999, page B4.

APPENDIX IV: GLOSSARY OF TERMS

ACCC	Australian Competition and Consumer Commission
conference	for the purposes of Part X, an unincorporated association of two or more ocean carriers carrying on two or more businesses each of which includes, or is proposed to include, the provision of liner cargo shipping services.
discussion agreement	an agreement between conference and non-conference operators to reach a non-binding consensus over, for example, the charging of common freight rates and a variety of service arrangements.
ocean liner (liner)	a ship engaged in a regular service for passengers and or cargo on given routes.
pooling	the apportionment of earnings, losses or traffic among members of a shipping consortium (or conference) cooperating for that purpose.
shipowner accords	an agreement or arrangement between conferences and non-conference carriers on a trade route, resulting from discussions on matters of mutual interest such as capacity and freight rates, held with a view to reaching a consensus.
shipper	the party on whose account goods are consigned (a shipper can be an exporter or an importer, but the 'shipper body' provisions in Part X relate to exporters).
TEU	twenty foot equivalent unit – the standard ISO container measures 20 foot by 8 foot by 8 foot.
TPA	*Trade Practices Act 1974.*

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