



Consort Express Lines Ltd

## Review of PNG Coastal Shipping

### Comments on Draft Report of the Independent Consumer and Competition Commission

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**Contact**

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## 1. GENERAL COMMENTS

Consort welcomes the Commission's review of the coastal shipping industry in Papua New Guinea and supports the recommendations of the Commission in regard to the retention of cabotage and the removal of price controls. The purpose of the submission is to provide further arguments to support the recommendations of the Commission.

### 1.1. COMPETITION AND CONTESTABILITY

The Commission supports the retention of cabotage. The main reason for this is that the entry of international ships into the coastal trade would result in 'cream skimming', undermining the ability of the coastal shipping industry to maintain the existing levels of services to many parts of the country and to shippers that would not be serviced by international liner shipping.

The draft report is contradictory in parts about the extent of competition in the market for coastal shipping. In parts of the report the Commission argues that there are limited barriers to entry and that the market is contestable. In other places it is argued that there are significant barriers to entry into coastal shipping that provide incumbents with significant market power.

In a number of submissions to the review, including the Consort submission, it is argued in some detail that there are no barriers to entry into coastal shipping and that the market is therefore contestable. As a result, market pricing, services and the supply of shipping would be similar to that of a competitive market. In a contestable market there is therefore no justification on economic efficiency grounds for price regulation. Price regulation cannot improve on the existing market outcome from the perspective of the welfare of PNG society.

In other parts of the draft report, the Commission argues that there are barriers to entry. Presumably these relate to the cabotage policy and the 'existence of substantial sunk costs'. The cabotage policy and the licensing of coastal vessels do not present a barrier to entry as the requirements for licensing can be met at little cost. This simply involves establishing a PNG registered business and registering the vessel in PNG. The Minister has the power to issue additional coastal shipping licences.

The Commission states on page 24 that the industry is characterised by substantial sunk costs. As argued in the Consort submission, sunk costs are insignificant. Evidence to support this, in terms of capital and operating costs, was presented in the Consort submission. A large part of the capital costs of coastal shipping consists of ships, loading equipment and containers. These capital items can be readily chartered or hired on well developed international markets. Vessels and containers owned by a coastal shipping company in PNG can be readily re-deployed in other parts of the world at minimal cost. Sunk costs are therefore minimal. Similarly, entry into the PNG market either short term or long term is not deterred by sunk costs. Vessels can come in and out of the trade at relatively low cost. Moreover, long term contracts do not present a barrier to entry to coastal shipping.

## 1.2. ECONOMIES OF SCALE AND INEFFICIENT ENTRY

In its submission Consort argued that the main justification for cabotage is that it prevents inefficient entry. The coastal shipping market in PNG is characterised by substantial economies of scale relative to the size of the market. As a consequence, even the high volume routes (eg Port Moresby to Lae) can only efficiently support one viable operation. However, this does not mean there is a barrier to entry because the same 'technology' is available to both the incumbent and a new entrant. The incumbent does not have an enduring cost advantage over a new entrant.

Coastal shipping firms are able to service low volume routes as part of their overall business because they are able to recover capital costs on their main routes and to price secondary routes closer to marginal cost. The problem with allowing access to international shipping is that these ships would only service the main routes and the more lucrative cargoes on those routes. International shipping can service these trades by only charging marginal operating costs without the need for a capital or fixed cost charge. International ships would not service lesser routes and would not handle 'difficult' cargo.

The result of entry by international vessels would be a reduction in revenues of coastal shipping companies. To continue to provide the same service, coastal shipping companies would need to increase charges on the remaining trades. If they were unable to raise charges, because of price controls or because of reduced demand following price increases, coastal shippers would need to reduce costs in order to remain viable. Where there is little scope for cost savings from existing operations, this might involve the provision of a lower cost service.

The outcome would be lower rates, perhaps only for a time, provided by international shippers to some customers along the main routes but higher rates and/or reduced service offerings to other parts of the country. As the Commission notes, this would have adverse implications for economic development and social development outside of the main cities.

## 1.3. PRICE CONTROLS

It is understood that the Commission is in favour of removing price controls on the industry because the market is contestable. The industry supports this position. However, as it currently reads, the report appears to be advocating a continuation of price controls. The industry has been subject to price controls for the past 25 years. Prices have been fixed and infrequently varied. As a result, the profitability of the industry has been depressed. This has resulted in dampened incentives to invest and to innovate.

Consort seeks clarification of what the Commission is advocating in relation to price controls. It is understood that the Commission is advocating the removal of the price ceiling. That is, coastal shipping companies would be free to vary prices in response to changes in market circumstances. A review of price increases would only arise from time to time if there was a complaint from shippers that price increases were excessive. The complaint would then be reviewed by the Coastal Trading Committee.

Consort supports this approach to pricing. However, rather than price disputes being resolved by a Committee that reports to a Minister, a better approach would be for the Commission to resolve such disputes. This would avoid the problems associated with political interference in commercial matters and the prospects of biased decisions by a Committee captured by vested interests. It is also not clear that the Committee would have the technical competence to review a pricing decision. The Commission has both the authority and the capability to consider price disputes.

If disputes are to be resolved by the Commission, there would be the need to develop a process that efficiently handles disputes. In particular there would be a need to screen against unreasonable complaints by shippers against price increases and for the Commission to act to resolve complaints only as a last resort.

## 2. SPECIFIC COMMENTS

Page 7 (repeated on page 23):

*The market for charter services is generally more competitive than the market for scheduled services because operators do not face the risk of having insufficient cargo to cover costs and consumers are able to exercise a greater degree of market power due to the fact that they have exclusive use of the service. Furthermore, consumers with long term contracts with coastal shipping operators are able to achieve discounts on the commercial rate due to the ability for coastal shipping operators to lock-in payments from these consumers.*

It is not clear why the absence of this risk means that the charter market is more competitive. In Consort's submission, it is argued that the absence of barriers to entry mean that the liner shipping market is contestable and therefore has the same properties as a competitive market outcome.

Page 8:

*The Commission publishes the results of this annual review (of performance) and notes where PNG Harbours may have fallen short of the standards and what action is proposed to address this issue.*

The Commission does not publish this review on its website. A copy of the review could be made available to allow Consort to more fully comment on the performance on PNG Harbours. According to the Commission, PNG Harbours has met the performance requirements. There is obviously a problem with the performance requirements if this is the case, as noted by the Commission. In terms of capital expenditure, it is not clear whether PNG Harbours has actually spent, rather than committed, the capital expenditure amounts agreed in the performance contract and upon which its regulated rates are based.

Page 9:

The Commission discusses a range of reform options for PNG Harbours Board. While Consort agrees that these reforms should be evaluated and may lead to improved performance, the Commission does not have direct responsibility for this issue. The Commission should consider making recommendations on PNG Harbours direct to the Government or the relevant Minister.

Page 9:

*Of the 19 declared ports operated by PNG Harbours only a small percentage are profitable or at least capable of being operated profitably on a stand alone basis.*

This is not correct. The owner of a port would have a monopoly on the provision of port services in that region. If would be able to set price at sufficiently high a level that the port could be operated on a profitable basis. Given the different costs structures and amounts of trade through the various ports, this would mean that port charges would vary across the country. If fixed costs are relatively important, smaller ports would probably have higher unit costs and therefore higher charges. The reason why a port company would be unprofitable would be because of the presence of a price ceiling that did not allow prices to rise to a level sufficient to recover the costs of providing the service. If the Government decided that port charges should be subsidized, and if individual port companies are to remain financially viable, it would need to fund the community service obligation through a subsidy to the port companies.

Page 10

*The Commission notes the availability of PPP arrangements, but highlights the need for caution in using this form of funding without very careful and precise consideration of all the issues involved in the project to be undertaken in this way particularly as they relate to the transfer of risks between the various parties involved. The first step will be the development of financial accounts within PNG Harbours that allow open and transparent consideration of the costs and potential benefits of the operation of the individual ports. It is only with access to this type of information that a fully informed decision can be taken regarding the benefits of potential PPP opportunities.*

The transfer of risks between the two parties needs to be elaborated upon. Can the Commission direct PNG Harbours to prepare separate accounts for each of the ports?

Page 13:

*Currently there are 14 coastal shipping companies in PNG that service ports around the country including several river ports.*

A list of these companies would be useful. Some are primarily in the shipping business while others carry coastal cargo as a 'by-product'.

Page 13

*The Commission is not inclined to regulate these coastal shipping rates for the main ports as a substitute for competition or as a trade off for the continuation of the cabotage arrangement. However, there is a need to find a mechanism which will encourage continuing innovation and investment by the existing industry in the absence of competition from the international shipping operators. The Commission will be seeking further information from the coastal shipping industry on this matter before finalising its position in the Final Report.*

The Consort submission put the case that there are no barriers to entry into coastal shipping. This means that the market is contestable. As such, competitive pressures on coastal shippers from potential entrants would provide sufficient incentives to invest and innovate in a way that reduces costs of providing a given service or improved service.

Page 13:

*Currently coastal shippers have invested in vessels designed specifically for particular PNG environments and locations.*

The vessels are not designed specifically for PNG conditions. The vessels selected are appropriate to PNG conditions.

Page 14:

*Thus, it is likely that allocative efficiency has actually been optimised as a result of the investment that has occurred under the existing cabotage arrangements rather than in spite of cabotage.*

This sentence makes no sense. Allocative efficiency refers to the situation where resources are allocated across economic activities in a way that maximizes the welfare of society. That is, resources are allocated to their most productive uses. What does 'in spite' of cabotage refer to?

Page 14:

The Commission needs to define what it means by dynamic and productive efficiency and why there is a trade off with allocative efficiency under cabotage.

Page 15:

*Key aspects of the tariff...*

The dot points have nothing to do with the tariff but relate to coastal shipping licences.

Page 16:

*The Commission notes that freight rates have been held constant for a number of years. This would suggest that the price determining powers of the CTC would not need to be called upon often.*

The regulated freight rate has been held constant for a long period of time. Coastal shipping companies have not varied rates for some time because they have felt bound by the price controls. Only recently, on the view that price controls have not been in operation, have companies varied their freight rates. Freight rates have fallen substantially in real terms over the past decade or so. There was clearly a need for a meeting of the CTC to consider variations to rates. Why did this not occur? Did industry propose an increase in rates to the CTC?

Page 17:

*The industry as a whole has been in decline over a number of years, largely as a result of a contracting PNG economy.*

This is not true. The industry has grown over the past few years.

Page 19:

*Furthermore, the paper has analysed the impact of the various alternatives to the current industry structure in an effort to determine the appropriate structure of the industry. In so doing, the Commission has been careful to consider the full implications of any potential changes to the current industry structure and has been mindful of the implications of changing the structure of the industry in related industries, with a particular reference to the tourism sector.*

The report does not consider the implications for tourism at all. Tourism is not mentioned throughout the remainder of the report.

## 2.1. CONTEXT

Page 21:

*The review of the aviation industry should be seen as the direct counterpart to this review in that a number of the findings, particularly as they relate to the provision of infrastructure, will be relatively common across both industries.*

No reference is made to the aviation industry in the report after this statement. What do the two industries have in common?

Page 22:

*The coastal shipping industry is primarily classified into Tier One, Tier Two; and Tier Three operators. Most of the submissions received were from those engaging in Tier One operations such as the Consort Express Lines, Steamships Shipping, Lutheran Shipping and Rabaul Shipping.*

The Commission should define what is meant by these terms. Rabaul Shipping is not a Tier One shipping company.

Page 24:

*Consort has observed that this does not mean that there is a natural monopoly over service provision in its service areas. Rather, Consort competes for charter services*

This statement needs elaboration.

Page 24

*The Commission does not agree with the assertion that there are no barriers to entry to the market. The Commission notes, similar to many industries, there are a number of natural economic barriers which new entrants must overcome before they are able to compete with incumbents. These natural economic barriers include high set up costs and a high level of sunk costs.*

The Commission offers no evidence to support this statement. Relative to many activities, set up costs are minimal (vessels can be chartered) and sunk costs are low, as was argued in the Consort submission. Elsewhere the Commission argues that costs of entry are low and that the market is contestable. The Commission goes on to state that:

*For example, cabotage restricts competition in a particular market to particular operators or particular ships.*

Cabotage does not restrict competition since there is no restriction on the number of licenses granted by the Minister and there is no constraint on registering a business in PNG.

Page 25:

*The nature of this market may provide Steamships with a significant competitive advantage over a potential new entrant given the need for ships with special dimensions and characteristics in order to service these ports and navigate the rivers involved.*

The vessels employed by Steamships are of a kind that can be readily purchased or chartered by a potential entrant, so Steamships has no competitive advantage in this respect.

Page 25:

*While Steamships holds a strong position over liner services in this region it faces a number of competitors in the market for charter vessels.*

The Commission appears to treat liner and charter vessels as separate markets, whereas charter vessels can compete for cargos that would otherwise be carried by liner shipping companies.

Page 25:

*Steamships has provided the Commission with confidential information which purports to show a very poor financial return on assets employed for its liner services and spot charter business. It has been suggested that on a stand-alone basis, Steamships could not afford to continue these services were it not for its other activities. The Commission is not able to confirm these figures, but notes that Steamships, as an integrated transport operator with other widely dispersed trading and business activities in PNG, is able to take a much broader view of its overall business operations, which would include not only a decision to continue a service that might not be profitable on a stand-alone basis, but also make decisions on the allocation of costs, particularly overhead costs between different profit centres.*

The figures provided by Steamships accurately indicated the profitability of the coastal shipping business as a stand alone business. Overheads were appropriately shared between its coastal shipping and other businesses. The fact that Steamships is an integrated transport operator does not mean that it does not require an adequate return on its investment in coastal shipping. The reason why profitability was low in the coastal shipping business is because regulated rates were fixed at inappropriately low levels.

Page 27;

Figure 1 may be based on outdated data. Real GDP did not fall by 30% in 2000. According to recent published sources, it fell by around one percent in that year

(<http://www.adb.org/papuanewguinea/png-ado.asp>  
[http://www.treasury.gov.pg/files/tem/march\\_2004.pdf](http://www.treasury.gov.pg/files/tem/march_2004.pdf))

Page 27:

Discussion of the poor profitability of the industry does not mention controlled prices which have not kept up with cost increases.

Page 28:

*In a market where these potential alternative service options exist, the need to recover high fixed costs at a time of low volumes in the domestic market is possibly the main cause for the current poor financial results being reported by the industry. This conclusion seems to be supported by submissions received by the Commission which have focused upon the lower demand and volume results in recent years.*

This is not accurate. Both Consort and Steamships tonnages have increased in recent years. See the figure below taken from the Commission's Issues Paper. The figures indicate that coastal throughput was 45 percent higher in 2005 than five years earlier. Note that these are Harbours Limited tonnages so to get shipped tonnages there is a need to effectively divide the figures by two in the case of coastal cargo.

**Table C1: Cargo Throughput (revenue tonnes)  
from 1995-2005**

Year	Overseas Vessels	Coastal Vessels	Total
1995	2,355,347	1,322,443	3,677,790
1996	2,772,654	1,564,215	4,336,869
1997	2,944,437	1,692,615	4,637,052
1998	3,032,282	1,650,703	4,682,985
1999	2,977,924	1,715,081	4,693,005
2000	2,923,566	1,779,459	4,703,025
2001	2,635,279	1,620,878	4,256,335
2002	2,731,145	1,832,190	4,563,335
2003	2,816,406	1,912,965	4,729,371
2004	2,970,467	2,039,757	5,010,224
2005	2,905,972	2,349,031	5,255,003

Source: PNGHL and ICCA Analysis

## 2.2. PORTS

Page 30:

The Commission devotes a large part of the draft report to port infrastructure and the performance on PNG Harbours. However, it makes no firm recommendations and in any case does not have the authority to determine policy towards port ownership and control. While the Commission supports the case for port reform, it does not have the power to drive such reform. The Commission is responsible for enforcing the terms of the regulatory contract. Under its watch, PNG Harbours has been awarded substantial price increases. These price increases were predicated upon a certain level of investment in infrastructure and achievement of performance standards. Neither has been met. The Commission refer to an annual review of PNG Harbours being publicly available, however this review is not available on the ICCA website.

Page 31:

*PNG Harbours faces a number of problems which are relatively unique to the PNG shipping industry.*

Only one problem is mentioned, siltation from the Markham River at Lae port. This problem is not particularly unique to the PNG shipping industry.

Page 32:

*PNG Harbours has cited a number of issues which they consider need to be addressed in order to provide a more workable environment for investment in harbours, including... Limited availability of funds for continuous repairs and maintenance of wharf facilities, and upgrading of inadequate navigational equipment.*

The complaint by PNG Harbours about limited funds for repairs and maintenance is odd. PNG Harbours has a regulated tariff that allows it to recover all of its operating costs and capital expenditures. If the tariffs were properly designed, there would be adequate funds for R&M expenditures.

Page 32:

Consort, Steamships and Kambang in their submissions to this review all complained about the extent of the increase in PNG Harbours charges that were approved by the Commission.

The Commission only notes these comments but provides no attempt to justify the price increases. It does not address the concerns of these coastal shipping companies in relation to charges and the quality of services. These concerns may be alleviated if the Commission's reviews were publicly available.

Page 33:

In relation to the Regulatory Contract, the Commission notes that the Contract may not have provided for "sufficient capital expenditure to ensure an efficient level of infrastructure." Moreover, the Commission admits that while PNG Harbours has met the performance standards, the standards may not be sufficiently prescriptive. The Commission then goes on to discuss the costs that inadequate port facilities and services can impose on the PNG economy.

This discussion suggests that the Regulatory Contract is failing to deliver adequate infrastructure and services and therefore should be reviewed and if necessary amended. Amendment of the contract would not impose undue hardship on PNG Harbours since the pricing formula is effectively a cost plus formula. If PNG Harbours were forced to commit more funds to investment and repairs and maintenance, the regulated tariffs would be set at a level that would allow these costs to be recouped.

The Commission is currently undertaking a mid-term capital expenditure review. This would seem to provide an opportunity to reevaluate capital expenditure requirements in light of the major concerns that stakeholders have in relation to port infrastructure and services.

In undertaking the review, has the Commission consulted with users of port facilities? If available, a summary of the results of the mid term review could be included in the final report for the coastal shipping review.

The Regulatory Contract is for a period of 10 years, which is relatively long for such a contract. Normally contracts are for periods of 5 years. A disadvantage of the 'building blocks' approach to regulation is that capital expenditure is set in advance based on a long term forecast of demand and capital expenditure requirements and there are difficulties in changing capital spending in response to changes in circumstances.

The Commission notes that if PNG Harbours increased its capital expenditure during the regulatory period over and above that upon which the regulated charges are determined, it would still be able to obtain a return on capital spending and depreciation as this additional spending would be rolled into the capital base for the next regulatory period. This is not correct as PNG Harbours would only begin to be compensated for this additional spending with a lag of several years and this would impose a real cost on PNG Harbours.

Page 36:

*The Kent and Fox analysis could be applied to the PNG coastal shipping market to estimate the impact of port inefficiencies on the PNG economy. For the purposes of this review, the Commission has confined its analysis to noting the potential impact and welfare benefits that are available to the economy from ensuring that port facilities are operated as efficiently as possible. This places considerable responsibility on PNG Harbours to meet its service and capital investment objectives, and also on the Commission to ensure that the performance of PNG Harbours is made public and transparent so that appropriate policy action can be taken if there is clearly a failure in performance. Given the backlog of work that needs to be undertaken on port facilities in PNG and the expanding need for improved facilities, particularly in the major ports and those that are servicing the minerals boom, there is possibly a need for PNG Harbours not only to meet its 'projected' capital expenditure targets as specified in the Regulatory Contract, but to extend itself beyond these targets so as to address the emerging need for further improvements in the shipping transport infrastructure.*

The analysis of Kent and Fox could be applied to PNG by employing a computable general equilibrium model of the PNG economy. Such a model is available. This analysis would demonstrate the very high costs that inadequate port infrastructure is imposing on the economy and allow an estimate of the economic and social rate of return to additional investment in ports. This rate of return is likely to be very high relative to rates of return available from other investments of public money. Such an analysis would enable policy makers to place the appropriate priority on encouraging or even directing PNG Harbours to increase investment.

Does the Commission have any powers to force PNG Harbours to increase its level of capital expenditure beyond that set out in the Regulatory Contract? If not, this suggests a major weakness in the approach to regulation of the ports authority.

Page 37:

*While the Commission is responsible for the regulation of essential port services provided by PNG Harbours, pilotage is not an essential port service under the Regulatory Contract.*

PNG Harbours has a monopoly on the supply of pilotage services in declared ports. Does the Commission have the power to extend its regulatory activities to regulate the supply and pricing of pilotage services? The Commission considers that there is a case for waiving pilotage requirements when there is significant experience in navigating a particular port. Does the Commission have the power to make firm recommendations to PNG Harbours or only make suggestions which PNG Harbours can choose to ignore?

### 2.3. CABOTAGE

Page 51:

*The protection afforded to the local industry from the cabotage arrangements in PNG can be readily avoided should a new entrant wish to establish activities in the market. This could be a situation where an international shipping operator wishes to take advantage of the low marginal costs that it can price its services at should it wish to pick up and discharge at coastal ports along its route into or out of PNG. Under the regulations, the Minister has the discretion to grant a one off allowance for foreign vessels to enter the market. This discretion would be used should there be a shortage of coastal vessels to handle demand for coastal services. Thus, effectively the coastal shipping industry faces a situation where there could be new entry into the market at relatively short notice should demand increase to a level which the industry is unable to meet. This therefore acts as a constraint on the ability of the domestic industry to charge rates that might be regarded as excessive or exercising a degree of monopoly profit taking.*

The Commission is saying that there are no or minimal barriers to entry and that this means that the domestic industry cannot charge monopoly prices.

The Commission goes on to state that:

*The cabotage laws in PNG do not prevent the participation in the industry of foreign companies. Rather, foreign companies only need to register as a business in PNG to enter the shipping market.*

Again, the Commission is stating that there are no barriers to entry. The market is therefore contestable. A contestable market has the same properties as a competitive market. In particular under contestability, the industry will operate efficiently. Efficiency involves a number of dimensions including allocative efficiency (goods and services are provided in the right amount), technical efficiency (goods and services are produced at minimum cost) and dynamic efficiency (the firms have ongoing incentives to invest and innovate so as to reduce costs over time). The Commission discusses these various aspects of efficiency at different points in the report. They argue that allocative efficiency is achieved under cabotage, but not technical and dynamic efficiency. Monopoly power however is associated with allocative and dynamic inefficiency but not technical inefficiency- a profit maximising monopoly has an incentive to minimize costs (technical efficiency).

Page 52:

*This outcome is a consequence of the cross subsidisation of routes that has occurred over time in PNG. Without some form of direct subsidy from government, there will be no incentive for shipping lines to continue to service the less profitable routes.*

The Commission ignores the impact of regulated rates. There are cross subsidies built into the regulated rate – these relate to types of cargos (eg village foods) and distance traveled.

Page 53:

*These companies have argued that given the need for specialist investment in the vessels needed to service remoter locations, there is justification in the government providing some protection against these bulk carriers so that companies which have invested in specialist infrastructure are able to generate a return on this investment.*

The companies do not argue this at all.

Page 53:

*The Commission notes that a relaxation of cabotage would result in a more open, competitive market.*

How could this be the case since the Commission argued that there were no barriers to entry into coastal shipping.

Page 53:

*There has been some significant investment by existing participants in the coastal shipping sector which would suggest to the Commission that it is unlikely that these participants would walk away from the coastal shipping market immediately once cabotage is relaxed.*

This is not necessarily true as much of the investment is not sunk and vessels can be deployed in other parts of the world.

Page 55:

*One solution may be for the tier one companies to increase their volumes on these less profitable routes and provide less frequent services.*

This will add to costs of holding inventories, result product deterioration and undermine the reliability of supply of producers in these regions, imposing significant costs.

Page 57:

DFAT has not argued that “the removal of the cabotage arrangements and allowing international carriers to transport goods between ports in PNG will reduce the cost of freight for consumers.” The report was paid for by DFAT but written by independent consultants provided no analysis to support this view.

Page 57:

*Any ‘network’ system of the type operated by a shipping line will inevitably involve some degree of cross subsidization...*

Why is this the case? Elaboration of this point would be helpful.

Page 58:

*..the Commission is unaware of what action is being taken by the industry to anticipate competition and to address the concerns of shippers operating out of the main ports about the freight costs in PNG.*

The submission by Consort provided evidence that freight rates in PNG are low by regional standards and have fallen substantially in real terms over the past decade. The fact that the industry has been able to survive attest to the fact that it has operated efficiently.

Page 58:

*However, there is a need to find a mechanism which will encourage continuing innovation and investment by the existing industry in the absence of competition from the international shipping operators. The Commission will be seeking further information from the coastal shipping industry on this matter before finalising its position in the Final Report.*

What evidence does the Commission have that there has been insufficient innovation and investment? One reason why investment has been inadequate has been price controls.

Page 64:

*As noted by the Maritime Workers Industry Union, cabotage has not resulted in a consistent level of services across all ports as evidenced by Luship's recent decision to withdraw from the New Guinea Islands and parts of the Milne Bay, Oro and Momase coast. Luship has argued that the cost of providing these services has continued to rise whilst fares and freight rates have not risen commensurately.*

Price controls are probably responsible for undermining the viability of this operation as prices have not been allowed to rise to reflect increased costs.

Page 67:

The Commission discusses the role of the Coastal Trade Committee.

It first notes that the composition of the Committee is appropriate but then goes on to say that:

*Given the incentives for incumbents to resist increased competition, the Minister should be aware that the majority of the CTC is likely to provide advice which may be contrary to the net economic benefit of the PNG economy due to their personal/business interests.*

This is debatable as the majority of the members are non coastal shipping companies. In any case the Commission concludes that the:

*As such, the CTC should only ever be seen as an advisory board rather than as quasi policy body.*

Having said that, the Commission goes on to propose that the CTC be responsible for resolving price disputes. The Commission states that coastal shippers and shipping companies, who form the majority of the Committee, could oppose the issue of new licences because they can pass any resulting cost increases onto final consumers. Surely if this were the case, the CTC could also set excessive prices for coastal shipping as these costs would also be passed through to final consumers.

The Commission provides no comments on the past activities of the CTC. It treats the CTC as a functioning body, yet the CTC has rarely met.

## 2.4. PRICE REGULATION

Page 68:

*A maximum freight tariff for coastal shipping was set by the Department of Transport in the mid 1980s in accordance with Section 238 of the Merchant Shipping Act (Chapter 242). The last time that the tariff was reviewed was in 1990 and the recommended maximum tariff came into force on 1 January 1991.*

Surprisingly, the Commission does not comment that this is a long time for a maximum tariff to remain unchanged. Yet it emphasizes in several places the need for coastal shipper to invest and innovate and that to do so they need to be adequately compensated. If there has been underinvestment in the industry, the past price controls are an obvious cause.

Page 69:

The Commission discusses the fact that the Committee has not met for the past three years and the reasons for this. It is not clear that the Committee has ever met on a regular basis given that the maximum tariff has been so infrequently changed.