

KAMBANG HOLDINGS LTD



**SUBMISSION TO ICCC ENQUIRY INTO PAPUA NEW
GUINEA COASTAL SHIPPING INDUSTRY**

**PREPARED FOR KAMBANG HOLDINGS LTD,
PRINCIPALS OF LUTHERAN SHIPPING**

by

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SUBMISSION TO ICCC ON BEHALF OF KAMBANG HOLDINGS LTD, PRINCIPALS OF LUTHERAN SHIPPING

21st April 2006

Introduction

Kambang Holdings LTD is the commercial arm of the Lutheran Church in PNG. Lutheran Shipping (Luship) is a wholly owned division of Kambang Holdings Ltd.

Kambang Holdings Ltd was founded in 1975 and Luship 1907 as a church run shipping service supporting its missionary activities, it became commercial in 1975. Luship operates passenger and cargo vessels between Lae, Morobe, Finschhafen, Aitape and combination of passengers and freight vessels to Madang, Wewak, Vanimo, and smaller ports along the way. It used to operate to Kimbe and Rabaul, Oro Bay and Milne Bay but has ceased doing so because of the lack of profitability of these routes. Luship is struggling to continue operating on the routes that it maintains because of the very low level of profitability (mainly due to the increase in fuel costs) and community service obligations imposed by its owners which took up the previous role of the government fleet.

This paper will examine the structure of Luship and suggest some alternative solutions to the problems outlined.

General

Kambang believes that the government has community services obligations to the rural maritime and river populations, these people live in isolated areas and are presently not receiving regular and reasonably priced water/sea transport. This means that most of these people, except those who live in and around the major ports do not receive goods and services except by very expensive and often unsafe motorised dinghy (banana boat) service, and therefore cannot export cash crops and receive very few government services¹.

By comparison the government spends something in the order of K300 million annually on roads and road maintenance. Luship believes that this is unfair to the maritime and river people. It believes that in the immediate future the government has an obligation to ensure that transport services are made available to all the people of PNG so they can participate in the cash economy and receive basic services like health care, education and extension.

Historically, the PNG Government operated a fleet of trawlers and workboats that were handed over by the Australian Government in the 1970s. However, owing to high operational and maintenance costs and other related factors, the entire fleet was disbanded and transferred to Provincial governments in the coastal provinces. The remaining vessels were eventually disposed of to private interests. A handful of provincial governments own and operate coastal vessels mostly for government services².

¹ See ADB; *Report and Recommendation on a Proposed loan to PNG for the Community Water Transport Project*; Manila, July 2002, p3-“the maritime and river-based communities suffer from extremely constrained transport conditions , where living standards are nearing absolute poverty. In many cases these communities lack sufficient soap, salt staple food and do not have access to educational or health services”

² ICCC; Issues Paper: PNG Shipping Industry; Port Moresby March 2006, p14

According to the Department of Transport Maritime Division (“DoT-MD”), coastal shipping is undertaken by structured operators through to informal small boat operators. These include:

- Principal line operators;
- Secondary line operators: and
- Non-liner commercial companies³.

Economics

Pure economics espouses the value of the market allocating resources, which would suggest that the PNG coastal shipping industry should be exposed to more competition. The obvious way to do this would be to expose the industry to competition from overseas vessels on coastal routes. Many people get exasperated when the case for PNG being “special” is advanced as a reason for accepting “second best” economic policies.

However PNG’s coastal transport is quite unique. It is expected to serve isolated communities with small populations that have little or no produce to ship and therefore no demand for inwards cargo. The result is that most of these communities are largely ignored, receiving none or very few government services like health, education and extension. There are no alternative or cheaper transport modes available. The choices for PNG lie between accepting that shipping needs subsidising⁴ and ensuring that services are provided to these isolated villages and communities or abandoning them to increasing isolation which will mean that development gains made over the last fifty years will gradually decline.

The Government is committed to providing better services to all Papua New Guineans which means that the market will have to be regulated or distorted in a positive manner to ensure that transport services are available equally. The challenge is to ensure that any subsidy is delivered in a manner which minimises distortions to other sectors and delivers the most efficient service possible within the constraints. This means creating an environment that provides as near as possible to market conditions such as tendering for service provision, justification of fares and freight rates, elimination of or compensation for external distortions (fuel prices, cost of repairs and spares etc.).

1. Current Services of Luship.

Vessel	Type of Service	Ports Served	Frequency of Voyages	Age of Vessel	Size of Vessel
MV Kuder (1)	Container Carrier	NA	NA	15 years	
MV Wewak (1)	Container Carrier	NA	NA	16 years	
MV Madang Coast	Container Carrier	PNG Ports and Townsville Australia	Bi-monthly	20 years	2, 500 tonnes
MV Umboi	Combination pax/freight	Manus, Madang, Aitape, Wasu, Finschhafen	Weekly	21 years	440 tonnes/150 passengers
MV Maneba	Combination	Manus, Madang, Aitape,	Weekly	22 years	401 tonnes/150

³ ibid p.14

⁴ “The remote transport service cannot be provided at breakeven tariffs due to the limited extent of the cash economy in remote areas of PNG, hence the need for an initial subsidy”, ADB ibid p4

		Wasu, Finschhafen			pax
MV Nagada (2)	Combination	Finschhafen, Wasu and small ports between Morobe and Madang	Weekly	22 years	280/130 pax
MV Momose Express	Passenger	Wasu, Finschh, Siassi	Weekly	19 years	274 pax
MV Rita	Passenger	Madang, Wewak, Aitape, Vanimo	Twice week/weekly	17 years	317 pax
MV Talimbun	Charter/ open barge	Sepik River/Ramu/Karkar	Charter as and when	21 years	40 tonnes
MV Morobe Coast (3)	Container	PNG Ports and Townsville Australia	Bi-monthly	20 years	2, 500 tonnes
MV Gejamsao (2)	Passenger	Finschhafen (two ports)	Five days/week	9 years	180

1. Ships are not currently operating
2. Vessel carries out community services as determined by Church.
3. Morobe Coast is one third owned by Luship.

Luship is further constrained by the fact that Kambang Holdings has an agreement with Consort Lines to restrict the services it operates on the Momase coast especially into and out of Madang, Wewak and Vanimo. This agreement is about the leasing of a fully owned vessel by Luship to Consort and a vessel that is partially owned by Luship and operated by Consort. However the contract between Kambang and Consort is now under dispute and this could lead to the unravelling of the current agreements. There has also been deterioration in the relations between Kambang and Consort due to shareholder issues.

Luship has been pursuing new ships and new solutions to the coastal shipping problems facing PNG. It considers that a combined passenger and cargo vessel with roll-on-roll off capability and shallow draft so it can go onto remote beaches, could be the solution. Luship would use this to service remote locations that currently do not have shipping services. Such a service would need to be subsidised for a number of years in order to build up outwards cargo volumes which in turn provides income to encourage the purchase of inward cargo.



MV Rita, passenger vessel



MV Maneba, combination passenger and cargo vessel



MV Gejamsao, passenger vessel

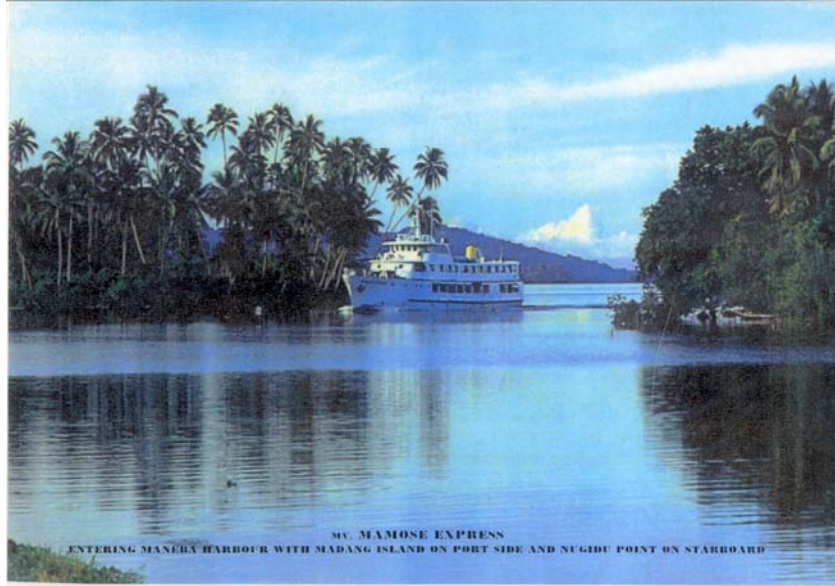
The cost of such a vessel would be in the vicinity of K3.5m., it would cost K2.9 m p.a. to run, and need a subsidy of approximately K700, 000 or around 25% of operating cost. The subsidy would need to be carefully monitored and designed to reduce over a finite period. This would have to coincide with the time necessary to establish cash crops that would provide the outwards cargo and give the villagers some cash income⁵.

Kambang is currently in confidential discussion with a number of potential venture capital partners regarding the introduction of new vessels. It is also aggressively searching for suitable vessels for PNG waters. The outcome of these negotiations may see the expansion of some of its services.

The alternative would be for the government to purchase one or more such ships and licence domestic shipping operators to operate them at little or no rental but an obligation that they would serve the coastal people of PNG at least monthly. This may mean some subsidisation until the people became confident that the service was going to be regular and either resumed or began production of cocoa, copra and other crops and produce. These vessels would not be allowed to trade between existing main ports except for loading and unloading.

⁵ There will be a need for agricultural and other forms of extension to ensure that the agricultural and cash production increases.

Kambang believes that a properly equipped maritime industry would be a cheaper form of transport than road and air transport. Over the long term PNG can expect a greater degree of urbanisation which will then reduce the cost of providing transport and other infrastructure to isolated communities.



In our opinion the government has no business in regulating shipping rates, to the extent that this is possible, these should remain the prerogative of market forces and competition. However the issue of *cabotage*⁶ needs to be dealt with. The common misconception is that by allowing overseas vessels to pick up cargo between domestic ports the freight rates will be cheaper. In the case of the larger ports of Port Moresby and Lae to Madang, Wewak and Rabaul this may be true, but it will mean that the smaller ports will become even more uncompetitive and freight rates will have to be raised or subsidised if they are to continue.

⁶ Cabotage is the practice of allowing overseas vessels to pick up and carry domestic cargo on domestic routes

2. Current Schedule of Freight and Passenger Rates

Lae to:	Passenger Fare	Freight Rate m ³ (1)	Wharfage and Handling	Bunker Adjustment Factor	Currency Adjustment Factor	VAT	Maritime College	NMSFA
Morobe	40-60	26-44	174	347	110%	10%		
Finschaffien	35-45	26-44	174	347	110%	10%		
Sialum	40-70	26-44	174	347	110%	10%		
Wasu	40-65	26-44	174	347	110%	10%		
Madang	40-45	26-44	174	347	110%	10%		
Wewak	155-200	30-48	174	347	110%	10%		
Lorengau		30-48	174	347	110%	10%		
Aitape		30-48	174	347	110%	10%		
Vanimo		30-48	174	347	110%	10%		
Madang to:								
Aitape	80-150							
Vanimo	105-150							

(1) Rates set in 1991, cheapest item is village food, dearest is hazardous and obnoxious cargo, rate set by tonne or m³ whichever is the highest.

NOTE: Freight rates have not been varied since 1991 due to failure of price controller to consider adjustments.

3. Profitability

	Revenue	Expenses	Surp/Def	Add Deprecn	less O/H	Total cash
Gejamsao	96041	166632	-70591	84222	84244.82	-70613.8
Kuder		136728	136728	84222	84244.82	-136751
Mad. Coast	56370	84245	-27875	84222	84244.82	-27897.8
Mam. Expr.	182269	192012	-9743	84222	84244.82	-9765.82
Maneba	108241	246091	137850	84222	84244.82	-137873
Mor. Coast	23970	84222	-60252	84222	84244.82	-60274.8
Nagada	70055	155876	-85821	84222	84244.82	-85843.8
Rita	393330	254753	138577	84222	84244.82	138554.2
Talimbun	116875	90730	26145	84222	84244.82	26122.18
Umboi	167738	148429	19309	84222	84244.82	19286.18
Wewak	289747	220122	69625	84222	84244.82	69602.18
Leased Containers	187933		187933			187933
TOTAL	1692569	1779840	-87271	926442	926693	-87522

It can be seen that in October, the last month that figures are available, Luship operated at a cash deficit of around K87, 000, this is exacerbated by the fact that MV Kuder was on the slipway but it can be expected that one vessel will always be under repair or survey. It can also be seen that 7 out of 11 vessels operated at a loss. In addition the Leased container income is about to end and may not be renewed reducing income by a further K187, 933. On the surface the future looks untenable.

The solutions appear to be either reduce overheads, increase revenue or both. Suggestions are made below:

1. Reduce Overheads

- Consolidate shipping office in one place, Lae or Madang.
- Examine staffing level.
- Tighter controls

These are under active consideration by Kambang as part of its on-going management efforts.

2. Increase revenue

- New Routes or remove restrictions on existing ones
- New vessels more appropriate to needs of PNG coastal trade e.g.roll-on roll-off, able to trade the more isolated villages and communities with inwards and outwards cargo.
- Government subsidy to provide cargo capacity to isolated areas e.g. Morobe, Oro and Milne Bay, New Guinea Islands and atolls where there are almost no ships calling in which means that cargo has to be brought in and out by banana boat making it very dangerous due to overloading and expensive due to high petrol prices and taxes.
- An explicit subsidy by other activities of Kambang Holdings to offset the costs of operating into unprofitable destinations.

- Redevelop property in Lae and Madang, especially Lae wharf site.

3. Reduce Costs

- This requires a much more detailed technical and financial analysis than has been carried out in this brief study but there are undoubtedly areas where costs can be cut.
- Cease operating to unprofitable destinations.

Port and Maritime Safety Services

a) National Maritime Safety Authority

The National Maritime Safety Authority provides the following;

- Coastal Trade Licence-PNG Regulation
- Navigational Services-PNG Regulation
- Oil Spill levy-PNG Regulation
- Shipping Officers Service
- Normal vessel-Overall survey inspection
- Annual Registration

It charges fees for these services. It is also supposed to provide a subsidy for coastal shipping services which are not paying. Kambang Holdings believes that the NMSA should be the sole regulator of shipping so long as it remains within the International Maritime Organisation's rules. Kambang supports the work of the Authority subject to its adherence to the above services and regulations.

b) PNG Harbours Ltd

Kambang Holdings believes that PNG Harbours Ltd should be privatised and that the regulation of stevedoring licences should be transferred to the NMSA. It believes that there will be an increase in efficiency, reduction in losses on the wharves and better management of the wharves. Kambang also believes that the recent imposition of pilotage services into domestic ports is excessive and should be reviewed.

International comparisons tend to support this view even though PNG cargo handling is more efficient than Australian ports despite the fact that it has very little modern capital equipment. This is largely the result of the work of private stevedores who are able to get good productivity from their workers.

c) Transport department

Kambang Holdings has no comment regarding the operation of the Transport Department.

Areas in the industry that should be regulated.

Kambang Holdings strongly recommends that overseas vessels be not allowed to pick up and deliver cargo between domestic ports. It maintains that this will make its own operations even more unprofitable and mean that even more of the smaller ports will be abandoned to coastal

shipping. References made in the ICCC position paper are **NOT** applicable to PNG, we were unable to find any reference to cabotage in the footnote on page 23 of the Position Paper (Australian Bureau of Transport and Regional Economics, Information Paper No. 50). The other reference on page 26 of the Position Paper has one line on the subject which states that:

“There are other recommendations in the shipping area designed to improve the functioning of markets, such as the proposal to modify the cabotage regime. In the case of PNG, where there is considerable reliance on coastal shipping, relaxation of cabotage would have larger benefits than in some other Forum Island Countries (FICs)”⁷.

There is no detailed argument to support this contention and no recognition that conditions in PNG are vastly different than those in Australia. Australia has a well developed road and rail transport system and more than 90% of the population is clustered around these systems so that sea transport is less important than it is in PNG where 87% of the people still live in rural areas and approximately half of those live in coastal and island areas which are almost only served by sea transport.

Any change in the cabotage regime will have a direct effect on provision of coastal shipping and therefore the local economies of rural coastal people. PNG is an isolated country without the benefits of other methods of transport and therefore the provision of economic and social services will always be an expensive exercise unless people are persuaded to move from their villages to places where transport and other services are available. Already there is much talk about the problems of squatters in and around major centres, failure to bring adequate services to rural people will only hasten that phenomena. **The key is to get the right mix between Community Service Obligations and Commercial Principles.**

Any change in the cabotage regulations needs careful analysis on how it will affect the lives of these people. If it does reduce the number of coastal vessels it will make their lives even more difficult and expensive. The answer to their lives lies in new more efficient vessels designed for PNG coastal conditions and able to carry produce out as well as trade cargo into these areas. These vessels may well require subsidization of the purchase price and running costs for several years.

It believes that overseas shipping should be confined to Port Moresby and Lae except for direct services to mineral, petroleum and gas projects where volumes warrant direct service.

It believes that the coastal shipping industry should be restricted to PNG companies that are at least 76% PNG owned.

It believes that the stevedoring industry should all be 100% domestically owned by Landowner Groups, Superannuation Funds etc. It also recommends that all agreements between stevedores and shipping companies be regulated by the ICCC.

Areas in the industry that should be opened up to competition.

⁷ Australian Department of Foreign Affairs and Trade; *Pacific Regional Transport Study Vol 2*; PNG Country Report 2004, p2.

Kambang Holdings recommends that competition between domestic shipping operators owned by majority PNG holdings be encouraged.

It likewise recommends that greater competition between overseas vessels carrying cargo from the outside world to Port Moresby and Lae be encouraged. As the domestic industry returns to viability it should also generate the ability to compete on the international market.

Issues relating to conduct of other shipping operators/market participants which are anti-competitive.

None.

Any other information

None

COMMENTS ON SPECIFIC ICCC QUERIES

1. The Commission seeks comments from the public and any interested parties on the scope of services which should be included in this review.

Luship believes that the enquiry should look at all aspects of the cost of providing competitive shipping services in PNG, both direct and indirect. This includes the cost of fuel as a result of the Interoil refinery, wages policies, industrial policies, ownership and operation of ports, cost of maintenance of vessels, maritime safety, insurance, international compliance costs (IMO) etc.

2. The Commission seeks comments from the public and any interested parties on any matters relating to the legislation and whether it provides an appropriate legal framework for the efficient operation of the industry.

i. Major Legislation:

- Merchant Shipping Act (Chapter 242) Consolidated to No. 11 of 2003 (“MSA”);
- Harbours Act (Chapter 24) (“PNGHL Act”); and
- The National Maritime Safety Authority Act 2003 (“NMSA Act”).

ii. Other Affecting Legislation

- Customs Act;
- National Agricultural and Quarantine Inspection Authority Act;
- Investment Promotion Authority Act;
- ICCC Act 2002; and
- Companies Act 1997

iii. Merchant Shipping Act

Currently being reviewed. Luship would like to see enforcement of third party and public liability insurance on all domestically flagged ships in much the same way as third party motor vehicle insurance is imposed.

International shipping policy

The Government of Papua New Guinea through the Department of Transport, Works and Civil Aviation is responsible.

- (a) For planning and co-ordinating policy development activities for both coastal and international shipping in consultation with other departments, agencies and authorities including;
 - (1) Investment policies
 - (2) User charges policies
 - (3) Freight rate
- (b) Formulating, review legislation to facilitate standing policies and new initiatives where appropriate.

Harbours Act (Chapter 24) (“PNGHL Act”)

The Papua New Guinea Harbours Limited is a successor company to the Papua New Guinea Harbours Board and is constituted under the Papua New Guinea Harbours Limited Amendment Act 2002 and is responsible to the Chief Executive of the Independent Public Business Corporation (IPBC).

The Papua New Guinea Harbours Limited is responsible for the supplying of the following services:- Berth Reservation Services, Berthing Services, Wharfage Services and Stevedoring Access and all activities and services associated with the supply of such services.

The Papua New Guinea Harbours Limited is not responsible for the registration of shipping, pilotage services, licensing of ships, surveys, manning, building and maintenance of wharves etc; these regulatory functions are the responsibility of the Department of Transport. The issuing of regulatory contracts or licensing of activities within the port services industry is the responsibility of the Independent Consumer and Competition Commission (ICCC).

Papua New Guinea Harbours Limited is financially autonomous and is required to submit to the Government annually financial statements approved by the Auditor General. Charges and Dues are set out in the By-Laws which require the approval of the National Executive Council and the Head of State.

Out of revenue PNGHL must provide for the management and maintenance of the ports, depreciation, interest and payment of loans, land rates rents, insurances and other miscellaneous provisions. PNGHL is subject to Government tax regulations.

PNGHL is also required to provide for a proportion of capital works expenditure to be met from revenue supplement by loans from internal sources negotiated by the Government. Luship believes that there has historically not been enough investment in the main ports especially Lae which is leading to increasing congestion which will be exacerbated by the Hides gas project and other mineral developments including Hidden Valley and Wafi.

To the extent that PNGHL regulates the use of wharves and the provision of stevedoring services it has the potential to affect the cost of shipping services. At this stage PNGHL is not interfering with Luship's operations of its own wharves and stevedoring and **it is strongly recommended that this does not change.**

NMSA Act

Luship supports the concept of the NMSA and does not have any comment on the operation of the NSMA Act. It understands that the Act is currently being reviewed.

Other Relevant Acts

Luship has no comment on the operation of the other Acts referred to above.

3. The Commission seeks comments from stakeholders on the various issues of cabotage; including:

3.1. Is cabotage resulting in consistent service level throughout the years where it is being applied?

Cabotage has not resulted in a consistent level of services as evidenced by Luship's reduction of services in the New Guinea Islands and parts of the Milne Bay, Oro and Momase coast. The cost of providing these services has continued to rise whilst fares and freight rates have not risen commensurately. At the same time the frequency of overseas shipping has reduced and the main ports of Lae and Port Moresby, and to a lesser extent Rabaul, have achieved the status of "hubs" from where coastal ports are served. There is no indication that opening coastal ports will increase the frequency of visits of overseas vessels to smaller ports.

Overseas Shipping to PNG Ports

Shipping Line	Port of Origin	Tranship?	Ports Served
Austral Asia Line	Port Kelang	N	Lae, Oro Bay, Rabaul, Kavieng
Chief Container Service	Melbourne	Y	Port Moresby, Lae
Pacific Forum Line	Auckland	Y	Port Moresby, Lae
New Guinea Pacific Line	Hong Kong	Y	Port Moresby, Lae, Madang, Rabaul
Crocodile Line	Europe (US, India)	Y	Port Moresby, Lae
Bank Line	Hamburg	Y	Rabaul, Kimbe, Madang
Indotrans Asia	Hong Kong	N	Lae, Kimbe, Rabaul
Pacific Container Line Agencies	Brisbane	Y	Port Moresby, Lae
Pacific Container Line Agencies	Port Kelang	Y	Port Moresby, Lae

Y=Yes, N=No

Source: PNG Post Courier 18th April 2006

3.2. Does the monopoly service provision of cabotage result in artificially high prices?

There is no monopoly service provision of long standing in PNG. There has been competition between all ports which comes and goes according to the profitability of the run and availability of ships. There is currently a single line operating between the New Guinea mainland and New Guinea Islands but that has only just emerged as a result of Luship terminating its passenger service.

Consort also has a virtual monopoly for freight between Port Moresby and coastal ports except on the Sepik coast where Luship provides an alternative service.

It is currently impossible to isolate the various factors in the estimation of cost of service provision. PNG is an expensive place to run ships, volumes are low and therefore unit costs are high. The vessels being used on the coast are old and inefficient but there are not the freight and passenger volumes to attract new investment in modern efficient vessels. Nevertheless basic shipping rates have not been changed since 1991 resulting in adjustments being made via various surcharges, costs of bills of lading etc.

3.3. Can alternatives be found to the current system of cabotage

It is always possible to find alternatives to the current system of cabotage. **The relevant question is what does the Commission want to achieve?** Does it want to reduce fares and freight rates? If so, will the lifting of cabotage do this and will it reduce the level of services to smaller ports? It is highly unlikely that additional overseas vessels will call into smaller ports like Alotau, Oro Bay, Kerema, Daru, Vanimo Kavieng, Lorengau and secondary ports. Some of the revenue earned from shipping between main ports goes to cross-subsidise the cost of providing services to smaller ports. The Lutheran Church currently subsidises high cost routes by between K500, 000 and K1, 000, 000 a practice that has been going on for many years.

As stated above the answer to the problem of high cost is to get more efficient low cost vessels on the coastal run which can generate cargoes both into and out of areas where the lack of service has meant stagnation of economic activity and therefore little or no demand for shipping. This can only be reversed by the purchase of suitable vessels which will need to be subsidised to provide a service to isolated ports and atolls. The demise of the Government fleet has meant that many of these areas no longer receive and services and health and education services have deteriorated as a result. There are strong humanitarian reasons for resumption of subsidised services to ensure that rural people again receive the same services available to urban dwellers.

3.4. The Commission seeks comments from stakeholders as to the validity of the conclusions of the Australian Department of Foreign Affairs and Trade report into the cabotage regime in PNG.

“There are other recommendations in the shipping area designed to improve the functioning of markets, such as the proposal to modify the cabotage regime. In the case of PNG, where there is considerable reliance on coastal shipping, relaxation of cabotage would have larger benefits than in some other Forum Island Countries (FICs).”

3.2.2 Cabotage

There is considerable dissatisfaction with the coastal service as it currently operates. As noted in Volume 1, the opening up of coastal trades to competition by abolishing or modifying cabotage rules has the potential to lower transport costs and encourage innovation in domestic shipping markets.

Recommendation PNG7: The Government of Papua New Guinea should consider the benefits of modifying its cabotage regime, either through the relaxation of restrictions on foreign flag tonnage or through the regional exchange of cabotage rights.

In **Volume 1** of the *Pacific Regional Transport Study*⁸ the authors outline the problems that small island states and countries like PNG face with the provision of shipping services, all of which add up to high costs which are **UNLIKELY TO BE AFFECTED** by the removal of cabotage:

4.1.2.1 Coastal and inter-island shipping services

Within the several types of shipping services identified above, it is worth emphasising the importance of coastal and inter-island shipping services (inter-island services). These play a

⁸ Pacific Regional Transport Study, Volume 1 pp34-6

pivotal role in linking scattered settlements in Pacific Island states. However, substantial distances between sparsely populated islands and relatively “thin” flows of freight and passengers create difficulties for service providers. Low income levels limit the ability of inter-island shipping operators to recover the cost of service provision, leading to low levels of maintenance and an inability to replace ageing and sometimes unsafe vessels.

Historically, inter-island services have been provided by a variety of government and private sector shipowners, although the mix of public and private ownership has varied across FICs.³¹

The majority of FICs have legislation reserving coastal and inter-island trades for locally registered vessels, although the specific provisions of the legislation vary across the region. In general, coastal and inter-island shipping is reserved for national flag carriers, except where a requirement for a particular type of vessel creates a need to employ a foreign flag vessel.

In general, the prices charged for passenger and freight transport are low and do not allow operators to put aside funds for vessel replacement. Ideally, prices should reflect the real resource cost of providing coastal shipping services, including provision for vessel replacement. In practice, prices are constrained by ability to pay and/or political factors⁹.

As a consequence, many domestic shipping operators, particularly small companies, operate on very tight profit margins, making it extremely difficult - if not impossible to accumulate sufficient capital to purchase new vessels. Replacement tonnage is provided either through aid funding or is purchased second-hand (more typically third or fourth-hand). Second-hand vessels are chosen on the basis of affordability, and are frequently unsuitable for the trade in question. Typically vessels do not comply with the requirements of recent international conventions. Vessels employed in coastal and inter-island trades are characteristically old and in poor condition.

A 1997 ESCAP study estimated that 50 percent of the region’s domestic shipping was over twenty years old¹⁰. Given low replacement rates, the proportion of the fleet over twenty years old is likely to have increased since 1997.

It is common for inter-island shipowners economise on maintenance. As ESCAP notes “*age combined with low standards is, practically speaking, a recipe for disaster.*”¹¹ Technical Team interviews in various FICs confirm ESCAP’s observation that there is a lack of adequate repair facilities in the region, particularly in the more remote FICs. Interviews also confirmed concerns about the high cost of repairs and the standard of workmanship. Given the age of the inter-island fleet, the availability of spare parts for main engines and auxiliary machinery poses a real problem for shipowners. The study team agree with ESCAP’s observation that the “*net cumulative effect is a more rapid deterioration of vessels already aged and subject to severe climatic conditions*”¹²

⁹ Some attempts at privatization of domestic shipping services have foundered on the inability of the market to support a viable service.

¹⁰ United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), *Study on Shipping and Port Capacities in the Island Developing Countries*, New York, 1997, p.1

¹¹ United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), *Study on Shipping and Port Capacities in the Island Developing Countries*, New York, 1997, p.5.

¹² United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), *Study on Shipping and Port Capacities in the Island Developing Countries*, New York, 1997, p.5.

Managers of inter-island shipping services face major challenges, including the availability of finance for vessel replacement, the operation of old and poorly maintained vessels, and seasonal and cyclical fluctuations in demand. The sector needs an injection of management skills. There is an urgent need for capacity building in the coastal and inter-island trades.

Masters 4.1.3 Freight rates

Freight rates: are set through the interaction of supply and demand factors. They can vary as supply and demand forces change. For example supply of vessels in the region is currently tight because of the increase in demand for vessels on the China routes.

Current freight rates to and from selected FICs are listed in Table 8. The total freight charge is made up of a base freight rate plus various additional charges, which may comprise up to 40 percent of the total freight rate. Commonly levied charges include:

- *Bunker Adjustment Factor (BAF)*: a charge designed to recoup the additional cost of fuel at times of rising world oil prices (known in the USA as an Emergency Fuel Adjustment Factor);
- *Currency Adjustment Factor (CAF)*: a charge designed to minimise the impact of currency fluctuations on the “bottom-line” of shipping companies;
- *Port Service Charge (PSC)*: charged by container shipping companies and designed to cover statutory port costs; and
- *Terminal Handling Charge (THC)*: a surcharge imposed by container shipping lines that aims to recover the cost of moving a container from the ship’s side to the container stacking area.

Other charges that are commonly imposed include a document handling fee.

Freight rates to and from FICs appear high by comparison with rates charged on the main line trades. However, the cost of supplying shipping services to FICs is very high, and reasons include the following:

- Long distances between ports of call;
- Small scale of cargo flows;
- Imbalance in trade, with high container repositioning costs; and
- Need to employ relatively expensive geared vessels.

The Australian Department of Foreign Affairs and Trade report deals **VERY SUPERFICIALLY** with the issue of cabotage. It makes no compelling case that freight rates will be reduced, it fails to deal with the problems of small and isolated communities and the cost of providing services to them. It fails to address the issue of cross-subsidisation of routes by some ship owners and although Volume 1 deals with some of the problems associated with isolation nowhere is the case for removal of cabotage dealt with in sufficient detail to enable a decision to remove cabotage to be made. Incidentally the submission by the same Department to an Australian Senate Enquiry excluded cabotage from an offer to liberalise transport services¹³.

¹³ “Cabotage is excluded from this offer” (of liberalization of transport services); Submission by DFAT to Senate Foreign Affairs and Trade Committee Enquiry into the General Agreement on Trade in Services and the Australia Free Trade agreement; April 2003

3.5. The Commission seeks comments from stakeholders on whether or not the current system of cabotage should be retained in some form due to the need for humanitarian or defence capacity.

Much of the literature about cabotage in Australia and the United States concentrates on the defence advantage from maintaining domestically flagged ships:

“Meanwhile House Armed Services Committee Chairman Duncan Hunter (R-Calif) and ranking member Ike Skelton (D-Mo) expressed their concern (that a redesignation of Panama which would allow their flagged vessels to carry freight and passengers) ‘would undercut our domestic maritime industry which contributes significantly to our military defense by ensuring that the nation has an adequate pool of qualified seafarers to meet our military sealift requirements amongst other things¹⁴”.

Princeton University concluded that “National security enhancements from extending the cabotage laws would take the form of a few possible additions to strategic sea-lift capability and resulting increase in seafaring employment implied. If the most favourable outcomes are assumed, the results could be US-flag fleet additions of up to 20 shuttle tankers and 10 passenger ships. Both of these ship types are considered militarily useful¹⁵.” This is at best a lukewarm endorsement of the defence argument for cabotage.

“A New Zealand operated fleet will reduce the risks to our port security and biosecurity. Domestic carriers mean less chance of terrorist activity¹⁶”.



MV Madang Coast-rescuing Talwat people, ENB 1994

¹⁴ Seafarers International Union; *Congressmen, Organisations Urge Protection of Cabotage Laws*: www.seafarers.org/log/2004/09204

¹⁵ Princeton University; *Competition in Coastal Seas: An Evaluation of Foreign Maritime Activities in the 200 mile EEZ*; Princeton 1989, p30

¹⁶ NZ Maritime Union; *Why New Zealand Needd Cabotage to Ensure a Future for Our Merchant Fleet*; www.munz.org.nz/cabotage.html

It is difficult to quantify the benefits from having PNG flagged ships in terms of assistance for defence or humanitarian reasons. PNG flagged ships were used and helped in the evacuation of Bougainville in 1990, evacuation of stranded villagers after the Rabaul volcanic eruption and more recently evacuation of Manam Island. It is unlikely that the defence argument is as strong in PNG because of the small size of the defence force and the strategic location of barracks around the country.

4. The Commission seeks stakeholder comments on the issues associated with market concentration.

The concentration of the overseas shipping market into a few players is a reflection of the demand for shipping services in PNG. “In general, the pattern of international trade in PNG is one in which the Northern ports handle an excess of exports over imports and the Islands and Southern ports usually handle more imports than exports.

PNG’s trade is imbalanced. In tonnage terms, exports amount to only 52 percent of imports. For the combined years 2001 and 2002, a total of 3.6 million revenue tonnes of cargo was imported, whilst only 1.7 million revenue tonnes was exported.

International freight rates are similar to those applying in most of the region¹⁷”.

It would appear that the concentration of overseas shipping companies is something that the country can have very little influence over.

The size of the PNG domestic market is to some extent defined by the size of the market and the ability of one operator (Consort) to dominate the inter-port market with a few exceptions e.g. until recently MV Sea Lark (POM-Lae), other Bismark Maritime vessels (POM-Lae-Lihir) and Luship (North Coast). Only when the market increases or current operators charge excessively will there be an increase in competition.

5. The Commission seeks comments from stakeholders as to the current market structure and operation of such arrangements. The Commission is also seeking to understand whether or not these arrangements impact on the efficiency of the market.

As the Issues Paper rightly observes¹⁸ the existence of international conference agreements are outside the scope of PNG law and therefore cannot be affected by this enquiry. To the extent that the conferences and international agreements set freight rates they could give an indication of what the charges would be if cabotage was removed.

Coastal shipping in PNG is dominated by Consort Express Lines and there are approximately 13 other shipping lines operating in the country at present¹⁹. It is difficult to estimate an optimal number of shipping lines that would produce enough competition to reduce freight rates. Luship contends that there first has to be an injection of capital into the industry so that smaller lines can afford to replace old and inefficient vessels with modern ones that can operate at lower cost and into more ports and villages.

It does not believe that the withdrawal of cabotage will make an impact on the basic problem which is the need to generate produce as outwards cargo and store goods as inwards cargo so

¹⁷ Pacific Regional Transport Study, Volume 2 Country Reports – Papua New Guinea Page 13

¹⁸ p28

¹⁹ Issues Paper p14

that it is economical to serve these isolated places. Some of them may never be economical to serve and will require a subsidy unless the people can be persuaded to move away from their villages. As stated above this will lead to exacerbation of the urban drift problems that are growing throughout PNG.

6. The Commission is seeking stakeholder comments on the various compliance costs and the impact of competition on such arrangements.

PNG has little control over safety and security measures that are set by international bodies for the world wide shipping industry. The recent fire and sinking of a relatively new (on the PNG coastal run) vessel shows the need to maintain standards that will ensure the safety and security of both passengers and cargo on the coastline. The international standards imposed by the major maritime countries mean that PNG has to comply to be able to receive overseas vessels into its ports.

The Issues paper requests the opinion of the industry on entry into compliant and non-compliant ports. All the main ports served by the PNHL are compliant and it is unlikely that the costs of visiting smaller ports that are non-compliant would be in any way offset by the reduced costs as compared with the small volumes of cargo inwards and outwards available at those ports. Luship does not see compliance as a significant barrier to entry or non-compliance as a significant attraction to provide services to smaller low volume ports.

The issue of compliance does not come into the equation as far as visiting isolated communities which is where the greatest potential growth of coastal shipping lies.

7. The Commission invites comments and submissions from the public stakeholders and any interested parties on the level of coastal shipping services, particularly freight and passenger services, and whether they are adequate to service the needs of all users.

The Issues Paper incorrectly quotes the Australian Bureau of Transport and Regional Economics “Information Paper No. 50”, January 2004 as stating that “in general PNG shippers and freight forwarders maintain that they are satisfied with the availability of shipping space and frequency of current shipping service (both coastal and international)²⁰”. This paper deals exclusively with AUSTRALIAN COASTAL SHIPPING and does not deal with PNG at all. We were not able to find any papers in this series that deals with PNG.

It is unlikely that many shippers are satisfied with either the frequency or the costs of coastal shipping in PNG coastal waters. This submission has already drawn attention to the chronic lack of shipping services to most of the PNG coastline due to lack of cargo and paying passengers. This is compounded by the high cost of small boats (banana boats) due partially to the excise on outboard motor fuel and partially to increased cost of fuel due to world price rises.

8. The Commission is seeking stakeholder comments on the current pricing structure used for both freight and passenger services. The Commission is particularly interested in comments regarding the level of cross subsidization which is occurring throughout the market. In addition, the Commission is interested in understanding the pricing

²⁰ Issues Paper p30

structure of all fees and government charges which are levied throughout the industry. This includes all fees associated with regulatory services.

Luship reiterates that the basic freight rate has not been changed since 1991. However there is an ability to adjust surcharges such as bunker surcharges, insurances, bills of lading, (until recently) exchange rate factor, documentation etc. These charges have been the main area where there has been competition in coastal shipping especially on the Port Moresby-Lae route.

Passenger fares are not regulated and there has been competition e.g. until recently Lae-Rabaul where fares were competitive. When the competition is removed fares naturally increase. There is still passenger fare competition between the ports of Madang and Wewak.

Investment in other highly profitable parts of the industry has enabled Luship to continue to provide services to non-profitable ports in the Morobe region. The size of the subsidy is not quantified in the accounts of Luship which is a remnant of the church policy of providing subsidised services to its adherents under which the shipping line was founded. The church made even greater efforts to ensure services were provided to its members after the Government fleet was withdrawn.

9.1 The Commission seeks comments from stakeholders as to the adequacy of training facilities within PNG. In particular, the Commission is seeking to understand whether or not the current training regime is sufficient to provide pilots, masters and crew capable of piloting and servicing the shipping industry at an appropriate standard.

Luship maintains that the training of maritime crews at the Madang Maritime College is one of the best in the region and it spends around K500, 000 per year on training at the college. PNG crew finds it difficult to reach international certification because of the difficulty in gaining a berth and consequent experience on overseas vessels, needed for Grade 1 Master and Engineer status.

9.2 The Commission is also interested in understanding the accreditation framework for pilots, masters and crew to perform these functions.

Standards of PNG pilots, masters and crew are satisfactory and they are able to carry out their functions. Accreditation procedures are also satisfactory.

9.3 The Commission seeks comments from stakeholders on the recognition of qualifications received in other jurisdictions.

Luship crews are recognised by the Australian Maritime Safety Authority and have been specified by AusAID as a preferred supplier of shipping services within PNG and to Australia for its projects. PNG recognises overseas qualifications and some operators are using foreign crews and officers.

9.4 The Commission seeks comments as to whether these requirements represent a barrier to new entrants entering the market.

Assuming the person qualifies for a PNG Work Permit there are no barriers to people holding overseas qualifications entering the market.

10. The Commission seeks comments from stakeholders as to the current impediments to the coastal shipping sector which impact directly on the tourism sector and what action may be appropriate.

A study by Princeton University concluded that that “an 800 passenger cruise vessel ...(with) a crew of 259 operating in the Caribbean cruise trade with US construction and a partial union crew for the US flag vessel. Construction costs would be \$20 million higher and the increase in per diem passenger costs would be 35% of above a foreign flagged vessel²¹”

PNG has to be careful that it does not add to the cost of an already expensive tourist industry by insisting that all tourist operations should be carried out by PNG flagged vessels. This would kill the liner tourist trade which is gradually building up after a very low couple of years. It would also affect some of the dive boats which carry tourists to PNG from Australia. It is up to the tourist operators to make whatever case is necessary regarding the right mix of PNG and foreign flagged vessels.

11. The Commission seeks views from stakeholders on the likely developments or changes in the existing structure of the coastal shipping industry, including entry of new service providers, over the next decade.

Luship does not see the need for any barriers to overseas shippers entering the market. The size of the market and the ability of existing operators to adapt to changing circumstances will largely dictate the composition of the market. Luship/Kambang recognises that there is a need for competition and is currently seeking new solutions to the current shipping regime.

Technology is rapidly changing in all areas of commerce and it is impossible to predict what new innovations in shipping will emerge as part of the global trends. Luship will endeavour to embrace these changes and adapt to new technologies.

²¹ Princeton ibid p.26

Appendix 1. Recommendations from Volume 1 of Pacific Regional Transport Study pp80-84.

8.3.1 Reforming the market for coastal and inter-island trade

Coastal and inter-island shipping services (inter-island services) play a pivotal role in linking scattered settlements in Pacific Island states. However, substantial distances between sparsely populated islands and relatively “thin” flows of freight and passengers create difficulties for service providers. Low-income levels limit the ability of inter-island shipping operators to recover the cost of service provision, leading to low levels of maintenance and an inability to replace ageing and sometimes unsafe vessels.

Government owned and operated coastal and inter-island shipping services are typically inefficient and loss making, requiring substantial subsidies (explicit or implicit) to keep services operating. Accordingly, there are good reasons to commercialise the government owned business enterprises operating in the coastal trades. Commercialisation may take the form of *corporatisation* (i.e. the creation of a corporate entity to remove government from day-to-day operation of commercial shipping service) or *privatisation* (i.e. sale of government assets to private sector in expectation that they will be used more efficiently and productively).

Recommendation R14: Certain Pacific Island governments should consider commercialising (corporatisation or privatisation) the remaining coastal and inter island-shipping services operated by government shipping lines.

Low traffic density and long distances mean that shipping services to remote communities and/or outer islands are unlikely to be commercially viable. If left to market forces, the outer islands would not be served. However, there are strong social, political and nation building reasons for providing such services²².

Historically, subsidised shipping services on routes considered non-viable by commercial operators have been provided by Government owned vessels or by vessels owned by a corporatised Government entity. Ministries of Finance have typically determined the amount of the subsidy and service provision has been organised and/or provided by the Department of Transport. In many cases, the services operated by government shipping lines have proved operationally and financially unsatisfactory.

The study team recommend that in these cases government attempt to deliver these services through the market. International experience suggests that the most cost effective method of involving the private sector in the provision of shipping service to outer islands is through some form of franchising or competitive tendering. The cost of subsidised shipping services to remote communities or outer islands will be a function of the required quality and frequency of the service. Such a subsidy may or may not be accompanied by a system of route licensing²³. Guidelines for the design of a franchise system to deliver outer island services through private sector operators are contained in Box 4

²² There are cases where provision of a modest subsidised shipping service may reduce the demand for a more expensive subsidised domestic air service. The outer islands of Vanuatu are an example of this situation. In this case there were statements from potential beneficiaries that they valued a shipping service that might call once every 6 months over an air service because the shipping service provided the potential for commercial development of agriculture.

²³ A route licensing is a system designed to protect the route franchisee. There are arguments for and against route licensing in this context. One of the main arguments in favour of route licensing is that it eliminates the risk of opportunistic competition and thereby reduces the potential financial risk of the franchisee. However, it is difficult to see why opportunistic competition should be a threat on such routes since the reason for subsidising them is that private operators find them unprofitable to serve without a subsidy.

Box 4: Guidelines For Design of a Franchise System for Outer Island Services

The following observations, which draw on the experience of several franchising schemes, may be of use to FICs designing a franchising scheme for outer island services:

Reform Prior to Award of Franchise: subsidization of outer island shipping services is likely to be considerably more expensive if the tendering process is undertaken prior to reform of the shipping sector. Where possible, the study team suggest that desirable reforms – which might take the form of corporatisation or privatisation, abolition of cabotage, labour market reform etc - should be undertaken prior to the award.

Define the Service Requirement: the franchising authority should clearly define the nature and frequency of the services to be provided and the contractual provisions required. Issues to be considered include: what is the purpose of the subsidy? What standard of service is required? On what basis are fares and freight rates to be set? How should the subsidy be administered or managed?

Franchise Administering Authority: whilst the concept underlying the franchising of specified shipping services is relatively simple, the franchising process needs to be carefully planned and managed. Contracts should be drawn up carefully and should lay out precisely the service required, the type of vessels to be used, tariffs and charges, contingency arrangements, arrangements for payment, responsibilities and liabilities of the contractor, and conditions under which the contract may be cancelled. A Franchise Administering Authority should be created to manage the subsidy scheme.

While the Authority might be located within the Department of Transport or Marine Department, the study team suggest that the managerial, legal and financial skills are such that the Authority should be separated from the normal line functions. The Solomon Islands Shipping and Marine Sector Study recommends that the franchising scheme be administered by a Shipping Authority or by a Marine Department with a significantly enhanced capacity. However, the Meyrick Report into the feasibility of establishing a Government Commercial Shipping Company to service Fiji's Outer Islands recommends the creation of a 'Virtual Shipping Corporation' (i.e. a non-vessel owning body) to deliver the required service through a system of contractual arrangements with private shipping companies.

The Tender Process: as noted above, franchises for the operation of subsidised services should be assigned via a competitive bidding process. The tendering process needs to balance the following objectives:

- Ensuring that prospective franchise holders have the financial and operational capacity to provide the required services;
- Ensuring that all potential tenders who could provide the required services are invited to tender; and
- Encouraging bids from competent operators who do not necessarily have experience of operating this type of service.

The study team agree with the conclusion of the Solomon Islands Shipping and Marine Sector Study that this is most likely to be achieved with a two-stage bidding process, involving a prequalification phase followed by a formal tendering phase. Pre-qualification process should be designed to ascertain whether a prospective bidder offers credible credentials – financial and technical capability and relevant operational experience.

Tenders to operate the subsidised services should be invited from all pre-qualified applicants. The tender documents should define the service requirement (see above) in sufficient detail to enable tenderers to make a realistic appraisal of the costs and benefits of operating the service(s). As noted above, the tender documents should lay out precisely the service required, the type of vessels to be used, tariffs and charges, contingency arrangements, arrangements for payment, responsibilities and liabilities of the contractor, and conditions under which the contract may be cancelled.

Management of the Franchised Service: as noted above, the franchising scheme should be administered by a Shipping Authority or a Marine Department with the managerial capacity to carry out this task (See Box 1 on Good Governance).

The objective in subsidising shipping services to outer islands should be to provide regular and predictable services at a predetermined interval. Thus, in designing a franchising scheme, there will be a requirement for the Government to finance the difference between the cost of operating the shipping service to the community or island in question and the revenue that an efficient shipping operator could reasonably expect to obtain from the service.

Recommendation R13: In the case of uneconomic outer-island routes, for which the government is prepared to provide a subsidy to ensure service provision, there should be a transparent franchising or competitive tendering process that would determine the operator for the route and the level of subsidy.

Competitive Restrictions on Domestic Trade: ESCAP (1997)²⁴ notes that almost all FICs have

some form of legislation providing for the issue of trading licences (as distinct from safety certificates) to vessels employed in domestic (coastal and inter-island) trading.⁸⁷ Such legislation sets out to:

- Reserve domestic (coastal and inter-island) trades for vessels registered in and/or beneficially owned by nationals of the FIC in question. Most legislation allows for the employment of foreign flag vessels when no suitable domestic vessel is available;
- Prevent over-tonnaging of coastal and inter-island trades; and
- Ensure provision of adequate services, not only in the heavily trafficked inner island trades but in the thinly trafficked outer-island trades.

In general, licensing does not appear to be fulfilling the above objectives in the FICs. As ESCAP (1997) notes ‘Over-tonnaging appears to be prevalent, especially in the larger shipping countries, and the supply of poorly paying services to the outer islands has become a critical social and economic problem.’²⁵

As noted above, the majority of FICs have legislation reserving coastal and inter-island trades for locally registered vessels (i.e. they practice cabotage), although the specific provisions of the legislation vary from country to country. In general, coastal and inter-island shipping is reserved for national flag carriers except where a requirement for a particular type of vessel creates a need to employ a foreign flag vessel.

In so far as the interests of locally owned and registered ships are protected at the expense of foreign owned and registered vessels, cabotage is clearly discriminatory. In a world in which barriers to trade are being reduced and countries are moving towards regional trading arrangements cabotage appears increasingly anachronistic.

In the extreme case in which coastal trades are completely closed to foreign shipping, the cabotage laws imply a zero import quota. The study team note that cabotage is a form of protectionism that is likely to lead to higher freight rates and, hence, lower levels of coastal trade than would be the case in a more competitive environment.

When considering amendments to cabotage, a variety of policy options are available:

a. *Modified Cabotage Regulations:* existing cabotage rules might be relaxed by exempting certain trades from the cabotage rules, by instituting a quota system (whereby foreign vessels would gain partial access to the coastal shipping market), by replacing existing licensing provisions with a tariff or tax that could be progressively reduced, and/or by

²⁴ United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), *Study on Shipping and Port Capacities in the Island Developing Countries*, New York, 1997, p.6.

²⁵ United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), *Study on Shipping and Port Capacities in the Island Developing Countries*, New York, 1997, p.6.

adopting a Single or Continuing Voyage Permit system, enabling foreign flag vessels to

operate on the coast for a single voyage or a specified time period;

b. *Regional Cabotage*: under this option national cabotage rules would be replaced by regional free trade in shipping services. Those FICs choosing to take part in the regional cabotage initiative would exchange cabotage rights. In other words, a shipowner domiciled in any signatory nation would be able to operate international or coastal shipping services throughout the region; and

c. *Open Seas*: under this option any user of coastal shipping services would be free to purchase the services of a shipping operator of his choice, be it a domestic or overseas carrier. Under this option the government would continue to regulate to ensure compliance with safety and environmental laws.

The opening up of coastal trades to international competition by abolishing or modifying cabotage rules has the potential to lower domestic transport costs and encourage innovation in the domestic shipping market. For example, vessels employed in international voyages, which call at two or more ports within a FIC might be permitted to carry coastal cargoes. The backhaul rates offered by such services will normally be lower than those offered by coastal shipping. The modification of cabotage rules may also lead to the entry of foreign shipowners into coastal and inter-island trades, leading to greater competition, improved service and lower freight rates. The study team note that provinces of FICs that are closer to ports in other countries than to their own capital (e.g. Temotu province in the Solomon Islands is closer to Vanuatu than to Honiara) may gain from the abolition of cabotage.

The study team also note that the abolition or modification of cabotage may have a negative impact on some players. For example, opening up of coastal trades to foreign competition would have a negative impact on seafaring employment in an economy whose entrepreneurs fail to take advantage of the opportunities created by the opening of shipping markets. In such cases, government may experience a loss of tax revenues.

In conclusion, the study team agree with the World Bank that FICs need to provide an “enabling environment” for coastal and inter-island shipping through “incentives and market conditions, which promote efficiency through entry, exit and pricing freedoms for private operators or autonomous government-owned enterprises.”⁸⁹

Recommendation R12: Forum Island Countries that could benefit from services and greater competition in shipping should allow regional cabotage.

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