STEAMSHIPS SHIPPING

CONFIDENTIAL

Submission to the Independent Consumer and Competition Inquiry into the PNG Shipping Industry

Public Submission

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Executive Summary

Steamships Trading Company Limited (Steamships) welcomes the opportunity to submit its views on the Papua New Guinea Shipping Industry to the Independent Consumer & Competition Commission. Steamships have a long association with the coastal and international shipping industry in Papua New Guinea, as both a liner ship operating company and as a shipper.

Given the tight timeframe for receipt of submissions to this inquiry, Steamships has made its best endeavour to address the questions asked by the Commission. However, there are a number of matters within the scope of the inquiry that we have either not addressed in this submission or wish to address more fully. To accommodate this, Steamships may to lodge a further submission in the form of an update of this submission.

In this submission Steamships argues that the coastal shippers in Papua New Guinea are well served by the coastal shipping industry. In spite of the complexities of operating in Papua New Guinea and the small volume of cargos involved, most of the main ports in the country are services by safe, reliable and competitively priced liner shipping services. Changes to the cabotage regime that would allow foreign flagged vessels to enter the market has the potential to result in 'cream skimming' along the main routes, a practice that could undermine the economic viability of the Tier One coastal shipping operators. More importantly for the country as a whole, PNG coastal shippers would be forced to substantially raise freight rates on other routes to compensate for the loss of business on their main routes. If they are prevented by regulation from raising prices sufficiently to cover costs and earn a market rate of return on their assets, investment in the industry and the quality of coastal shipping services will decline In addition, the lower volume routes as a whole are likely to be more price sensitive than the high volume routes. As a result, there would be a decline in demand for the current services that coastal shipping companies provide leading to less frequent and lower quality services on many routes.

The prospect of the removal of cabotage raises significant economic, social and environmental risks for Papua New Guinea. Increases in freight rates and/or declining quality of services will reduce trade, both coastal and international and undermine economic development, particularly in remote areas of the country. The loss of profitability in the industry will also reduce the remaining industry's capacity to comply with marine safety and environmental requirements.

The removal of cabotage has the potential to drastically reduce the size of the Papua New Guinea national fleet, with the country having to rely to a greater extent on foreign flagged vessels for its linkages with world markets. The companies that operate these vessels have little financial or other stake in Papua New Guinea. The drivers of their commercial interests lie outside of Papua New Guinea, which accounts for a very small volume of their trades. In times of national emergency, the Government of Papua New Guinea will not have a coastal fleet upon which to draw for disaster relief. Security of supply of essential goods and services will largely be in foreign hands or in the hands of shipowners operating small, poorly maintained vessels with limited capability.

1. Introduction

Steamships Trading Company Limited (Steamships) welcomes the opportunity to submit its views on the Papua New Guinea Shipping Industry to the Independent Consumer & Competition Commission. Steamships has a long association with the coastal and international shipping industry in Papua New Guinea, as both a shipper and a liner ship operating company.

The first section of the submission provides an overview of Steamships' operations in Papua New Guinea, the coastal shipping services it provides, the competition it faces in those markets and the profitability of providing those services.

The second part of this submission addresses most of the issues raised in the Commission's Issues Paper. The short time available for comment on the Issues Paper has precluded us from covering all of the issues in depth.

2. Overview of Steamships operations

Steamships was established in 1919 and today it is a multi disciplined group with a diverse range of business interests spread throughout Papua New Guinea. The company has six divisions – Shipping, Transport, Properties, Hotels, Hardware, Manufacturing & Associates. In 2005, Steamships had turnover of K370 million and total employment throughout Papua New Guinea of 2,300. Steamships is a company that is registered and publicly listed in Papua New Guinea with 71.37 per cent of its shares owned by John Swire and Sons, 23.63 per cent owned by private investors and 5 per cent owned by Nasfund. The Shipping Division has the following businesses:

- Coastal Shipping
- Stevedoring: operations at Port Moresby, Lae, Madang, Kiunga, Kavieng and Rabaul
- Ship Yard: Marine Engineering Services in Port Moresby; and
- Shipping Agencies: at Port Moresby, Lae, Madang, Rabaul, Kavieng and Kimbe

In addition, Steamships has a 50 per cent interest in Pacific Towing (PNG) Limited, and a 33 per cent interest in Consort Express Lines Ltd.

2.1 Coastal shipping services

Steamships own and operate 10 vessels providing both a charter and a liner service known as Laurabada Shipping Services (LSS). LSS is the only scheduled liner service which covers some 30 ports throughout the Gulf, Central and Western Province and provides services for palletised, break bulk, liquid and containerised cargo. Most of these ports are river ports rather than coastal ports.

LSS operates a Port Moresby based ship maintenance, stevedoring and wharf operation which manages its liner service and landside co-ordination. It charters five vessels to Ok Tedi and provides spot charter opportunities for both local and overseas customers. LSS vessels are all certified, maintained and operated in accordance with international standards to ensure the safety of workers, the environment and customers' cargo.

LSS has been involved in coastal shipping operations since 1919. In 2005, LSS had turnover of around K12 million and employed 400 staff, both crew and landside. LSS operates both a liner service and a charter service.

The liner service provides the transportation of freight to remote ports and inland river landings typically by small landing craft type (LCT) vessels on a regular, scheduled basis. The liner fleet consists of the following vessels: MV Goada Chief, MV Kikori Chief, MV Agutoi Chief, MV Erima Chief, Ok Tarem, Ok Menga (tugs) and the Steel Challenger (a barge). Specifications for some of the vessels are provided in Table 1.

Table 1: Specifications of selected LSS liner service vessels

	Goada Chief	Kikori Chief	Steel Challenger
LOA (metres)	63	53	54
Beam (metres)	15	14	17
DWT	1,250	1,070	1,500
Max Draft (metres)	3.075	2.24	2.7
Speed (knots)	10	10	6
TEU capacity	62	54	48
Gear	25 mt SWL	30 mt SWL	

The charter service provides long term and spot charters for the transportation of freight by a variety of multi purpose vessels. In 1982, Steamships established a charter contract with Ok Tedi Mining Limited (OTML). This charter fleet consists of specially designed and built multi purpose vessels able to carry copper concentrate, containers, break bulk cargo and fuel and one vessel which undertakes environmental research. The charter fleet consists of the MV Kiunga Chief, MV Obo Chief, MV Bosset Chief, MV Lahara Chief and MV Tahua Chief.

LSS operates three liner services to the Gulf and Western Provinces:

- The Agutoi Chief Liner Run from Port Moresby to Daru and back to Port Moresby.
- The Goada Chief Liner Run from Port Moresby servicing the Fly River ports up to Kiunga; and
- The Kikori Chief Liner Run from Port Moresby serving the Fly River ports, Balimo, Awaba, Kikori, Kopi and Kumul.

Maps containing the routes and ports visited by each of these liner services are contained in the Appendix to this submission.

The LSS liner services are provided to communities in remote parts of Papua New Guinea where economic and social infrastructure is poorly developed. Much of the trade is on long, narrow rivers where navigation is difficult due to water levels and other conditions which are highly variable. Compared to coastal shipping to the east of Port Moresby and along the north coast, vessels are comparatively small (Limited in size due to river conditions) and port facilities are very basic.

LSS liner services to the Gulf and Western provinces are characterised by an imbalance of trade. For the past three years, inward tonnage (that is cargo from Port Moresby) has accounted for around 80 per cent of total tonnage. Ships leave Port Moresby relatively full and return to Port Moresby relatively empty. This trade pattern adds substantially to the costs of servicing Gulf and Western Province ports.

Cargo volumes vary significantly by liner service and by port. In 2005, the Goada Chief liner run from Port Moresby to Kiunga accounted for 54 per cent of total tonnages. The Agutoi Chief liner run from Port Moresby to Daru accounted for 30 per cent of cargo. The Kikori Chief Liner run accounted for only 17 per cent of cargo carried.

The trade is dominated by the ports of Kiunga, Daru, Kopi, Kikori and Balimo . These five ports accounted for 92 per cent of LSS liner service tonnages in 2005. The remaining 25 ports that LSS services in the Gulf and Western provinces accounted for only 8 per cent of the total tonnage. The total amount of cargo handled by LSS liner services is small by PNG standards, so the amount handled at these small ports is very small.

2.2 Competing operators

An assessment of Steamship's competition in the liner shipping and charter markets is provided in Table 2 and Table 3. Both the liner shipping and charter markets are served by a number of competing operators.

The main competition in the spot charter market includes Curtain Brothers, with two landing craft, Island Shipping, with two tugs and barges and Bismark, with the capacity to operate one landing craft and one tug and barge. There are also a number of small coastal traders that operate in the spot charter market.

Table 2: Market share of coastal shipping in Central, Western and Gulf Provinces

Operator	Trade	Service	Vessels	Type	Dwt	Share
STC (LSS)	Gulf Central & Western	Liner	3	LCT	2,600	4.5%
Pacific Frontline	Central & Gulf	Liner	2	LCT+Ferry	600	1.1%
STC - OTML	Western	Charter - Copper + FAK	4	Bulk carrier + LCT	12,200	21.3%
WTB - OTML	Western	Charter - Copper + FAK	6	Bulk carrier	20,800	36.3%
RHT	Central & Gulf	Charter - Timber + FAK	5	LCT	5,000	8.7%
RHT	Central & Gulf	Charter- Logging	2	Barges	3,000	5.2%
STC (LSS)	Gulf Central & Western	Spot Charter	2	LCT + Tug & Barge	1,900	3.3%
Curtain Bros	Gulf Central & Western	Spot Charter	3	LCT + Tug & Barge	3,500	6.1%
Bismark	Gulf Central & Western	Spot Charter	2	LCT + Tug & Barge	2,300	4.0%
Islands Shipping	Gulf Central & Western	Spot Charter	2	Tug & Barge	4,500	7.9%
Coastal Traders	Gulf Central & Western	Spot Charter	6	Various	870	1.5%
Total			37		57,270	100.00%

Table 3: Small coastal traders in spot charter market

Coastal Traders	Trade	Service	Number of vessels	Vessel	Tonnage
Warren Dutton	Gulf Central & Western	Spot Charter	2	Koku + Silvan	200
Wayne Golding	Gulf Central & Western	Spot Charter	1	Heron Bay	100
George Leahy	Gulf Central & Western	Spot Charter	1	Emily	200
James Collins	Gulf Central & Western	Spot Charter	1	Rankin	70
Samson Jubi	Gulf Central & Western	Spot Charter	1	Mundi	300
Total			6		870

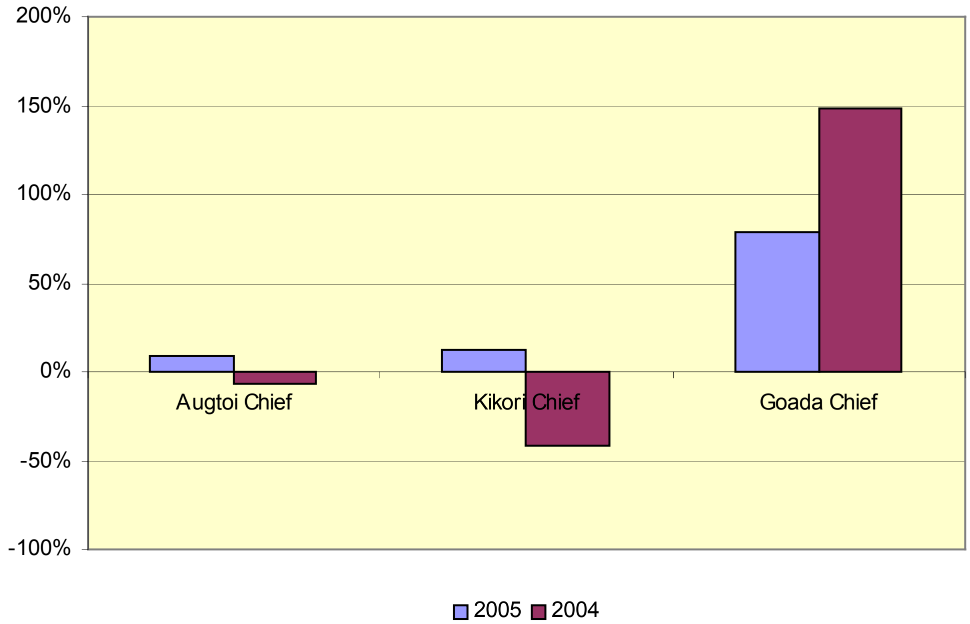
Since the reduction in mineral and exploration activity in the 1980s and the general downturn in the economy in the 1990s, operators have had to compete in a declining market. Ports are located in remote locations where port and navaid infrastructure is poorly maintained or non-existent.

2.3 Steamships financial performance

EBIT as a return on the value of assets employed was -2 per cent in 2005, compared to -13 per cent in 2004 and -3 per cent in 2003.[1] Since the asset value used related only to ships and containers and did not include equipment, buildings etc, and the estimated return is an overstatement of the true profitability of the business.

The results provide strong evidence that the licensing system is not allowing Steamships to earn monopoly rents. Indeed, Steamships liner shipping business, as a stand alone business, is in a precarious position. The main contribution to revenues is from the Goada Chief that is used to provide liner services and spot charters between Port Moresby and Kiunga. The Kikori line and the Augtoi line (to Daru) make minor contributions to earnings. Earnings from the Goada line heavily cross subsidise earnings on the other two lines.

Figure 1: Contribution to earnings by liner service vessels



[1] The financial results are for the coastal shipping part of Steamships Shipping and does not include results for OTML charter activities. Administration charges are allocated between Liner and OTML charter services on a standard percentage split that is set an the beginning of each financial year.

3. Issues

3.1 The Scope of the Review

The Commission is concerned with the economic efficiency of coastal shipping in Papua New Guinea. Generally speaking, competition in the provision of services produces efficient market outcomes to the extent that prices reflect marginal costs. It is important therefore for the Commission to gain a complete understanding of the level of competition in the market for coastal services.

Competition is not a narrow concept—it has product, spatial and inter temporal dimensions. If the scope of the review is cast too narrowly, the Commission may make incorrect judgements as to the extent of the competition in the market and therefore the efficiency of current market outcomes.

In most countries, freight can be moved by road, rail, air or sea. These different freight modes to varying degrees compete for the custom of shippers. Papua New Guinea is unusual in that there is only very limited inter modal competition. The road network in Papua New Guinea is limited and there is no rail network. Air services compete with coastal shipping only for very high value, low volume cargos. The bulk of the freight task in Papua New Guinea is undertaken by the coastal shipping industry. To this extent, the industry could be said to be providing an essential service. If the industry failed, there would be nothing to replace it and the economic consequences for Papua New Guinea would be dire. For this reason, it is critical that the coastal shipping industry in Papua New Guinea operate efficiently and that regulation of the industry does not undermine incentives to invest in the industry.

Cargo is carried around the coast of Papua New Guinea by a range of individuals and companies. Potentially, all are competing for the same cargo, although their ability to supply the services that the shipper desires at the price they are willing to pay differs. In liner services to the Gulf and Western provinces, Steamships is currently competing with the services of Pacific Frontline alone. However, in the competition for cargo, Steamships is competing with a wider range of market participants. Competition for Steamships' services comes from the following market participants:

- Other companies providing liner services or with the potential to provide liner services should it become attractive for them to do so;
- Companies that currently provide services dedicated to the export shipment of their own production and to the import of their own requirements (some of these companies also carry general freight for distribution to communities within or in the vicinity of their project areas);
- Companies not currently operating vessels but with the capacity to bypass Steamship services by chartering or purchasing their own vessels or by providing the base load cargo to underwrite new entry into the industry;
- Companies that compete with Steamships in the spot and long term vessel charter market; and
- The numerous owners of small work boats that move cargo along the coast and along PNG's navigatable rivers.

If these other companies were not moving cargo, Steamships would have access to a much larger volume of cargo than it currently does.

Competition has an inter temporal dimension. The cabotage regime in Papua New Guinea does not present a barrier to entry to companies wishing to enter the market in competition with Steamships and other coastal shippers. There are no restrictions on the number of coastal licences that the Minister may issue. What is required is that the vessel employed be locally registered (PNG flagged) and that the business be registered in Papua New Guinea. These are not onerous requirements. The costs of entering the coastal shipping market are not high, as indicated by the history of entry and exit from the coastal trade since Independence. Moreover, the Minister has the discretion to grant permits to foreign companies to carry coastal cargo where in his view a local service is inadequate or too expensive. Steamship's market is therefore a contestable market and contestability is compatible with economic efficiency objectives.

The level of actual and potential competition in the coastal shipping market means that Steamships is constrained in its pricing decisions. If Steamships were to set its prices too high relative to its competitors or to 'skimp' on the quality of the services it currently provides, it would lose business to those competitors. By setting its prices too high and causing customer dissatisfactions, it would provide incentives for other firms to enter the market in competition with Steamships. These entrants could include established coastal shipping owners operating in other parts of the country.

The degree of competition that Steamships faces in its coastal shipping business is evident from its rates of return for the provision of those services. In competitive markets, returns are only sufficient for a company to recover its operating costs plus a competitive or market rate of return on its capital outlays, adjusted for the relative riskiness of the business. Steamship's rates of return from its liner shipping services have been below the market average in Papua New Guinea and internationally for some time.

A maximum tariff regime has operated in Papua New Guinea since Independence. The maximum tariff has not been revised since 1991. While the introduction of a Currency Adjustment Factor (CAF) and a Bunker Adjustment factor (BAF) have allowed coastal shippers to recover some of the cost changes that have been beyond their control, this cost recovery has been far from complete. As a result, prices charged for coastal shipping have fallen significantly in real or inflation adjusted terms. The inflexibility of regulated prices has been a major contributor to the poor performance on Steamship's liner shipping services. Steamships is committed to providing a competitive, frequent, regular and continuous service to the ports it serves in the Gulf and Western provinces. However, under the current price controls, this means that the costs of servicing many of these ports far outweigh the revenues received.

Steamships provide a 'universal service' to these ports without subsidy from the Government of Papua New Guinea. It is normal outside of Papua New Guinea that governments compensate companies for meeting community service obligations.

In conclusion, Steamships recommends that the Commission broaden the scope of its inquiry to consider, in addition to the provision of lining shipping services, spot and long term charter operators, customers with the potential to by pass liner shipping companies and operators of small unregistered vessels. The Commission should also consider potential competition from outside the market.

3.2 The Legislative Environment

In the Issues Paper, the Commission seeks comments on legislation governing the coastal shipping industry and whether that legislation provides an appropriate legal framework for the efficient operation of the industry.

The main pieces of legislation governing the coastal shipping industry in Papua New Guinea are the *Merchant Shipping Act 1975* (MSA), the *Harbours Act* and the *National Maritime Safety Authority Act 2002*.

Steamships understands that the National Marine Safety Authority (Authority) is reviewing the MSA to incorporate updated maritime regulations and conventions to enable the authority to fully implement its mandate. Since Steamships is not privy to this review of the MSA, we are unable to comment on how any changes to the current Act may impact on coastal shippers.

While the Authority is focussed on technical and safety aspects on the industry, this Review of the PNG Shipping is focussed on competition issues and the economic efficiency of coastal shipping. In Steamship's view, the MSA, the Harbours Act and the NMSA, in either their current or amended forms have the potential to substantially affect the efficiency with which coastal shipping services are provided. The Commission needs to understand all the existing legislation that is relevant to coastal shipping and the changes that are being proposed. The work of the Commission and the Authority need to be complementary to ensure that coastal shipping services are delivered in an efficient, safe and environmentally sound manner.

3.3 Cabotage

The Commission has invited stakeholders to comment on various issues associated with Papua New Guinea's cabotage regime. In particular, the Commission has asked:

(1) Is cabotage resulting in a consistent service level throughout the years where it has been applied?

(2) Does the monopoly service provision of cabotage result in artificially high prices?

(3) The Commission also seeks opinion on the validity of the Australian Department of Foreign Affairs and Trade (DFAT) report into the cabotage regime in Papua New Guinea.

DFAT conclusion

Before answering the first two questions, it is necessary to correct a misconception. DFAT did not prepare a report on the cabotage regime in Papua New Guinea. It appears that DFAT provided funding for a report that was commissioned by the Pacific Islands Forum Secretariat and undertaken by an independent Study Team. The Study Team considered a wide range of transport matters in Forum member economies. The report only contains a few pages on coastal shipping and provides no analysis of the desirability of maintaining a cabotage regime in Papua New Guinea or any other country. The Study Team recommended, among a number of other recommendations, that the Government of Papua New Guinea consider its position in relation to the cabotage regime.

Steamships' opinion of the 'conclusions' of the so called DFAT report is that they are unsubstantiated.

Consistency of service level

Papua New Guinea is currently well provided with coastal shipping services, relative to its stage of economic development, the size of its coastal shipping market and the cost of providing those services. All of the major ports and most of the minor ports are currently supplied with liner shipping services that are frequent (relative to the amount of cargo involved), regular and continuous. Shippers are connected to most parts of coastal and island regions of the country and, where feasible, inland areas. Shippers are also connected to most parts of the world through international liner services at the major ports.

The question of whether the cabotage regime has resulted in a consistent service level begs the question of what the situation would have been without cabotage. In our view Papua New Guinea would have been be less well served without cabotage. The reasons for this are as follows.

The coastal shipping industry in Papua New Guinea is able to provide extensive coverage with its liner shipping services in spite of the fact that many ports and sectors are not profitable given the regulation of coastal freight rates. The industry is able to do so by cross subsidising these 'thinner' trades with income earned on the main routes. In the case of Steamships, the Port Moresby to Kiunga service and its charter contracts allow it to continue to service less profitable and unprofitable ports. Without these more profitable sectors, Steamships would not be able to afford to continue to provide Tier 1 services to many of the ports it now services.

Without cabotage, it is likely that international liners would skim the 'cream' off the coastal shipping trade. That is, they would provide services only to ports that justified the costs of providing those services. At present, international liners service Port Moresby and Lae. These, and perhaps Rabaul, are the only ports that justify a visit as part of an international liner service. The profitability of large scale international ships depends on maintaining tight schedules to many ports in Australia, Asia, the Pacific and beyond that are far more profitable than the Papua New Guinea trade. Coastal cargo will be attractive to international liner operators only where it is on their main routes and only where the cargo is in a form that can be quickly loaded and off-loaded. International lines would be more attracted to containerised, large volume cargo rather than the loose small volume trade that constitutes much of the coastal trade. However, this large volume containerised cargo is also the cargo that underwrites the business of the coastal liner shippers.

PNG coastal shippers are unlikely to be able to match the rates offered by international liners picking up 'convenience cargo'. If price controls are maintained, the loss of business on these main routes would either force coastal shipping companies out of business or cause them to reduce the quality of the services (and therefore the cost of providing those services) that they offer to the market segments not captured by the international liners. If price controls were lifted, the result would be a substantial increase in freight rates required to service most ports in Papua New Guinea outside of Lae, Port Moresby and perhaps Madang, Rabual and Kimbe. However, demand on a range of these routes is likely to be price sensitive so that price increases are likely to lead to a reduction in the frequency and quality of services.

To summarise—if an open seas policy had been in place in Papua New Guinea, large coastal containerised cargo on the main routes would most likely be dominated by international shipping companies. Papua New Guinean coastal shipping companies would continue to service the higher cost cargos along the main routes and cargos on lesser routes but the frequency and quality of services would most likely decline. Maintaining service qualities to the residual customers would require a substantial increase in freight charges. If the market could not bear these charges, there would be a decline in the quality of services offered with the market slipping toward Tier 2 and Tier 3 service levels. The end result would be that outside of the main trades, coastal shipping services in PNG would be more expensive, less reliable and less safe to life, property and the environment.

Monopoly provision of coastal services

The coastal shipping regime in Papua New Guinea does not confer monopoly rights to service the coastal trade as a whole or to service particular segments of the coastal trade. There are no restrictions on the number of coastal shipping licences under the MSA. All that the MSA requires for the award of a coastal shipping licence is that the applicant is a PNG registered business and the vessel for which the licence is sought be a PNG flagged vessel. Steamships have no monopoly on the routes that it services. It competes with a number of other local operators in both the liner shipping and the charter market.

Prices in Papua New Guinea are controlled by regulation. The regulation of prices has meant that in real terms prices paid by coastal shippers have fallen significantly over the past decade. Steamships is operating in a competitive market under a price ceiling. It is not in a position, like a state owned enterprise such as PNGHL, to pass on inefficient costs to its customers. It has a responsibility to its shareholders to minimise it's cost of providing the services that its customers require. If Steamships is not operating its assets efficiently (that is maximising profits), its assets should be deployed elsewhere or would be a target for take-over by commercial interests that thought they could provide the service more efficiently..

Steamships would argue that, rather than being artificially high, the price control regulations have forced artificially low prices on coastal shipping companies. Steamships consider that the market for coastal shipping is a contestable market and as such there is no case for price regulation on economic grounds. Economic efficiency requires that prices be cost reflective: that is, prices to customers in different market segments should reflect the cost of providing the service that that customer demands. If coastal shippers are not receiving a market rate of return on their investment, then investment in the coastal shipping industry will decline and service quality will be eroded.

3.4 Concentration of market power

The Commission is seeking views on the issues associated with the concentration of market power in coastal shipping.

The relationship between Steamships and the Swire Group

The Commission notes that shipping operators, shippers and freight forwarders have expressed concerns in relation to the seemingly entrenched position of the Swire Group in both the domestic and international segments of the shipping market. Furthermore, the Commission notes that Swire has significant investments in Papua New Guinea, more particularly in the retailing of consumer goods and building supplies and materials. However, the Commission notes, it has recently divested its interests in the hospitality and automobile industries. This reference is incorrect and should read that Steamships has recently divested its interested in Merchandise Division (retailing and wholesaling of consumer goods) in October 2005 and its Automatic Division in 2002.

The Commission mentions suggestions that Swire may favour their own products when charging for shipping into and within Papua New Guinea. According to the Commission, concerns have also been raised in relation to the seemingly dominant position of Swires in the stevedoring and tug boat sectors of the industry.

There are some misconceptions in the Issues Paper that need to be corrected. John Swire & Sons holds approximately 72 per cent of Steamship Trading Company Limited Shares. Steamships is a publicly listed company and relations between Steamships, John Swire Sons and their Marine interests, namely Swire Shipping, are conducted on an arms length basis. As noted above Steamships has divested its retailing and automotive interests and generates a relatively small amount of cargo for Swire Shipping. There is no cross subsidisation of freight rates for Steamships shareholders by charging higher rates for third parties.

Steamships has a 100 per cent shareholding in Laurabada Shipping (LSS) and a 33 per cent shareholding in Consort Express Lines. The management of LSS is totally autonomous from the management of Swire Shipping and the interests of LSS are aligned to those of Steamships (again taking full account of minority interests in a public listed company), not Swire.

Steamships do not have a controlling interest in Consort Express Lines, nor by extension does Swire. Consort operates as an independent entity as evidenced by the vigorous competition between with CCS on the Australia-Pacific trade.

Steamships acts as agents for Swire Shipping trades and provides stevedoring services on an arms length basis to protect the interests of minority shareholders in Steamships.

Market concentration issues

Regulators such as the ICCC are rightly concerned with the protection of customer interests against the exercise of market power. However, high levels of industry concentration (that is industries that are served by a few firms) and vertical integration are not sufficient conditions for the exercise of market power. In a country the size of Papua New Guinea, the coastal trade will only support a relatively few viable competitors. This is a natural outcome of the economies of scale and scope that characterise the trade and the small volumes of trade on all coastal routes in Papua New Guinea. However, this does not mean that there is no competition. As mentioned earlier Steamships has a number of competitors for cargo in the parts of the country that it services and there are no barriers to entry to the coastal shipping industry.

The equation of market power with industry concentration can lead to misguided policy remedies. Appropriate economic regulation should focus on the achievement of economic efficiency rather than the number of service providers. Some industries naturally involve small numbers of suppliers. This is particularly the case in a relatively small economy such as Papua New Guinea. A competitive market structure (that is, one with large numbers of suppliers) is neither appropriate nor efficient for coastal shipping in PNG because of the economies of scale and scope and the size of the market.

3.5 Compliance with International Maritime Standards

The Maritime Industry Restructuring project sponsored by the Asian Development Bank and AusAID led to the transfer of safety and related aspects of maritime regulation away from the Department of Transport Maritime Division to the newly created NMSA. The two main objectives of the NMSA as conferred by its Act are to:

- Raise standards of maritime safety in PNG waters; and
- Strengthen controls over maritime pollutions from ships.

Steamships considers that these two objectives are appropriate. For commercial and insurance reasons Steamships vessels and crews all comply with the highest international standards of safety and environmental protection. However, this compliance comes at a cost in terms of rasing Steamship's administration costs and the operating and capital cost of the vessels that it employs in the coastal trade.

A major impediment to the ability of Steamships to compete with second and third tier operators is that these operators are not subjected to the same safety and environmental requirements. This reduces their operating costs relative to the costs of Steamships, Consort and other tier one operators. Not only does this distort competition, it has the potential to increase the market share of Tier two and three operators. Non regulation by these operators therefore increases safety and environmental risks, counter to the objectives of the Act.

While the costs of licensing and regulating all vessels is likely to be high and the capacity of the NMSA to enforce regulations is limited, Steamships considers that ultimately all except very small vessels should be regulated in a similar manner to the Tier One operators.

3.6 Coastal freight rates

Price controls on many routes are an important reason why the liner shipping business has been unprofitable. The tariff rate has been set since 1991. A currency adjustment factor (CAF) has allowed Steamships to recover part of its losses arising from the fall in the value of the Kina. However, the current CAF at 110 per cent does not fully compensate for the impact of the Kina depreciation since 1991.

The following provides an illustrative but representative example of the erosion in shipping revenues over the past fifteen years. In 1991, the maximum freight rate for general cargo carried from Port Moresby to Awaba, Balimo and Emeti was fixed at K50 per revenue ton. In December 2005, the maximum tariff rate was equal to the base rate plus the CAF at 110 per cent, a total shipping charge of K105. Over the same period, the value of the Kina relative to both the US and the Australian dollars fell by about 70 per cent. As a result, in $US terms the maximum shipping charge on 1 January 2006 was 38 per cent below its level in 1991.

In real or inflation adjusted terms, shippers are paying less today than in 1991. Adjusting for inflation, the shipping charge (freight plus CAF) on 1 January 2006 was 39 per cent lower than in 1991.

3.7 PNG Harbours Limited

PNG Harbours Limited (PNGHL) is a government owned company that is responsible for the regulation, management, operation and control of declared ports and the movement of shipping in declared ports. PNGHL is also responsible for the provision and maintenance of lightships, buoys, piers, jetties, landing stages, landing ramps and platforms in declared ports as well as the provision and maintenance of machinery, equipment and installations used in connection with the operations of declared ports. PNGHL operates almost all of the public ports in Papua New Guinea.

PNGHL is regulated by the Commission which is responsible for the issue of licences for the conduct of various port services. PNGHL has a license to provide wharfage and berthage services in the declared ports and is also responsible for the provision of pilotage services. PNGHL is required under its regulatory arrangements supervised by the Commission to maintain certain minimum standards at the ports it owns and operates.

Steamships notes that this review is not intended to embrace a review of the operations of port services. However, since the efficiency and the cost at which these services are supplied are vital to the cost of coastal shipping, a number of points need to be made.

PNGHL has recently raised a number of its charges. Wharfage and berthage chares were raised by 15 percent in May 2004 and by 17 percent in January 2005. In January 2006, pilotage charges were increased by approximately 500 percent as the calculation of fees was changed from a length to a gross registered tonnage basis. It should also be noted that these increases have been taken without improvement to infrastructure as is provided for in the Regulatory Contract.

PNGHL is responsible for providing minimum standards of service at its ports. Steamships recommend that the Commission review the issue of congestion at Lae and other ports in particular Daru due to inadequate port facilities and poor service delivery.

Inadequate facilities at Daru and other PNG ports under the control of PNGHL impose major costs on coastal ship operators and their customers. The costs of delays include the direct costs associated with the initial time lost - additional fuel, wages and other operating costs as well as the cost of capital not being utilised. The initial delays have cascading effects because ships have limited capacity to make up time to meet the remainder of their schedules. This can result in further delays in forward ports. The indirect costs are also significant. This can involve the loss of customers due to unreliability in the service schedule.

One solution to the difficulties would be to allow the private sector to invest in both private and multi-user port facilities. This would reduce the financing commitment required of PNGHL and the Government.

Appendix: LSS Liner runs

Map 1 : Gulf and Western Province Agutoi Chief Liner Run

Map 2: Gulf and Western Province Kikori Chief Liner Run

Map 3: Gulf and Western Province Goada Chief Liner Run