

11th May 2006

Acting Deputy Secretary

Secretary

**RE: ISSUES PAPER ON PNG SHIPPING INDUSTRY AND AIRLINES
INDUSTRY**

As part of the 2006 Budget Strategy of the Government, the Minister for Treasury has directed the ICCC to carry out reviews of the competition framework for the Shipping and Airlines Industries. The ICCC has provided us with Issues Papers for the Shipping and Airlines Industries respectively, upon which they seek our comments. Attached is a proposed letter to the ICC setting out our views on the two issues papers.

Mr. Andrew Numbasa

Acting First Assistant Secretary

Structural Policy and Investment Division

11th May 2006

Mr. Thomas Abe
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National Capital District

**RE: ISSUES PAPER ON PNG SHIPPING INDUSTRY AND AIRLINES
INDUSTRY**

I refer to your letter of 24th March 2006 requesting the Department to comment on the two Issues Papers. As you are aware, the reviews are part of the Governments 2006 Budget Strategy and the Treasurer has highlighted during the presentation of the 2006 Budget that certain industries in Papua New Guinea have to be reviewed with the view to encourage competition and for these industries to be regulated by reducing their charges and user costs and to improve the overall service of these industries.

In this case, the Shipping and Airlines industries are some of the industries that have to be reviewed with the focus of strengthening competition and regulatory control over their operations. The airlines industry currently has a high air transportation cost, which is having an impact on its consumers and it is Government policy to increase competition where possible within this industry and thereby to reduce air transport costs.

The department will be supporting the ICCC during the process of these reviews. Having said that, below are Treasury's comments on the two reviews.

COASTAL SHIPPING

Whilst the department notes all the issues that the industry is facing, we will concentrate our comments on the issues we think require Government policy and direction as to the way forward. Our comments will focus on issues relating to the current system of cabotage in PNG, international conference agreements, and tourism.

Cabotage

We note that the Merchant Shipping Act is restricting new entries to operate in our coastal ports. Whilst the domestic shipping companies are benefiting from the protection under the MSA, the freight charges that are being imposed by the domestic shipping companies on the transportation of commodities used in manufacturing or through the distribution of finished goods by the consumers have been very high because of the

monopoly status of these shipping industries. We agree that relaxing cabotage by regulating this sector and introducing competition will have economic benefits arising from access to lower freight rates including efficiency.

However, we would like to also point out that the actual benefits of relaxing cabotage will depend on the size and structure of the shipping market. As indicated in the issues paper, our domestic shipping market size and structure is larger in the busiest ports than in the other ports. If competition is to be introduced within our domestic shipping market, it is likely that the domestic shipping companies and the new entrants would be operating on the routes which optimize their cargoes and returns rather than the routes which provide limited returns.

Treasury is supportive in that abolishing cabotage will have an overall economic benefit to PNG, however, we are concerned of the fact that in the event that there is competition within the domestic shipping market, the competitors will be maintaining their shipping services only in the busiest ports that maximize their returns rather than the others which do not provide much return. This counters the purpose of introducing competition as the services has to be provided to all the ports in the country. It would be appropriate if the issues paper can elaborate further on such arrangements and how services will be shared in this respect.

International Conference Agreements

We also note and would like to highlight our concerns on the above agreements. We agree that shipping arrangement is a resultant of a form of cartel. Since the Government is moving towards encouraging competition in coastal shipping, such arrangements will have an impact on the market price and the services provided by the shipping companies.

We note that there are a number of known conference agreements including a slot charter arrangement between Pacific Forum Line (PFL) and the Chief Container Services (CCS). It is obvious that the shipping companies who are engaged in such arrangements could co-operate in fixing prices and/or carve up the market by restricting the services they provide by determining the number of goods and commodities they transport. The aim of such collusion is definitely to increase profit by reducing competition and this is against government policy. We note that Part 6 of the ICC Act highlights on price fixing and restricting services which are anti-competitive in economic sense therefore it is recommended that there should be regulatory oversight in this kind of arrangements.

Standards

In relation to the impact of compliance costs and its relation to competition between compliant and non compliant ports, two scenarios have been raised in the issues paper in relation to competition. First, is a situation whereby the non compliant port reduces its cost structure and winning the business and another whereby the compliant port wins when compliance standards are fully implemented by the shipping industry and ports in PNG.

Because of the fact that PNG is a signatory to the International Maritime Organization, we strongly recommend that the ISPS Code and SOLAS have to be fully implemented by the shipping industry and port facilities in the country. The threat of terrorist acts against the shipping and port facilities are real and not imaginary and it is for these reasons that compliance measures and procedures have to be taken seriously by the shipping industry and port facilities in Papua New Guinea.

Furthermore, non compliance by our domestic shipping industry to these standards could mean a trade ban while any international vessel who calls in to our domestic port that is not compliant with the ISPS code may subsequently be denied the access to ports in other countries. For these reasons and as far as competition is concerned, we recommend for all ports to be compliant with international standards. However, in order for the ports to be compliant to meet international standards, funding would be needed to upgrade the standard of the ports. Because of the fact that the Government has limited resources available, we recommend for an arrangement to be done to upgrade the port infrastructures to meet international standards internally.

Tourism

Treasury notes the current impediments that the coastal shipping section impact directly on the tourism sector. We fully support the recommendation by the Tourism Promotion Authority to abolish all port and related charges on cruise ships. The port and related charges should only be limited to cruise ships rather than cargo and passenger ships. The Government is serious about the impediments surrounding the Tourism industry and is working towards removing these impediments with the aim of boosting the industry.

AIRLINES

Tourism Issues

Treasury agrees that one of the impediments to the Tourism industry and its growth in PNG is the passenger fare that is charged by ANL. The charges are very high compared to other Pacific Island States and it is one of the reasons why there is a decline in the number of Tourist visiting Papua New Guinea. As it stands, travel agents do not have any choice but to engage ANL as a default service provider for the Tourist because apart from Airlines PNG, ANL has the dominance in the market. The real question, of course, is whether it is barriers to entry that are causing the high prices. If indeed there are regulatory impediments to entry into the market (be they Papua New Guinean or Australian), we would be very keen for these to be closely examined with a view to their removal.

We also note in the issue paper that the TPA identified that the reasons for the high ticket prices is basically because of the tax component built in the ticket prices. As Treasury is responsible for taxation matters, we would like the ICCC to note that the only tax component in the ticket prices is the departure tax. Given that the PNG taxes on a return

ticket from Australia amount to only K100, this fails to explain the difference in price between international travel to PNG and travel to other Pacific countries.

Late last year we contacted both airlines requesting a breakdown of these additional “taxes” into each of the components. The information provided is summarized in Table 1. While it is possible that some items may have varied slightly in the intervening period, these changes are likely to be at the margin. There are also some slight differences in information provided by the two airlines in this table due to currency fluctuations.

TAXES & CHARGES ON POM-CAIRNS FLIGHTS

Type of Charge	Airlines PNG	Air Niugini
<i>Airline-imposed charges</i>		
Fuel Surcharge	385.60	399.00
Insurance levy	16.60	
<i>Australian taxes & charges</i>		
Australian Departure Tax	92.30	91.20
Cairns Airport Charge	87.00	85.80
<i>PNG charges</i>		
CAA Facility Charge	60.00	60.00
CAA Screening/Security Charge	14.50	14.30
<i>PNG Government taxes</i>		
Departure Tax	30.00	30.00
<i>Other charges</i>	32.60	
Total	718.00	680.30

This table clearly shows that the largest single component of the “taxes” on airfares on this route is the fuel surcharges the airlines impose themselves. Clearly, describing these charges as taxes is misleading.

The table also shows that Australian taxes and charges on the route are higher than their PNG equivalent for both airport charges and departure tax.

Indeed, the only component that is technically a Government tax – departure tax – is only K30 per passenger (or less than 5 per cent of the total “taxes and charges”). Clearly, Government taxes are not responsible for the high additional “taxes and charges” imposed on ticket prices.

We recommend the above issues be taken into consideration to clear the uncertainties that the Tourism industry have in relation to the tax component of the ticket fare.

Airport Infrastructure Issues

We note in the issues paper that there are 24 major airports and out of the 24, seven apart from Jacksons airport, can handle international traffic. Treasury agrees that the existing airport infrastructure should be restructured, however, as far as Treasury is concerned, an extensive cost-benefit analysis should be undertaken to consider the economic and social case for international airport expansion with reference to the current levels of economic activity as a benchmark case. The study will need to quantify how each airport will contribute to that region's and nation's economic activity, the expected economic rate of return on each airport, the costs of funding the recurrent items such as maintenance and extra services like quarantine, customs, immigrations, air traffic controls, savings to industry of not using Jacksons, the cost of Jacksons airport of lower freight and passenger numbers and the identification of the impact on net revenue of the CAA. We note that the international airports currently in place seem to be substantially under-utilised – for example, we are not aware of any international traffic to Alotau or Kavieng, despite their international airport status.

With regard to the transfer of ownership of airport infrastructure from public ownership to private sector, based on the assumption that private sector is more efficient in terms of delivering the necessary services to airport customers, we are of the view that these assumptions should be clearly identified, including how the private sector will be delivering the necessary services, the type of services and of which particular customers will their services be targeted to. Particular attention should be paid to potential security impacts of private sector involvement in the running of airports.

Currently, the Government and the CAA have an arrangement in place to transfer all the assets and liabilities from the State to CAA. We are concerned that the transfer of the airport infrastructure assets from CAA to the private companies will have an impact on the current arrangement the Government has with CAA.

For your noting and information

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Secretary