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Issues in Shipping's Future

Need for, and Prospects of, Liner Conferences

by Paul Burke, Washington *

This paper examines the need for liner conferences, or cartels, in international shipping, and compares investment in shipping to investment in housing, an industry which is not usually organized into private cartels. Then the paper discusses how the quantity of goods being shipped is likely to grow in the future, and how that growth can be expected to affect shipping conferences.

Lines which carry general freight on a particular route usually group together in a shipping conference, or cartel, which sets minimum rates for each type of goods carried. These conferences, however, have only the mildest government supervision. The justifications given for such a cartel, even in countries which otherwise rigidly control monopolies, or break them up, deserve ever-repeated scrutiny. It is hoped that the point of view presented here will encourage further thought on the circumstances when these conferences may be justified or should be regulated.

The Argument of "Cut-throat" Competition

It is said that in the absence of minimum prices, "cut-throat" competition would exist¹. The argument goes that shipping involves extremely heavy fixed capital costs, besides the costs that vary with the amount of goods shipped. Furthermore, the supply of ships is rather inelastic in the short term because ships take two or three years to build, and when built, may last twenty-five years. Therefore competition would cause great instability: if some shipowners began to cut prices, others would have to follow suit, and would continue to cut prices below the level that covers both capital and operating costs, shipowners being willing to stay in business down to a price which only covered operating costs. If prices fell so low, the argument concludes, shipowners would eventually go bankrupt, to the detriment of both shippers and shipowners.

While it is true that in the short run prices can fall as low as the price that will only cover operating

costs, which would be below the breakeven point, that low level will drive some shipowners out of business and will make entry into the industry unattractive, so the supply of ships will fall, until they can once more command a price that covers both capital and operating costs.

Comparison with Other Industries

That is a theoretical textbook-type answer, which, of course, may not work in the real world. So it is useful to see whether there are other industries that have a similar financial structure, where long-lived expensive capital goods are a major item of costs. Railroads or telephone companies are ready examples, and as it happens, they are also usually monopolies. But they are monopolies because a route really does need only one set of railroad tracks, and a residence needs only one telephone connection², so competition would involve unnecessary duplication. But a shipping route needs to be served by several ships anyway, so there is no parallel physical need for a monopoly in shipping. A better example of an industry with a financial structure similar to shipping is

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¹ John S. McGee, "Ocean Freight Rate Conferences", in: Allen R. Ferguson, et al., *The Economic Value of the United States Merchant Marine*, Transportation Center, Northwestern University, Evanston, 1961, pp. 343-436; and Carleen O'Loghlin, *The Economics of Sea Transport*, Pergamon Press, Oxford, 1967.

² Actually in some countries there is competition in several aspects of telephone service. Large users can rent private lines or share the use of another company's private lines. Businesses also usually can have their phones installed by one of several specialized equipment companies that compete with the local phone company.

the market for rental apartments. Large apartment buildings are multi-million dollar investments, which last even longer than ships, up to 40 or 60 years. Once a building is built, the capital costs, as in shipping, are a large fraction of total costs, often half.

In some small neighbourhoods, a particular apartment owner may dominate the rental market, but in general, there is substantial competition within any housing market. If apartment owners pointed to their capital structures, deplored the problems of "cut-throat" competition, and asked to be allowed to form cartels, they would not be taken seriously, because people have seen that the housing market can work on a competitive or government-regulated basis. Our immediate past experience with shipping, however, has been with cartels, so governments have not been able to see how a competitive shipping market would work, and therefore shipping companies' arguments have been accepted, at least by the developed countries which could regulate them³.

Therefore, it is worth seeing how far one can take the analogy of ships to apartment buildings. It will also be useful to compare liner shipping with tramp shipping, which has somewhat similar economics but has not been dominated by cartels. The conferences' minimum tariffs are said to stabilize prices, and in fact research comparing indexes of liner tariffs and tramp rates has shown tramp rates to be significantly more volatile⁴. It is very possible therefore, that a competitive market for liners would result in steep price rises when shipping space is scarce and steep falls when excess space is available. Even in the absence of conferences, however, there are several other factors that also could or do limit fluctuations.

Nothing would prevent major or minor shippers from signing long-term contracts with individual shipowners, similar to the ones now signed with conferences. Such a contract would stipulate a price, volume, and frequency of shipments, to the advantage of both shipper and shipowner. In apartments, long-term leases are used in this way to avoid temporary price fluctuations for both landlord and tenant. In tramp shipping, long-term charters are similarly used, to provide the shipowner a stable income and the shipper a stable price, regardless of fluctuations in spot prices.

³ For a discussion of developing countries' views, see W. R. Malinowski, "UNCTAD: Regulation versus Self-Regulation", in: *INTERECONOMICS*, 1972, No. 9 (September), pp. 279-82, and the reply by R. B. C. Farthing, "Shipowners' View on Liner Conferences", in: *INTERECONOMICS*, 1972, No. 12 (December), pp. 379-83.

⁴ See McGee, cited in note 1, and S. G. Sturme, *British Shipping and World Competition*, University of London, 1962, chapter 13.

Competition for liners from alternate means of transport — airlines, tramps, etc. — provides another limit on the fluctuations in liner freight prices. When prices rise too high, especially on high value items where transport is not a large fraction of the ultimate cost, airlines become competitive. When prices rise too high on goods which are shipped in large quantities, tramp ships become competitive. For apartment buildings, single-family houses and condominiums offer a similar kind of imperfect competition which prevents price fluctuations from proceeding too far.

Impact of Price Fluctuations on the Consumer

There is another limit on shipping prices for goods where transport is a large fraction of the ultimate cost; sales of the goods themselves would drop if the transport portion of their cost rose substantially. Thus demand for shipping for these goods would similarly drop. There is a parallel in real estate; households have finite incomes and have other expenses besides housing, so demand for housing falls when the price of housing rises substantially.

These limits on price fluctuations would still allow more fluctuation in liner prices than there is now. Just as tramp owners have in the past, liner owners in a competitive, fluctuating market would need to keep reserves in good times in order to go through lean times. Shippers would be able to save money when rates are low, in order to pay the rates when they are high. Thus consumers would not necessarily face the full range of fluctuations. Even to the extent that consumers do face price fluctuations, shipping costs are a small fraction of most finished consumer goods, so the fluctuations in total consumer prices of products traceable to shipping tariff fluctuations would be slight.

The area where fluctuations in shipping costs would have greatest impact on consumers is in bulk shipment of foods. It should be noted that many, if not most, such shipments already travel by tramps, and already feel the full force of tramp rate fluctuations. However, in any case, it is instructive to look in general at the ways in which volatile commodity prices have been treated. They are not controlled by permitting a private monopoly to form and set the price. To the extent they are controlled at all, commodity prices are controlled by governments or by groups of governments. It may be necessary for shipping tariffs to be held stable when massive amounts of food aid, for example, move around the world, but that need does not argue for private control, rather it argues for government control.

Apartments are sometimes considered to be in short supply, and apartment rents are therefore sometimes accused of being too high. It can be argued that the risky capital-intensive nature of the industry, in the absence of a cartel, frightens away capital. Then it would follow that shipping would also end up in short supply if conferences were abolished and shipowners were exposed to the risks of fluctuating prices. The presence of risk is in fact considered a cost by most investors, so a greater degree of risk will be passed on in higher costs to consumers. However, monopoly also entails higher costs to consumers, and it is not clear that extra costs caused by risk would be as large as the extra costs caused by monopoly. Most businesses entail risk, yet most businesses are not allowed to form conferences to fix prices. Furthermore, the most extreme risks can be averaged out by insurance at the cost of a modest profit to the insurer⁵. Banks are willing to provide mortgage money for apartment buildings in the US, because most or all of the risk of default on the mortgage can be borne by government or private mortgage insurance, as long as the building meets certain standards.

Apartment rents are "high", partly because of the risks faced by the owner which cannot be covered by insurance, but largely because of the high land costs, construction costs, financing costs involved in a multi-story building.

It may be recognized here that we cannot definitely say that liner prices will be lower in a high-risk competitive market with fluctuating prices than they are in a low-risk non-competitive market where prices are fixed by conferences. Again though it needs to be said that, if price fluctuations are such a problem and need to be ironed out, it is more appropriate for a government to do so than a private shipping conference.

Quantity of Shipping in the Future

The above theoretical discussion of shipping conferences becomes particularly important when seen in the light of the dependence of developed and developing countries on shipping. Figures on the volume and economic value of shipping are commonly presented. In this paper we will examine how even more important shipping is likely to be in the future. In order to look at trends in the volume of shipping, we will present time series data on shipping and on gross national product (GNP) for four countries from 1953-73. It is not the purpose here to hypothesize a model

which includes all the factors that may affect the future growth of shipping. Data on imports and exports will only be compared to GNP, as a measure of economic activity, in the expectation that it is the single major factor most directly related to shipping, and that its growth trend, which is somewhat stable, will help predict the growth trend of shipping.

Data on GNP and on shipping must not be regarded as precise, because they are collected or estimated by many different procedures. The reader is referred to the original sources of the data used here for a full discussion of their drawbacks⁶. However, the figures indicate that GNPs have been rising (1968-73) in all countries studied, and are even rising per capita in virtually all⁷. The theoretical effect that this economic growth will have on shipping is two-fold. The growing countries will come to have large enough markets to manufacture some things locally and replace imports, therefore needing less shipping. On the other hand, they will be able to buy more specialized manufactures and raw materials from other countries, and ship abroad their own manufactures, therefore needing more shipping. Raw materials are bulkier and heavier than finished manufactures, so with growing GNP a country tends to move from a position where exports (of raw materials) outweigh imports (of manufactures) toward a position of greater balance, or where imports outweigh exports. The empirical question whether, on net, a large-GNP country has less trade than a small-GNP country is definitely answered in the negative in the statistics below. Developed countries have substantially more trade than developing, and as a country develops, the growth in its trade seems to parallel the growth in its GNP.

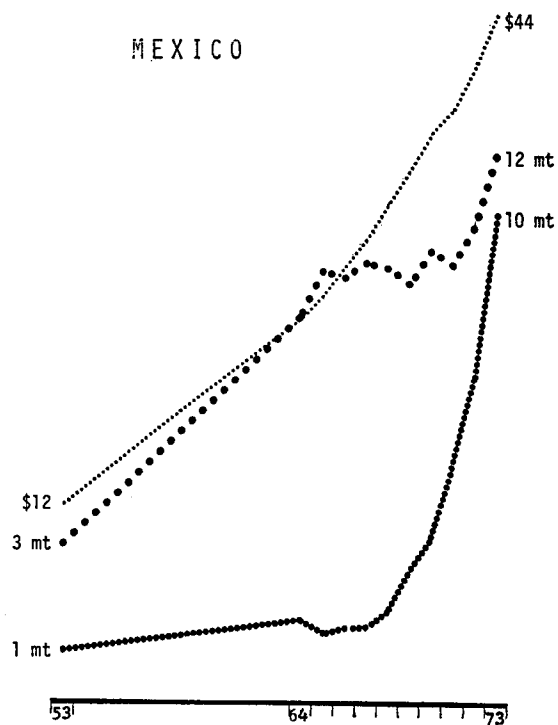
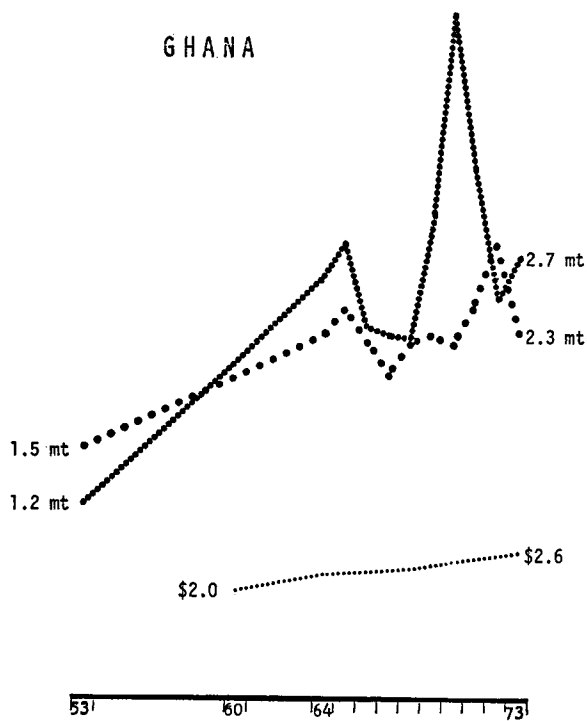
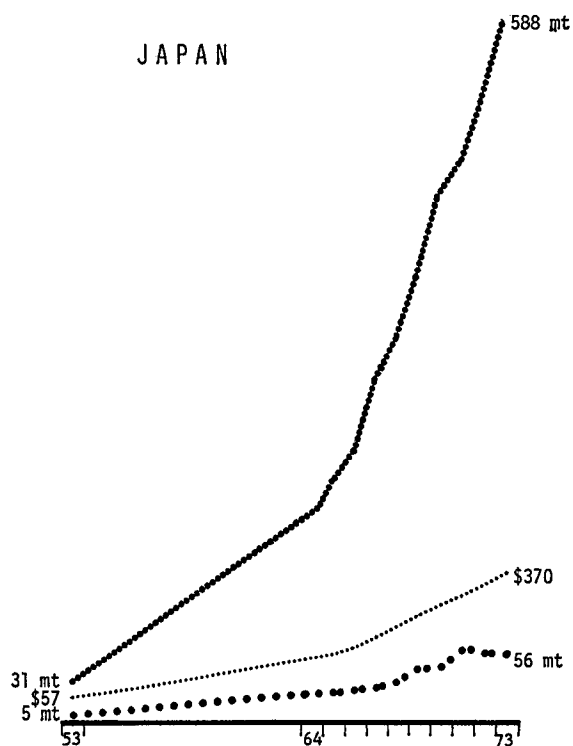
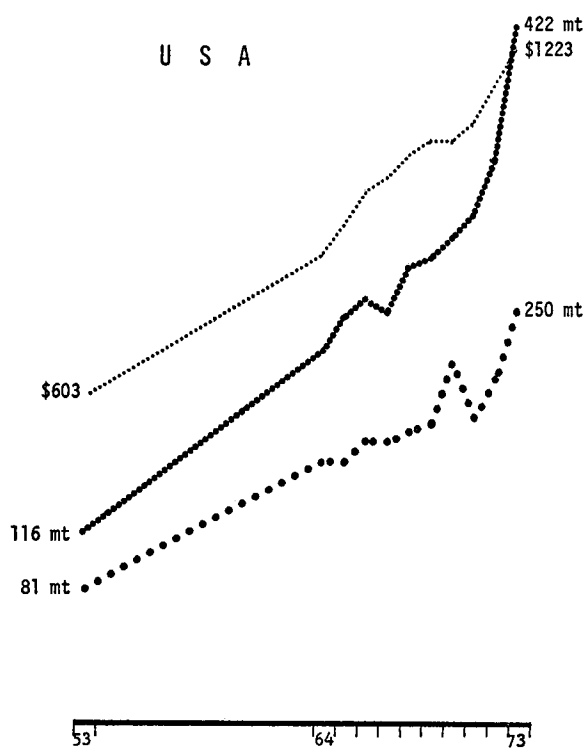
The chart shows time series data for four countries from 1953-73. The United States is presented because it will be familiar to most readers; Japan in order to show its recent very fast growth; Mexico and Ghana as medium and smaller economies, respectively. All four graphs show an upward trend in GNP (small dots) paralleled more or less closely by upward trends in exports (widely spaced dots) and imports (closely spaced dots). In the US and Japan these three trends are

⁵ Esra Bennathan and A. A. Walters, "Shipping Conferences: An Economic Analysis", in: *Journal of Maritime Law and Commerce*, Vol. 4, No. 1 (October 1972), pp. 93-115.

⁶ GNP data 1953-73 from: US Agency for International Development, "Gross National Product Growth Rates and Trend Data", 1974, (RC-W-138); and from: US Agency for International Development, "Estimates of Gross National Product for Non-Communist Countries", 1974, (report control No. 137). Shipping data 1953, 1964 from: UN Statistical Office, *Statistical Yearbook*, 1972, UN, New York, 1973, table 153. Shipping data 1965-73 from: printer's proofs of tables 155 and 157 of the *Statistical Yearbook*, 1974, received from M. Borovik of the UN Statistical Office. General comments on the UN data are included in: UN Statistical Office, 1967 Supplement to the *Statistical Yearbook* and the *Monthly Bulletin of Statistics, Methodology and Definitions*, UN, New York, 1968, pp. 232-5.

⁷ US Agency for International Development, "Gross National . . .", cited in note 9.

GNP and Trade, 1953-73 in four Countries



Source: See Note 6.

..... EXPORTS, shipborne trade in millions of metric tons

————— IMPORTS, shipborne trade in millions of metric tons

- - - - - GNP, in billions of 1972 US Dollars

very stable, because the large economies average out the fluctuations in individual industries. The trends in Ghana, and to a lesser extent in Mexico, fluctuate more, because their smaller economies cannot average out fluctuations. Neither of these countries is extremely small; they represent what the future may hold for countries which are now even smaller than they are.

In the US and Japan, imports outweigh exports, because as mentioned above these countries tend to import raw materials and export manufactures. The US has less of a gap between imports and exports because it does export quantities of grains and other raw materials. In Ghana imports also outweigh exports, partly because Ghana does import raw materials such as bauxite for partial processing and re-export, partly because Ghana was living beyond its means in 1969 and 1970, until a military government brought down the import rate substantially in 1971. Mexico provides a better example of a less developed country exporting more weight than it imports. It may be however that Mexico's situation is changing as the country becomes industrialized; Mexico's exports have not been rising dramatically in recent years, while its imports have.

In all of these countries, an upward trend in GNP has been accompanied over the last twenty years by upward trends in shipborne imports and exports. Although the composition of trade has certainly shifted, the level has moved upward fairly consistently. If GNPs continue to rise, as seems likely, both shipborne imports and shipborne exports will rise in parallel. These four countries together cover a wide range of GNPs, and they are not atypical, as similar analysis of other countries can show⁸. Therefore it is safe to conclude that all of the countries whose GNPs fall in this range (a large number of countries) will, if their development paths are at all similar, experience the same growth in imports and exports, paralleling their GNP growth. The potential for increases in shipping is substantial.

Impact of the Quantity of Shipping on Conferences

It seems appropriate now to look back at the discussion above of shipping conferences, from the perspective of a substantially increasing volume of shipping.

When shipping conferences hold tariffs higher than these would otherwise be, they act in direct conflict with the needs of shipping countries, and the conflict will become greater as needs for shipping increase. The price of shipping restrains trade as much as any tariff barrier to trade, and

if it is too high, it restrains trade unnecessarily. In the past, developed countries have tolerated conferences, although there is some regulation in the US and a few other countries⁹. They have tolerated conferences in part because any monopoly profits largely accrued to shipowning companies in developed countries. As more countries are able to make their wishes felt, this easy situation may not last.

There are several actions shipping countries can take. Countries may attempt to break up shipping conferences' control of rates; if countries organize in regional groups to do this, they are likely to succeed. Countries may try to regulate conferences; again regional groups will be successful in gaining adherence to the regulations, though the regulations may or may not be successful in limiting price increases. Countries with small but growing economies may try to join conferences both to bring down prices and to bring home some of the monopoly profits. The first option, breaking up the conferences except perhaps as scheduling agencies, would provide the best guarantee of minimum rates. This break-up might or might not be followed up by any port state or regional regulation of the competitive liner market. It is not clear whether regulation would be able or would be necessary to keep markets stable and to prevent excess profits from accruing to traditional shipowning countries.

Control of conferences is as subject to international negotiation as any other issue in the law of the sea. However decisions can be implemented effectively by regional, rather than by worldwide agreements, and in some cases by single countries. This issue does not inherently conflict with other interests discussed at the Law of the Sea Conference, so it can be advanced by regional or national actions whether or not an overall balancing of interests is reached at the New York session. It does conflict with other issues in other fields, which explains why shipping conferences have been extensively discussed at UNCTAD¹⁰, but there is little to prevent an economically strong regional group of countries from establishing its own regulations on conferences. Even if a general Law of the Sea agreement is reached which does not allow such actions, they may well be taken because of their importance to many countries whose shipping is steadily growing.

⁹ Andreas Lowenfeld, "To Have One's Cake . . . The Federal Maritime Commission and the Conferences", in: *Journal of Maritime Law and Commerce*, Vol. 1, No. 1 (October 1969), pp. 21-71.

¹⁰ See Malinowski, cited in note 3, and William J. Bosjes and William G. Green, "Comment, The Liner Conference Convention: Launching an International Regulatory Regime", in: *Law and Policy in International Business*, Vol. 6, No. 2 (spring 1974), pp. 533-74.

⁸ See note 6.