

1. Background

The Productivity Commission has been instructed by the Parliamentary Secretary to the [federal] Treasurer to hold an inquiry and make a report on Economic Regulation of Harbour Towage and Related Services.

This arises in part from the responses from industry and the ACCC to Adsteam's price increases for towage services in six ports including Melbourne. The inquiry is not however focused on the Adsteam issue.

The terms of reference are to report within six months on

- The impact of structural reforms on the provision of harbour towage and related services.
- Measures to increase competition in provision of these services.
- Whether continuing prices oversight is required.

The current "declaration" under the Prices Surveillance Act 1983 of these services in the five ports runs out in September 2002. The Inquiry is to report in August.

An Issues Paper has been published with a request for "Initial Submissions" by April 19 2002. A Position Paper will issue in June with a further request for comment.

The AAMPA has made a submission dealing with the detailed points in the PC's Issues Paper, and we generally subscribe to the comments in that submission. MPC therefore makes this initial submission outlining issues and principles that we consider that PC should address in the terms of the Inquiry. In particular we highlight issues upon which opinion is divided or where there is insufficient data to confidently formulate policy.

We suggest areas where the research and recommendations from this Inquiry would assist port and marine authorities in determining firm positions on this complex set of issues.

We compliment the PC on the thorough way it is being pursued and for the opportunity to comment.

2. Institutional and Statutory framework

Under the Port Services Act, the MPC is responsible for the management of the land activities of the port of Melbourne and the VCA is responsible for the management of the sea and river channels.

Under the Act, the MPC has to operate in a manner that is economically efficient and encourages competition among port service providers.

Unlike some other jurisdictions, the MPC has no powers to regulate, contract or license service providers such as towage. Neither does the VCA.

Regulation applicable to towage vessels in Melbourne is that related to vessel movements, which are controlled by the Harbour Master for the VCA, and vessel safety, regulated by Marine Safety within DoI.

In Victoria, the Essential Services Commission (ESC) has generic powers to regulate certain specified industries, including the ports industry. There are two ways that a specific industry can be brought under the ESC's regulatory powers: if it is specified in other relevant legislation such as the Port Services Act, or if it is declared by Order under the ESC Act. This form of regulation can comprise standards and conditions of service and supply, licensing, market conduct and other economic regulatory matters that may be conferred in the Order.

Currently however, unlike Geelong, Hastings and Portland, towage in Melbourne is not a prescribed service under the Port Services Act. Melbourne was omitted (it is assumed) as it had been declared along with other major container ports under the federal Prices Surveillance Act.

If the declaration under the federal PS Act indeed expires in September, there would thereafter be no economic regulation or prices surveillance of towage in Melbourne.

Therefore, it would seem that the State might consider its powers to introduce economic regulation over towage in Melbourne either by amending the Port Services Act to add Melbourne to the list of ports for which towage is a prescribed service, or by making an Order bringing towage in Melbourne directly under the purview of the ESC.

Naturally a case would have to be made that such regulation would be in the interests of economic efficiency and the public interest in general. It would also need to satisfy the test that the compliance costs would not exceed the benefits of the exercise of the regulatory power.

A further alternative, that is available in other States, would be to give the port manager the power to contract for the provision of towage services or to license towage operators on an exclusive or non-exclusive basis. This would require legislative change and a re-orientation of policy.

Exclusivity in contracts or licences implies a degree of regulation through market intervention. Non-exclusivity on the other hand is more clearly directed towards qualifying providers as to capability and viability, as well as safety and service standards.

The question for Melbourne is whether there is a need for economic regulation of this particular service, and if so, the scope of that regulatory power. The research being done for the PC Inquiry will provide useful information on which to reach a conclusion in this regard.

3. Impact of price increases for towage services at Melbourne

The MPC does not have detailed data on the quantum or proportional impact of towage costs. However, as an indication, it is clear that the increased charges for towage implemented by Adsteam are very substantial indeed. Prices increased on 6 March 2002 by an average of 23.4% on top of an increase of 10% in 1999.

For example, a 2,000 TEU ship (in the 30,000 to 40,000 tonnes range) previously incurred a cost of \$3175.70 per tug (including GST). The new charge is \$3918.82, an increase of \$743.12 per tug job. A ship of this size would often require at least two tugs: so for a single port visit with two tugs required at both arrival and departure, the increases would add almost \$3000.00 to the costs of the visit.

Adsteam have indicated that their average per vessel towage billings in Melbourne have decreased in real terms in the last decade. Others argue that while these efficiencies are hard won and highly commendable, there is potential for more efficiencies and that these should be delivered back to the cargo owners in the interests of trade.

There is an issue with the volume of billings in each ship size range, because "bracket creep" with the trend to larger ships would see gross towage revenues rise due to the sliding scale of charges. For example, over the past 25 years there has been an average increase of 7% per annum in gross tonnage of ships visiting Melbourne and Geelong, which significantly exceeds the average annual growth in trade.

The number of ships visiting the Port of Melbourne however decreased in 2000/01, notwithstanding the growth in trade. This decrease reflects the increase in size of ships. The extent to which higher towage revenues per ship offset the reduced number of ships is a factual matter that the PC Inquiry could research.

There is concern that increases will be passed on directly by the shipping lines to the cargo owners. As a result, imports would cost more, and exports would be less competitive on the international market. Each small increment in any cost item, or sacrifice of a potential efficiency saving, is aggregated across huge volumes of trade. Every effort should be made to achieve even the smallest efficiencies in unit costs.

Opinion is however divided on whether shipping lines can simply pass on such cost increases. Nevertheless, there is potential for increases in towage charges to impact on service level decisions of shipping lines and ultimately on Australia's trade performance.

The Issues Paper recognises that much of Australia's produce is sold into highly competitive world markets where a few cents per tonne or a few dollars per shipping container can make a difference.

The quantum of such increases, the issue of ship size and frequency, the proportion that towage costs comprise of the total transport costs of the goods, and the extent to which they are absorbed by shipping lines or passed on to cargo owners should be matters for the PC Inquiry to research.

4. Contestability and Industry trends

The issue now is no longer whether Adsteam's new pricing was justified, because that issue has been aired by the ACCC. The issue for the PC is whether measures are needed to encourage competition in the towage industry such that competitive pressure would ameliorate prices of this element of the transport cost chain.

Adsteam has a monopoly at the Port of Melbourne (and a near-monopoly throughout Australia). There is no contestability at present. There would be significant barriers to entry for an alternative service provider, but indications are that these may not be insurmountable. Certainly, the recent increases implemented by Adsteam would be encouraging for any prospective new entrant, and recent announcements indicate that this may happen shortly.

Adsteam maintains that the number of tugs per ship is declining, due to pilot decisions in part, but also to improved ship technology that reduces the need for assistance. On the other hand a number of shipping lines have complained that excessive numbers of tugs are being ordered. Again this would seem to be an appropriate issue for definitive data to be collated by the PC Inquiry.

At present and for the short term, it is likely that the demand for tugs will continue to be closely related to the number of ship movements. That is despite the improved technologies such as communications, positional aids, dynamic under-keel clearance systems, ships' side thrusters and improved tug manoeuvrability, there remains the basic equation that large ships need tugs to assist or to standby while they are negotiating complex channels, berths and turning basins in all weathers, states of the tide, hours of the days and traffic conditions.

An argument that is put by the towage industry is the need to have sufficient tugs on "standby" at short notice, at all hours – i.e. even if this is not reflected directly in usage patterns, thereby incurring significant sunk costs in order to meet a "just in case" requirement of the pilots and shipping lines. While this increased flexibility is of great benefit to port users, and comes at a price, we need to be confident that the data supports the argument.

The issue of sunk costs in terms of the initial capital investment in tugs needs to be investigated further. The cost of deploying new tugs is the major start-up cost and therefore potentially a barrier to entry. Opinions appear to differ on the market for second hand tugs, critically affecting the life-cycle costs to be factored in to a new towage enterprise.

Of course there is also investment in shore facilities, trained staff, specialised equipment, administrative and communications systems that may not be readily redeployed and would comprise an anticipated cost of terminating the business.

The implications of all these factors on the future trends in usage is difficult to determine, and it is cogent that the PC Inquiry is able to shed some light on these issues in order that policy decisions arising out of the Inquiry are well informed.

5. Principles for a satisfactory outcome

The following are some principles, from the perspective of the port manager, that are relevant to the key questions posed in the Inquiry's Terms of Reference.

- Neutral attitude to the present operator in Melbourne. The issue of future economic regulation of towage in Melbourne should be based on the factual analysis of the market conditions as envisaged in the PC Inquiry, and viewed with an open mind, notwithstanding the concern expressed about the recent price increases.
- The overall objective is to secure efficiencies in all port services and to deliver as much of these benefits as possible to cargo owners, to improve competitiveness at the point of delivery. This principle derives from the State Government's policies for economic and regional development consistent with social and environmental outcomes.
- The best option for ensuring lower costs/better service outcomes would appear to be concurrent competition among different towage companies for tug jobs, where that is practicable. Failing that a form of serial competition through licensing can be contemplated. An unregulated monopoly supplier would imply a considerable element of risk that prices would derive from factors extrinsic to the port.
- Economic regulation, including price controls, is a legitimate role of State Government where circumstances justify. The decision to implement such regulation would be based on the practical consequences in the short term for exporters and importers, as well as broader policy considerations such as securing contestability.
- The outcomes should recognise the structural and historical differences among ports and among jurisdictions across Australia. There may be good local, legislative and commercial reasons for different outcomes for different ports.
- It would be desirable nevertheless that the solution, be it active competition or regulation by State or port jurisdictions, should have a degree of consistency across States in terms of the principles applied.
- The outcome should be based on proper research and due consideration of findings and recommendations of independent review. The consultation process and the formulation of recommendations through the PC Inquiry will go a long way to satisfy this principle.

6. Summary and Conclusion

The MPC welcomes the PC Inquiry and the call for comment and input. We support the detailed submission made on behalf of ports by the AAPMA. In addition, this initial submission in essence conveys the following:

- Neither MPC or VCA has power at present to regulate, contract with or license towage service providers, but the legislation in Victoria would enable economic regulation by the State in terms of pricing, service standards and market conduct, if the State Government were so persuaded.
- MPC is concerned that if the declaration of Melbourne Port under federal Prices Surveillance legislation expires in September, there would be no economic regulation or prices surveillance of towage in Melbourne.
- MPC is concerned about the scale and impact of the recent increases in Adsteam's towage charges, averaging 23.4% on top of an increase of 10% in 1999.
- There is insufficient data on the combined effects of larger but fewer ships and the sliding scale of charges on the aggregate earnings of the tugs and other capital deployed by the tug company.
- Increased towage charges impact initially on the shipping lines and it is moot whether these costs are absorbed or passed on, creating uncertainty as to the profitability and service levels of enterprises involved in Australia's foreign trade.
- There are significant barriers to entry for any new towage enterprise, characterised by the scale of the initial investment, the contracts and other business arrangements held out by the incumbent operator in Melbourne and across Australia, as well as uncertainty as to potential asset disposal values and potential windup costs.
- The impact of technological changes in ships, tugs and channel management systems on the demand for tugs seems to be anecdotal at present.

MPC puts forward a number of principles that we would like to see embodied in a satisfactory outcome for the Inquiry:

- Objectivity and neutrality.
- Efficiencies to be reflected in benefits to trade.
- Concurrent competition is preferred, alternatively serial competition.
- Economic regulation is legitimate if circumstances require.
- Ports and jurisdictions are different and may require a range of solutions.
- Consistency of application of principles across States is desirable.
- Recommended outcomes should be based on research and consultation.

MPC therefore calls upon the Inquiry to investigate key research questions and provide data upon which well-informed policy can be formulated and practical and beneficial decisions taken.

MELBOURNE PORT CORPORATION
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