

NATIONAL BULK COMMODITIES GROUP

SUBMISSION TO THE

PRODUCTIVITY COMMISSION INQUIRY

INTO

**ECONOMIC REGULATION OF HARBOUR TOWAGE
AND RELATED SERVICES**

19 April 2002

Outline of the National Bulk Commodities Group

The National Bulk Commodities Group, established in 1983, is the peak national body representing Australia's bulk commodity shippers.

The aim of the National Bulk Commodities Group is to represent the collective interests of its members on issues connected with the production, transportation, storage, loading/unloading and shipment of Australia's dry bulk commodity trades.

The principal focus of the National Bulk Commodities Group is the promotion of efficient and quality maritime services that are available to Australian shippers at internationally competitive prices.

Objectives of the National Bulk Commodities Group

To ensure that Australia's dry bulk commodity exporters/importers have access to efficient and quality shipping services at internationally competitive prices.

The provision of efficient and cost effective port and marine services within Australia.

The recognition by governments and the community of the importance of the dry bulk commodity trade to Australia's economy.

The recognition that the dry bulk commodity trades must be conducted within a framework that supports safe shipping and protection of the marine environment.

The promotion of a performance based regulatory framework by Federal, State and Territory Governments that:

- promotes the growth and development of the dry bulk commodity sector;
- provides Australian dry bulk commodity shippers with timely and efficient access to internationally competitive marine services;
- promotes safe shipping, quality marine services and the protection of the marine environment; and
- is developed through consultation with industry including dry bulk commodity interests.

The promotion of a maritime industry in Australia that is able to provide integrated shipping and marine services to dry bulk commodity shippers.

To raise public awareness of the contribution that efficient, safe and competitive marine services makes to the national and regional economies.

Introduction

Australia's dry bulk commodity products compete in a competitive global market environment. In the export trades Australian producers and exporters are price takers with global markets determining the prices at which trades are made. In many trades Australia has a competitive disadvantage in the maritime transport component of the product based on the tonne kilometre task. This disadvantage combined with price volume ratio of many mineral and rural products requires particular attention to the cost of transport in order to remain competitive. In fact transport and related costs make up a high and sometimes the largest proportion of the final cost of the product delivered to the customer.

In pursuing inefficiencies in the transport sector it remains important to examine all components of the total transport chain. Statements that harbour towage and related services are a relatively small component of the total port costs do not mean that these services can or should be exempt from critical examination of the contestability of the market. In most cases the towage and related services are a significant proportion of the port related costs and for some ports can be very significant. However, regardless of the relative share of port costs the objective is to ensure that harbour towage and related services are supplied in a cost effective and safe manner and subject to effective competition where possible. **In circumstances where effective competition cannot be guaranteed than effective price control must be considered.**

The National Bulk Commodities Group welcomes the Inquiry by the Productivity Commission into the "Economic Regulation of Harbour Towage and Related Services" announced by the Government on 20 February 2002. The following submission responds to the Issues Paper released by the Productivity Commission on 12 March 2002 and covers other matters that the National Bulk Commodities Group considers should be examined as the inquiry continues.

COMMENTS ON THE ISSUES PAPER

ABOUT THIS INQUIRY

The National Bulk Commodities Group (NBCG) notes the Terms of Reference for the Inquiry that are reproduced in the Issues Paper. In particular, the NBCG draws attention to paragraph 6 that requires the Productivity Commission to review the market structure in the provision of harbour towage and related services including;

- the effectiveness of competition, including factors that might restrict competition;
- the extent to which cost structures differ between ports depending on the market structure in each port;
- pricing of harbour towage and related services, including structural and regulatory impediments to efficient pricing or service provision; and
- relevant regulations and legislation that may affect the efficient provision of harbour towage and related services.

While the NBCG accepts that proposed, and subsequently implemented, price increases of towage services in five ports declared under the *Prices Surveillance Act 1983* was the defining act leading to the reference for the Inquiry there are other factors to be considered.

The market concentration arising from the takeover of Howard Smith Towage by Adsteam Marine in 2001 provided Adsteam Marine with a dominant position of service provider in many of Australian ports. This dominant position of service provider includes all of the major ports with the exception of some bulk commodity ports where the integrated producer and associated entities provide the services. Examples include Port Hedland, Port Dampier and Hay Point.

At the time of the proposed takeover the NBCG expressed its concerns to the ACCC in the following points:

- concerned with the possible lessening of competition for the provision of towage services that may arise from the proposed merger;
- concerned that other towage service providers and new entrants may face commercial constraints in bidding for contracts in ports where Adsteam Marine Limited is a supplier of Australian wide services;
- concerned that a dominant market provider may not pass on productivity gains to users; and at a minimum
- recommending that the monitoring of prices, services and profits of towage service providers continue whether or not the acquisition is approved.

Adsteam Marine implemented price increases in the Ports of Albany and Geraldton prior to the notification to the ACCC in respect of the five declared ports in December 2001. The price increases in these ports were resisted by users but, in the absence of effective competition in the market place, were implemented. It is apparent that Adsteam Marine is or will be seeking substantial price increases in other Australian ports in the future. The NBCG notes that the Port of Newcastle is a declared port under the *Prices Surveillance Act* and that this declaration will expire on 30 June 2002. The Port of Newcastle was subject to competition for towage previously and the position of the current supplier to prices and services post 30 June 2002 will be watched carefully by the industry.

The NBCG submits that Adsteam Marine pricing is one of the symptoms of the existing pressure for the inquiry or the outcome of the market structure that has resulted in less than effective competition in the provision of harbour towage and related services in Australian ports. The NBCG concurs with the view that the Productivity Commission will not be addressing directly the question of whether the price increases are justified. **The NBCG believes, however, that the Productivity Commission should focus directly on the market structure, the contestability of the market and provide recommendations on increasing the level of competition in the market for harbour towage in Australian ports.**

As set out in the Terms of Reference “cost structures differ between ports depending on the market structure in each port” and this will need to be considered. The NBCG further submits that the size of the harbour towage and related services market can and does vary significantly between Australian ports and therefore an effective competitive model in the larger ports may not be effective in other ports. In fact a number of models may need to be considered to provide a basis to introduce effective competition in all ports and in some cases effective price regulation may be necessary to provide the optimal outcome for the users of harbour towage and the broader economy.

ISSUES

Market characteristics and performance

Australia’s land mass, the total population and its concentration in a limited number of urban centres, the location of manufacturing centres and the regional and remote centres for rural and mineral production have necessitated the development of a number of ports of differing cargo volumes and composition.

All of these factors have resulted in Australia having developed ports that are geographically distanced from one another. The ability to provide harbour towage and related services to more than one port by using the same assets is limited. Land based transport links have generally been directed towards linking a particular port to its hinterland as Australia developed. Except for more recent developments in the south-east region of Australia this remains the current situation.

Hence the NBCG submits that the majority of Australian ports are geographical monopolies for many service providers including in this case for providers of harbour towage and related services.

In addition port conditions, cargo type and volumes, ship types and ship movements in each port will determine the demand for harbour towage and related services. The interrelationship of these factors results in a variety of conditions that affect market contestability for harbour towage and related services. Some salient facts are that four ports (Sydney, Melbourne, Brisbane and Fremantle) handle almost 70% of Australia’s annual seaborne trade by value with some 55% to Melbourne and Sydney combined. In terms of volume some 60% of Australian seaborne trade flows through five ports (Port Dampier, Port Hedland, Hay Point, Gladstone and Newcastle).

The Ports of Sydney and Melbourne have the largest number of ship movements and for this reason require the most frequent harbour towage task. The other ports named above have a substantial harbour towage task, as do other ports with special conditions or a relatively large number of ship movements to cargo values and volumes. Some regional and remote ports have specific harbour towage tasks but of a relatively low level of incidence. **This suggests that market characteristics can be and are very different in Australian ports in relation to the demand for harbour towage and related services and may require different market structure models to provide optimal outcomes for safety, service and efficient pricing mechanisms.**

Towage industry structure in Australia is partly a response to the requirements for the services. Vertical integration continues in some ports where the port volumes are supplied by a single or limited number of suppliers. Examples are the Ports of Dampier, Port Hedland and Hay Point where iron ore, natural gas or coal is the primary export through the port. These commodity trades were also developed during the last 50 years and substantial new infrastructure was required at the port to service the trade.

This is a different position to other commodity trades where the existing infrastructure in the port was in place or provided by an established port entity as part of the perceived trade facilitation role. Grain, sugar and fertiliser commodity trades tend to fall into this category. Coal exports and the bauxite/alumina trade through the Port of Gladstone substantially changed the nature of the port traffic but not the port servicing arrangements. Ports with an established presence and corporate structure have generally provided services to a number of users and have therefore relied on separate towage arrangements to service the demand.

The Port of Newcastle is an interesting case in the provision for towage services. The large demand for port services created by the significant development of the coal export trade required the commodity producers to build new port infrastructure. The requirement to service a large number of ships led to the establishment of a separate towage arrangement using the vertical integration model. Improved service levels and a substantial reduction in cost were one outcome of moving to a vertically integration model. The towage company operated in competition with another towage operator in the port.

The cost of providing towage services is outlined as a major issue for the inquiry. There is a perception that towage services should be priced on the cost plus model and that cost are relatively fixed. This is manifested in the view that as the demand for services fluctuate then the price changes to maintain a minimum level of revenue. That is, if the demand falls then the price increases (and therefore total revenue remains the same) in order that the service can remain the same.

The NBCG would first challenge the proposition that towage services need to be provided on a cost plus model to provide efficient services. The beneficial outcomes of micro economic reform of production and service industries in Australia combined with a focus on competition models has provided a flexible and robust economy that can respond to external shocks. Productivity and efficiency improvements arising from competition or effective price regulation has enabled service providers and producers to monitor and control costs to meet market requirements. There is no apparent reason for the towage service industry to be excluded from this process.

Secondly mineral and rural products that are sold into very competitive global markets dominate Australian traded goods exports. Australian producers are effectively price takers. Further many of the globally traded commodities are sold on a US\$ market price. In adverse market conditions the producers have to respond by cost control and productivity improvements to remain competitive or exit the market. **Producers must consider internal productivity and cost responses and ensure that contracted services in the transport chain are provided efficiently at globally**

competitive prices. This has been the case for internationally shipping with chartering markets being acknowledged as very competitive. There is no reason why harbour towage and related services should be exempted from similar commercial rigour in providing services to users.

Competition and Market power in Towage Services

The NBCG has argued above that most ports in Australia are natural or geographical monopolies. In addition the relative demand for towage services in Australian ports varies significantly. The demand task ranges from the possibility that the two largest ports (Sydney and Melbourne) may be able to sustain direct competition by two or more towage service operators with most ports only able to sustain one towage service operator for optimal service outcomes. In some of the regional and remote ports it may be problematical for the demand to sustain a full time commercial presence with the assets only being required for a limited period on an irregular basis.

This demand requirement suggests that the incumbent towage operator have substantial market power in the majority of ports whether the ports are declared or otherwise under the *Prices Surveillance Act*.

The Issues Paper notes that towage services are inputs in a long supply chain. Hence there is little scope for users to vary the amount of towage and related services required in the short to medium-term. In the longer-term changes in demand for the product shipped, the capacity and availability of technically advanced ships as well as improvements in port infrastructure can all impact on the demand for towage and related services.

Growth in international trade and the globalisation of the Australian economy over the past 40 years has significantly increased the demand for shipping services and hence the demand for towage and related services. On the other hand fluctuations in global economic activity and improvements in shipping technology can change the short and medium-term demand. It is as necessary for the towage and related service industry to be sufficiently flexible to meet the challenges of fluctuating demand as it is for commodity producers and other service providers in the total transport chain.

The economies of scale and the economies of scope outcomes have assisted the establishment of a dominant towage operator in Australian ports. This is especially the case where one operator has managed to acquire a dominant supplier status in the market and is in a position to offer pan Australian rates to customers calling at a number of ports or requiring substantial towage and related services. The acquisition of the only other substantial towage service provider in Australia has strengthened the dominant operator's market power.

It is to be expected that a dominant towage service provider should be able to make substantial productivity and efficiency gains in the utilisation of capital and labour and in marketing the services. The NBCG acknowledges that hard fought reform in manning levels have produced productivity gains but NBCG members have indicated that there has been no corresponding reduction in towage service pricing. Indeed, the implementation of the proposed price increases in declared ports suggests any cost

saving from productivity and asset management have been retained by the towage operator.

The important issue for consideration is whether and how effective competition for towage and related services can be achieved in Australian ports. If this preferable commercial outcome cannot be achieved then the issue is a regulatory mechanism to ensure effective price control of towage and related services.

This concern is outlined in the section titled “Increasing competition and options for prices oversight”. The NBCG would welcome a thorough examination of options and models for the introduction of effective competition into the market for towage and related services in Australia ports given the current demand and supply position.

As previously discussed there is limited scope for direct competition within a port. The economies of scale benefit a single operator in the majority of ports. In addition the economies of scope favour the incumbent operator. Any new entrant in direct competition within a port with sufficient demand would face commercial pressures to win market share unless the new entrant was in a position to provide towage services at other port calls for the same customer. That is the competition on price within one port maybe insufficient to attract customers that may be offered volume and loyalty incentives arising from economies of scope of the dominant operator.

The introduction of serial competition has been established in the Port of Bunbury and tested in the Federal Court. The granting of an exclusive contract for a set period with price and performance conditions that are acceptable to users and the supplier would provide the incentive for the introduction of effective competition in ports. This would particularly be the case where currently there is no or little competitive pressure for the supply of towage and related services. This model may also limit the opportunity of the dominant supplier to utilise economies of scope to retain market share but on the other hand may also reduce the benefits to customers arising from economies of scope. On balance the NBCG considers that the overall gains from the introduction of effective competition would out weight the existing benefits provided to customers through economies of scope. The time period of an exclusive contract is an important issue. The objective is to provide a reasonable period to entice new entrants but of limited duration to ensure that serial competition provides acceptable and competitive outcomes for users.

Vertically integrated arrangements for towage and related services in some commodity ports should be able to continue and may provide scope for other ports with a well developed commodity producer/port management/shipping interface to consider the establishment of a competitive towage arrangement for the port. The Port of Newcastle was such an example.

Ports in remote centres with a relatively small demand task may require a different arrangement for the provision of towage and related services. Models where the port management and/or major user procures the assets with a competitive tender arrangement to determine the towage operator for a fixed period could also be considered.

Price oversight is also an issue that must be considered. It is important that effective price regulation be in place for the transition period as Australian towage and related services are subject to the introduction of effective competition. Effective price regulation should continue to be available for those ports that are unable to put in place effective competition for the supply of towage and related services.

The NBCG submits that the preferred outcome is the transition to commercial models that lead to the introduction of effective competition in the supply of towage and related services in Australian ports and will support procedures and processes to achieve this outcome. The NBCG accepts that industry will need to respond positively and where appropriate provide support for commercial efforts to introduce effective competition. However the transition period may require some regulatory measures, administrative arrangements and /or incentives from governments and port authorities in order to ensure the progressive introduction of effective competition and effective price regulation.