WORLD SHIPPING COUNCIL
PARTNERS IN TRADE

November 14, 2016

World Shipping Council Statement on the Global Shippers' Forum Paper About the State of the Liner Shipping Industry

The World Shipping Council has read with interest the paper issued today by the Global Shippers' Forum (GSF) about the liner shipping industry. The main thrust of the GSF paper is that the container industry is rapidly changing in a number of ways, and that those changes warrant the attention of people that are affected by the business. Nobody disagrees with that.

Beyond the encouragement to pay attention, however, the GSF paper is largely a repackaging of a longer paper that the OECD published last year. The difference is that the GSF paper cites as fact numerous statements about the industry that the OECD paper actually posed as open questions. The OECD paper was more candid about the difficulty of making sense of all of the interconnected changes in the global economy that are driving liner shipping companies to adapt in new ways. Specifically, the OECD report stated on page 63 that:

> "The interplay of these factors makes calculation of transport costs related to mega-ships a challenging exercise. So it is with many reserves and caveats that we present our calculations; these should be considered a first preliminary exercise, based on a thought experiment, with various assumptions that could be challenged."

Much of the GSF paper is dedicated to asking whether consolidation in the shipping industry would be preferable to alliances from a shipper perspective. It is no criticism of the GSF paper that events are moving so quickly that the question has largely been rendered moot – clearly we will have both consolidation and alliances.

Whatever one perceives as the primary drivers of the current condition of the liner shipping market, the facts are that demand is down and capacity is up. That translates into exceedingly low freight rates, leaving cost-cutting as the only avenue to better returns for shipping lines. That means burning less fuel per container moved, and that in turn has meant bigger ships where they can be used effectively, and also alliances where those arrangements add efficiency. Do those actions have implications for the larger supply chain, for port investments, and for service? Of course they do – some positive and some negative, depending on where one sits. But those effects are the result of carrier reactions to the signals that they are getting from their shipper customers and from the global economy: what are customers willing to pay for, and how do you run a business on the available revenue?

The GSF paper seems to suggest that these basic economic drivers should be replaced by some as-yet undefined global collective planning process made up from all parts of the supply chain. GSF (page 17) again quotes the OECD for the recommendation that:

> "A constructive discussion would need to take place with the relevant transport stakeholders, including governments, regulators, port authorities and all interested constituents. The objective could be to facilitate an exchange of views, an understanding of objectives and plans, and ultimately better coordination to ensure optimum supply chain configurations, including optimized use of mega-ships."

Although it is in the interest of all affected parties to be aware of the changes taking place in the liner shipping business, and customers and service providers should always discuss what each needs from the commercial relationship, these are in the end just that – commercial relationships. Carrier decisions – just like shipper decisions and port investment decisions – are made, and will be made, on the basis of what makes the most sense for their businesses, including the need to serve their customers.

There are two related suggestions that the GSF paper makes with which WSC disagrees. The first GSF suggestion is on page 18 of its paper. There, talking about the trend of consolidation, GSF argues that:

> "Should the market become consolidated to 6-10 major operators controlling the main trade lanes it would seem inevitable that the market share thresholds for alliances and consortia agreements would have to be so low that it would be ruled out on competition grounds with carriers having to compete head-to-head."

This GSF suggestion of what would be "inevitable" in terms of competition analysis is both unexplained and incorrect under well-established market concentration measures. One of the most common tools used to assess market concentration is the Herfindahl-Hirschman Index (HHI). To take the GSF example, a market with ten competitors of equal share would have an HHI score of 1000. Any HHI number below 1500 represents an "unconcentrated" market. Even the GSF hypothetical of six competitors would render an HHI score of about 1670 if their market shares were equal. That number would just make it into the lower end of "moderately concentrated" markets, which fall in the HHI range of 1500 to 2500.

Regulators around the world can and do make decisions with respect to liner shipping in part based on competition analysis, including market concentration. As a general matter, however, conclusions that are unsupported by facts or analysis do not inform the regulatory discussion, and the GSF's unsupported statements on market share are no exception.

The second specific suggestion that GSF makes (page 32) is that consideration should be given in the European Union to reintroducing a notification process for consortia agreements, at a very low market share threshold. Similarly, the GSF paper asks whether, in the United States, the law should be changed back to the pre-1984 process of carrier agreements requiring affirmative FMC approval before becoming effective. Such approaches would be counter-productive, because the delays and uncertainties associated with such procedures – which were retired for good reason – would reduce competition rather than protect it. If alliances are subject to open-ended affirmative approval processes, then parties would be less inclined to make changes to those alliances in response to changing market conditions. That disincentive to market adaptation would negate some of the very efficiencies that consortia and alliances can bring.

Regulators already have the tools and the demonstrated will to address situations that they deem to be problematic. Regulators' effectiveness would not be improved by procedures that make carrier collaboration less responsive to market forces.

The liner shipping industry is undeniably in a period of rapid change, driven by the need to adapt to economic conditions that demand that the industry become more efficient. Those commercial demands for greater efficiency are reinforced by new international environmental regulations designed to further reduce air emissions. For example, the 0.5% global fuel sulphur cap that will become effective in 2020 is estimated to add tens of billions of dollars of annual costs to the liner sector. Greater fuel efficiency is one way to mitigate those new costs.

The GSF is correct that everyone who is involved in the international supply chain needs to be aware of the changes in the liner industry and needs to find ways to adapt. From a regulatory perspective, however, what all parties need is a clear, stable regime that allows carriers and shippers to plan and to innovate. What global trade does not need is a shifting regulatory landscape at the same time that the liner industry is adjusting to a new economic reality.