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BEFORE THE
ADVISORY COMMISSION ON CONFERENCES IN OCEAN SHIPPING

COMMISSION AUTHORIZED

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Mr. Chairman and members of the Advisory Commission: I am John Peterman, Director of the Bureau of Economics of the Federal Trade Commission. It is a pleasure to appear today to discuss the views of the staff of the Bureau of Economics of the Federal Trade Commission ("the staff") concerning conferences in ocean shipping.[1]

The Shipping Act of 1984 required the Federal Maritime Commission (FMC) to collect and analyze information concerning the Act's effects on the ocean shipping industry and the FMC met that requirement by releasing a report in September 1989. The 1984 Shipping Act also required the FTC to conduct its own analysis of the Act's effects. The Bureau of Economics prepared this analysis for the FTC, which was released in November 1989. My purpose here today is to reflect some of the concerns raised in this earlier analysis.

My comments focus on four areas: 1) the effects of the 1984 Act; 2) antitrust immunity; 3) tariff filing and enforcement; and 4) service contracts.

The Effects of the 1984 Shipping Act

[1] This statement reflects the views of the staff of the Bureau of Economics of the Federal Trade Commission and does not necessarily reflect the views of the Commission or any individual Commissioner.

The 1984 Shipping Act represented a compromise, attempting to balance the interests of carriers, who favored continuation of the conference system, and shippers, who favored greater flexibility in arranging shipments. The 1984 Act contained procompetitive and anticompetitive features. Assessing the net impact of the 1984 Shipping Act, and the likely effects of further alterations to the regulatory structure, thus requires a careful review of the evidence available to the Advisory Commission.

Our 1989 Report concluded that consumers generally benefit when impediments to competition are removed. We also noted that the procompetitive features of the 1984 Act -- providing carriers the explicit right to take independent action after ten days' notice and permitting carriers and shippers to enter into service contracts -- appeared to provide such benefits in the form of lower prices and improved service. Yet, the 1984 Act also contained some potentially anticompetitive features. In particular, the Act clarified the conference practices permitting the joint setting of tariffs and other terms of trade that would qualify for antitrust immunity and streamlined the procedures for FMC approval of such conference agreements. These changes triggered an increase in the number of conference agreements, and encouraged the development of so-called "super-conferences."[2] Some important agreements were filed after 1987, the most recent year for which price data were available for the 1989 FTC

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[2] See FMC Report, pages 108-113 for a discussion of the trends in specific trades. For example, the FMC Report indicates that prior to the 1984 Act ten conferences operated on the North Atlantic Trade. Shortly after the passage of the Act, these conferences reorganized into two "super-conferences." In 1989, the two super-conferences were combined into a single super-conference. The FMC Report notes that similar consolidations and agreements have occurred in the Pacific trades. One particularly important agreement is the Transpacific Stabilization Agreement, filed in December 1988.

Report. The Advisory Commission might consider examining closely the effects of these recent changes made possible by the 1984 Act's clarification of antitrust immunity. In particular, it might be useful to extend the statistical analysis of rates supplied in the Appendix to the FTC's 1989 Report beyond 1987, which was the latest year for which data were available to us.

In the staff's view, the removal of impediments to competition (e.g., antitrust immunity, tariff filing and enforcement, and restrictions on entering certain types of contracts) typically tend to benefit consumers. Our earlier analysis suggested this was probably the case in ocean shipping, or at least that the case for the continuation of such impediments had not been sufficiently made. Should the Advisory Commission recommend that these types of restrictions be maintained in the ocean shipping industry, it seems important that the theoretical and empirical justification for this recommendation be more clearly articulated than has been the case.

Antitrust immunity

Even though ocean conferences had enjoyed some measure of immunity from the antitrust laws since the 1916 Shipping Act, some confusion had arisen regarding the practices that were safely immune from antitrust sanctions. One purpose of the 1984 Shipping Act was to clarify which agreements among ocean common carriers would be exempt from the antitrust laws. The Act appears to have achieved this objective: the number of agreements filed with the FMC has increased markedly since 1984.[3]

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[3] The FMC compared the number of agreements filed in the three years prior to the Act's passage (1981-83) to the number filed in the three years (continued...)

The structure of shipping markets and the level and structure of shipping rates will depend, to some degree, on whether conferences maintain their antitrust immunity, or whether this immunity is revoked. As it considers whether to recommend any changes to the conferences' existing immunity, the Advisory Commission might attempt to estimate the likely costs and benefits of continuing to provide antitrust immunity to conference agreements. Antitrust immunity should then be extended only if the likely benefits exceed the likely costs.

Because the staff cannot claim to be an expert on ocean shipping markets, we are unable to offer you estimates of these likely benefits and costs. We would, however, like to make several points that we believe deserve consideration as you complete your review over the next several months.

One concern raised by a number of carriers is that, absent antitrust immunity, they would not have been able to negotiate a number of agreements recently filed with and approved by the FMC. Some recent conference agreements -- such as space chartering agreements, equipment interchange agreements, and electronic data interchange agreements -- could reduce carriers' costs and, ultimately, shipping rates. But even in industries that do not enjoy antitrust immunity, agreements among competitors whose basic purpose is to lower costs or raise demand do not necessarily run afoul of the antitrust laws. Many types of information exchanges and operating agreements, for example, have been upheld by the antitrust courts. The decisions have recognized that the exchange of information and other joint operations may serve useful purposes. As a

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[3](...continued)
after its passage (1985-87) and concluded that the number of new agreements increased by 209 percent and that the number of modified agreements increased 87 percent. See FMC Report, page 104.

result, the courts have not applied a per se condemnation of otherwise efficient agreements or arrangements.

The main question is whether much of the information sharing that is required to negotiate conference agreements that lead up to joint tariffs -- negotiations that typically would not be permitted under the antitrust laws -- overcome nonetheless the presumption against it. We raised substantial questions in our earlier analysis about the need for and desirability of such joint agreements. Basically, the staff does not see antitrust as a bar to efficiency. In general, antitrust bars agreements shown historically or theoretically to have harmful effects.

Proponents of antitrust immunity also argue that immunity is needed to prevent "destructive competition." Few analysts have attempted to define rigorously the characteristics of a "destructively competitive" market, and both economists and antitrust enforcement officials have treated the concept with some skepticism.[4] Yet the key features of such a market appear to be three: (1) sunk costs (i.e., costs that, once borne, are forfeited if supply is withdrawn) represent a large proportion of total costs; (2) cost conditions are such that new firms enter the market when demand and prices are high even though, from a purely economic perspective, such entry is inefficient;[5] and (3) demand is uncertain, causing extended periods of excess capacity when demand falls. The existence of significant excess capacity (which arises due to the assumption of significant sunk costs) generates incentives for firms to reduce prices down to marginal costs, prices which are too low to permit firms to cover their total costs.

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[4] See FTC Report, pages 15-16.

[5] In economic terms, entry could be attractive in the short run but not viable in the long run.

Let us make a few points about the "destructive competition" argument. First, entry and exit do not appear difficult in these markets, suggesting that trade-specific sunk costs are not high. Because ships are mobile assets, carriers would appear to have latitude in deciding where to operate. Yet, the ease with which carriers can shift their capacity among the various trades is unclear, particularly in light of the recent emergence of "super-conferences." The Advisory Commission should examine this question, since it seems to be an important element of the "destructive competition" rationale for continued antitrust immunity. Second, as detailed in our 1989 Report, there is little evidence to support the position that shipping markets possess the characteristics necessary for "destructive competition" to arise. In particular, econometric studies suggest that economies of scale are not significant in maritime transportation. Thus entry, when it occurs, would not appear to be economically inefficient. Finally, if shipping markets do suffer from "destructive competition," the appropriate remedy would appear to be regulating minimum prices and entry into the industry. Currently, conferences do neither.[6] Thus, it is unclear how providing antitrust immunity to conferences acts as a cure for the problem posed, assuming it existed.

Tariff filing and Enforcement

The general issue of tariff filing is important. Since 1961, conferences and independent carriers on U.S. foreign trades have had to pre-file their

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[6] Conferences do, of course, set prices for their members. Their ability to exert control over these prices is diminished by the presence of independent carriers and by the ability of conference members to take independent actions. Conferences have no control over entry.

freight rates with the FMC.[7] The requisite notification period is 30 days prior to the effective date of a rate increase in the normal course of business.[8] The FMC polices the industry to ensure that carriers do not offer unpublished discounts on these rates, a practice known as rebating.[9] Conferences and independent carriers are also required by the 1984 Act to file their rates on service contracts and include a description of the essential terms of these contracts.

Tariff filing was initially introduced to ensure that carriers did not price discriminate among individual shippers and to make price information easily obtainable. It was also perceived as beneficial in that it encouraged rate stability.[10] Tariff filing also facilitates the FMC's role of policing against secret rebating activities.[11] As a result, it serves as a cartel-enforcing device to the extent that conference carriers do not engage in independent action. In addition, the notification and filing requirements in the case of "independent action" may potentially exert significant anticompetitive pressure. The filing requirement can also facilitate anticompetitive interaction between conferences and independent carriers.[12]

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[7] On domestic routes, tariff filing has been required since 1916.

[8] FMC Report, p. 495. Ex-post tariff filing with the Federal Maritime Board had been practiced since the 1930's.

[9] The practice of rebating was effectively outlawed by the Shipping Act of 1916, and remains outlawed under the 1984 Act.

[10] FMC Report, p. 496.

[11] FMC Report, p. 486 and p. 575. The argument that tariff filing reduces the FMC's monitoring costs, while obviously true, provides no compelling basis for the regulation.

[12] For instance, the public posting of prices encourages price-leadership behavior, where certain firms announce their price early in order to encourage other firms to raise their prices.

Some proponents of tariff filing claim that the elimination of filing requirements would impede shippers from collecting accurate information on transport rates.[13] Costs would be incurred in collecting information, and inefficiencies would arise. While it seems clear that the dissemination of accurate rate information can help markets operate efficiently, it is less clear that tariff filing and enforcement are needed to ensure that dissemination, particularly when tariff filing and enforcement can have independent anticompetitive effects. Indeed, market mechanisms already exist to provide shippers and carriers accurate rate information. If mandatory tariff filing were abolished, it would be expected that these and other mechanisms would develop to provide the information demanded by industry participants.

Profit-maximizing carriers have incentives to provide shippers with easy access to information concerning their prices, and shippers have incentives to spread this information to other market participants. If a carrier offers a price lower than its competition, it would try to enlarge its customer base by disseminating information on price comparisons. In trying to obtain the lowest price possible, shippers might often inform carriers of price offers made by rivals. Given the current industry contracting structure, which includes clauses that release shippers from the contract in the presence of low-cost alternatives, shippers may have an impetus to collect and spread considerable price information.[14]

If tariff filing and enforcement were eliminated, shippers would probably not have to consult a variety of sources to obtain rate

[13] FMC Report, p. 489.

[14] Such contract clauses, known as "Crazy Eddie" clauses, may also reduce the incentives of individual carriers to offer price reductions.

information.[15] Currently, shippers can use freight forwarders and NVOCCs to obtain transport services and transport rates; the latter have every incentive to collect rate information and find the low-cost providers of services.[16] The elimination of tariff filing requirements could be expected to enhance incentives to collect and distribute price information.

Finally, the tariff filing requirements make it more difficult for carriers and conferences to adjust to changing supply and demand conditions.[17] The requirement of public notification of prices impedes the ability of firms to respond efficiently to these changes. For instance, in the event of a sudden market downturn, conferences would have to meet in order to revise prices and then notify the FMC before their rates became effective. In the meantime, conference profits and consumers would

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[15] This statement may appear inconsistent with the FMC's finding that a majority of shippers surveyed support continued tariff filing and enforcement by the FMC. (FMC Report, pp. 532, 534) However, we interpret that result to indicate that shippers prefer more information to less and that shippers want to obtain the lowest shipping rate possible, not that they believe that those outcomes could not be provided by an unregulated market. We also note that surveys of shippers reveal that they strongly endorse independent action and would prefer to see it extended to service contracts. (FMC Report, pp. 684, 648) Those responses appear to indicate that shippers prefer the freedom to obtain price information from individual carriers.

[16] When regulated by the Civil Aeronautics Board, the airline industry had a centralized structure for providing rate information. Subsequent to "deregulation", consumers could receive rate information for most carriers from any travel agent. Freight forwarders, which provide a service similar to travel agents, would have equal incentive to collect and provide rate information.

[17] Relative to other industries, ocean carriers have considerable incentives to adjust price to changing economic conditions. Slack demand cannot be alleviated through inventory accumulation as in manufacturing industries. Once capacity is established, an ocean carrier becomes concerned with finding as many customers as possible to occupy its cargo space. Thus, there are strong incentives to make price adjustments and to provide information to customers concerning those adjustments.

suffer.[18] If firms were relieved of the tariff notification requirement, they could change their prices more rapidly while informing prospective customers of any changes. The prospect of lower adjustment costs might also encourage entry into the ocean shipping industry, which would result in even lower prices in the market for shipping services. It would appear that requiring tariff notification imposes costs without providing benefits that would not otherwise be provided through private market incentives.[19]

Service Contracts

Service contracts are arrangements between individual shippers and individual carriers (or conferences) to transport a specified quantity of cargo over a specified period. The 1984 Act requires that the essential terms and conditions of service contracts be filed publicly with the FMC and that the carrier (or conference) make these same terms and conditions available to any similarly situated shipper.

Currently, conferences can decide whether to permit their members to negotiate service contracts individually with shippers or whether to channel all contracts with shippers through the conference at rates and terms determined by the conference jointly. By-and-large, conferences have prohibited their members from negotiating directly with shippers (i.e., from taking independent action on service contracts.)

No issue seems to separate shippers and carriers more starkly than whether conference members should have the right to take independent

[18] An individual conference member would, of course, be free to file an independent-action tariff, which would take effect in ten days at the most.

[19] Because tariff filing is currently required pursuant to statute, only an act of Congress (and not rulemaking by the FMC) could eliminate that requirement.

action on service contracts. According to the 1989 FMC Report, "carriers oppose, while shippers support, requiring independent action on service contracts."

Service contracts would not exist unless both the conferences and shippers found them mutually beneficial. Contracting would likely be even more efficient, however, if contracts between shippers and individual carriers were permitted by conferences. A shipper-conference service contract may allow conferences to set prices for these agreements that may not accurately reflect the competitive incentives of the individual carriers. By contrast, a shipper-carrier contract would be more flexible in addressing the competitive conditions facing individual firms and also the individual demands of shippers. Further, the elimination of the need for coordinated action in changing contract terms would allow carriers to adjust more rapidly to changing market conditions.

It is difficult to determine the likely effects of permitting conference members to negotiate service contracts directly with shippers because conferences tend not to give their members this freedom. Yet, one temporary exception to this rule arose between 1984 and mid-1986 when some conferences in the Far East trade allowed their members to enter service contracts directly with shippers. Since mid-1986 the Far East conferences have joined the others in prohibiting their members from entering service contracts not negotiated through the conference.

This brief episode in the Far East trade provides the Advisory Commission with an opportunity to determine the likely effects of allowing conference members to negotiate service contracts directly with shippers. The Advisory Commission might conduct a review of this episode, paying particular attention to the reasons given by the conference for revoking its members' freedom to negotiate directly with shippers, the

shippers' assessment of the impacts of this change, and any changes in observable measures of market performance, such as prices and service quality. The FTC's 1989 Report contained a brief analysis comparing the rates in the Far East trades with those in the Atlantic trades, concluding that the "decision to prohibit direct negotiations between their members and shippers may have contributed to the upward momentum in inbound and outbound transport rates between the United States and the Far East." The Advisory Commission could scrutinize this time period more closely to learn whether our initial assessment on prices is correct and, if so, whether the changes can be explained by factors (such as differences in service quality or differences in input prices) not related directly to the decision regarding independent action on service contracts.

Conclusion

The Advisory Commission will be considering the likely effects on the ocean shipping industry should conference antitrust immunity be revoked and replaced by exposing conference practices to the existing antitrust laws. Because conference antitrust immunity has existed, to some degree, since 1916, it is difficult to visualize the industry without it. Nonetheless, it may be instructive to draw from the experiences of other transportation industries, which previously possessed substantial regulatory structures in ways similar to the one that currently exists in ocean shipping. Since 1980, federal deregulation has occurred in the trucking, railroad, and airline industries. Opponents of deregulation had raised numerous concerns about the potential changes. Yet, economic assessments of the effects of these changes have indicated that deregulation generally reduces transportation

rates without sacrificing service quality.[20] The concerns that are being raised today by those who believe that the conference system must be retained are similar to the concerns raised prior to deregulation in other transportation markets. In deciding whether to recommend retention or modification of the existing regulatory structure, the staff recommends that the Advisory Commission consider whether ocean shipping markets differ fundamentally from those transportation markets for which deregulation has brought tangible consumer benefits, and from other markets generally which seem to operate effectively without antitrust immunity.

Price-fixing agreements among competitors tend to raise prices and reduce output and facilitate price discrimination among classes of shippers. These effects have been the reasons for concern with conference agreements. Even if the agreements are open to competitors, they may tend to encourage too much capacity or other forms of service competition and also may permit price discrimination to continue. Such outcomes typically harm consumers. The staff has not seen the arguments and evidence sufficiently developed to show that these concerns are no longer justified -- at least not on grounds of efficient pricing and resource allocation. Other grounds of support may exist. These we do not discuss.

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[20] For an assessment of rail and trucking deregulation, see Winston et al., The Economic Effects of Surface Freight Deregulation, The Brookings Institution (1990). For airlines, see Secretary's Task Force on Competition in the U.S. Domestic Airline Industry, U.S. Department of Transportation (February 1990).