A Critical Appraisal of Canadian Liner Shipping Legislation and Policy

by

Joseph Eric Fillmore

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This thesis by Joseph E. Fillmore
is accepted in its present form by the
Department of Economics
as satisfying the thesis requirements for the degree of
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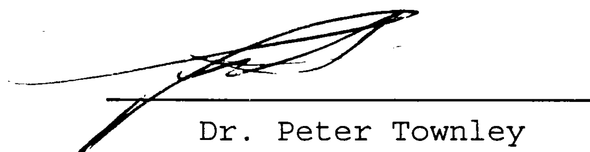
Approved by the Thesis Supervisor

Dr. John Davies

Date 22/3/96

Approved by the Head of the Department



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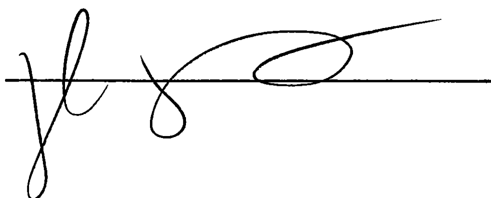

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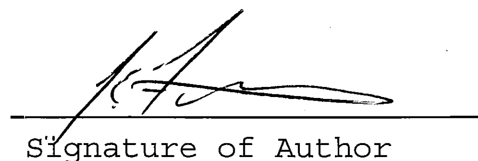

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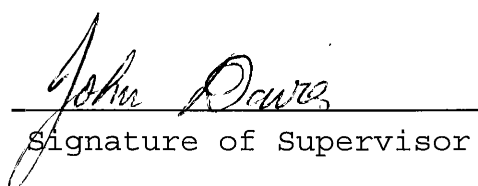

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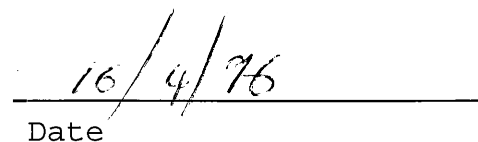

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Abstract

A Critical Appraisal of Canadian Liner Shipping Legislation and Policy

Joseph Eric Fillmore

This thesis is a critical appraisal of Canadian policy and legislation as it relates to the liner shipping industry. Particular attention is paid to the economic justification of exempting cartels from the antimonopoly provisions of Canada's Competition Act (1986), something permitted by the Shipping Conferences Exemption Act (1987). To this end, the thesis examines the historical circumstances that resulted in this policy position, and emphasizes the contrast that traditionally has existed between Canadian and American policy and legislation. The reasons behind a recent convergence between American and Canadian policy is also investigated.

The desirability of continuing to exempt shipping cartels from the Competition Act is evaluated by investigating the economic functioning and market performance of the liner industry. This analysis suggests that there is little to be gained from a continuation of existing policy, and that national welfare could be enhanced through exposing cartels to the antimonopoly provisions of the Competition Act.

CHAPTER 1

Introduction: The Study in Perspective

1.1 Background

The liner industry has existed since the 1860s when the invention of the steam engine allowed ships to adhere to scheduled services. Unforeseen, this marvel of modern technology was to be the underlying cause of many economic problems that would come to plague the industry. The difficult conditions that ensued brought together several entrepreneurial shipowners; their solution to the despondency was the formation of a collusive association, known as a conference, that would set minimum rates and rationalize sailings.[1]

Obvious from the outset, conferences and their practices were contrary to competition legislation. This has led Canada, along with other maritime nations, into a process of determining the proper position that should be taken with respect to shipping policy. During the early twentieth century, both the US and the UK conducted in-depth investigations into conferences[2]; in the case of the US this led to enactment of legislation in 1916. Canada, greatly influenced by the British investigation which was generally supportive of conferences, did not adopt legislation, and instead chose to leave the conferences alone.

In 1965, the Restrictive Trade Practices Commission reported the results from Canada's first thorough investigation of conferences.[3] The report, known as the MacLellan Report, concluded that conferences promoted stability in the liner trades. However,

the report also noted that "member lines lessened competition within the meaning of the Combines Investigation Act."[4] The report made several key recommendations and eventually formed the basis for the Shipping Conferences Exemption Act (SCEA) of 1970 which, as the name implies, exempted shipping conferences from the provisions of the Competition Act.

The SCEA represented a cautious approach to conference regulation. The Act contained an expiry clause that forced reconsideration of the legislation after a specified period[5]; nine years later the Act was rescinded and the revised SCEA (1979) introduced. The new legislation mandated that conferences shall meet with a body of shippers when requested, and further broadened the scope of exemption from the Combines Investigation Act.[6]

In the early 1980s, several important events occurred that caused the government to take a serious look at the direction in which policy should evolve. Particularly important here was the introduction of the celebrated new US Shipping Act of 1984, and the changing face of the liner industry brought about by containerization and intermodalism. In 1987, the government addressed these events by revising the SCEA again. This new Act contained two innovative provisions, borrowed from the American legislation, to enhance competition within the conference system: independent action and service contracts.[7]

1.2 The Changing Character of the Liner Industry

The SCEA (1987) was a product of both policy evolution and the considered economic and political appraisal of circumstances that

the liner industry had evolved to in the 1970s and early 1980s, and as such is firmly rooted in the ideologies of that period. The continued relevance of these policies has become suspect over the last nine years as there have been several important developments, both national and international, that called into question the favourable treatment accorded conferences under such national legislation. In Canada, a controversial merger between two shipping companies has focused attention on the degree of competition that presently exists in the liner industry, while in Europe, several ongoing lawsuits are calling into question the economic consequences and the legality of certain conference practices.

In 1994, Canadian Pacific's shipping division, Canadian Maritime, announced plans to purchase Cast Group. Concern was voiced, however, that the merger would create a monopoly by giving the new company control of 84 percent of the container cargo moving through the port of Montreal.[8] When the National Transportation Agency conducted their investigation into the merger, the agency concentrated on the level of market competition faced by Montreal, not within Montreal. The investigation concluded that "Cast and Canmar should not be able to dominate or abuse market power due to effective competition on Canada/US-North Europe trade."[9] This ruling is very important as it recognizes the increased level of competition and the effect of intermodalism on the liner industry-liner markets can no longer be defined as narrow trade corridors, instead they are large geographical areas that may include many

actual and potential competitors. However, this view was controversial and had not one of the parties to the merger become bankrupt, it was likely that the Bureau of Competition Policy would have launched an investigation under the Competition Act.

In 1995, in a lawsuit between the European Union's (EU) competition commission and the Transatlantic Agreement (TAA), a liner conference consisting of fifteen members, the EU accused the conference of using a capacity management programme to reduce capacity and thereby inflate prices; for example, the price for carrying a container of car parts across the Atlantic rose from $1,100 in 1992 to $1,486 in 1993, an increase of 35 percent. Also at issue is intermodalism, the EU is disturbed over shipowners attempts to fix land rates as part of a multimodal service. Expressing his concern, the EU Commissioner stated that shipowners are already "allowed to do things no other sector is allowed. . . we cannot be hijacked to cover attempts to form supercartels."[10] There is also a similar lawsuit pending against the Far Eastern Freight Conference. Perhaps such action by the EU is indicative of the decreasing tolerance that governments have towards certain conference practices, or even towards the conferences themselves.

In the US, an amendment to the Shipping Act of 1984, referred to as the Ocean Shipping Reform Act of 1995, has been introduced in the House of Representatives. If adopted the Act will have a new declared purpose: "to promote the growth and development of United States (US) exports through competitive, nondiscriminatory, and efficient ocean transportation."[11] To this end, the amendments will

induce increased competition through shortening the period for giving notice of independent action and the implementation of a strategy to convince foreign nations to divest themselves of ownership and control of national liner interests.

While academics and civil servants ponder policy, the industry's evolution has proceeded uninterrupted. Within North America this has been manifested in the great expansion of intermodal transportation services and the concomitant large capital investments being made. During the 1990s, Canadian Pacific and Canadian National have invested heavily in expanding their rail services; in 1994, the companies ordered a total of 124 new locomotives, and upgraded their respective lines to accommodate double stack rail cars.[12] Zim Israel Navigation, the thirteenth largest liner company in the world, have acquired no less than fifteen vessels since 1992, and have purchased eight more 3,400 TEU container vessels for the North Atlantic trade alone.[13] For the liner industry this investment translates into increased competition: the procurement of vessels increases competition between liners, while expansion of rail services offers external competition through landbridges and transshipment.

The ability of conferences to act as monopolists in the face of such increasing competition and a growing political intolerance is greatly diminished. If the benefits of being collusive in nature can no longer be reaped, perhaps the entire concept of conferences and their exemption from anti-monopoly legislation should be reviewed within the context of present economic

conditions. This is especially true given the recent hostility shown the conferences by their customers. In view of the above, the purpose of this study will be to address the appropriateness of Canadian liner shipping policy given the changing character of the industry.

1.3 An Overview of the Study

Given the changing technological, organizational, economic and political environment of the international liner shipping industry, the objective of this study is to assess whether Canadian liner policy is appropriate. As such the thesis deliberately targets the interface of economics, policy and law as they relate to liner shipping. It investigates whether liner conference practices are detrimental to society in general; the economic basis for their continued special legal treatment; their importance to Canadian ocean-borne trade; the level of actual or potential competition exists; and examining whether the conditions that warranted the formation of conferences still pertain. These are some of the economic questions that need to be answered in order to make an accurate assessment of the performance of the liner market. Along with these economic questions, the study undertakes the equally important task of addressing liner policy. To this end, the evolution of liner policy is chronicled from the earliest investigations to the current legislation. Attention is focused on the underlying reasons for each policy as well as any influences or innovations. Overall, this study seeks to explore the present state of both the economic conditions and the policies that affect,

and have affected, the liner shipping industry.

The study is organized into six chapters. Following this introductory chapter, Chapter 2 describes the general nature of the shipping industry, both liner and non-liner, with an emphasis on the ability of the individual markets to operate under free market conditions. Emphasis is placed on Canadian ocean-borne trade in an attempt to establish the relative importance of each industry. Finally, the different approaches available to the government to cope with the policy dilemma created by the advent of liner shipping conferences are addressed.

Chapter 3 is dedicated to the evolution of liner policy in Canada and in the US. These countries present a study in contrast and thus serve admirably to highlight the legal implications of the conference policy dilemma. With Canada we find indifference, tolerance and an initially implicit and then explicit acceptance of *laissez-faire*. The US, by contrast, has sought to regulate the minutiae of conference operation, resulting in the creation of a massive legal edifice and the development of political problems on a similar scale, as it sought extraterritorial application of its laws.

Chapter 4 deals exclusively with the current Canadian liner legislation, the Shipping Conferences Exemption Act of 1987. The principal reasons underlying the need to revise the previous Act are examined. The innovative provisions added to the revised Act are examined and compared with distinctly similar features found in the recently enacted US legislation. Overall, the purpose of this

chapter is to illustrate the current atmosphere, with respect to policy, in Canadian liner shipping.

Chapter 5 is concerned with the economics of the liner shipping industry. The various attempts by which economists have sought to explain pricing and performance in the industry are reviewed and critically evaluated. Additionally, the economic conditions which are supportive of arguments in favour of conferences, and by contrast, in favour of their abolition, are also critically assessed. Based on the economic analysis contained in this chapter, inferences as to the continued necessity of conferences can be established.

In the final chapter, the principal findings from the study will be summarized and conclusions about the appropriateness of the current SCEA (1987) in terms of national economic welfare are presented. The question: has the changing character of the liner industry rendered the present legislation obsolete or completely unnecessary is answered.

Notes

[1] Daniel Marx, International Shipping Cartels, (Princeton: Princeton University Press, 1953), 45.

[2] Marx, 50-53.

[3] Restrictive Trade Practices Commission, Shipping Conference Arrangements and Practices, (Ottawa: Department of Justice, 1965). (referred to as the MacLellan Report).

[4] Restrictive Trade Practices Commission, 100.

[5] Shipping Conferences Exemption Act of 1970, Section 14(1). (Henceforth referred to as the SCEA 1987).

[6] SCEA 1979, Section 15(1).

[7] SCEA 1987, Section 4.

[8] Canadian Press, "CP gets Green Light to Buy Cast Group," Financial Post, 21 Jan. 1995, 17.

[9] National Transportation Agency, Transportation Trends and Issues: 1994 Annual Review, (Ottawa: Supply and Services Canada, 1994), 138. (Henceforth cited as NTA Review 1994).

[10] "Shipping Cartels: Piracy?," Economist, 18-24 March 1995, 67.

[11] Ocean Shipping Reform Act of 1995, H.R. 1081, 104th Cong., 1st sess., 28 Feb. 1995 (internet: http://thomas.loc. gov/ , 3 Jan. 1996).

[12] NTA Review 1994, 90.

[13] "Three More for Zim," Port of Halifax, Dec. 1995, 7; TEU is an acronym for twenty-foot equivalent unit, and indicates the general dimensions for a standard size container used on liner vessels and all types of intermodal transportation.

Chapter 2

The Nature of the Liner Shipping Industry

2.1 Introduction

International ocean shipping can be divided into two broad categories: the non-liner and the liner shipping industries. The non-liner industry is predominately concerned with the on-demand transportation of bulk, low-value cargo while the liner industry is involved with the scheduled transportation of relatively high-value, general cargo. Furthermore, the liner industry can be divided into conference and independent liners.

The nature of each industry will be addressed in this chapter with particular attention paid to their respective market's ability or inability to promote economic welfare. Also addressed is the role each industry plays in transporting Canadian ocean-borne trade; this is viewed from both a quantitative and value perspective. In keeping with the thesis of this study, concern is primarily focused on conferences and the policy dilemma they present the Canadian government.

The chapter is divided into four sections. First, the characteristics of the non-liner industry are examined. Second, a history of the evolution of the liner industry from steam to containerization and the reasons behind the formation of conferences is covered. Third, the volume and value of Canadian trade afforded by each industry is explored and, in

particular, the division between conferences' and independents' market share is examined. Finally, upon ascertaining the relative importance of conference liners to Canadian trade, the policy dilemma that arises due to their collusive nature is explored.

2.2 Non-liner Shipping

In Canada, the non-liner segment constitutes by far the greatest proportion of the total volume of international ocean-borne trade. In 1994, non-liner shipping carried approximately 92.7 percent or 229 million tonnes of goods.[1] Underlying this tremendously one-sided balance in volume is the nature of the cargo shipped.

Cargoes carried by non-liners are typically classified as either dry or liquid bulk commodities. For Canada, in 1994, the largest dry bulk commodity in terms of volume exported was coal at 30 million tonnes; other major exported commodities ranked according to decreasing total volumes are iron ore, wheat, lumber, and potash. The primary liquid bulk commodity is imported crude petroleum at nearly 22 million tonnes.[2] The nature of transporting large volumes of bulk commodities has pronounced implications for service, ownership, and capacity utilization in the industry.

Shippers that require bulk transport basically have two choices: purchase their own vessels or hire the services of a tramp vessel. Irving Group, a large Canadian corporation with interests in refining and pulp and paper, presently owns five

foreign-flagged bulk vessels. Tramp vessels can be chartered privately and through active exchanges, such as the Baltic Exchange in London, where brokers match the needs of shippers with the supply of shipowners, much in the manner of a stock exchange. The terms of the charter arrangements range from chartering for a particular voyage to engagement in a long-term contract of affreightment.[3] Since shippers control the entire cargo capacity of the vessel, they need not adhere to scheduled departure dates and, as a consequence, the vessels rarely leave port without a full load.

The capital requirements for operating in the tramp market are relatively low. A tramp service can be established with only one vessel, since they are chartered "on demand": if tramps offered scheduled service then several vessels would be required. There exists an extensive second-hand market for tramps, where a prospective buyer may purchase these relatively unsophisticated bulk carriers at a fraction of the cost of a liner vessel. Finally, there is no need for the purchase of containers or any special handling equipment.[4] The low capital costs combined with a readily available resale market means that entry and exit barriers are extremely low.

Given low barriers to entry, low absolute cost requirements, large numbers of buyers and sellers and the perfect knowledge afforded by the specialist brokers of the ship exchanges, the non-liner sector is close to being perfectly competitive, with prices being determined by the

immediate and visible interplay of supply and demand.[5] Accordingly, the invisible hand of the price system will serve to maximize the welfare of consumers.

In short, the non-liner shipping industry is such that vessels always sail completely loaded, vessels do not adhere to fixed sailing schedules, and shippers have the choice of tramp chartering or ownership. Most importantly, the industry is close to being perfectly competitive and, therefore, requires no government regulation. In stark contrast, the liner sector of the industry presents a very different picture.

2.3 Liner Shipping

Until the first half of the nineteenth century the shipping industry was comprised of wooden ships that relied on the wind for propulsion. As winds were far from predictable, these sailing ships were not in a position to offer regular, scheduled service. Also, the availability of capacity was minimal for shippers of general cargo since these ships were either owned or chartered by important merchants.[6] However, the middle of the nineteenth century was to witness two technical innovations that would revolutionize the industry.

The first development was that of steel, which permitted the construction of larger ships with greater structural strength. Steel quickly replaced wood as the preferred material. The second development was that of the steam engine. No longer dependent on the wind for power, the new

"steamships" were faster and more reliable than their sail counterparts. Together, this combination of steel and steam yielded larger, faster ships that could adhere to fixed schedules.[7]

From this revolution, the liner shipping industry was born, an industry that is committed to providing regular, scheduled service between stipulated ports of call. The immediate effect of providing such service was the overall growth in the levels of world trade. The inherent advantages afforded by liners resulted in the rapid proliferation of their services: in a short time all major trade routes were served by liners. The industry, however, was to become the victim of its own success as its growth served to create an unprecedented degree of competition within the industry.

In the UK alone, the registered steamship tonnage "increased more than five-fold between 1860 (450,000 tons) and 1880 (2,720,000 tons)."[8] Even though global trade was quickly increasing, the rate of increase in tonnage was far greater. As a consequence of this trend, supply greatly exceeded demand, and the industry was cast into turmoil. The over-abundance of ship capacity forced shipowners to drastically reduce prices in an attempt to lure additional cargo; this practice usually resulted in cutthroat pricing and prolonged price wars. As a result, a great number of lines went bankrupt.

During the early 1870s, seven British shipowners who

operated liner services on the UK-Calcutta trade route determined a solution to the debilitating effects of cutthroat competition: they sought to substitute cooperation for competition. Specifically, they agreed amongst themselves to regulate the number of sailings each would make and to fix equal minimum rates from all ports in the UK to Calcutta.[9] With this arrangement the first liner conference was formed.

Due to the conference setting minimum rates, most shippers became dissatisfied as their previously low rates increased. Several powerful shippers threatened to charter their own ships as there was no incentive for them to continue using the conference members' ships. In 1877, as a measure to overcome the discontentment of shippers and to ensure their continued business, the conference introduced the deferred rebate system: the conference would grant the shipper a rebate on rates but only after a contracted period of "loyalty" was demonstrated. Payment of the rebate did not simply occur upon conclusion of the initial contracted period, but only after an additional period of contracted loyalty, during which the shipper was to commit all of their business to a conference member.[10]

Shipowners the world over quickly came to recognize the conference system as a viable escape from the problems that plagued the industry. The introduction of the deferred rebate as a method of tying shippers to a particular conference further increased the popularity and effectiveness of the

conference system amongst shipowners. In 1975, exactly a century after the first conference was formed there were approximately 360 conferences operating on all major trade routes worldwide.[11]

The avoidance of the tendency to cutthroat competition and the concomitant provision of high quality, stable, scheduled services were the principal benefits of conferences. However, conferences, like all cartels, periodically did break-down, as was the case during the Great Depression when serious cutthroat pricing resulted.[27] Nevertheless, they almost always formed again. Consequently, the historical record confirms conferences to be amongst the longest lived of all cartels.[28]

After the advent of steam and steel, nearly 110 years elapsed before the next great technological development impacted on the liner industry: in the 1960s, the liner industry underwent the container revolution. As liners carried primarily general cargo, the idea of constructing vessels that were capable of carrying containers was quite logical. These containers, typically 20- or 40-feet in length, could be loaded at the producer's plant then sealed and transported to their final destination before being reopened. Shipowners also benefitted from faster loading and unloading, less time spent in port, and the fact that container vessels were designed to operate at faster speeds.[14]

The container revolution went far beyond the shipping

industry, impacting on both rail and trucking modes of transport. The containers could easily fit on rail cars and truck trailers thereby facilitating inland transportation. Rail companies invested heavily in new rail cars that were capable of carrying two containers in a "double-stacked" configuration, and in adapting their rail lines to handle these higher cars; for example, in 1994, Canadian National opened the double-stack St.Clair tunnel between Sarnia, Ontario, and Port Huron, Michigan. As a result of this investment, transit time between the port of Halifax and Chicago decreased by 12 hours, something which was intended to increase the port's cargo catchment area.[15] The advent of containers and their subsequent impacts on the different modes of transportation have created a new era in transport known as multimodalism or intermodalism.

Containerization greatly increased the capital requirements needed to operate in the liner shipping industry. In 1990, the cost for a 3,500 to 4,000 TEU container vessel was in the range of 80 to 85 million US$, plus an additional 25.2 million US$ per vessel for containers. It should also be noted that the requirement to provide scheduled service meant that a fleet, not a single vessel, was required. For example, to commence weekly scheduled sailings on the trade route between Europe and the Far East a total of nine vessels were needed at an initial capital cost of 992 million US$. Furthermore, add to this initial cost the costs of feeder

vessels, truck trailers, special containers, and port facilities. The overall cost for a prospective entrant could easily exceed 1 billion US$ on this particular route.[16]

Due to the high capital costs required to operate a modern, containerized liner fleet, the industry has become dominated by large liner companies. As of 1993, the top twenty liner companies worldwide controlled 44 percent of the total shipping capacity. The largest liner company, Denmark's Maersk Line, alone controls nearly 5 percent of the world's liner capacity. The next two largest lines are COSCO of China and Evergreen Marine Corporation of Taiwan. No Canadian liner firm is in the top twenty.[17]

Whereas the non-liner sector caters to shippers of low valued bulk cargoes with sufficient volumes to fill an entire vessel, the demand for liner service is characterized by a relatively large number of shippers who require small volumes of general cargo to be transported. These general cargoes are heterogeneous and traditionally of high value such as electronic equipment, frozen foods, and manufactured goods. The demand for scheduled transportation service of such shippers is clearly derived from the demands for the goods carried. The derived nature of the demand for liner services, complete with the high value character of the commodities carried, serve to create an overall demand for liner shipping that is distinctly inelastic.

According to Robert Stern, the best estimate of the price

elasticity for a set of eighteen industrialized nations are -0.93 for exports and -1.06 for imports.[18] Using these results, Sletmo and Williams, calculated the transport price elasticities of nine different product groups. They found that their best estimate for each group was significantly less than unity in absolute terms, and varied little between groups. This lead them to conclude that the available evidence "strongly suggests that demand for transport services for major liner commodities is highly inelastic."[19]

Further contributing to the high inelasticity for liner shipping is the general nature of the cargoes transported. The individual cargoes are mainly low in volume, but high in value. The relatively high final selling price of the product transported means that the proportion of the price that constitutes the cost of ocean shipping is low, typically in the vicinity of five percent.[20] Additional shipping costs may further reduce the significance of the liner costs; for instance, the majority of goods manufactured in Canada for export require extensive inland transportation before reaching an ocean port. Sletmo and Williams, writing on total *versus* ocean transport, concluded that:

> Whenever these [inland transportation] costs are significant in relation to the costs of ocean freight, their overall effect is to make demand for ocean transport even more inelastic than suggested by our previous estimates.[21]

The importance of the elasticity of demand for liner transport being highly inelastic is that it may contribute to

destructive competition, something which will be addressed subsequently in this thesis.

2.4 The Canadian Trade

Without a substantial Canadian-flagged liner fleet, Canadian ocean-borne trade is almost entirely dependent on foreign-flagged fleets to provide international ocean transport. Classified according to the total tonnage of all cargo transported, foreign-flagged vessels accounted for 99.9 percent of Canadian trade.[22] When limited to only liner shipping, the percentile for foreign composition is quite similar.

In terms of volume, the Canadian ocean trade is dominated by bulk, low value added shipments by non-liners; in 1993, non-liners carried approximately 206 million tonnes or 92 percent of cargo by volume. Shipments by liners constituted approximately 18 million tonnes or 8 percent, cargo carried by conferences constituted 40 percent of the liner total, while the balance belonged to independents or non-conference lines. From the perspective of aggregate trade volumes, the relative size of the conference liner market is quite low, amounting to little more that three percent of the total.[23]

In 1993, over 75 percent of the total volume of liner shipments loaded and unloaded in Canada were containerized.[24] The growth in containerization is evident when this 1993 level is contrasted to the 1975 level of 47 percent.[25]

The volume of shipments carried by liners may represent

less than one tenth of that carried by non-liners, however, this situation is reversed when the value of the shipments are considered. Despite the lack of up-to-date data on the value of liner shipments, there is no reason to believe that the ratio from a previous study conducted in 1982 has changed:

> In 1978, Canadian deep-sea (non-US) waterborne trade was estimated to be approximately $29.8 billion. Liner traffic accounted for $20 billion or 67% of the total traffic in value, while non-liner traffic accounted for $9.8 billion or only 33% of the total traffic in value.[26]

In 1993, liners carried eight percent of the total Canadian ocean-borne trade; this number has remained relatively stable when compared to 10 percent in 1975. Nevertheless, the ratios by volume carried by conferences and independents which comprise the total volume shipped by liners has changed. In the nineteen-year period from 1975 to 1993, this ratio has changed from 69 percent conference and 31 percent independent to 40 percent conference and 60 percent independent.[27]

The change in volumes transported by conferences and independents is reflected in the numbers of each serving Canada. In absolute terms, the number of independent operators serving each coast exceeds their conference counterparts. The decline in conferences is most pronounced on the west coast, where in the eight year period from 1987 to 1994 a total of ten conference members withdrew, almost a 45 percent reduction. The decline on the east coast was not so dramatic as only three withdrew during the same time period.

The number of independents has remained relatively unchanged on the west coast and has staged a modest increase on the east coast. These changes in respective service levels are illustrated in Table 2.1 which shows the number of liner services into and out of Canada during the period 1987-1994. It should be noted that the data in the table includes service through US ports and mini-landbridge service on the major Canadian trade routes to Europe, Australia, and the Far East.

TABLE 2.1
Liner Services[1] on Major Eastern and Western Canadian Trade Routes between 1987 and 1994

YEAR	Western Canada		Eastern Canada	
	Conference	Independent	Conference	Independent
1987	23	20	23	33
1988	20	18	23	32
1989	23	14	25	28
1990	23	14	24	27
1991	19	18	21	27
1992	19	16	22	27
1993	12	22	19	30
1994	13	21	20	37

Note: [1] Includes services via US ports and mini-landbridges
Source: NTA Reviews, 1987-1994.

Overall, in terms of total volumes shipped, Canadian ocean-borne international trade is dominated by the non-liner sector which specializes in bulk, low value-added goods. However, when Canadian trade is viewed from a value-of-goods shipped perspective, the liner sector represents two-thirds of the total. Within the liner sector there has been a transition from primarily conference service to independent

service over the past two decades. Nonetheless, conferences still play an active role in Canadian liner shipping.

2.5 Policy Dilemma

The presence of conferences in Canadian maritime trade dates from the late nineteenth century, approximately the same time as the introduction of competition legislation. In 1889, Canada introduced its first combines legislation which was referred to as "An Act for the Prevention and Suppression of Combinations Formed in Restraint of Trade", an extremely apt name given the purpose and nature of shipping conferences.[28]

There was an indisputable conflict between the new competition legislation and the mere existence of conferences: the former proclaimed the latter illegal. However, the proliferation of conferences worldwide and their conditional support by many governments and shippers made the prospect of banning conferences in Canada practically difficult and economically questionable. The very existence of cartels in liner shipping, coupled with these practical considerations, forced the government of Canada to wrestle with a basic policy dilemma: should it enforce the competition legislation or leave the conferences alone?

On one hand, the government may elect to subject conferences to the full force of the competition legislation, thereby disallowing their existence in Canada. Historically, the liner industry has been prone to detrimental bouts of cutthroat pricing. Therefore, the consequence of banning

conferences will most likely be to introduce a significant degree of instability into the industry. Also, if conferences are no longer permitted to operate within Canada, then they can easily relocate their services to the US and still serve Canadian trade through transshipment of cargo. Finally, by adopting a legislative stance that is vastly different from those of other nations there arises the problem of comity: one nation may decide to impose its legislation on the shipping firms of another nation, thus, creating a conflict of jurisdiction that can easily escalate to the point of straining comity between the two nations involved.

On the other hand, the government may recognize the innate instability that banning conferences would wreak upon the liner industry. Therefore, in order to ensure the high quality of services they provide and to espouse their importance to international trade, the government may elect to leave them alone. However, by allowing the existence of an obviously collusive sector of the liner industry, the government may be inviting the possibility of monopoly abuses.

2.6 Conclusion

The non-liner segment of the ocean shipping industry operates within a market structure that approaches perfect competition and, as such, there is no requirement for government intervention. This is not the case for liner shipping where the market has historically been seen to invite cutthroat competition and instability, and where, as a

response to this instability, conferences were formed.

Even though there are advantages in allowing conferences to operate, a conflict arises between them and competition legislation. This presents the government with a particularly difficult policy dilemma: whether to allow or not to allow conferences. The dilemma stems from the fact that there are benefits and costs to both approaches. For Canada, adopting a policy stance was a long and arduous process that both reacted against and drew from US, British, and distinctly Canadian influences. Accordingly, the next chapter will focus on the evolution of policy in North America which provides a classic illustration of the different ways governments can approach the liner conference policy dilemma.

Notes

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Chapter 3

The Evolution of Liner Shipping Policy in Canada and the United States

3.1 Introduction

The development of liner shipping policy in Canada is very dissimilar to that in the US. This dissimilarity is rooted in the different regulatory approach each country has undertaken, and in the general perception they have toward the problems that are thought inherent to the liner shipping industry.

Formal liner shipping policy in the United States originated as the Shipping Act of 1916, perhaps the single most important piece of legislation ever to affect the liner shipping industry. Within the US, the Shipping Act created a complicated regulatory system that was characterized by several layers of overlapping bureaucracy. Initially the Federal Maritime Commission (FMC) was the sole agency responsible for administration of the Act; however, over time the Department of Justice (DOJ) became increasingly involved. Finally in 1984 a revised Shipping Act was introduced that aimed to minimize regulatory intervention.

Canada, unlike the US, had no legislated system of regulation for liner shipping until 1970. Prior to this time both the Canadian and the British governments conducted comprehensive investigations into shipping conference practices, but none resulted in the adoption of legislation.

The industry was allowed to self-regulate within the loosened confines of the Combines Investigation Act. In 1970, The Shipping Conferences Exemption Act was introduced, and Canada thereby had its first shipping legislation.

This chapter will undertake to explore the evolution and genesis of both the American and Canadian liner shipping policies. The importance in developing this is twofold: first, since the countries are neighbours and typically very close culturally and economically, it is interesting to note the distinctly different approaches to regulation; second, changing conditions leading up to the mid 1980s caused the two approaches to converge in many respects. The latter point will not be apparent until the fourth chapter. This chapter will commence with US liner policy and will then address Canadian policy.

3.2 The Genesis and Evolution of Liner Shipping Policy in the US

In the United States, regulation of the liner shipping industry is governed primarily by the Shipping Act of 1984. This piece of legislation (along with its predecessor, the Shipping Act of 1916), has effectively set the tone for American liner regulation during most of the twentieth century. The provisions contained in both Acts seem to reflect two major concerns of US regulatory policy: first, there is a paradoxical desire to maintain the utmost competition possible while also recognizing the need for liner

shipping conferences', and, second, to assist in the development of a domestic merchant marine.

One of the major provisions of the US Shipping Act of 1916 was to promote the development of a merchant marine. Adding weight to the need for this provision was the fact that the advent of the First World War was only one year away when the Act was passed; the legislators realized the importance of a merchant marine to the national interest of the US during wartime. Throughout subsequent revisions to the Shipping Act and the introduction of the Merchant Marine Acts of 1920 and 1936 the provision for the promotion of a merchant marine has remained intact and embodied within the latest legislation: the Shipping Act of 1984.

The logic behind the simultaneous promotion of both competition and a viable US-flagged merchant marine resides in the recognition that the US does not possess a comparative advantage in merchant shipping. Consequently, the legislation sought to establish rules that would safeguard competition in general and US competitors in particular. For instance, the legislation made it unlawful to deny a US-flag common carrier membership, on equal terms with all other parties, to a conference through the provision for mandatory open conferences.

The Pre-Legislation Years: until 1916

In 1906, the British government appointed the Royal Commission on Shipping Rings in response to complaints from

commercial interests as well as from interests elsewhere in the Empire. Three years later, in 1909, the Royal Commission presented its findings.[1] The Royal Commission found that given the role conferences had played in developing and maintaining high quality scheduled services, liner shipping conferences, with their use of deferred rebates, were necessary. Although, should excessive monopoly power have arisen, it ought to be subject to checks to prevent it from causing abuse. A regulatory board and the compulsory arbitration of rates were not considered feasible or necessary given the prevalence of actual and potential competition. None of the findings contained in the report of the Royal Commission resulted in any legislative action. However, the time and effort required to compile the report was to be beneficial to the forthcoming investigation of conferences in the United States.

During the early part of the twentieth century in the US, there was a very prominent concern regarding the potential monopoly power that was possessed by shipping conferences. The previous experience of mid-western farmers with the railroads during the 1870s and 1880s, combined with the growth and development of giant corporations during the industrial revolution contributed to a belief that competition was essential if the well being of the public was to be served. Any practice that might result in the lessening of free competition, such as the formation of trusts or monopolies,

was viewed sceptically. Legislatively, this scepticism was embodied in the passage of the Sherman Anti-trust Act in 1890 and the Clayton Anti-trust Act in 1914. Both of these Acts made the formation of conferences explicitly illegal, and thereby provided the government with a legal edifice to prosecute any shipping company that entered into conference agreements.

In 1911, the US Department of Justice (DOJ) brought legal actions against three conferences for violations of the anti-trust laws. The three lawsuits United States v. Hamburg-American Line, United States v. Prince Line Ltd., and United States v. American Asiatic Steamship Co. all alleged that the conferences were illegally granting deferred rebates.[2] By the time the cases reached the Supreme Court, World War I had started and the practices that formed the basis of the original complaint had ceased, thus the Supreme Court deemed the matter to be irrelevant and never rendered a decision.

The failure of the DOJ to prosecute the aforementioned conferences did nothing to resolve the original problems that gave rise to the cases. In 1912, the United States House of Representatives approved a resolution introduced by Joshua W. Alexander, chairman of the Committee on Merchant Marine and Fisheries, to have the Committee investigate shipping conferences. The Committee issued a complete report of their findings in 1914, which subsequently formed the basis for the regulatory portions of the Shipping Act of 1916.[3]

The Alexander Report concluded that unrestricted competition in the liner shipping industry was not possible. If the industry was disallowed from entering into conference agreements, then detrimental rate wars could result, thereby potentially eradicating competition. The effects could be so far reaching as to cause instability in both service and American international trade. But allowing conferences simultaneously invites the possibility of monopolistic abuses. In lieu of such ominous consequences the Committee stated, "...the disadvantages and abuses connected with steamship agreements and conferences as now conducted are inherent, and can only be eliminated by effective government control."[4] This is the main point where the Royal Commission on Shipping Rings and the Alexander Report differ: the Royal Commission did not advocate a regulatory body whereas the Alexander Committee deemed it essential.

The recommendations put forth by the Alexander Report for shipping in the United States foreign trade are as follows:[5]

1) Shipping companies be brought under the supervision of the Interstate Commerce Commission (ICC) as regards the regulation of rates and the approval of contracts entered into with other shipping or transportation companies.

2) All agreements, understandings, or conference arrangements, and all modifications and cancellations of such agreements should be filed with the ICC which should be empowered to order cancellation of any such

understandings, or any parts thereof, that it found to be discriminatory or unfair, or detrimental to the commerce of the United States.

3) Rebates on freight rates and other discrimination between shippers should be made illegal.

4) The ICC should be empowered to investigate all complaints regarding the unreasonableness of rates, and to institute proceedings on its own initiative.

5) The use of "fighting ships"[6] and deferred rebates be prohibited in both the export and import trade of the United States, and that carriers be prohibited from retaliating against shippers for any reason.

6) Adequate penalties be provided to correct and prevent the abuses previously mentioned in these recommendations.

The Shipping Act of 1916 was based directly on the recommendations the Alexander Committee submitted to the Congress two years earlier. However, there was one significant change from the Committee's suggestions: regulatory control would reside with the newly formed United States Shipping Board instead of being added to the ICC's workload. The Shipping Board was also delegated with encouraging and creating a merchant marine to meet the commercial and naval requirements of the US.

Sections 14 and 15 of the Shipping Act were of greatest consequence to international liner shipping. The former section prohibits deferred rebates, "fighting ships",

retaliation or discrimination against any shipper, and unfair or unjustly discriminatory contracts with any shipper. The penalty for breaching any of these provisions is a fine of not more than $25,000 for each offense. If foreign water carriers violate the provisions of this Section or deny an American common carrier admission to a conference on equal terms with all other parties, the Secretary of Commerce, upon verification by the Shipping Board, was empowered to bar the vessels of the offending parties from United States ports.[7] In this way, promoting competition was also serving to promote the US merchant marine.

Section 15 of the Shipping Act stipulated that all agreements, understandings, conferences, or other arrangements between parties subject to the Act which affect competition in any way, or changes in earlier agreements, must be filed with the Shipping Board. Furthermore, the Board, may disapprove, cancel, or modify any agreement that it deems to operate outside the bounds of the Act, to the detriment of US commerce, or in an "unjustly discriminatory" manner. Any agreements that were approved automatically gain exemption from the anti-trust laws; the penalty faced by violators was a fine of $1,000 for each day of the offense.

The most important and most damaging provisions of the Shipping Act are also in Section 15, one being the requirement for conferences operating out of the United States to be open. An "open conference" means membership is available to any

shipping line which agrees to abide by conference practices and which has the capability to provide liner services. This practice of stipulating "open conferences" is unique in the world; all other nations that sanction conferences do so as closed conferences. The limitations of the "open conference" is stated as the conclusion of the Rochdale Committee:

> ...the "open" conference appears least likely to serve the interests of shippers. It is also least likely to serve that of shipowners;in their evidence to us they agreed that such a conference arrangement typically resulted in low load factors, low profits and rising freight rates.[8]

Originally only US-flagged carriers were required to adhere to tariffs and to file maximum rates with the Shipping Board pursuant to Section 18 of the Act. With respect to rates in foreign trade during peacetime, the Act went only as far as to prohibit those rates which were discriminatory or retaliatory. Competition, both actual and potential, was relied upon to keep rate levels reasonable; if the rates were thought unreasonable, regardless of whether the carrier was domestic or foreign, the Board cum Commission would simply decertify the conference agreement and the parties thereto would lose their anti-trust exemption.

Regulatory Laxity: 1916-1958

The original Shipping Board was very slow to commence its regulatory affairs. A large part of the reason for this slow start is articulated by S.S. Sandberg, vice-chairman of the Shipping Board:

> ...it was seriously contended until the latter part

> of 1929, that the board had no authority under the Shipping Act over carriers in foreign commerce of the United States, unless such carriers were American-flag carriers and particularly that the Board's regulatory authority did not extend to rate and practice controversies when the contracts of affreightment were made in a foreign country.[9]

In 1929 the US Supreme Court upheld an earlier decision of the Circuit Court of Appeals that the authority of the Shipping Board was as applicable to foreign-flag carriers engaged in US commerce as it was to American-flag carriers, and the place where the contracts of affreightment were made was of no consequence.[10] Even, with the scope of its regulatory powers clearly defined by the Supreme Court, the Board still faced problems.

The Shipping Board's first dealings with conferences was not as a regulator, but as a member. This situation arose when the government bestowed upon the Board the additional role of promoting American shipping, operating the huge merchant fleet amassed during World War 1, and the returning to private ownership of the same fleet. To this end the Board established several permanent American-flag shipping fleets. These fleets held active memberships in many important conferences, such as the British North Atlantic Conference, some of which engaged in practices that would have been illegal in the US.[11] The government created a situation where a conference member not only regulated itself, it regulated the industry. Once the government's merchant fleet had been privatized the Board's promotional functions continued. The

Board was now responsible for the direct promotional policy of administrating the subsidization of American lines put forth in the 1936 Merchant Marine Act.[12]

Attaining the greatest amount of industry self-regulation seems to be what the Maritime Commission strived to secure through its regulation of the conference system. To this end the Commission would automatically approve all conference agreements thereby granting them exemption from anti-trust laws under section 15 of the Shipping Act. However, if, subsequent to approval, an investigation by the Commission revealed prejudicial behaviour or illegal practices, the conference could be stripped of its exemption. This automatic approval of conferences meant that the Commission sanctioned exclusive patronage contracts (dual-rate contracts) and pooling agreements, both of which could enhance the monopoly power of the lines employing them.

Several court cases pursued by the Department of Justice during the late 1940s and early 1950s left the exemption from the anti-trust laws granted by the Shipping Act unclear. In 1948, the DOJ prosecuted one particular case, United States v. Far Eastern Conference[13], on the grounds that the exclusive patronage contract violated both the anti-trust laws and the Shipping Act. The court contended that the power of the Commission to approve conference agreements was constrained and therefore did not necessarily exempt conferences from the anti-trust laws. Four years later, the Supreme Court reversed

the lower court's decision: it decided that the Commission did indeed have primary power to grant exemptions. The result of this court case was to cause confusion within the industry, as to whether exclusive patronage contracts were to be tolerated and as to whether the Commission had primary jurisdiction.

By the end of 1958, there were mixed reactions as to the effectiveness of the Commission since its formation in 1916. However, the general perception was that the Commission did very little in the area of active regulating, relying more on industry self-regulation. During this period the Commission pursued 127 cases regarding violations of the 1916 Act, of which only half led to any regulatory edict[14]. Only six of these edicts were referred to the DOJ; the DOJ prosecuted none of them.

A Period of Change: 1958-1961

During the period from 1958 to 1961, the Shipping Act was to come under increasing scrutiny. No less than three independent committees conducted investigations: the Bonner Committee, the Cellar Committee, and the Senate Sub-Committee on Merchant Marine and Fisheries. The result of each committee's investigation, separately and together, was to have a drastic impact on the Shipping Act.

The US Congress' Committee on Merchant Marine and Fisheries, The Steamship Conference Study Hearings Before the Special Sub-Committee on Steamship Conferences, referred to as the Bonner Committee, convened their investigation in 1959.

The Bonner Committee concerned themselves with the Federal Maritime Commission's (FMC) regulatory scope and the type of instruments they required to implement policy. As a result of the Committee's investigation, a previous legal case that found the dual-rate system to be illegal was reversed.[15] However, the Committee Chairman, Clarence Morse, made the reversal somewhat ambiguous when he stated that dual-rate contracts could still be denied:

> In its recent decision, the Board had emphasized that a dual rate system will not be approved if its effect will be a monopoly in the conference lines to the virtually complete exclusion of all independent competition.[16]

The Department of Justice's Antitrust Sub-Committee of the Committee on the Judiciary, referred to as the Cellar Committee, also convened in 1959. The Cellar Committee conducted their investigation in the area of the perceived laxity of the FMC (and its predecessors) in administering the Act, and on the applicability of antitrust laws towards conference operations. As a direct result of this investigation, the FMC was divested of its promotional functions.

The Senate Sub-Committee on Merchant Marine and Fisheries, which was part of its Commerce Committee, had the role of filtering the recommendations of the first two committees before any legislation could be enacted.

The most important law to stem from the three investigations was Public Law 87-346, passed on October 3,

1961. This law, also known as the Bonner Act, legalized dual rates.[17] However, the conferences paid a price for their right to use dual rates. The most important aspect of this price was the provision that the contract shipper could withdraw on ninety days' notice. The overall effect of the new regulations has been to seriously weaken the loyalty system, thereby opening up the liner industry to more competition from independents. Arvid Frihagen, a Norwegian professor, observed that the passing of PL 87-346 would stimulate other countries to develop their own regulatory laws since,

> ...more direct conflicts will arise between the rules of various countries. Such difficulties of both a practical and legal nature will develop even if other countries do not go as far as the United States, whether with respect to the extra-territorial reach of such rules or in terms of the degree of detail and complexity of rules. If other countries should go as far, should go as far establishing equally far-reaching rules, it will lead to comprehensive and almost insolvable conflicts of jurisdiction and interest...[18]

Further condemnation of the impact of this law is articulated by R.O. Goss:

> ...they [lawyers] have many carriers so scared of the law's [PL 87-346 and the Shipping Act] intricacies that they are inhibited from providing services, or extensions to services, which would be fully justified by ordinary commercial standards. Thus the law damages the commerce between the USA and other countries and the public interest suffers accordingly.[19]

Both the FMC and DOJ, through separate but similar investigations of the liner industry, had their regulatory and legal powers increased. The brunt of these powers would be felt by the industry for the next twenty-plus years.

Zealous Enforcement: 1961-1984

The period from 1961 until the arrival of the revised Shipping Act in 1984 was characterized by the extremely ardent enforcement of shipping regulations. The FMC pursued its role with renewed zeal after gaining increased powers, and the courts became increasingly involved in the area of policy formation.

One of the largest undertakings of the FMC during this time period was the attempt to apply the Shipping Act not only to American shipping lines but also to foreign lines serving the foreign trade of the US. The US failed to realize, or deliberately chose not to acknowledge, that its foreign trade is also the foreign trade of other countries and that these countries might take offence at the extraterritorial extension of US laws. This extension was accomplished through the ability of the FMC to subpoena files and records from conference members for the purpose of conducting investigations; however, many members and their files were located abroad. The forthrightness of the US position regarding the reach of their laws is evident in a speech by the former Federal Maritime Commissioner, George E. Hearn:

> The foreign shipping industry must, nevertheless, respect the judgement of our Congress in adopting certain shipping statutes, and realize that when foreign vessels engage in our trade, it is on condition of observance of our law....We are the users of foreign transportation services, and we therefore set rules not only for our own benefit, but also to ensure fairness for all those engaged in the trade.[20]

This stance by the US threatened comity between countries, and even led to several European countries adopting "blocking statutes" which forbade their shipping lines from providing the FMC with certain requested data.[21]

Both the US courts and Congress realized that the FMC's extraterritorial subpoena power was causing a fury of discontent in the international community and that a solution needed to be reached. The courts reacted by relaxing the demands for documents located in foreign locations if it contravened the laws of the foreign country. Congress reacted by amending the Shipping Act so that subpoena power be limited to any place in the US.[22]

The courts had arguably the single largest effect on regulatory policy during this period. The courts, in the course of deliberating each case, perversely changed the interpretation of Section 15 of the Shipping Act so that the antitrust laws became superimposed on the Act.

The 1968 case of Sabre Shipping Corporation v. American President Lines[23] shows the extent to which the courts expanded antitrust applicability to the Shipping Act. A federal district court, and later a federal court of appeals, both ruled that in certain circumstances, even though conference rates had been set in accordance with FMC approved agreements, a conference could retroactively lose the antitrust immunity granted under Section 15; this in turn exposed the conference to the triple damage liability provided for under the existing

antitrust laws. Previously, in the 1966 precedent-setting case of Carnation Co. v. Pacific Westbound Conference[24] the Supreme Court ruled in a similar fashion when it made the conference subject to triple damage liability.

When the Shipping Act was amended in 1961 an important new criterion regarding approval of agreements was incorporated: those conferences seeking antitrust immunity must prove to the FMC that the agreement in some way resulted in significant public benefit. If the conference were unable to prove there were a public benefit, then the agreement would not be approved. This criterion for approval was adopted by the Supreme Court and subsequently came to light in the 1968 case of FMC v. Aktiebolaget Svenska Amerika Linien[25].

In the Svenska case the Supreme Court ruled against the conference. The court stated that a conference agreement which would result in an illegal restraint of trade, were it not for the immunity afforded by the Shipping Act, requires the submitting conference to prove that the agreement serves some serious transportation need and results in significant public benefits. The direct consequence of this ruling was that the burden of proof was entirely the responsibility of the conference; an indirect consequence was the effect the decision had on the FMC: they now needed to consider all approvals in conjunction with the objectives of antitrust laws.

The effect of the courts was to apply the antitrust laws

to liner shipping regulation despite the Shipping Act, and to reverse the burden of proof from the FMC to the conferences. A critical analysis of the courts' influence on liner regulation in the *Northwestern Journal of International Law and Business* concludes:

> ...the antitrust presumption of unapprovability has become the automatic talisman for those who would impede or destroy a functioning conference system, an open invitation to protracted, expensive, and aimless hearings, that ultimately result in the talking to death and smothering of worthwhile conference advancements and innovations. Noteworthily, the Antitrust Division of the Department of Justice had discovered in this economic fact of life its most effective tool for the subversion of its arch-foe, section 15 of the Shipping Act.[26]

<u>The Need for Further Revisions</u>

By the early 1980s conference members serving the US, especially the domestic members, were lobbying for drastic revisions to the Shipping Act. Developments in the areas of regulation, judicial proceedings and the industry had made the Shipping Act no longer an asset to conference operation but a hinderance to it.

The zealous involvement of both the FMC and especially the courts had made procedural delays and complications commonplace. The agreement approval procedure of the FMC had become uncertain, expensive and lengthy. The time frame required for approval had been several months; however, now this could easily be stretched to several years. The opponents of conference agreements realized and utilized a great tool for thwarting or delaying agreement approval: FMC

forum[27]. The effect of all of this was that conferences were left unable to react to dynamic market conditions, particularly the onslaught of containerization and intermodalism.

The industry and the demands placed on the industry by shippers were quickly changing throughout the 1970s and into the 1980s due to containerization and intermodalism. The shipping industry wanted to offer intermodal transportation and door-to-door service but were unsure of their antitrust liabilities. The FMC thought it had the authority under the Shipping Act to approve intermodal rates, but the DOJ contested this interpretation. This conflict ended up in court as United States v. Federal Maritime Commission[28], but the court did not rule in a definitive manner. The ambiguity left conferences unable to offer intermodal rates.

Experiences in Western Europe and Asia proved that the advantages brought forth by the container revolution could be further expanded through rationalization. Complete rationalization was viewed as a cure for many of the problems that had plagued the liner industry such as overtonnaging, destruction of huge investment in specialized vessels and ancillary equipment, and the elimination of weak carriers.[29] However, there was tremendous uncertainty with regard to the ability of carriers and conferences to obtain FMC approval for the agreements necessary to implement rationalization; therefore, within the US, full rationalization remained an

unachievable objective.

The demands of both the FMC and DOJ for the subpoena of documents had threatened comity between the US and its trading partners. These countries viewed the extraterritorial extension of American laws as an unwelcome infringement on their sovereignty; twelve trading countries even enacted 'blocking statutes'. Although these measures offered protection to foreign carriers, the domestic carriers were still subject to the wrath of the FMC and DOJ. The US carriers found that agreements involving only foreign carriers were not scrutinized as closely.[30]

The need for new shipping legislation was too strong to be ignored any longer. Carriers and shippers alike realized that the industry was undergoing drastic change and that, in order to take complete advantage of this progress, major legislative revisions were required. The government responded by introducing the Shipping Act of 1984.

The US Shipping Act of 1984

Officially, on March 20, 1984, President Reagan signed into law the new Shipping Act of 1984. This new legislation introduced many significant changes, the most important of which was the substitution of market regulation for government regulation. Other changes were aimed toward expediting the time required to approve agreements, legalizing intermodal through rates, and increasing the conferences antitrust immunity. There were also "Shippers' Provisions" incorporated

into the new Act such as Mandatory Independent Action, Service Contracts, and the right to form Shippers' Associations.

The Carriers Get...

Considering the previous nightmare conferences had to go through to receive approval and possibly defend this approval in a court, it is no surprise that a major part of the new legislation, from the conferences' perspective, deals with antitrust immunity. Generally, all aspects regarding antitrust immunity have been improved over the old Act.

An important change for carriers is the legalizing of intermodal through rates. It is now permissible for a carrier to negotiate with a non-ocean carrier for rates and services concerning the inland transportation of goods under a single through rate; however, this permission does not extend to conferences or groups of two or more carriers.

And The Shippers Get...

The new Act requires that every conference agreement includes a clause that allows any conference member to take independent action. Independent action is the ability of a conference member to change a rate or service item required to be filed in a tariff; the conference must include the new rate or service item in its tariff for use by that member. This was considered to be a safety arrangement which would provide individual conference members with the competitive flexibility of rate making while retaining conference membership. Although this concept was initially introduced by the American

carrier Sea-Land[31], in practice the advantage of using independent action goes to the shippers. Shippers now have the ability to "shop around" different conference members in order to find the best rate.

Service contracts are defined in the Act as contracts between a shipper and an ocean common carrier or conference in which the shipper makes a commitment to provide a certain minimum quantity of cargo over a fixed time period. Every contract filed with the FMC is confidential; however, filed concurrently with the FMC and made available to the public are the essential terms of the contract. Seemingly, the Service Contract was an attempt to replace the illegal practices of loyalty contracts and dual rates.

The new Act legalized the formation of Shippers' Associations: groups of shippers can come together in an organization for the purpose of collective bargaining. The ability to have a combined voice was thought to be a great advantage for small and medium sized shippers who individually would not constitute a large enough entity to effectively negotiate with conferences.

Summary

Although change occurred somewhat quicker than that described in Darwin's Theory of Evolution, the US Shipping Act of 1916 still required sixty-eight years to evolve into its present form. During this time period the Act underwent more changes in interpretation than in content: there was only one

period of revision, that being in 1961. However, the FMC and its predecessor organizations, along with the DOJ, altered their orthodoxy with respect to interpreting and enforcing the Act several times. The ambiguity this changing interpretation caused, combined with the problems experienced by shippers, diplomatic difficulties, and intermodalism and containerization provided a powerful motivator for legislative change.

Long overdue from both the shippers' and conferences' stand point, the new Act heralded an era of regulation that relied on market forces instead of government. The conferences received relief from the intimidating clutches of the DOJ and its mighty talon the Sherman Act; relief also came in the form of quicker approval times for agreements and the legalizing of intermodal through rates. The shippers, who were not included in the original Act, were now allowed to form Shippers' Associations, negotiate Service Contracts and utilize Mandatory Independent Action.

By having always relied on legislated regulation for the shipping industry, the US provided a great example of what to do and even more so what not to do. With the radical changes incorporated into the 1984 Shipping Act, the US has provided an even better example, and one that Canada has heeded.

3.3 The Genesis and Evolution of Liner Shipping Policy in Canada

Although not through lack of debate, Canada did not adopt

shipping legislation until 1970. The reason for this reluctance to legislate regulation has many facets: there was a strong colonial influence from the United Kingdom where there was no legislation, Canada did not recognize a requirement for a merchant marine as did the US, and Canada already had the Anti-Combines Act of 1889.

The Canadian government never considered the requirement for a merchant marine sufficient to warrant legislation, though this is not to say that the government did nothing to promote such a goal. Initially, at the time of Confederation, the government provided subsidies to steamers which carried overseas mail; the generosity of the subsidies was meant to promote both shipping and stable mail service. Despite the use of subsidies, the size of the merchant fleet continued to shrink.

In 1918, the Canadian government formed the Canadian Government Merchant Marine (CGMM), the purpose of which was to form a steel, ocean going, merchant marine. As an interesting note, the CGMM was a member of the North Atlantic Conference. In 1936, as a consequence of its never being a commercial success, all the assets were liquidated.

The next attempt was occasioned by the Second World War when the government formed the Park Steamship Company to supervise the operation of the merchant vessels it had amassed. As was the case with CGMM, the government found this new company to be unprofitable and had it liquidated in 1949.

Park Steamship would prove to be the government's last foray into the realm of merchant shipping.

Before Legislation Arrived: pre-1970

In 1889, Canada was first in North America to introduce anti-competition law beating the US by one year. However, unlike the American's Sherman Act, the Canadian legislation had little impact, except in one or two areas, and, as noted by Bruce Doern, the Act amounted to "a weak statute based in criminal law."[32] To illustrate how little the Act was used, note that during the period 1889 to 1949 there were only twenty-three combines prosecutions, none of which pertained to the shipping industry. This changed in 1923 with the introduction of the 1923 Combines Investigation Act; this provided the original Act with a broader scope by specifying indictable offenses.

Under the Combines Act, the major implication for the shipping industry in Canada is that conferences are illegal since they partake in price fixing and create monopolies, all of which are explicitly prohibited. The reason that they have been allowed to exist and, furthermore, have never been prosecuted is a matter of historical influence.

In the decades that followed confederation there is no shortage of evidence to show that Canada was greatly influenced by the United Kingdom. This influence even extended into the area of shipping. Canada's first investigation into shipping was launched the same year that

the Royal Commission on Shipping Rings reported their findings, 1913. Sir Henry Drayton, chief commissioner of the Board of Railway Commissioners, was appointed to head the investigation. Both the Royal Commission's minority report and Drayton's report concluded that some form of regulation was required; however, neither report resulted in any legislative action. Nearly ten years passed before another Canadian investigation occurred.

In 1923, a Special Select Committee, appointed by the House of Commons to inquire into agricultural conditions, unearthed problems in the shipping industry with regard to freight rates. The Committee was especially concerned with the monopolistic character of shipping lines operating between Canada and the UK and the fact that eastbound rate quotations were good for periods of less than a week. These concerns were apparent in the committee's report which states:

> ...upon the regular steamship lines trading from Canadian ports the price of transportation service is determined neither by the law of supply and demand, nor on the basis of a cost plus a reasonable profit, but that a combine exists... known as the North Atlantic and UK Conference.[33]

The committee concluded that the government should hear complaints from shippers of unfair practices by ocean carriers and subsequently hold investigations into these complaints; these recommendations went unheeded. In 1925, the government once again authorized an investigation which was very critical of conferences, and once again the recommendations were dismissed. In failing to act upon any of the previous

committees' recommendations, the Canadian government ostensibly followed the British government in adopting a *laissez-faire* approach to shipping regulation.

An incident occurred in 1959 that was to prove paramount to the future direction of government shipping policy. Shippers in Quebec City who were current members of the Canada-UK and Canada-Continental freight conferences were not permitted to employ a non-conference ice-breaking vessel despite the fact the conference possessed no such service. This incident, which became known as the "Helga Dan Incident", led to an investigation by the Trade Practices Commission.

The Commission, which was chaired by R.S. MacLellan, presented its report in 1965. The MacLellan Report concluded that conferences and their practices were necessary for continued stability in the industry. However, the report went on to state that conference behaviour should be subject to specific government implemented safeguards, although it did not promote regulation of freight rates.

Although the report did not result in any prosecution with respect to the Helga Dan Incident, many of its findings were championed. A recommendation to improve the bargaining position of shippers resulted in the founding of the Canadian Shippers' Council the following year. Most importantly, within the report was the framework for the forthcoming shipping legislation.

The Shipping Conferences Exemption Act of 1970

On October 7, 1970 the first shipping legislation in Canada, the Shipping Conferences Exemption Act (SCEA), was given Royal assent. The stated purpose of this legislation was to exempt certain shipping conference practices from the provisions of the Combines Investigation Act. The Act is quite precise in explaining which conference practices are exempt and which practices are not exempt; also contained in the Act are stipulations for the filing of documents, reasons for the convening of a inquiry, and punishment for noncompliance. A unique feature of this Act is contained in Section 14: the Act had an expiry date.

The SCEA exempts from the Combines Investigation Act any contract, agreement or arrangement between members of a conference to the extent that the contract, agreement or arrangement

a) requires the use by members of the conference of tariffs established by the conference;

b) requires the members to carry out any patronage contract entered into by them if that contract

i) provides that it may be terminated by either party at any time given ninety days written notice,

ii) utilizes tariffs that incorporate a dual rate system in which no contract rate is less than the non-contract rate by more that fifteen percent, and

iii) makes no provisions for the payment of rebates;

c) provides for the allocation among members of ports within Canada;

d) regulates the times of sailings;

e) provides for the sharing of earnings and losses of members; or

f) regulates the admission of ocean carriers to membership in the conference and the expulsion of members from the conference.

Also, there are certain conference practices that do not receive antitrust exemption, and if any members of a conference conspire, agree or arrange to enter into such practices, this will result in the loss of exemption:

a) the use of a vessel for the purpose of hindering competition by a non-conference ocean carrier;

b) the refusal to transport goods for a shipper that has previously used non-conference ocean carriers; or

c) preventing or limiting the use of port facilities or services to an ocean carrier who is not a conference member.

The Act contains provisions for the filing of documentation by every ocean carrier who is a conference member. These documents must be filed with the Canadian Transport Commission pursuant to specific conditions. Any conference member which fails to file the required documents is guilty of an offence and liable on summary conviction for a fine not exceeding 100 dollars per day.

There is due consideration paid to the investigation of shipping conferences in the Act. The Director of Investigation and Research is appointed under the Combines Investigation Act. Either on his or her own initiative, or upon direction from the Minister of Consumer and Corporate Affairs, or at the request of the Restrictive Trade Practices Commission, he or she may conduct an inquiry into the operations of a conference and the effect that the conference practices have in lessening competition or injuring trade. Any inquiry carried out by the Director shall be deemed an inquiry under the Combines Investigation Act.

Unique to all Canadian legislation is Section 14 of SCEA. This section sets an expiry date of three years from the day it comes into force, unless extended by proclamation. In 1974, just before the expiry date, the SCEA was extended for a period of five years, until the arrival of the SCEA of 1979.

The Shipping Conferences Exemption Act of 1979

The SCEA of 1979 offered no major changes to the provisions in the original Act, but it did introduce minor ones. The exemption accorded by the SCEA to the Combines Investigation Act was broadened with respect to whom it covered. Members of a shipping conference were now required to have an office in Canada and meet with shipper groups.

The original SCEA extended exemption only to members of the same conference. The 1979 SCEA extended exemption to members of the same conference, between the members of a

conference and those of another conference or between the members of a conference and an ocean carrier that is not a conference member. Also, the section on limitations of the antitrust exemption was accordingly generalized from members of conferences to "all or any of the ocean carriers that are parties to the contract...."

Members of conferences were now required to maintain an office in the region of Canada where they operated. They were also required to make available for public inspection copies of all documents on file with the Canadian Transportation Commission. Members must also meet with a Minister of Transport designated "shipper group" when requested to do so by the group. The member must provide to the "shipper group" information sufficient enough to conduct the meeting.

As was the case with the original 1970 legislation, the 1979 SCEA also included an expiry date. The Act was to expire on March 31, 1984 or not later than five years beyond that when extended by proclamation. Twice the Act was extended by proclamation, but in 1987 it was finally repealed and replaced with the Shipping Conferences Exemption Act of 1987.

3.4 Conclusion

There is very little common ground to compare the evolution of liner shipping policy in Canada with that of the United States. Initially, the policy directions each country followed were polar opposites, but with the passage of time the policy differences grew smaller.

In 1912, the US launched its first investigation into the practices of shipping conferences. The Alexander Report was issued in 1914 and soon became the basis for the original Shipping Act of 1916. Up until 1961, enforcement of the Act by the previous Boards or Commissions was very lax.

The 1961 revisions to the Act brought hard times to the US shipping industry. The Federal Maritime Commission found new zeal in its regulation, and the Department of Justice started to prosecute conferences for antitrust violations despite the Shipping Act. By 1984 the need for change could be heard from not only ocean carriers and conferences, but also shippers.

The Shipping Act of 1984 was a radical piece of legislation. A major goal of the Act was to augment government regulation with market regulation. The Act also saw the introduction of mandatory independent action and service contracts. The scope of the antitrust exemption was expanded for conferences and approval times for agreements was decreased.

Just as the US started with the Alexander Report, in Canada there was a report put forth by Sir Henry Drayton that was also critical of conferences. However, the similarities end here. None of the recommendations of Drayton's report were adopted by the government. With the failure to integrate Drayton's recommendations into legislation, the doctrine of *laissez-faire* regulation continued.

The MacLellan Report of 1965, inspired by the "Helga Dan Incident", signalled a turning point. The report contained recommendations for policy change; eventually these recommendations formed the basis for Canada's first shipping legislation: The Shipping Conferences Exemption Act of 1970.

The SCEA exempted conferences from the provisions of the Combines Investigation Act, set requirements for the filing of documents, provided procedures for investigations, and stipulated punishments for non-compliance. The inclusion of an expiry date allowed the Act to be extended via proclamation until the arrival of the SCEA of 1979. The 1979 SCEA offered only minor revisions, the most important of which was the broadening of the exemption criteria. Once again, the SCEA was given an expiry date, and after two extensions the Act was rescinded in 1987.

The US perceived that government regulation was necessary in order to prevent monopolistic conference abuses, to achieve stability in the liner trades and to form a viable merchant marine. On the other hand Canada was not convinced of the monopoly problem and felt that stability was best achieved through *laissez-faire* regulation. Additionally, the requirement for a merchant marine was not paramount. When both countries had shipping legislation, during the 1970s and early 1980s, their approach to regulation was very different; the Canadian approach was very tolerant whereas the US was very sceptical of conferences.

The mid 1980s, however, was to witness a marked convergence of policy. In the US a much more tolerant attitude to conferences was embodied in the 1984 US Shipping Act. The Act, together with the circumstances that motivated it, were to influence the recent development of Canadian legislation. The nature of the legislation, and the forces that shaped it, will form the basis of the next chapter.

Notes

[1] Report of the Royal Commission on Shipping Rings (London, 1909). 5 vols., cd. 4668-70. The Commission's recommendations are in vol. I, cd. 4669.

[2] US v. Hamburg-American Line *et al.* 239 US 466; US v. Prince Line Ltd. *et al.*, and US v. American Asiatic Co. *et al.* 242 US 537.

[3] US Congress, House, Committee on Merchant Marine and Fisheries, Investigations of Shipping Combinations, 62nd and 63rd Cong., 1913-14, 4 vols. (Washington: GPO, 1915). (referred to as the Alexander Committee).

[4] Report on Steamship Agreements and Affiliations in the American Foreign and Domestic Trade, vol. 4 of the Alexander Committee, 418.

[5] More extensive regulation was recommended for operating within the domestic trades of the United States.

[6] A "fighting ship" is a vessel, placed on berth by one or more established lines, which quotes lower rates than its sponsors in order to render entry of a newcomer to the route difficult.

[7] 39 Stat. 733 (1917), 41 Stat. 996 (1921), 46 U.S.C. §812 (1940).

[8] Great Britain, Committee of Inquiry into Shipping: Report, 132, par. 468.

[9] Proceedings of the Sixth National Conference on the Merchant Marine, (Washington: GPO, 1933), 77-78.

[10] Comp. Generale Transatlantique v. American Tobacco Co., 280 US Reports 555 (1929).

[11] Economic Fragments, London: P.S. King & Sons, Ltd., 1931, 114-115.

[12] C. G. Morse, "A Study of American Merchant Marine Legislation," Law and Contemporary Problems, Winter 1960, 64.

[13] US v. Far Eastern Conference, 94 F. Supp. 900.

[14] W. W. Gardner, "Steamship Conferences and the Shipping Act 1916," Tulane Law Review, vol. 35 (1960): 135.

[15] Federal Maritime Board v. Isbrandtsen Co., 356 US 481 (1958).

[16] US Congress, House, Committee on Merchant Marine and Fisheries, Steamship Conference Study, hearing, 86th Cong., 1st sess., 25 Feb. 1959 to 18 Aug. 1959 (Washington: GPO, 1959) part 1, 16-17.

[17] 75 Stat. 762 (1961).

[18] Arvid Frihagen, "Linjekonferanser og kartell-lovgiving," (Oslo, Norway: Arkiv for Sjorett Universitetsforlaget), 447.

[19] R. O. Goss, "USA Legislation and the Foreign Shipowner: A Critique," Studies in Maritime Economics, (Cambridge: Cambridge University Press, 1968), 45.

[20] George E. Hearn, Federal Maritime Commissioner,"Remarks at the 25th Annual Institute on Foreign Transportation and Port Operations," sponsored by Tulane University, New Orleans, Louisiana, May 8, 1974. FMC Press Release (SP 74-5), 2-4.

[21] A.V. Lowe, "Blocking Extraterritorial Jurisdiction: The British Protection of Trading Interests Act, 1980," American Journal of International Law, (April 1981): 257-282.

[22] 46 USC 826 (1964) amended to 81 Stat. 544 (1967).

[23] 285 F. Supp. 949 (S.D.N.Y. 1968) and 407 F. 2nd 173 (2nd Cir.).

[24] 383 US 213 (1966).

[25] 39 US 238 (1968).

[26] F. Conger Fawcett and David C. Nolan, "United States Shipping: The History, Development and Decline of the Antitrust Exemption," Northwestern Journal of International Law and Business, (1979): 563.

[27] H.R. Rep No. 98-53, Part 2, 98th Cong., 1st sess. 12 (1983).

[28] 694 F. 2d 793 (D.C. Cir. 1982).

[29] S. Rep. No. 3, 98th Cong., 1st sess. 7-8 (1983).

[30] N. Shashikumar, US Shipping Act of 1984: A Scrutiny of Controversial Provisions (Castine, Maine: Maine Maritime Press, 1987).

[31] H.R. 1878 Subcommittee on Monopolies and Commercial Law of the Committee on the Judiciary, 98th Cong., 1st sess., 224-227 (1983).

[32] G. Bruce Doern, Canadian Competition Policy Institutions in a Global Market (Winnipeg: Hignell Printing Limited, 1995), 4-6.

[33] Canada, Journals of the House of Commons, Appendix to 60th Volume (1923), viii-ix.

Chapter 4

The Shipping Conferences Exemption Act of 1987

4.1 Introduction

The Shipping Conferences Exemption Act of 1987 (SCEA 1987) came into effect on February 17, 1988, thereby superseding the previous legislation which was enacted in 1979. The new Act borrowed several key innovations from the US Shipping Act of 1984. These innovations were to signal a major turning point in government's policy towards liner conferences in Canada by recognizing the need to stimulate the competitive discipline of market forces. Besides enhancing competition, the new legislation also attempted to redefine the scope of conferences' exemption from the Competition Act, provided new procedures for the investigation of conferences, and changed the punitive measures.

The first section of this chapter explains the complex reasons that necessitated the introduction of the new legislation. The second section covers the main areas of revision that differentiate the SCEA 1987 from the earlier legislation and, as such, explains the new innovations borrowed from the American shipping legislation. Finally, due to the undeniable influence of the US Shipping Act of 1984 on the SCEA 1987, a brief comparison of similarities and differences between the Canadian and US legislation will be included.

4.2 Reasons for the New Legislation

In the early 1980s, signs of growing concern were emerging over the requirement to revise the SCEA 1979. Several important developments, both national and international, had proceeded since the 1979 legislation that placed enormous pressure on the government to take action. This section will highlight these concerns and their origins.

In 1982, a survey conducted on behalf of Consumer and Corporate Affairs found ample evidence of increasing dissatisfaction with conference arrangements among shippers. The survey of exporters, importers, and freight forwarders found that a mere 20 percent of those interviewed favoured continuation of the SCEA 1979, while 42 percent favoured rescinding the legislation.[1] The Canadian Shipper's Council, in public hearings conducted by the Canadian Transport Commission, voiced their concerns over the 100 percent loyalty contract, and the unresponsiveness of conferences to their needs.[2]

During the early to mid 1980s the concept of deregulation was having a great impact on the perception of the legislative frameworks in which all modes of transportation operated. Studies conducted during this time showed that deregulation would result in advantages gained through an increased reliance on competitive market forces.[3] The airline, railroad, and trucking industries were the first to undergo deregulation. To a lesser extent, deregulation in the liner

industry was also thought beneficial. In "Freedom to Move", a discussion paper published in 1985, the Minister of Transport endorsed this view by asserting that "Canadian shippers require greater freedom of action with respect to shipping conferences."[4]

The introduction of containerization and intermodalism into North America gave rise to the possibility of transshipment of Canadian cargo through US ports and vice versa. Throughout the late 1970s and early 1980s the volumes being transshipped were steadily increasing. The advent of deregulation further hastened this trend. From a policy viewpoint, transshipment was forcing interdependence of transport policies between both countries. Therefore, when the Americans enacted the US Shipping Act of 1984, replete with innovative provisions that were favourable to conferences, Canada was obligated to respond with a legislative framework that was as at least as hospitable to conferences, or possibly risk losing all conference business to the US.

Finally, the most overriding reason for requiring new shipping legislation was the expiration clause contained in the SCEA 1979. This clause stipulated that the Act would cease to exist on March 31, 1984 unless extended by proclamation for a maximum of five years. The maximum time limit was never reached as the SCEA 1987 was given Royal assent on June 30, 1987.

The concerns described here provided the impetus for the new conference shipping legislation, the SCEA 1987. The concerns also provided policy makers with a framework that served to highlight the specific areas that required revision and the type and extent of those revisions. The following section will explore these specific areas.

4.3 Enhancement of Rate Competition within the Conferences

In 1984, the United States introduced new shipping legislation that incorporated two specific provisions intended to increase the rate competition within conferences. In 1987, Canada revised its legislation, the SCEA, and introduced two similar provisions modelled after those found in the US Shipping Act of 1984. These critical provisions related to the right to mandatory independent action (IA) and to the ability of shippers to negotiate service contracts.

Independent Action

Independent action is the offering of rates or services by individual conference members that are different from those agreed to in any tariff established by the members of that conference. This provision provides conference members with a statutory right to take independent action on all published rates and services. By investing the conference members with the ability to set rates different from those established in conference tariffs, the intention is that "the effect of this right is to legitimize and facilitate a form of price competition within the conference."[5] The principal objective

of this intra-conference competition is to curtail the possibility of excessive rate-setting by the conferences.

There are time constraints that accompany the ability to take independent action. Before any member of a conference can take independent action, the member must give the other members of the conference such number of days written notice as is fixed by order of the Governor in Council, or such lesser number of days notice as may be specified in the conference agreement[6]; currently the governor in Council requires 15 days notice.

Service Contracts

Service contracts are confidential arrangements between a shipper and one or more members of a conference whereby the shipper agrees to provide a specified minimum quantity of goods over a fixed time period and, in return, the contracted members of the conference agree to transport the goods at a prearranged rate and level of service.[7] From the shippers' point of view, the ability to ensure fixed rates provides them with marketing gains, and, in effect, service contracts become a marketing tool to stabilize rates and service levels over the contract period. Another important benefit of service contracts has been aptly articulated as:

> The significance of service contracts in terms of stimulating competition within liner shipping is that at the negotiation stage they promote competition between conference lines and independents for a shipper's business, while after the consummation of the contract, the successful party is shielded from retaliation throughout the life of the contract.[8]

Nevertheless, a significant amount of influence still resides with the conferences as they have the ability to dictate the terms and conditions respecting the use of service contracts by their members.[9]

4.4 Redefining Conference Exemption from the Competition Act

The purpose of the SCEA has not changed since its introduction in 1970: according to the preamble in all three versions, the SCEA is "An Act to exempt certain shipping conference practices from the provisions of the Competition Act [Combines Investigation Act]. . . ."[10] The SCEA 1987, while still serving the same purpose, restricts the scope of the exemption of conference agreements from the Competition Act.

First, the ability of conference members to form collusive agreements with non-conference carriers has been totally eliminated.[11] Since non-conference carriers provide the most important source of competition for the conferences, allowing collusive agreements between them to continue was viewed as unduly limiting of competition.

Second, conferences are no longer permitted to collectively negotiate rates with inland carriers.[12] Conference members can still offer shippers combined multimodal rates, but these rates must result from negotiations between an individual conference member and an individual inland transportation company.

Third, any member of a conference who engages in, or conspires with another person to engage in, predatory pricing

will not be exempted from the Competition Act. This in no way abolishes healthy price competition since "the standards applied under the predatory pricing provisions of the Act [Competition Act] leave broad scope for pro-competitive price cutting."[13]

Fourth, all exemptions from the Competition Act with respect to conference agreements will not apply unless a copy or description of the agreement is filed with the Canadian Transport Commission.[14] The earlier legislation, SCEA 1979, also required the filing of conference agreements; however, misinterpretation was possible due to the broad wording.

Finally, an historically important area of conference exemption that has undergone major alteration regards the use of loyalty contracts. Loyalty contracts, previously referred to as patronage contracts, were a potentially powerful tool that conferences could use to reduce competition from independents. In the SCEA 1979 a patronage contract "required shippers to commit themselves to the nearly exclusive use of a conference carrier."[15] However, under the SCEA 1987, conferences are explicitly prohibited from requiring a commitment of 100 percent of a shipper's cargo as a condition of the shipper signing a loyalty contract.[16] By disallowing a 100 percent commitment from shippers, this new provision has effectively killed all use of loyalty contracts since no carrier or conference will give a discount for loyalty when the definition of loyalty is not legally specified, and

therefore it cannot be monitored or enforced.

4.5 New Procedures for the Investigation of Complaints and Punishment

A major reason for the requirement of new shipping legislation was the dissatisfaction that shippers felt with respect to the procedures for settlement of complaints. The SCEA 1987 addressed this issue by revising both the mechanism for the investigation of complaints and the magnitude punitive measures.

In an attempt to increase public input a complaint may be brought before the National Transportation Agency (NTA) by any person who has reason to believe that a conference agreement or practice "has, or is likely to have, by a reduction in competition, the effect of producing an unreasonable reduction in transportation services or an unreasonable increase in transportation costs."[17] If the NTA, upon completion of the investigation, finds the conference agreement or practice to be contrary to the provisions of the SCEA 1987, the NTA may order either the removal of the offending feature from the agreement or the cessation of the particular practice. Also, the NTA, in conducting their investigation may elect to hold public hearings.

Regarding punitive measures, should any conference or inter-conference agreement not be exempt from the Competition Act, then the offending party will be subject to the penalties provided by that Act. If the member of a conference fails to

comply with an obligation imposed under the SCEA 1987, then the member is liable to a fine not exceeding one thousand dollars per offence; where the offence is committed on more than one day or continued for more than one day, each day shall be considered a separate offence.[18]

4.6 Comparison of the 1987 SCEA and the 1984 US Shipping Act

The SCEA 1987 draws heavily on the US Shipping Act of 1984 for direction with respect to new innovations. The first innovation borrowed from the American legislation is the right of independent action by conference members on published freight rates; the second, is the ability to negotiate service contracts between conference members and shippers; and finally, there is the procedures for the administration of complaints.

An area of significance where Canadian and US legislation diverges is with respect to the extent of regulatory involvement. In the US, shipping legislation explicitly prohibits conferences and independents from offering rates which are different from their published rates; the Federal Maritime Commission (FMC), the US regulatory body, actively monitors rates, and conducts periodic investigations into rate discounting activities. In Canada, only conference rates must be filed with the NTA; once filed there is no provision for monitoring these rates. Unlike the US, the purpose of the Canadian SCEA is to exempt certain conference practices from

the Competition Act, not to regulate the industry.

Besides deviating on the extent of regulation, there are additional differences between the two pieces of legislation. The SCEA 1987 allows conferences to use loyalty contracts, albeit under restrictive conditions, whereas in the US these contracts are subject to anti-trust legislation. The SCEA 1987 continues to permit conferences to control entry and exit from their membership: "closed" conferences are permitted in Canada unlike the US "open" conference system.

4.7 Conclusion

In the early 1980s, pressure from domestic as well as international sources was necessitating the requirement for the government to revise the SCEA 1979. The source of this pressure was the growing dissatisfaction of domestic shippers, and the trend towards Canadian and US transport policy interdependence brought on by increasing transshipment and deregulation. The pressure culminated in the formulation of the SCEA 1987.

Borrowing from the US Shipping Act of 1984 and the Canadian government's conviction regarding the need to introduce market forces as a regulatory measure, the SCEA 1987 was enacted. The most significant measures were the US innovations of independent action and service contracts. These were to be the instruments through which competition was to be enhanced and market forces brought to bear.

The SCEA 1987 was conceived as a reaction to events that

occurred in the early to mid 1980s. Now, approaching ten-years old, the applicability of not just the provisions contained in the Act, but the entire Act itself must be questioned. In the early 1990s, many shippers have been quite vocal over their dissatisfaction with the SCEA, the Chairman of the Canadian Manufacturers' Association (CMA) stated:

> This is outdated legislation and no longer serves the purpose of today's transportation needs. There is no good justification for this particular mode of transportation to have immunity from the Competition Act.[19]

The 1990 NTA Review added that:

> The Canadian Shippers' Council (CSC), the only designated shippers' group under SCEA, again expressed scepticism of the value of SCEA in that it continued to offer few benefits to Canadian shippers in 1990. The CSC explained that the conference system in Canadian liner trade formed a barrier to satisfying shipper needs. Shippers require choice and variety in both type and quality of service, effective price competition, and the ability to negotiate and exchange information freely and confidentially with individual shipping lines.[20]

Considering the concerns expressed by both the CMA and the CSC, perhaps the present economic conditions and state of the industry are quite dissimilar to those that existed in 1987. If so, the current legislation may be inappropriate and in need of major revision. The possibilities for this will be discussed in the next chapter which explores the fundamental economics of the current liner shipping industry.

Notes

[1] E. M. Ludwick and Associates, Shipping Conferences: Survey of Users' Views, Consumer and Corporate Affairs Canada (Ottawa: Supply and Services Canada, 1983).

[2] Canadian Shippers' Council, Submission to the Water Transport Committee of the Canadian Transport Commission (1982).

[3] See A.A. Walters, "Gains from Deregulation of Ocean Shipping", from Proceedings: In Search of a Rational Liner Shipping Policy (Northwestern University Transportation Research Centre Forum, March 13 and 14, 1978); R. Larner, "Public Policy in the Ocean Freight Industry", in Almarin Phillips, ed., Promoting Competition in Regulated Markets, (Washington, D.C.: Brookings Institute, 1975).

[4] Minister of Transport, Freedom to Move: A Framework for Transportation Reform, (Ottawa: Supply and Services Canada, 1985), 2.

[5] R. D. Anderson and S. D. Khosla, "Canada's New Shipping Conferences Legislation: Provision For Competition Within The Cartel System," Canadian Competition Policy Record, vol. 9, no. 1 (March 1988): 6.

[6] Shipping Conferences Exemption Act of 1987, Section 4(3). (henceforth referred to as SCEA 1987).

[7] SCEA 1987, Section 5(1)(b).

[8] J. E. Davies, "The Evolution of Canadian Liner Shipping Policy", Maritime Policy and Management, vol. 21, no. 1 (1994): 84.

[9] SCEA 1987, Section 4(1)(c).

[10] SCEA 1970, preamble; SCEA 1979, preamble; SCEA 1987, preamble.

[11] SCEA 1987, Section 5, (1) subsection 4(1)(a).

[12] SCEA 1987, Section 5, (2) subsection 4(1).

[13] Anderson and Khosla, 5.

[14] SCEA 1987, Section 4(2).

[15] Mary R. Brooks *et al.*, Monitoring Transportation Regulatory Reform, (Halifax: The Oceans Institute of Canada, 1989), 22.

[16] SCEA 1987, Section 4(1)(b)(iv).

[17] SCEA 1987, Section 13(1).

[18] SCEA 1987, Section 24.

[19] G. Rowan, "End Urged to Shipping Cartels," Globe and Mail, 18 June 1992, B11.

[20] National Transportation Agency of Canada. Annual Review of the National Transportation Agency of Canada 1990. (Ottawa: Supply and Services Canada, 1990), 111-112.

Chapter 5

The Economics of the Liner Shipping Industry

5.1 Introduction

The complex nature of the liner shipping industry has been the focus of much analysis by both economists and governments. However, neither group has been able to produce universally agreed upon conclusions, especially in the area of market performance. As a consequence of these differing conclusions, there has been a wide variation in official liner shipping policy.

Given this, the present chapter will proceed in a conservative, uncontrovertial manner, looking at the principal facts which any economic analysis has to be able to explain, the problematic results that have accompanied the traditional structure, conduct, performance explanations of the facts and the results of more recent theories. Also addressed will be the actual and potential competition faced by conferences, and the degree of stability present in the industry.

5.2 Standard Industrial Organization (I/O) Model

The standard industrial organization approach to analyzing an industry focuses on three areas: structure, conduct, and performance. Concerning structure, a series of mergers and amalgamations in the late nineteenth and early twentieth centuries created in the liner shipping industry a distinctive oligopolistic market structure. Containerization and the scale economies it permitted reinforced this pattern,

resulting in the world's liner shipping industry in general, and any scheduled route in particular, being dominated by a few large firms. Thus it is clear that in the market that is relevant for price determination, and for which prices are actually set, the structure is unequivocally oligopolistic. In terms of conduct, the most obvious and important manifestation is overt collusion: conferences and the explicit agreements they embody for the purpose of collectively setting rate and service levels are collusive in nature.

Whereas the original intention of conferences was to afford its members a certain measure of protection from instability and cutthroat competition, the mechanism--a cartel--yielded the ability to set monopoly prices. Further reinforcing the conference's monopoly power were the considerable barriers to entry that appear to exist in the form of absolute capital costs, economies of scale, and tying arrangements.

The liner industry is very capital intensive due to the requirement for specialized vessels, containers, and specific port facilities. Chapter Two showed the cost of establishing a weekly liner service between Europe and the Far East to exceed 1 billion US$.[1] Also, the closed conference system allowed in Canada may entail that a prospective conference member pay an entrance fee. Overall, this makes the cost of entry prohibitively high for all but the financially strongest.

Economies of scale associated with vessel size, coupled with the requirement for scheduled services of a fleet of vessels, suggests the minimum efficient scale of entry to be typically high. However, the additional capacity introduced on the trade route may severely depress post-entry rates or cause load factors to decrease thereby increasing unit costs. Recognizing these likely effects of new capacity could thus deter entry.[2]

Tying arrangements are used by conferences to ensure that shippers are legally bound to the services of a member of a conference. These arrangements may be in the form of deferred rebates or dual rate contracts. If conferences are successful in tying shippers to their members, then an entrant may not be able to secure a large enough market share. Knowing that a viable market share is not available, no rational liner firm will enter the market.

The profit possibilities afforded to a cartel protected by high entry barriers are further reinforced by the universal tendency of conferences to practise price discrimination. The practice of discriminatory pricing was initially induced by the difficulties posed by high fixed and common costs. In this regard, once a scheduled service is offered, and vessels sail at prearranged times regardless of load factors so most costs become independent of actual output. Thus, in addition to capital and administration costs, operating costs like labour and fuel also become fixed. Indeed the only clear

variable costs relate to cargo loading and unloading. Given this, the great majority of costs become fixed in nature, or, more properly, they become common to all users.

Common costs cannot be attributed to any one particular cargo type, and the absence of that cargo has no effect on the magnitude of the costs incurred for the voyage. One solution to the problem of charging for common costs is the possibility of average cost pricing based on volume, weight, or a combination thereof. The drawback of averaging is that due to fluctuating demand on each sailing, there would be no price stability.[3] Also, differences in demand between two legs of a route results in the lean leg being charged a higher price; this is counter-productive since higher prices would further discourage utilization and increase unit (fixed costs). Herein lies the basis for discriminatory pricing or "what the market will bear" pricing; each cargo or class of cargo is charged a different rate that is inversely related to its price elasticity of demand: the maximum transportation rate that the market can bear and still be able to sell the good in the destination market will be charged. The effect on rates is that high-value cargoes absorb more than a pro-rata share per ton of the fixed costs.[4]

The classical view of conference performance would have the conferences restricting capacity, increasing rates via price discrimination, and consequently earning extraordinary profits. However, the theoretical predictions of conference

performance and reality differ greatly as there exists no hard evidence to support such high profits. The level of conference profitability has been the principal subject of several international studies.

In 1964, a study conducted by Standard and Poor's Corporation compared the profit rates of various US liner shipping firms to other industries for the years 1956 to 1962.[5] This study found the return on capital invested in liner shipping averaged 7 percent versus 10 percent for all other industries. A similar study conducted in the UK by B.M. Deakin used the Europe-Australia Conference Group (EACG); the profits earned by this conference were expected to be above average since it is closed, subject to limited non-conference competition, and highly rationalized. From 1958 to 1968, Deakin found the average return on capital was only 5.8 percent.[6] A Canadian study conducted by T. Heaver used the financial results from eight non-Canadian primarily liner-oriented corporations to calculate their return on net worth before taxes, during the period 1965 to 1980. The results varied from a low of -10.3 percent to a high of 11.3 percent, and averaged only 4.4 percent over the sixteen years.[7] Notably, the high value was associated with American President Lines which received government subsidization.

Recently, a study by Morgan Stanley Capital International found the world index of share prices rose by 23 percent in dollar terms during the twelve months to January 31st 1996.

However, when share prices are viewed on a sector-by-sector basis the shipping industry had the third lowest rate of return in the vicinity of one to two percent.[8] The conclusions reached in all four studies depict an industry that has not been able to earn monopoly profits or even normal profits.

Since the shipping industry has been unable to earn the monopoly profits that were predicted there must exist some extenuating constraints on profit. Three principal constraints have been proposed: excessive service competition, cross subsidization, and poor cartel discipline.

The reason that monopoly profits are not attainable, according to J.W. Devanney, is that a propagating process of excessive service competition forces costs to increase.[9] The concept of excessive service competition is rooted in the idea that conferences beget over capacity, and that the existence of too much capacity will endanger the conferences' monopolistic rates. Since collective rate setting precludes a member from lowering rates, the member must resort to service competition in order to attract more cargo and improve profitability. A principal area of service competition regards improving transit time; this requires faster vessels that cost more to purchase and consume more fuel. Eventually, costs will be pushed up to the point where they approximate rates thus eliminating monopoly profits.

The cross subsidization of cargo is a consequence of the

conferences using discriminatory pricing practices. As noted earlier, each cargo is charged a different rate that is inversely related to its elasticity of demand. The effect is that high- value cargoes pay more than their pro-rata share of fixed costs: the high-value cargoes end up subsidizing the low-value cargoes. The effect of cross subsidization is that the profit earned from charging greater than average cost rates to high-value cargoes is offset by charging lower than average cost rates to low-value cargoes. According to S.G. Sturmey, the motive behind offering such low rates on cargoes susceptible to tramp competition was to deter entrance into the conferences perceived market.[10]

The existence of poor cartel discipline may pose a significant reason as to why conferences do not earn monopoly profits. Conferences are comprised of many shipping firms, each possessing a different cost structure. Since the rate levels and cargo quotas set by conferences are derived through a process of negotiation amongst its members, the potential exists that the members with the greatest influence will gain preferential treatment. Should members with high cost structures gain larger quotas, then the level of profit for the conference will be reduced. Also, if the conference grants too many large quotas, then both prices and profits will fall. Individual members may resort to cheating, through undercutting conference rates, in an attempt to further expand their quota. Overall, the effects of poor conference

discipline are manifested in inefficient and ineffective cartel organization, which causes an erosion of monopoly profits.[11]

Under the standard industrial organization approach to analyzing conferences, it would appear that the shippers of high-value goods are disadvantaged by charging higher rates for conveyance of their goods. As a consequence of differential pricing, the problem of cross subsidization of cargoes arises which tends to eliminate monopoly profits due to the misallocation of resources.[12] Inefficiency and spiralling costs brought about by excess service competition and poor conference discipline, respectively, are also detrimental effects of conferences. Resulting from these problems are specific implications for liner policy.

The principal policy implication is that conferences should not be allowed to exist. Even the prospect of government regulation to control the behaviour of conferences is not appealing since this is both costly and basically serves to sanction their existence. However, should conferences be deemed a necessity and thus be granted special legal treatment, then measures are required to ensure an environment with sufficient price competition is fostered.

5.3 Recent Theories

Over the last fifteen years, academics have taken a keen interest in the peculiarities of the liner industry, producing a considerable amount of theoretical literature that attempts

to explain market behaviour and performance, and policy implications. Two prominent theories, the theory of contestable markets and the theory of the core, will be outlined concentrating primarily on their requirements and predictive ability.

5.3.1 Contestability Theory

The theory of contestable markets requires that three conditions of perfect contestability are met for optimal market performance:[13]

i) entrants and incumbents must be symmetrically placed,

ii) sunk costs must be absent, and

iii) a price sustainability condition must be met.

In order to ascertain the plausibility of these conditions in the case of liner shipping, and hence the applicability of the theory, they must be examined individually.

Symmetrical placement requires that all firms, both present and future, have equal access to technology, are subject to the same regulations, have equal access to customers, and produce a homogeneous service. Equal access to technology is assured through the ability to purchase or charter capital equipment, the only limitation being the financial backing of the firm. Due to differing national maritime policies and trade unions, there will exist, to a certain degree, variations in regulations. In Canada, the exclusion of 100 percent loyalty contracts in the SCEA 1987

means that access exists to all customers; customers are not legally bound to provide all of their cargo to one shipping line. Generally, the services provided by all liner firms are comparable, and the only ability to differentiate liners is through improving service levels, though this tends to result in similar price/service levels.

Sunk costs represent expenditures that once made can never be recovered. The level of sunk costs can be determined by taking the difference between the depreciated replacement cost and the current value if sold. Sunk costs reside as part of the liners' fixed costs. The specific areas that contain some degree of sunk costs are vessels and other capital equipment, investments in goodwill, and personnel development. The percentage of vessel costs which are considered sunk are surprisingly quite low. The reason for this low percentage is the existence of a flourishing second-hand market as well as "the presence of a substantial leasing sector providing an alternative strategic option which can greatly reduce the level of capital which must be committed to a new service."[14] Sunk costs have been estimated to constitute six percent of fixed costs, and only 2.9 percent of overall liner costs.[15] As a result of low sunk costs, there exists relatively low barriers to exit; also, low barriers to entry are made possible via the purchase of second-hand vessels or vessel chartering. Such low barriers are extremely important to making the liner industry contestable.

The price sustainability condition requires the ability of existing firms to alter their rates relatively slowly in comparison to that of customers or else that entrants are in a position to negotiate contracts prior to entry. With respect to altering rates, "conferences are not noted for the speed or flexibility of their rate setting procedures primarily because the need for consensus amongst member lines mitigates against this."[16] Contract negotiation is a commercial process and, as such, the possibility of obtaining contracts before the commencement of service exists.

Besides meeting the requirements for a seemingly high degree of contestability, the market must be subject to a large pool of potential competitors. The forthcoming section will provide evidence that there currently exists a sufficient pool of competition. With respect to this pool, a study conducted on the Canadian liner trades between 1976 and 1979 shows that entry and exit has been recurrent, large scale entry was present, hit-and-run entry was common, and profits were low;[17] such behaviour further reinforces the highly contestable nature of the Canadian liner market.

The theory is able to explain the liner industry's tendency towards destructive competition, whereas standard industrial organization theory did not recognize that it existed. According to W.J. Baumol *et al.*, there exist conditions under which firms in a contestable market are unable to establish prices that can deter entry while ensuring

financial feasibility.[18] As a consequence of these conditions, there arises an unsustainable pricing equilibrium. In an attempt to combat the detrimental effect of unsustainability, the conference system was adopted: it evolved through a process of natural selection.

Differential pricing in the liner industry is also explained by contestability theory. Conferences charge differentiated rates in order to overcome the problems presented by the existence of economies of scale and economies of scope, decreasing short-run costs, and an inelastic demand for their services. By offering lower rates to goods that would not normally be afforded liner transportation, members of conferences can increase their load factors. As long as the rate charged on low-value cargo covers the specific handling costs there is no cross-subsidization of cargoes present.[19]

The theory of contestable markets appears to apply quite well to the liner shipping industry: it suggests the ease of entry and exit through low sunk costs, the absence of monopoly power and profits due to the industry's structural contestability, and that differentiated pricing is beneficial. From the contestability analysis of liner shipping an important policy implication can be derived: long as the liner industry remains structurally contestable there exists no requirement for government regulation. The discipline of conferences by the market will be ensured through sufficient

competition, either actual or potential.

5.3.2 The Theory of the Core

The theory of the core further elaborates the implications of equilibrium, sunk costs, and price sustainability introduced in contestability theory. The theory explains how a stable, entry-deterring equilibrium may be impossible in the presence of a U-shaped average cost curve.[20]

The concept of a core evolved from attempts to find a determinate solution to non-cooperative games in which there were more than two participants. The solution to the game entailed forcing the players to form associations with the express purpose of optimizing their outcome. The core represents the optimal outcome. Relating the core to the necessary conditions, "unless the level of market demand is an integer multiple of the minimum point of each firm's average cost curve, it would not be possible for incumbent firms to set prices which both cover their costs and deter entry."[21] This is referred to as the core being empty: there is no optimal solution to the game, hence no competitive equilibrium exists.

The pertinence of the empty core to the liner industry is that market forces alone cannot produce a stable pricing equilibrium and individual liners desiring stability will be induced to form conferences. As with contestability, the formation of conferences was also due to a process of natural

selection in that conferences were a natural substitute for an empty core. Under circumstances of chronic instability, conferences were formed not for the purpose of earning monopoly profits, but as a method by which to promote stability.

Core theory only undertakes to explain the nature and consequence of unsustainability, and makes no attempt to explain any other aspects such as pricing. As far as policy implications are concerned, core theory is similar to contestability in that government regulation is not necessary. However, the theory would warn against the promotion of excessive competition since it may promote instability.

The principal policy implication of both contestability and core theories are that conferences do not require government regulation. However, the two theories deviate with respect to the appropriate level of competition. Core theory suggests that increased competition would result in promoting instability; whereas contestability theory suggests that increased competition would not result in instability.

5.5 Competition: The Market Power of Conferences

In some respects, all three of the theories previously described depend on the level of potential or actual competition that is available to conferences. On one extreme, monopoly would require that no competition be available, while on the other extreme, contestability requires decisive actual and potential competition to exist. The importance of

establishing the level of competition is that it will serve as an indicator of the degree of market discipline faced by conferences. This section thus seeks to assess the extent of competition in liner markets.

Developments over the past century have introduced into the liner conference industry a plethora of factors which, to differing degrees, enhance competition. All of the factors stem from either government regulation, the introduction of new technologies and techniques, or structural economic changes. To cover each factor adequately they have been divided into two groups: internal and external. Internal refers to competition that is present within a certain conference such as malpractice. External refers to competition that arises from sources outside the conference such as independent liners and tramps.

External Factors

The external factors that serve to enhance competition originate from the following sources:

i) inter-conference;

ii) independent liners;

iii) tramps; and

iv) air freight.

The extent of competition from each of these sources will be explored. The scope of this study includes both actual and potential competitors, thus, competition from any one or all of these sources may not be present on a given trade route-

however, the potential exists.

Inter-conference

The advent of containerization and intermodalism were two monumental innovations that have severely impacted on the level of competition between conferences. These innovations have provided containerized liner cargo with virtually unlimited mobility to any inland destination via compatible railcars and transport trucks. From the perspective of the Canadian shipper they are able to select ports on either coast and in Canada or the United States: shippers now have greater flexibility in searching for lower prices and/or better services. The repercussion for the conferences is that they must not only remain competitive within the port(s) they serve but over a much larger geographic area, potentially all of North America. Conferences do possess some power to mediate this circumstance.

Partially offsetting the gains in competition brought about by intermodalism and containerization is cross-conference membership. Cross-conference membership occurs, and is most effective, when at least one major liner firm belongs to many different conferences. The Celler Committee in the US recognized the potential danger and concluded in its report that:

> . . .the largest and most influential steamship lines are members of several conferences, some of them closely related and when the viewpoints of these lines dominate the conference to which they belong. . .these conferences will follow the same policies and practices.[22]

In 1994, four of the twenty conferences serving Canada via east coast ports not only had identical memberships, but one third of the members were amongst the top twenty largest container lines in the world.[23] According to S.G. Sturmey, such cross-conference membership provides an opportunity for "near perfect collusion between these conferences".[24]

There is no doubt that inter-conference competition does exist and that its scope is no longer limited to conferences serving the same ports. However, conferences have the ability to reduce the severity of this competition through the use cross-conference membership.

Independent Liners

Independent (or non-conference) liners offer services similar to those offered by conferences but without joining such associations. The independent liners are the most important source of competition for conferences. The N.T.A. in its 1993 Annual Transportation Review stated that "competition for international waterborne liner traffic pits shipping conferences against independent lines, and to a lesser extent, conference members against each other".[25] Within Canada the use of independents is quite extensive.

Independent liners are the predominant operators on both the east and west coasts of Canada. In 1994, there were twenty conference lines and thirty-seven independent lines operating via east coast ports, and thirteen conferences and twenty-one independents operating via the west coast. Many of

the independent liners also hold active conference memberships, for example Maersk Line, the world's largest container line, offers service as an independent and as a member of seven conferences on both coasts. However, plagued in recent years by depressed freight rates and overcapacity, independents have themselves sought to enter into agreements.

These agreements between numerous major shipping lines, both conference and non-conference, are typically in the form of joint service arrangements, common terminal facilities, container slot-chartering and vessel-sharing. Presently, in the Canadian trade there are two agreements in use: Transpacific Stabilization Agreement (TSA) and the Trans Atlantic Agreement (TAA).

In the Canadian trade independent liners are indispensable: they are the most important source of competition for conferences and transport a higher volume of cargo.[26] The introduction of agreements such as the TSA and the TAA may tend to limit competition in the liner trade; nonetheless, the economic forces that necessitated such agreements in the first place still exist.

<u>Tramps</u>

A tramp vessel is a common carrier, for hire by general shippers, which does not adhere to given routes and is therefore not bound to provide scheduled service. Due to low speeds and lack of special-cargo facilities, tramp vessels usually transport low unit value cargo compared to liners.

Also, the cargo is typically shipped in bulk quantities. The competition from tramps for the shipment of such cargo is sufficient enough for one report to conclude that ". . .liners and irregular carriers [tramps] are apparently good substitutes for each other."[27] A good indication of the actual or potential competition that conferences face for bulk cargo is found in the fact that they typically do not publish rates, opting instead for open rates.[28]

Because tramps are considered on-demand competitors that offer a poor degree of service in an area limited to low value bulk goods they are not a serious threat to conferences.

Air Freight

Air freight is a viable alternative to liner shipping for limited quantities of perishable or high value-added goods since the cost of air freight is substantially higher. In 1994, the total tonnage of international and transborder air freight in Canada was 383,515 tonnes.[29] When compared to total liner tonnages in excess of 18 million tonnes air freight amounts to a paltry two percent.[30] An opposite phenomena occurs when cargoes are compared by value. According to G.K. Sletmo, "in 1975, airlines carried more than 27 percent of the value of US trade transported by scheduled carriers (ie. air freight and liner traffic)".[31] It is obvious that air freight attracts only the highest value cargo away from the liners. Losing this particular cargo definitely hurts the liners financially; however, the nature of the cargo is such that

shippers can not afford the liners' much higher transit times, thus liners are not able to offer comparable service.

Internal Factors

The internal factors that serve to enhance competition do so from within the conference structure. The stress created by internal factors may take the form of malpractice, severe service competition, or government legislation. All of these factors can lead to the weakening of conference monopoly power and will be looked at in greater detail.

Malpractice

An inherent problem in any conference that undertakes to set collective rates is the prospect of malpractice by a member. Simply stated, malpractice is cheating. It can be defined as either a secret undercutting of conference rates or providing the shipper with covert advantages that would contravene the conference agreement.

There are several forms of malpractice employed by members of a conference to attract more business and increase profits. In 1963, the Bonner Committee in the US provided the following examples of malpractice in its report: the payment of commissions to freight forwarders, shippers, and consignees when no real service is rendered to the member line; the member line may absorb some of the cost of inland transportation or storage costs; a line may pre-date bills of lading to allow shippers to comply with contractual or credit obligations; and liners may offer free personal transportation

to shippers, lavish entertainment, or expensive gifts.[32] Should malpractice become prevalent within a conference, instability will most likely ensue: rampant malpractice by the majority of conference members will erode the overall effectiveness of the conference and, hence, the conference's ability to collectively set rates and service levels.

The exact magnitude of malpractice within conferences is not known. However, malpractice must be a growing concern to conferences since "in 1993, new self-policing arrangements were announced by carrier groups in both transatlantic and transpacific trades to ensure compliance with the terms of rate and capacity agreements on file".[33] Self-policing, if effectively employed, should prevent the possibility of rampant malpractice. Yet, unless policing is one hundred percent effective malpractice will serve as a powerful source of conference competition.

Severe Service Competition

In a conference organization where price competition among members is eliminated through binding agreement, it can be expected that non-price competition will be intensive. By itself, mere membership in a conference does not generate cargo: cargo must be sought by the individual member. When seeking cargo a member needs to offer services that effectively differentiate itself from its cohorts as well as other lines.

Businesses that require the use of international liner

services either possess their own in-house transportation expertise or purchase expertise from freight forwarders. Thus in offering services to businesses, liners must be aware that ". . .they [businesses] are in a strong position to distinguish between real performance and any attempt to create superficial, perceived differentiation".[34] Bearing this in mind, performance oriented service competition can take a variety of forms: transit times; the types of cargo services offered and the quality of ships used; number of ports of call served; the quality of the terminal facilities used by the liner firm; and the resolution of claims. This type of competition will force the conference members to continually improve services and upgrade equipment.

Government Legislation

In 1989, a pamphlet published by the National Transportation Agency of Canada stated the purpose of the recently revised Shipping Conferences Exemption Act as "the legislation tries to balance the market power of conferences through provisions intended to encourage price competition between conference members, for the benefit of shippers".[35] As detailed in Chapter Four, the main provision of the legislation that serves to create intra-conference competition is independent action (IA). The SCEA also prohibits certain conference practices that can limit competition, such as predatory pricing, the use of fighting ships, the refusal of cargo because a shipper has used a non-conference carrier, the

prevention of a non-conference from using a port, facility or service, and one hundred percent loyalty contracts.

The combined effects of both external and internal factors are responsible for introducing into the liner conference market a tremendous degree of competition. Conferences have attempted to devise some methods to counteract each factor's affect, however, "despite industry efforts to manage competition, market forces play a prominent role in the international liner trade".[36] Due to market forces the liner shipping industry is faced with a significant degree of discipline. The sheer magnitude of this discipline should be more than sufficient to ensure that conferences are not able to gain monopoly power.

5.6 Stability

The original purpose for the formation of conferences was to induce stability into an industry that was historically prone to the destabilizing effects of excess capacity and destructive competition. The three theories previously described all had distinctive views of conferences and their affect, if any, on stability. This section will review these theories from the viewpoint of stability in an attempt to establish a basis for conference existence. Finally, the theoretical findings will give way to an appraisal of the current trends and developments in the industry which impact on the conferences' ability to induce stability.

Under the standard industrial organization approach to

the liner industry, destructive competition is not recognized as a problem that threatens stability. Instead, the market is viewed as being normally stable and that destructive competition is merely the market's way of eliminating excess capacity.[37] Based on this view, conferences do not promote stability in the market, and consequently are not necessary.

The theory of the core finds the liner industry to be inherently prone to instability. The lack of a sustainable equilibrium price combined with the problem of excess capacity will result in recurrent bouts of destructive competition. The only viable method of preventing instability is through the formation of effective conferences.

Contestability theory recognizes that there are conditions under which a sustainable equilibrium price cannot exist, and therefore the industry may be subject to instability.[38] As with core theory, contestability also views conferences as a method of promoting stability. Based on the theoretical frameworks, both core and contestability theories perceive conferences as beneficial to stability, while standard industrial organization finds the industry to be normally stable. However, to augment the predictions accorded by these three theories the current state of stability in the liner industry needs to be explored.

If conferences are considered to be a viable solution to the problem of instability in the liner industry, then a great proliferation of their services would be expected. However,

in Canada, this has not been the case during the past ten years. In absolute terms, conferences have ceded their dominant position in Canada's international ocean borne liner trade to independent liners.[39] The decline in conferences and subsequent increase in independents would tend to indicate that conferences are no longer necessary for providing stability.

Accompanying the decline in the number of conferences is a marked increase in the degree of competition they currently face. Competition from independent liners or tramps that typically undercut conference rates serve to further erode their market share as well as rendering the practice of differential pricing ineffective. The sheer volume of actual and potential competitors should ensure stability in the supply of liner services.

Another trend that does not lend itself to an industry that is prone to instability and destructive competition is the increasing volume of new vessel orders. In 1994, the top twenty liner firms in the world ordered a combined total of 80 vessels which represents an additional capacity of 332,442 TEUs.[40] Obviously, these firms must believe they will be able to make a profit. Notably, most of these firms currently operate as both conference members and independents. Nevertheless, the introduction of such capacity is ostensibly viewed as not promoting instability.

Both core and contestability theories tend to predict

that conferences are necessary to promote stability within the liner industry. However, recent developments and trends seem to indicate the opposite: conferences are not important for stability. Although conferences are not necessarily promoting stability they are definitely not a factor in promoting instability, and therefore their continued existence would not have any stabilizing effect.

5.7 Conclusion

From a theoretical viewpoint both contestability and core theories regard conferences as necessary, but regulation of them as unnecessary. However, there is distinct difference with respect to the degree of competition: contestability purports that healthy competition is mandatory to ensure conferences are kept in check, while core supporters contend that too much competition may invite instability. Standard industrial organization theory views conferences as unnecessary and likely to cause problems through abuse of monopoly powers. Nevertheless, should conferences be deemed essential this theory would recommend regulation to protect the public.

Each theory offers compelling reasons as to why their respective predictions are correct, but the problem remains that each theory produces a different conclusion. Regardless of any predictions, the actual performance of conferences, both recent and past, provides valuable insights into the direction the industry is headed.

From the viewpoint of profitability, conferences have not been able to secure monopoly profits for their members. Several studies conducted over a forty-year period have shown their rate of return to be consistently below the average of all other industries. In Canada, the last ten-years have seen a drop in the number of conferences serving both coasts, while the number of independents has increased. Also, conferences are facing an increasing amount of competition from diverse sources such as air freight, rail roads, tramps and intra-conference.

If all of these events point to the declining role and power of conferences, then their contribution to maintaining stability within the industry must accordingly be declining. Based on the economic realities of the liner industry, it would appear that liner markets currently seem to be highly contestable, and therefore, while it would not diminish welfare should conferences be allowed to continue, the instability they are claimed to combat does not seem to be a real problem. Consequently, while conferences may not have any market power to abuse, neither do they serve to combat any tangible and demonstrable problem in the late 20th century.

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Chapter 6

Conclusions

The purpose of this study has been to analyze the interaction between law, politics, and economics in the liner shipping industry, focusing particularly on the appropriateness of Canadian policy. The study was motivated by a recognition of increasing opposition to the current form of Canadian policy and the fact that the industry itself has been undergoing rapid change. The study undertook to examine the nature of the ocean shipping industry, the evolution of liner policy, the current Canadian policy, and an economic analysis of the industry's functioning. The conclusions drawn from each chapter, when combined, form a framework from which an appraisal of current liner policy can be made.

The liner industry constitutes a small proportion of the total volume of Canadian ocean-borne trade, approximately eight percent in 1993. However, liners carry a highly significant share in terms of value, estimated at up to 70 percent of the total value of Canadian ocean trade. In 1993, the conference share of liner cargo amounted to 40 percent, a substantial decrease from 69 percent in 1975. Also, the number of conference lines serving Canada has steadily decreased in the past ten years, this being especially evident on the west coast. Presently, independent lines outnumber conference lines on both coasts. Although conferences have been losing their popularity in Canada, they still transport

a significant proportion of liner cargoes.

The first traces of Canadian liner policy appeared in 1965 when the Restrictive Trade Practices Commission presented the MacLellan Report on conference practices. The report concluded that conferences were necessary, but should be subjected to government safeguards. More importantly, the report formed the basis for the original Shipping Conferences Exemption Act (SCEA) of 1970. Both the 1970 SCEA and the following 1979 SCEA were rather lacklustre pieces of legislation based on outdated ideologies. During the eight years before the next Act arrived, they were many events that reshaped the industry and impacted on policy considerations.

Intermodalism was causing a massive transshipment of American cargoes through Canadian ports and vice versa. In order to ensure that transshipped cargo flowed in both directions, the transportation policies of both Canada and the US had to be aligned. Therefore, when the US Shipping Act of 1984 was introduced, there was no doubt it would influence the pending Canadian legislation. The impact was obvious: the SCEA of 1987 borrowed two innovative provisions from the US Act along with a few minor ones. Although the Canadian and American Acts did retain some quite distinctive features, there was nevertheless a clear alignment in their basic orientation.

The liner shipping industry formed conferences in response to problems that occurred over a century ago. The

extent of change in the industry since then has been nothing short of revolutionary: technological advancements have allowed much larger vessels, containerization, and multimodalism. There is presently a tremendous degree of competition faced by conferences, which effectively serves to impede their rate-setting strategies: conferences are losing their overall market power and market share. Further evidence is found in the fact that conferences have not been able to earn a normal profit, let alone monopoly profits. From an economic viewpoint, although conferences are overt cartels, there is no proof that they present a serious threat to economic welfare. Therefore, so long as a significant degree of actual and potential competition exists and conference practices do not adversely affect welfare considerations, there is no urgent need for their abolition.

In matters of policy, things are not as simple as they appear at first glance. Based on the present economic state of the liner industry there is sufficient reason to suggest that the SCEA (1987) should be rescinded, so as to allow market forces and the Competition Act to regulate the industry. However, the situation that exists now is similar to that when the present legislation was being contemplated during the mid 1980s: what degree, if any, does Canadian policy need to be aligned with that of the US? The simple answer is that policy needs to be aligned now more than ever.

The multimodal transportation links between Canada and the US have grown substantially in the ten years since the SCEA (1987) was enacted. Should Canada act alone and abolish the SCEA (1987), there exists a real possibility that conferences now calling on Canadian ports will move their operations to US ports where their existence is still sanctioned. Such action will do little to serve the interests of Canadian shipowners and ports. The possibility of this scenario limits the extent to which Canada can alter its policy.

The impact of the changing character of the liner shipping industry on the SCEA (1987) is such that the Act is no longer necessary. However, from the viewpoint of international comity, maintaining the current SCEA (1987) allows Canada in remain in harmony with its trading partners. Note that virtually all of Canada's shipping needs are provided by foreign-flagged vessels, and our exports (imports) are another country's imports (exports). Therefore, any attempt by Canada unilaterally to enforce its Competition Act could be legitimately seen as an extraterritorial application of Canadian law. Thus any change to the legislation must really be an international effort. Therefore, although the SCEA (1987) appears inappropriate with respect to the present economic character of the liner industry, in the interest of international comity and Canadian shipowners and ports, the legislation seems to be a necessary evil.

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