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Alliances and container shipping

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Analysis of the phenomenon

Global alliances have become a dominant feature of container shipping. They are cooperation agreements between container lines (carriers) on operational matters. Alliances usually consist of a series of agreements with global coverage on sharing vessels and slots on these vessels. The aim of such alliances is to achieve economies of scale and wider service coverage.

Whereas the early generations of global alliances that emerged in the mid-1990s provided a vehicle for cooperation between smaller carriers, alliances are nowadays cooperation tools for the largest container lines: the three global alliances (2M, Ocean and THE Alliance) that are operational since April 2017 regroup the eight largest container carriers of the world (Table 1).

Three global container shipping alliances and their members, November 2018

Alliance	Carriers
2M	Maersk, MSC
Ocean Alliance	CMA CGM, Cosco, Evergreen
THE Alliance	Hapag Lloyd, ONE, Yang Ming

Table 1 - Source: ITF, 2018

These three alliances represent around 80% of overall container trade and operate around 95% of the total ship capacity on East-West trade lanes, such as Asia-Med (Figure 1), where the major containerised flows occur.

Alliances have allowed carriers to acquire and operate mega-ships, reducing unit costs. Without alliances certain carriers would not have been able to acquire mega-ships. As it is the ordering of mega-ships that has fuelled overcapacity, there is a link between alliances and overcapacity. Alliances have also made the maritime transport offer more uniform and limited the possibilities of carriers to differentiate themselves.

Alliances have contributed to lower service frequencies (Figure 2), fewer direct port-to-port connections (Figure 3), declining schedule reliability and longer waiting times. This has increased total transport times and delivery uncertainty for various shippers, leading to higher inventory and buffer costs.

Moreover, alliances have proved to be inherently instable: considering that all major carriers are in alliances, changes in one alliance can have an impact on the whole sector.

Market shares on Asia-Med trade lane, 2012-2018

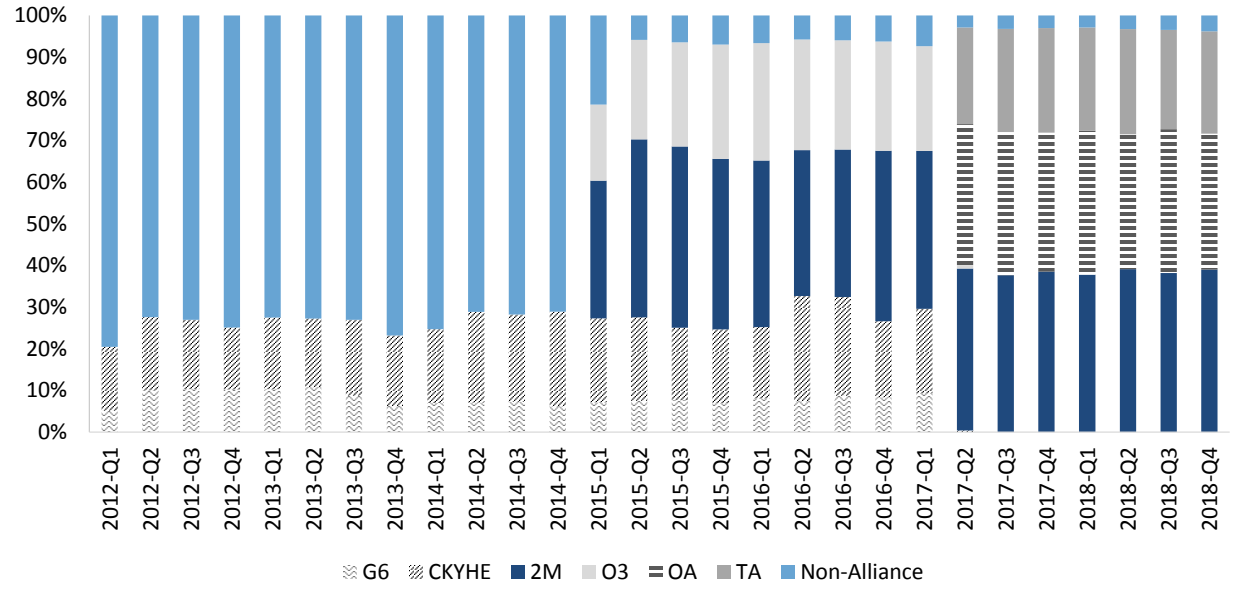

Figure 1 - Source: ITF 2019

Weekly service frequency on Asia-Europe trade lanes 2012-2018

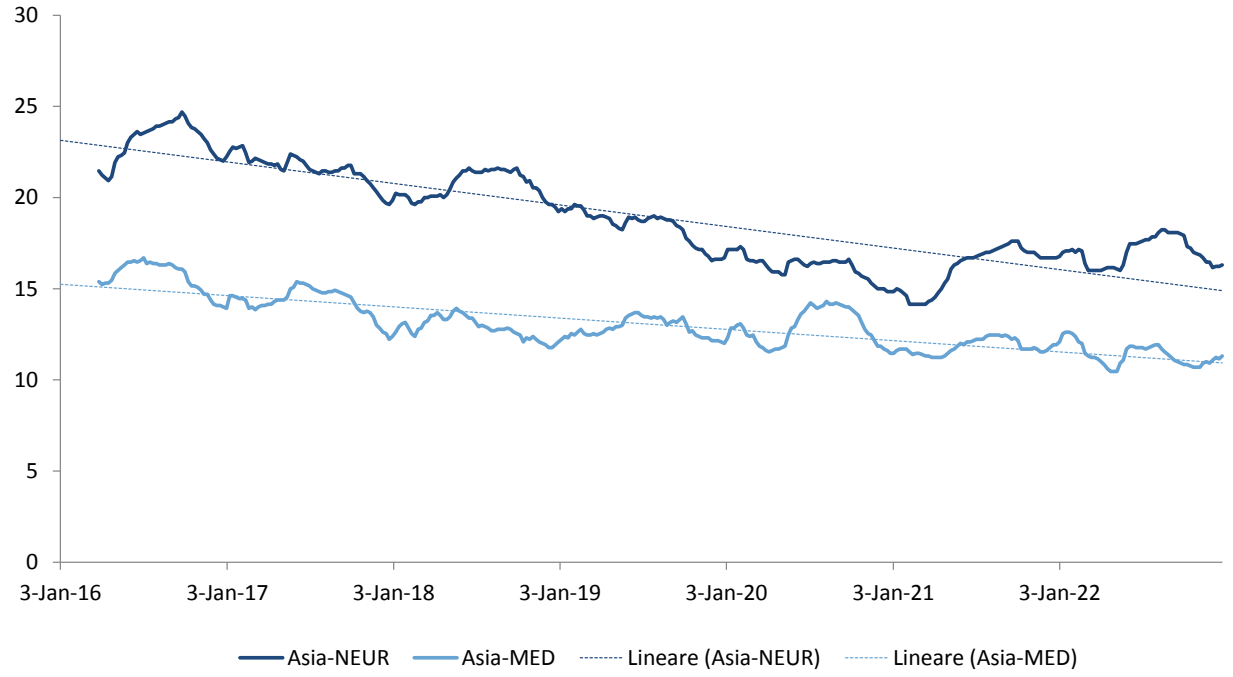

Figure 2 - Source: ITF 2019

Several impacts of alliances on the transport system as a whole can be identified.

They contribute to concentration of port networks and bigger cargo shifts from one port to another when alliances change port networks. Within ports, the buying power

of the alliance carriers can create destructive competition between terminal operators and between other port service providers such as towage companies. This can lower the rates of return on investment for the port industry, results in the decline of smaller container ports and the disappearance of smaller independent terminal operators, as well as towage companies. A particular concern is that alliances and alliance carriers frequently exert strong pressure for publicly funded infrastructure upgrades to be undertaken to support the use of megaships, while these expenditures often prove to be uneconomic, either due to shifting demand for port services or the monopsony power exercised by the alliances.

Although overcapacity in the liner sector has lowered freight rates, these cost savings are partly offset by a number of additional costs for shippers. Moreover, by limiting shipping options, alliances have frustrated the risk diversification strategies of shippers and freight forwarders.

Distinct port pairs on Asia-Med services 2012-2018

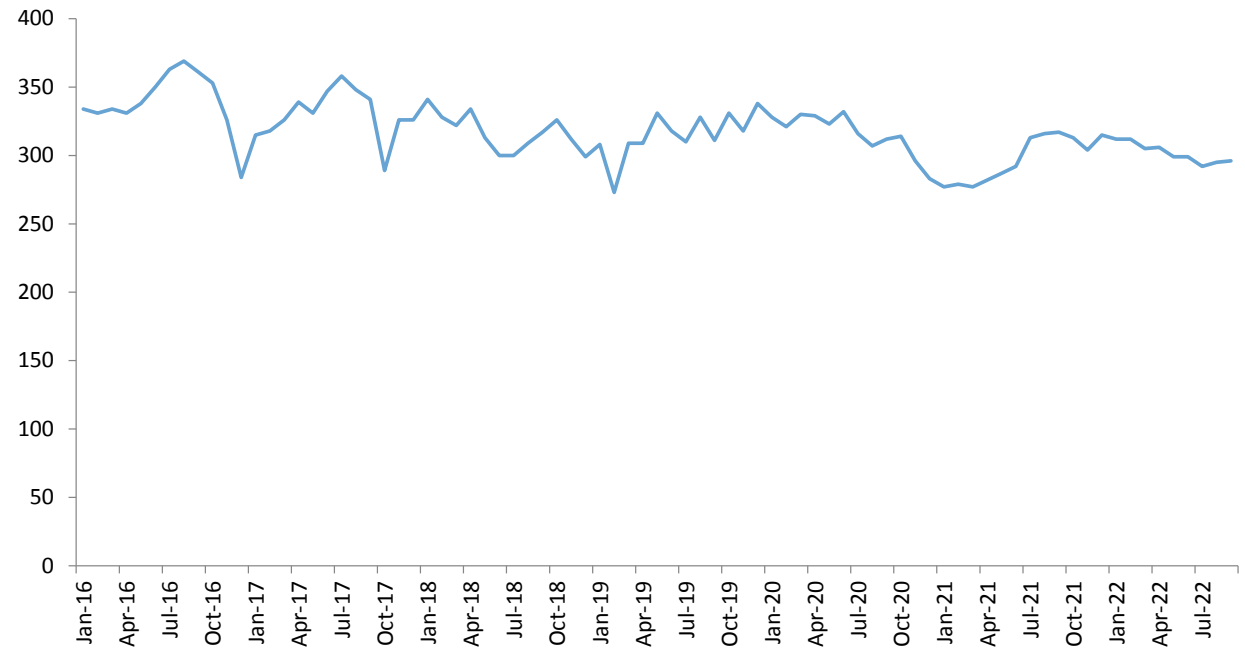

Figure 3 - Source: ITF 2019

Alliances could raise competition concerns in what has become a concentrated market. The top four carriers accounted for 60% of the global container shipping market in 2018. The market share of the biggest carrier (19%) is larger than the market share of any global liner alliance before 2012, which signifies the different character of current alliances.

Global alliances give more market power to carriers and have several implications.

First, they represent barriers to entry on East-West trades: only the largest companies would be able to compete on price for Asia-Europe services outside an alliance structure. Second, alliances could function as vehicles for collusion between carriers, as they provide carriers with in-depth insights on the cost structures of their competitors. Thirdly, alliances give very considerable bargaining power – "monopsony power" – to carriers in regard to ports and terminals. The result can be declining rates for port services, carriers requesting additional public infrastructure, and vertical integration by carriers, in particular in terminal operations. Consequently, the market share of carrier-dominated terminal operators has increased from 18% in 2001 to 38% in 2016. (Figure 5).

This could raise competition concerns if dedicated terminals exclude other carriers and if carriers' terminal investments raise entry costs that make container shipping a less contestable market.

Capacity market shares global carriers (1998-2018)

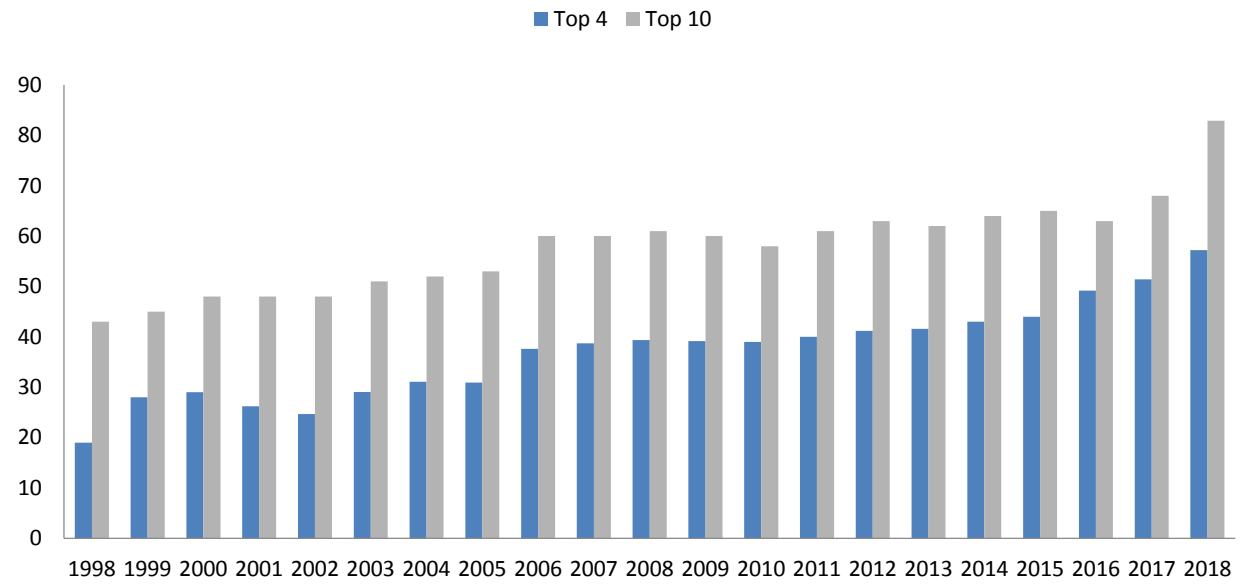

Figure 4 - Source: ITF, 2018

Types of terminal operators (2001-2016)

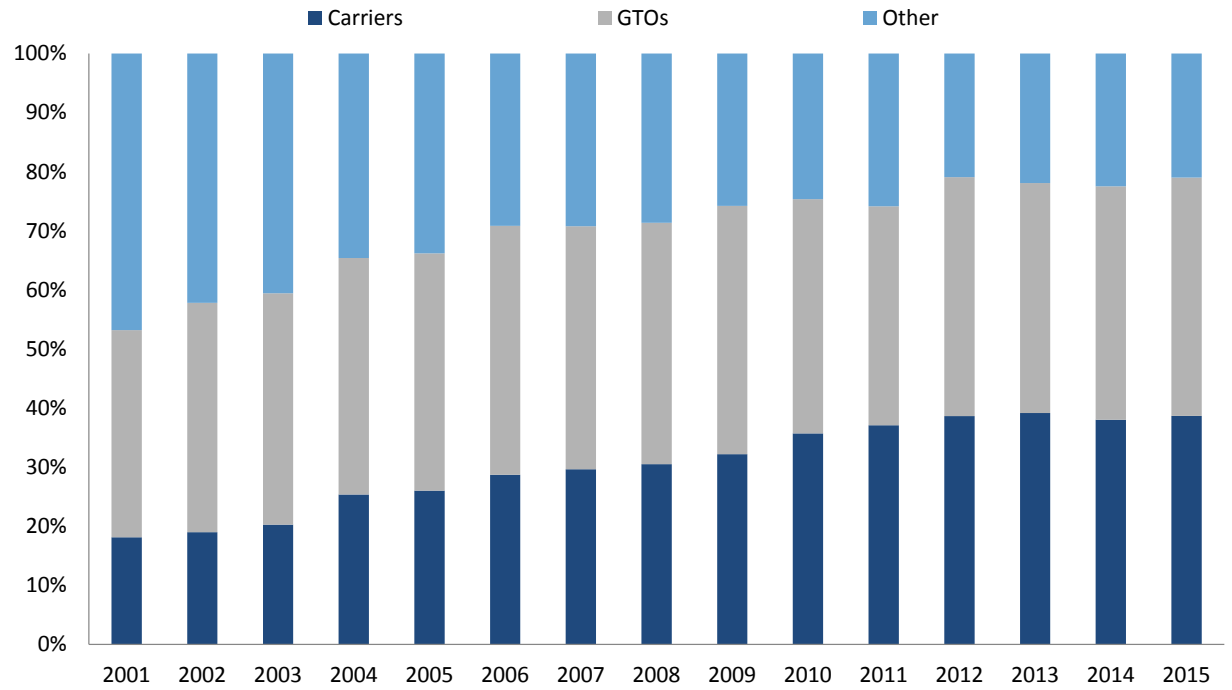

Figure 5 - Source: ITF, 2018

The first generations of alliances allowed smaller carriers to achieve economies of scale, based on complementarity between them, and as such increased shipping options. The current three alliances are not serving the smaller carriers but each brings together two to three very large carriers that would be able to offer most of their services outside an alliance. Contrary to some transport sectors – e.g. aviation - economies of scale in container shipping can also be achieved via mergers and acquisitions – or via the organic growth of carriers increasing market shares.

Over the last decades, the EU has acted to remove the sectoral exemption from competition policy long enjoyed by liner conferences. However, the remaining block exemptions for alliances have enabled a rapid evolution of these arrangements and the industry has, as a result, recently reached a position of high concentration when assessed on key measures. One could wonder if there are still welfare benefits from maintaining block exemptions.

Recommendations

1. Adopt a presumption toward repeal of shipping-specific block exemptions from competition law.

Liner shipping does not have unique characteristics that justify exemptions from competition law, either for conferences or for alliances. In line with the global long-term trend to dismantle sector-specific exemptions from competition law and in line with OECD regulatory principles, generic antitrust rules should apply to all agreements between liner shipping companies, as for any other industry, with regard to the cooperation that is allowed. Countries where "conferences" are still allowed should reconsider their position. In light of the longer-term trend toward the removal of block exemptions in the shipping industry, the European Commission should carefully consider allowing the EU Consortia Block Exemption Regulation to expire in April 2020, as currently scheduled, rather than extending it. A repeal of block exemptions is unlikely to result in the termination of current and future alliances, as these could still be authorised under competition law on a case-by-case basis. However, it would ensure greater scrutiny of individual alliances and thus more effectively deter any anticompetitive conduct in the sector. In order to maintain legal certainty, the European Commission could provide temporary guidelines on how to treat liner shipping in EU antitrust law. If the block exemption is extended, its scope should be limited, in particular by introducing a provision to consult maritime transport stakeholders and by excluding joint purchasing by alliances.

2. Improve project appraisal for port and hinterland infrastructure and adopt common principles for port pricing

Much of the investment required to upgrade ports to handle mega-ships is publicly funded, either directly or indirectly. It is essential that these public expenditures be based on sound economic assessments and that risk-minimisation strategies are in place. New port and hinterland transport projects should be based on sound projections of cargo flows, particularly from shippers. Demands from carriers for new facilities should be supported by enforceable commitments from their side to actually use these, to minimise the risk that publicly financed ports will be underused. In the European Union, this could be achieved by imposing stricter conditions on funding for port projects using EU- funds and those of the European Investment Bank. This could form part of the conditions governing EU member states' state aid for port infrastructure. The adoption of common principles for port pricing – ideally at a global level but at least at regional level - could help to offset the monopsony power of

alliances and support sound project analysis in cases where new facilities are proposed to accommodate mega-ships.

3. Establish more coherent ports policies to clarify roles and reduce risk of creating over-capacity

Governments should define clearly which ports are expected to service mega-ships and which ports have different roles. A reduction in the number of EU “core ports” in the Trans-European Network as part of the elaboration of a clearer and more detailed port strategy would also reduce over-capacity risks in respect of container ports for mega-ships. Cooperation between ports also provides a potentially significant source of countervailing power in a context of the rapidly increasing concentration of the shipping industry resulting from the growth of liner shipping alliances. Various governments, such as those of the US, Japan and China, have facilitated such cooperation by stimulating mergers of public port authorities and allowing port alliances. Within ports, collaboration between terminals could improve the efficiency of the maritime supply chain, subject to the constraints of competition policy. Governments could consider how – and under which circumstances – they could allow facility sharing in ports, without introducing new sector-specific block exemptions from competition law. The potential role of such co-operation arrangements is likely to be greater in contexts where block exemptions for liner shipping have not been eliminated. More collaboration between the different stakeholders in the maritime logistics chain could also help to reduce the inefficiencies

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