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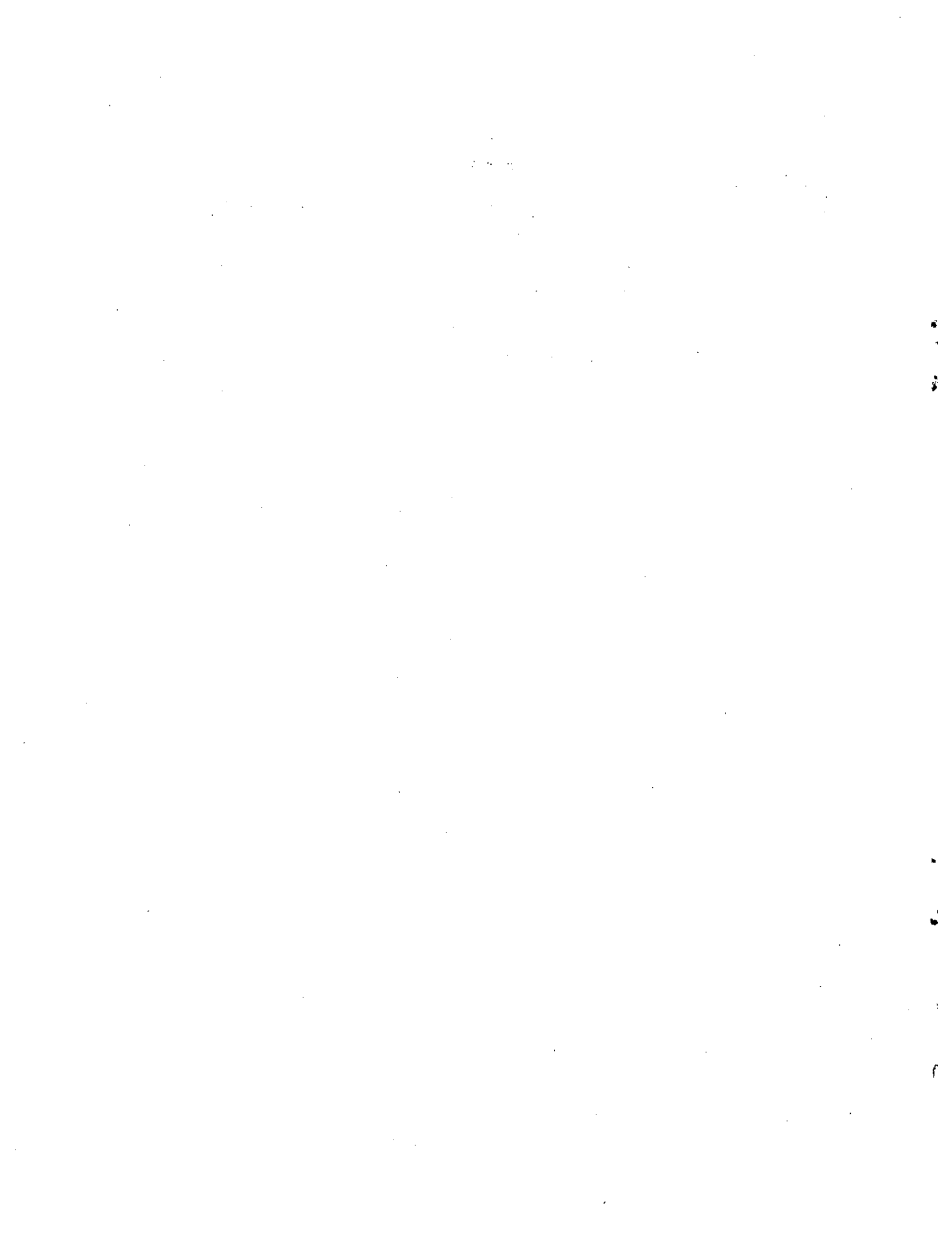
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THE THREE-PART TARIFF FOR OCEAN LINER CONFERENCES



## 1. Introduction

Constantly increasing liner freight rates have been a major concern of the developing countries for more than ten years. Even before the first session of the United Nations Conference on Trade and Development (UNCTAD I) in 1964, Latin America was urging that this problem be confronted by concerted international action. In the Tequendama Charter, adopted in Bogotá in 1967 in preparation for UNCTAD II, Latin America reaffirmed its position with regard to the question of freight rates <sup>1/</sup> and was pleased to see its recommendations incorporated into the Charter of Algiers, adopted by the Group of 77, and reflected in draft resolutions presented by the developing countries during UNCTAD II in New Delhi. Among the resolutions approved unanimously by UNCTAD II, resolution 3 (II), Freight rates and conference practices, is especially important, as the Conference recommended that Governments invite the liner conferences (1) to review and adjust freight rates particularly important to developing countries, (2) to establish authoritative representation in the ports of the developing countries whose trade they serve, and (3) to make their tariffs and other relevant information freely available to all interested parties.

During UNCTAD III in 1972 the developing countries made additional important advances. Resolution 69 (III), adopted without dissent, notes "that in recent years liner freight rate increases have been larger and more frequent," and resolves "that the Governments of States members of UNCTAD should urge liner conferences ... to endeavour to maintain as long as possible a period of stability in freight rates consistent with the needs of shippers and the need to provide conference lines with a reasonable return on capital."

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<sup>1/</sup> OECLA, Chater of Tequendama adopted by the Ad Hoc Committee on Latin American Coordination (OECLA) at its Fourth Meeting at the Expert Level (Bogotá, 25-30 September 1967), page 12, letter (c) of paragraph 2 of section IV.

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28 MAY 1972

Recently, in 1974, among the measures to be taken as part of the Programme of Action to establish a new international economic order,<sup>2/</sup> the General Assembly of the United Nations decided that all needed efforts should be made "To arrest and reduce the ever-increasing freight rates in order to reduce the cost of imports to, and exports from, the developing countries."

In addition to expressing its concern over the level of liner freight rates, Latin America has also pointed out the detrimental consequences of the inappropriate structure of rates, specifically, the practice of averaging freight rates over ranges of ports and the excessively high rates applied to potentially exportable products. These concerns were expressed during the Second Ministerial Meeting of the Group of 77 in Lima (25 October - 6 November 1971), which affirmed that, "Developed countries should urge their shipping lines that, when considering any freight increases, they should ensure that to the fullest extent possible the sensitive items in the trade of the developing countries are insulated from those increases," that account should be taken of "the feasibility of providing special freight rates to promote exports from developing countries of non-traditional items and/or to non-traditional markets," and further that, "Shipowners and liner conferences should cooperate closely with port authorities, especially in developing countries, so as to make effective use of port improvements. Port improvements should benefit the country in which the port is located, by being reflected in lower freight rates."<sup>3/</sup>

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<sup>2/</sup> Resolution 3202 (S-VI).

<sup>3/</sup> UNCTAD, Examination of Recent Developments and Long-term Trends in World Trade and Development in accordance with the aims and functions of UNCTAD (TD/143) that circulated The Declaration and Principles of the Action Programme of Lima, approved on 7 November 1971 by the Group of 77.



The practice of averaging freight rates over ranges of ports at each end of trade routes had already been examined by the UNCTAD Secretariat in a technical report which concluded that "averaging destroys any incentive for an inefficient port to improve itself, because an improvement does not secure any reduction in rates. As a result, the benefits of any improvements made are scarcely seen, since they are small in relation to the total costs incurred over the whole range," and further, "The device of the port surcharge is not a satisfactory solution to this problem since it is not coupled with discounts for markedly efficient ports and since, also, the surcharge is only imposed when the port becomes more inefficient than it has been." <sup>4/</sup>

While it might appear that the developing countries, in their efforts to attain their objectives in the field of maritime transport, are combatting the conference system in general, the fact of the matter is otherwise. These countries are not only aware of the need to consider factors other than freight rates, such as the quality of services offered, but they have also defended the conference system and are willing to cooperate with conferences in order that they function responsibly and be responsive to the needs of the developing countries whose traffic they serve. For this reason the developing countries agreed to Annex A.IV.22 of the Final Act of UNCTAD I, which states: "The Liner Conference system is necessary in order to secure stable rates and regular services. However, in order that the system might function properly, it is necessary that there should be close cooperation between shippers and the conference." <sup>5/</sup>

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<sup>4/</sup> UNCTAD, Perspectives and problems in world shipping (TD/102).

<sup>5/</sup> UNCTAD, Proceedings of the United Nations Conference on Trade and Development, vol. I Final Act and Report.

/With these

With these objectives in mind, the developing countries have repeatedly urged that international support be given to the following principles and guidelines related to conference freight rates:

a) More active participation of shipping lines of developing countries in the conferences which serve their international trade, to be achieved by:

i) Fostering the establishment and expansion of national merchant marines. This objective is stated in a draft code of conduct proposed by the developing countries during UNCTAD III and annexed to resolution 66 (III) in the following terms: "that developing countries have the right to protect and promote their national merchant marines and that the measures adopted to this end will neither be considered discriminatory nor give rise to retaliation."

ii) Assuring that national merchant marines are admitted to the liner conferences. In this regard, the Code of Conduct for Liner Conferences stipulates: "Any national line shall have the right to be a full member of a conference which serves the foreign trade of its country, subject to the criteria established in paragraph 2 of Article 1"<sup>6/</sup>

b) Consultation machinery between users and conferences. For consultations between conferences and users to be effective, it is of course essential that conferences give advance notice of proposed changes in freight rates, that they provide users and users' representatives with information, and that negotiations be carried out

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<sup>6/</sup> UNCTAD, United Nations Conference of Plenipotenciaries on a Code of Conduct for Liner Conferences, vol. II Final Act (TD/CODE/13/Add. 1).

in good faith. Consultation on maritime transport matters was dealt with prominently in paragraph 53 (h) of the International Development Strategy for the Second United Nations Development Decade: "Freight rates, conference practices, adequacy of shipping services and other matters of common interest to shippers and shipowners should be the subject of consultation between liner conferences and shippers and, where appropriate, shippers' councils or equivalent bodies and interested public authorities. Every effort should be made to encourage the institution and operation of shippers' councils, where appropriate, or equivalent bodies and the establishment of effective consultation machinery. Such machinery should provide for consultation by liner conferences well before publicly announcing changes in freight rates." <sup>2/</sup>

In addition, UNCTAD III, in resolution 69 (III), resolved that Governments should urge liner conferences to: "Provide reasons which in their opinion justify the proposed general increase in freight rates, together with an aggregated analysis of the data regarding their costs and revenues prepared by independent accountants as a basis for discussions."

c) Promotional freight rates. The UNCTAD Secretariat's technical report on promotional freight rates, which was used as the basis of discussion during UNCTAD III, defines these rates as follows: "A promotional freight rate is a liner ocean freight rate which is set at a level significantly lower than the level existing in the tariff or the level that would have otherwise ruled (i.e. in the absence of a promotional freight rate) and which, other things being equal, helps

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<sup>2/</sup> General Assembly resolution 2626 (XXV).

establish and/or increase a non-traditional export of a developing country in a market." <sup>8/</sup>

UNCTAD III, in turn, dedicated part of its resolution 69 (III) to promotional freight rates: "Recognizing the important part promotional freight rates can play in facilitating the expansion of non-traditional exports from developing countries," it is recommended that Governments urge conferences to "Recognize the need to assist exports from developing countries by granting promotional freight rates, whenever commercially possible, for their non-traditional exports."

d) More direct relation between freight rates and the cost of specific services. In order to apply this principle, the Group of 77 declared in 1971 in the Lima Action Programme: "Developed countries should urge their shipping lines to also investigate ... the feasibility of introducing f.i.o. rates and the implications thereof."

This proposal was endorsed by UNCTAD III in resolution 69 (III), which "Requests the UNCTAD Secretariat to study within available resources, the feasibility of introducing free-in-and-out (f.i.o.) rates in liner trades and the implications thereof."

In compliance with this request, the UNCTAD Secretariat published a technical report on f.i.o. rates in September 1975. <sup>9/</sup> A system of f.i.o. rates for liner trades would introduce a radical change in the traditional division of responsibility between shippers and shipping lines under liner terms, as shippers would be required to arrange and pay for stevedoring in the ports of origin and destination. The general

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<sup>8/</sup> UNCTAD, Promotional Freight Rates on Non-traditional Exports of Developing Countries (TD/105).

<sup>9/</sup> UNCTAD, Free in-and-out freight rates: report by the UNCTAD Secretariat (TD/B/C.4/135 and Corr. 1).

conclusions of the report are not encouraging. Even though f.i.o. rates would have the advantage of reducing in part the effects of averaging freight rates over ranges of ports, their application would encounter a number of practical difficulties, which makes doubtful their usefulness. <sup>10/</sup>

Nevertheless, it may well be that most of the objectives sought through a system of f.i.o. liner rates can be attained through other alternatives. Among these is the three-part liner tariff, which would also contribute significantly to improving the availability of information required by users and users' councils in their negotiations with conferences. The three-part tariff is a means of presenting the rates of a liner conference in such a way that the total charge under liner terms is divided up into three separately stated elements. The first of these elements refers to the costs of loading the cargo in the port of origin; the second corresponds to the line-haul movement between the ports of origin and destination; and the third refers to the costs in the port of destination. The present study describes the three-part liner tariff and examines advantages and disadvantages of its application.

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<sup>10/</sup> See discussion on f.i.o. rates during Seventh Sessions of the Shipping Committee of UNCTAD, UNCTAD, Report of the Committee on Shipping on its Seventh Session (TD/B/C.4/147).

## 2. Rate Establishment Under the Liner Conference System

Ocean shipping is an industry which exhibits relatively high fixed costs and relatively low variable costs, typical of many other transportation activities. Under conditions of competitive market forces, there would be a tendency for prices to be set such that the variable costs generally are covered but the fixed costs are covered only in periods—often of quite short duration before supply can catch up to demand—of comparative boom. There would be instability of rates and service, and the companies serving the market would frequently earn insufficient revenue to replace their fixed assets when these expire. One of the probable outcomes of a situation of this nature is that the supplying companies agree to maintain rates at a high enough level, and capacity at a low enough level, to assure that earnings are sufficient to allow their continuing existence in the market by generating the funds required to cover capital costs. The stability that this imparts often causes governments to tolerate or encourage such agreements. In the case of ocean shipping, the agreements reached have generally received governmental tolerance.

This sort of agreement in the ocean transport business is known as an ocean liner conference. The conference system dates from the 1970s, a period in which freight rates were under pressure from excess capacity. One conference generally differs somewhat from another, but all conform to the definition of an organisation of shipping lines participating in the general cargo market between a range of ports in one part of the world and a range of ports in another part of the world, whose reason for existence is primarily the mutual benefit of the member lines. There are about 350 conferences currently operational.

/A conference

A conference attempts to control the supply side of its market by limiting capacity and jointly establishing freight rates. Many conferences have developed sophisticated self-regulatory devices to assure that no significant loophole exists by means of which one member may disregard some aspect of the agreement to the detriment of the common good of all members. Ocean liner conferences exhibit considerable strength and have tended to be more durable than other types of cartels.

The common features of conferences are basically the following:

- (i) Capacity is controlled by measures such as the limitation of sailing frequencies per member, restrictions on the number of ports serviced, and restrictions on the amount of cargo that a member may lift. Such capacity limits may be supplemented by agreements to pool revenue, which tend to make the laying-on of extra capacity by any one member unprofitable to him.
- (ii) A further element of capacity control is imparted by restrictions on the entry of new members (except where this is prohibited by law <sup>11/</sup>) and on the withdrawal of existing members. Furthermore, the lines act jointly to impede competition, primarily by offering discounts to shippers who use conference services exclusively. These discounts may take the form of contract rates or loyalty rebates.
- (iii) All members charge the same amount for the carriage of a given product between any one port in a range of ports in the origin area and a port in the range in the destination area. The rates are generally based on "what the market can bear," as a means

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<sup>11/</sup> Conferences serving the U.S.A. are bound by law to admit qualified new applicants. Such conferences are "open" rather than "closed".

of distributing fixed costs. The tariff schedule displays a unique rate for the carriage of any one item of general cargo between the two areas, while products not frequently traded are covered by the application of a "not otherwise specified" rate (n.o.s.). When one item previously dealt with by the latter entry becomes sufficiently important to warrant separate treatment, a specific rate is agreed for it. Some products are excluded from the schedule, these being primarily bulk items for which the individual member lines are allowed to charge what they may think fit (open rate) so as to fill any empty space by capturing a market segment that would otherwise be serviced by tramp vessels.

- (iv) The rating schedule is established so that the weakest line belonging to the conference can earn enough to cover its costs <sup>12/</sup> and is based on the "full cost" principle, which seeks to make the sum of all revenues cover the sum of all costs, including profits, even though the revenues and marginal plus evenly-allocated costs on specific products need not be related. Although the level of rates is set so that total costs are covered, and at this level can be said to be supply condition orientated, the individual rates are demand responsive: "what the market can bear."
- (v) Individual rates may be raised (or lowered) as market conditions vary, being demand responsive. Periodic revisions of a "blanket"

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<sup>12/</sup> This is a suspicion, unproven and also unrefuted by analysis. The suspicions have occasionally reached the available literature in a usually less than fully explicit manner, e.g. (i) International Sea Transport: The Years Ahead, S.A. Lawrence, Lexington, Mass., USA, 1972, p. 13; (ii) Committee of Inquiry into Shipping Report, "Rochdale Report", H.M.S.O. London, U.K., 1970, cmd. 4337, paragraph 418 (i).

nature affecting, generally, all rates are made as cost or supply conditions determine. The full cost model implies that a change in any one rate may require an opposite change in another rate or rates, so that the revenue yield will not be affected.

- (vi) Occasionally one or more of the ports served becomes congested, thereby delaying vessels and disrupting schedules. The lines cover the additional costs forced upon them by requiring users to pay a percentage or additive surcharge on traffic through the ports concerned. When the congestion abates the surcharge is reduced or annulled, often with a long time lag. Unfortunately, there is no "efficiency discount" equivalent to the surcharge.

The relation between fixed and variable costs can be visualized on two planes. First, one may consider the case of a shipowner who is deciding whether his vessel should be laid up or whether it should set sail. The costs which would not be affected by the decision are depreciation, interest, most if not all of maintenance, hull insurance and administration. The sum of these costs amounts to about 20 percent of the total voyage costs. Thus, if he thinks that he will cover 80 percent of his fully allocated voyage costs, he will be likely to set sail. Once he has decided to set sail, virtually all of his costs, except cargo handling costs and commissions, become fixed. He is thus in a situation in which he might accept cargo at extremely low rates as the time approaches for him to sail, as long as there remains space available in the vessel. The conference system is designed to avoid temptation to accept cargo at less than conference rates.

Under the rate setting procedures and criteria used by conferences, those products with the highest ratio of value-to-weight are generally assigned the highest rates in the schedule, in the belief that demand

/for these

for these products —and hence maritime traffic— is relatively inelastic with respect to changes in freight rates. Another important reason why the rates for particular products may be quite unrelated to costs is that, as time passes, rates are subject to periodic adjustments of a blanket nature as costs rise in general. Thus, even if there had originally been any cost-based rationale for a certain rate, successive general rate increases would tend to diminish such rationality. Also, it is probable that only rarely are the rates on particular products modified to reflect changed market conditions, and there may be a time lag between the change in conditions and the adjustment of the rate so that the relation between any one rate and market conditions could also be weak.

Not all products are subject to the rate-setting model mentioned above. The case of large volume or other shipments where tramp competition is a viable alternative has already been mentioned. The lines also may offer promotional rates on products that may respond to initial market stimulation (small commercial samples are often zero-rated). Furthermore, in the relatively recent past there have been indications that nationally-owned lines that are members of a conference may sometimes use their influence so that the rate for a product of special importance to the economy of their country is lower than it might otherwise be <sup>13/</sup>.

Not only at the product level does the conference tariff tend to have a weak relationship with the costs of carriage. There also exists a less-than-perfect correspondence between costs and prices on the

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<sup>13/</sup> Once again, lack of information makes proof impossible. However, the delayed inclusion of coffee in a congestion surcharge for Buenaventura announced by the Association of West Coast Steamship Companies on 8 March 1974 may be an indication of such practice.

spatial plane. Mainly on the grounds of simplicity, conferences set the same rates from any one of a range of ports in the origin area of the cargo to any one of a range of ports in the destination area. Thus, the fact that one port may be much cheaper to use than another may not be reflected in lower rates. Sometimes a port is allocated to a different range of the grounds of different cost conditions, but usually the only way that cost variations are recognized is by the application of a surcharge to a port that is suffering from congestion.

The tariff listings vary widely in length, depending on the number of different ranges identified, the number of products traded frequently enough to warrant individual treatment, and the extent to which obsolescent nomenclatures are maintained. Products may be rated by weight, by volume, or by either weight or volume depending on which yields more revenue to the shipping line. The tariff book contains a section explaining the conditions under which goods are accepted for transport. Also included is a list of member lines, any general rate increases since the schedule was drawn up, congestion surcharges, definitions of relevant terms such as what is meant by samples which may be carried free of charge, any extra charges that may apply to goods shipped in heavy or voluminous packages, conditions of payment, etc. The rate schedule itself lists the products individually identified, with the rate shown, usually in US dollars, by range of ports. One overall price for dockside-to-dockside movement is quoted for each product. When any page in the volume is modified, whether in the part devoted to general conditions or to the tariff itself, a copy of the updated page is sent to all holders of the volume.

A conference tariff schedule is rarely made available to the general public except where required by law.

### 3. The three-part tariff

In order to grasp the concept of the three-part tariff, it is necessary to have an understanding of the individual stages involved in the movement of an item of cargo from its entry into the confines of the port of embarkation to its despatch from the destination port. These stages, which are of a physical rather than an institutional nature and thus independent of the terms of shipment, are outlined below:

- (i) The cargo enters the port of origin, usually in a truck or a railway wagon. Upon being received, it is generally stored to await movement to the transporting vessel.
- (ii) The ship reaches port and receives services such as pilotage, lighterage and dockage.
- (iii) The cargo is transferred from the warehouse to the dockside where the ship is moored.
- (iv) The cargo is loaded onto the vessel and placed in a secure position within the hold of the ship by gangs of stevedores.
- (v) The ship sails to the port of destination.
- (vi) Upon arrival at the destination port, the vessel commences to receive the services of pilotage, etc. similar to those that it received in the port of embarkation of the cargo.
- (vii) Having tied up, the vessel is boarded by stevedores who unload the cargo. The unloading gangs place the cargo on the wharf beside the ship.
- (viii) The cargo is removed from the dockside by other laborers and deposited in a warehouse.

/(ix) Once

(ix) Once having passed through the procedures of customs clearance, etc., the cargo is removed from the warehouse and placed in the vehicle that will take it to its eventual destination.

Under the terms offered by the members of a typical conference, the shipping line assumes responsibility for the activities described in stages (ii) and (iv) through (vii), which are included in the rate charged. The remaining stages are the responsibility of the exporter or importer. The line usually appoints an agent in each port to look after the activities of loading and unloading the vessel, but ultimately the responsibility for these tasks lies with the line, and it is the line that bears the overall cost and receives payment from the shipper. Under liner terms, the line specifies one rate and receives one payment which covers the following costs:

- loading the vessel in the origin port
- port dues at the origin port
- operation of the vessel while waiting in the origin port
- operating costs of the vessel while it sails from the origin port to the destination port
- operating costs of the vessel while waiting in the destination port
- port dues in the destination port
- unloading the ship in the destination port

There are a few instances in which conference members do not trade under these terms. Sometimes the loading operation is performed for the account of an entity other than the line; sometimes the unloading is the responsibility of a third party—either the importer or the exporter—depending on the terms of the contract of sale. When both

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loading and unloading are performed under the responsibility of a party other than the shipping line, the terms of shipment are known as "free-in-and-free-out" (f.i.o.). Sometimes the shipment may be either "free-in" or "free-out", discharge-free being an alternative expression for free-out. Carriage under any one of these terms is common in the case of trip charters for bulk products and has been tending to become more frequent in the liner trades since the latter half of the 1960s. In exceptional circumstances, a conference line may quote a rate f.i.o. so as to compete with a tramp who offers such terms to a shipper who may prefer them. Also, a few conferences have come to adopt either "free-in" or "free-out" rates as standard practice. Examples are conferences that involve the socialist bloc and those on certain trades in the Mediterranean, where a prime mover in the change from the traditional liner terms was an attempt on the part of the lines to divorce their rates from rapidly escalating cargo handling costs outside their control.

The f.i.o. concept was adopted as a means by which the lines could avoid the need to increase their tariffs when faced by rises in handling costs, particularly in the developed countries, over which they have little influence. However, as the introduction of f.i.o. terms means that the traditional division of responsibility between shipper and shipping line as defined by liner terms is upset, there are difficulties of an institutional nature which impede their introduction on a general scale. Furthermore, in the context of the liner trades especially, a complication in the use of f.i.o. rates is the need to have available not only the tariff book of the carrier but also tariff information for the ports of loading and unloading, which still would often not permit a shipper to know in advance what his real cost will be.

It is one of the characteristics of the three-part tariff that the separation between port costs and vessel operating costs is similar to

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that under f.i.o. terms, but the three-part tariff does not change the allocation of responsibility defined by liner terms, nor would the potential user of liner services have to be separately aware of port-related charges from sources other than the liner tariff. Basically, the three-part tariff is a means of presenting the rates of a liner conference in such a way that the total charge under liner terms is divided up into three separately stated elements. The first of these elements refers to the costs of loading the cargo in the port of origin; the second corresponds to the line-haul movement between the ports of origin and destination; and the third refers to the costs in the port of destination. Physically, the current manner of presenting the rates in the liner conference tariff could be maintained, but instead of there being a single column of rates alongside the identification of commodities, there would appear three columns plus a total. The three-part tariff is essentially a device to increase the information which is provided to users of shipping services and reflects standard commercial practice of presenting clients with an itemized bill for the services they purchase.

While the concept of the three-part tariff is exceedingly simple, there are two entirely different ways in which it can be defined for practical application. Both alternatives share the following common characteristics: the first column, corresponding to costs in the port of origin, includes direct cargo handling costs plus port dues and charges; the second column includes all ship's costs while navigating from the port of origin to the port of destination; and the third column includes direct cargo handling costs plus port dues and charges in the port of destination. The difference between the two alternatives lies in the treatment of the ship's operating costs while in the ports of

/origin and

origin and destination. Under the first alternative, these costs are placed in the second column together with the ship's costs while navigating. Under the second alternative, the ship's costs in the port of origin are placed in the first column and the costs in the port of destination are placed in the third column.

The first alternative has the advantage of simplicity in its application and clarity in the interpretation of the amounts in each column. In addition, it separates into different columns costs which are the consequence of actions by different entities, and hence permits a direct identification of the economic impact of these actions. The first alternative, however, does not take into account the economic cost of delays to ships in port or of low port productivity. In this sense the second alternative, which assigns the cost of the ship's time while in port to the first or third column, provides a clearer indication of the real relation between navigation costs and port costs.

An estimation of the quantitative effect of using the two alternatives is presented in table 1. The percentage breakdown of total voyage costs among the three columns is based on a hypothetical general cargo service from ports in developed countries to ports in developing countries.

Table 1

Percentage breakdown of voyage costs under alternative forms of three-part tariff

	Costs in port of origin in developed country		Navigation costs		Costs in port of destination in developing country	
	<u>Cost component</u>	<u>Percent</u>	<u>Cost component</u>	<u>Percent</u>	<u>Cost component</u>	<u>Percent</u>
Alternative I	1. Port dues and charges	2	3. Ship's time in port of origin	8	6. Port dues and charges	2
	2. Direct cargo handling costs	31	4. Ocean voyage	33	7. Direct cargo handling costs	12
		<u>---</u>	5. Ship's time in port of destination	<u>12</u>		<u>---</u>
		33		53		14
Alternative II	1. Port dues and charges	2	4. Ocean voyage	33	5. Ship's time in port	12
	2. Direct cargo handling costs	31			6. Port dues and charges	2
	3. Ship's time in port	8		<u>---</u>	7. Direct cargo handling costs	12
		<u>---</u>		33		<u>---</u>
	41				26	

4. Probable effects of applying a three-part tariff

The simplest application of a three-part tariff would not change any individual rate, as existing rates would merely be broken down into three components. Applied in this way, it would not resolve the concern of the developing countries to avoid the detrimental effects occasioned by the present practice of averaging conference freight rates over ranges of ports, but it probably would soon lead to the explicit recognition of variations in handling costs and productivity in the different ports served. Finally, as the application of a three-part tariff would show with more clarity the relationship in existing tariffs between the level of individual rates and the value of the commodity being transported, there might well be pressures, especially from exporters and importers of higher valued commodities, for reductions in the rates they pay.

In view of the foregoing, it is clear that an analysis of the probable effects of a three-part tariff is complex, and in part even speculative. To keep the analysis as orderly as possible, three alternative conditions are assumed: (1) individual rates are not modified, (2) cost and productivity variations among ports are taken into account, and (3) the present degree of rate discrimination among commodities is reduced.

a) A three-part tariff which maintains unchanged all existing rates

A three-part tariff which expresses existing rates as the sum of costs for loading in the port of origin, line-haul between ports, and unloading in the port of destination would provide users, users' councils and governments with important information which is not available to them at present. At the same time, it would show the

/true significance

true significance of the costs which liner vessels incur while in port. Despite the rapid increase in the costs of new vessels and of fuel in recent years, cargo handling accounts for at least one half of the total annual cost of a typical conference general cargo vessel. Handling costs in ports of developed countries are especially high since labor productivity often fails to increase as rapidly as earnings of stevedores.

A three-part tariff would also reveal more clearly the degree of commodity discrimination embedded in the present structure of freight rates, as can be seen from the following example. Suppose that two commodities have the same handling cost in the port of origin and that this is equal to US\$ 20, while both have handling costs in the port of destination of US\$ 10. If the respective freight rates for the two commodities are US\$ 80 and US\$ 50, the ratio between the rates under present one-part tariffs would be 1.6 : 1. Under a three-part tariff, with the port costs of US\$ 20 and US\$ 10 separated out and placed in the first and third columns, the middle column would show US\$ 50 for the first commodity and only US\$ 20 for the second, with a ratio between the two of 2.5 : 1.

Taking into account the properties of a three-part tariff which does not alter present freight rates, the following consequences can be anticipated:

1) Because of the availability of more detailed information, the bargaining position of users and users' councils in relation to the conferences would be strengthened. When conferences propose general rate increases to compensate for increased costs, they would be able to justify rate increases only by referring individually to the three columns. In turn, users and users' councils would be in a better position to verify whether handling costs or navigation costs have

/increased sufficiently

increased sufficiently to warrant the rate increases requested by the conferences. Users and users' councils would also be able to compare the amounts allocated to each column for particular commodities by different conferences serving the country's trade and to question when one conference shows, for example, a cargo handling cost in ports of destination much higher than that shown by other conferences for the same ports. Users would also be better able to compare liner rates with voyage charter rates, which are frequently f.i.o. The comparability of information provided by different conferences, and the ease with which users and users' councils could compare cost increases with requests for rate increases, would be greater under the alternative by which the end columns of the three-part tariff include only cargo handling costs and port dues, with all ship's costs placed in the center column.

ii) This type of three-part tariff would not identify particularly high or low cost ports, as the port costs included in the first column would represent an average cost over all ports of origin and those in the last column an average over all ports of destination to which the tariff applies. Nevertheless, the separation of average costs in loading ports from average costs in ports of destination would provide important insights into understanding the economics of maritime shipping, especially when one of the sets of ports encompasses a developed country or countries and the other set developing countries. This information, for example, would permit conferences to show that the smallest cost component corresponds to activities over which the shipping line has direct responsibility and control. In addition, it would assist in analyzing the desirability for developing countries to accept new technological systems, as well as to analyze potential benefits from concerted action to improve port capacity and facilities. For this

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type of analysis, it would be preferable to implement the alternative under which the first and third columns include both cargo handling costs and the cost of ship's time in port.

iii) The conferences would undoubtedly receive requests from shippers of high-valued goods for a reduction in their freight rates. The consequences of acceding to these requests are analyzed in a later section. When conferences establish a rate for a commodity which previously was not specifically identified in the tariff, there would probably be a tendency to set a rate closer to the average of existing rates under a three-part tariff than is the case at present, in view of the accentuation of the degree of price discrimination which would be apparent.

iv) The identification of a rate component which specifically relates to a country's ports (even though averaged with another country's ports) might raise questions about the applicability of national value-added taxes or other types of national taxes or regulations.

v) Even though individual freight rates did not vary with the application of this first type of three-part tariff, the conferences would probably encounter difficulty in reaching a consensus among member lines regarding the amounts to be allocated to each of the three columns. Agreement would be especially difficult if the first and third columns include the cost of ship's time in port, in view of the probable diversity among conference member lines with respect to daily ship costs resulting from the heterogeneity of ship types, size of crews, average crew wages, utilization of ships, etc. If the first and third columns contained only direct costs of cargo handling and port dues, there would be much less variation among shipping lines and

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it would be considerably easier for agreement to be reached on the amounts to be allocated to the first and third columns.

vi) For the three-part tariff to fulfill its potential as an information-providing mechanism, it is essential that users and users' councils know the criteria that were applied in the separation of existing freight rates into the three component parts. Nevertheless, much of the usefulness of a general application of the three-part tariff would not be fully attained until different conferences adopted unified criteria regarding treatment of the cost of ship's time while in port. It would therefore seem essential that those governments wishing to receive conference tariffs presented in a three-part format reach agreement, at a regional or subregional level, and in consultation with the appropriate conferences, on the criteria to be applied.

vii) The application of a three-part tariff would not affect conference loyalty discounts, rebates or contract rates.

viii) The task of preparing, distributing and updating conference tariffs in a three-part format should present no problems in this first case, in which existing freight rates are maintained unchanged.

b) A three-part tariff which reflects cost variations among ports served

In order to meet the concern of the developing countries over the consequences of averaging freight rates for ranges of ports, it would be necessary for the three-part tariff to reflect cost variations among the ports served. This recognition of cost variations could be at the national level or on the basis of individual ports (or groups of ports) within a country. In either case the application of the three-part tariff would result in changes to at least some existing freight rates, although frequently the new rates would simply incorporate existing port surcharges and hence would not significantly alter previous rates.

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A strong case can be made that, for a three-part tariff which reflects cost variations among ports to fulfill its objective, the columns which correspond to cost in port should be assigned both direct cargo handling costs plus the cost of ship's time while in port. Only in this way can total costs be compared among ports, as low direct cargo handling costs may be more than offset by long delays of the ship in port due to congestion, inadequate facilities or low productivity.

It might well happen that there would be no need to change the system of presenting rates for ranges of ports when a particular range is restricted to developed countries as ports of origin or destination. In any event, this is a question best left to the countries involved to decide, as in some cases national law now appears to prohibit any recognition in liner freight tariffs of cost variations among national ports <sup>14/</sup>. For the developing countries, it is sufficient that the three-part tariff reflect cost variations among their ports in order to have a basis on which to evaluate new port investments and to assure that cost reductions are incorporated into freight rates.

The probable consequences of the application of a three-part tariff which reflects cost variations among ports will depend to some degree on whether average costs are used at the national level or whether the three-part tariff reflects cost variations for individual ports. These alternatives should be kept in mind while examining the probable consequences which follow:

i) A direct link would be established between the freight rates which affect a country's foreign trade and the economic efficiency of its ports. Cost savings resulting from one country's efforts to improve its ports would not be shared with other countries, while the excessive

<sup>14/</sup> See, for example, United States Merchant Marine Act of 1936, section 205.

costs resulting from one country's inefficient ports would not be absorbed by other countries served by the same conference. Proposed port investments could be analyzed with the knowledge that the resulting benefits would accrue to the investing country. Consultations between governments and conferences on proposed port investments, changes in port operations, or the introduction of new maritime transport technology would become meaningful because the direct consequences could be anticipated. Concerted efforts to improve port efficiency would almost certainly be made.

ii) A framework would be provided for the application of rational port pricing. This is an important economic tool whose usefulness is at present severely restricted.

iii) When the port efficiency of each country is reflected in that country's freight rates, average freight rates for at least some countries will rise while those for others will fall. There would thus be some impact on the landed price of imported goods as well as on the earnings of exporters, although the quantitative significance of this impact should not be great. In a few cases of marginal exports, it is possible that markets would be lost. In those cases in Latin America where the ports of two countries serve the transit traffic of a third country, there could be diversion of traffic between the ports of the first two countries. In general, if the three-part tariff only reflects differences in port efficiency among developing countries at the national level, it is unlikely that its application would cause sharp changes in the traffic of individual ports.

iv) A three-part tariff which identifies the costs associated with a particular country's ports would permit changes in that country's exchange rates to be incorporated immediately and with considerable accuracy into the corresponding tariff.

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v) If the three-part tariff were to reflect cost variations among the ports of a single country, the possibility of traffic diversion from one port to another would be much greater. While direct cargo handling charges may be higher in the principal ports of a developing country, they may well be more than offset by the higher productivity permitted by the concentration of mechanical aids in those ports and by the economies of scale related to larger absolute amounts of cargo loaded or discharged during each ship's call. These factors might result in lower freight rates to and from these principal ports with a tendency toward even greater concentration of economic activity within their hinterland. This tendency might well be contrary to a country's regional development policy. Nevertheless, in other cases it is precisely the principal ports which presently suffer from congestion and to which surcharges are applied, so that a structure of freight rates which takes fully into account cost variations among ports could bring about a diversion towards ports in outlying regions. In general, the possibility of traffic diversion among ports should be examined with great care, as it might lead not only to underutilization of port installations but also to inefficient utilization of land transport infrastructure and services to and from the different ports. On the other hand, the dangers of traffic diversion should not be exaggerated; the country's port pricing policy could always be used to assure that the costs encountered by shipping lines in different ports reflect the real economic costs to the country.

vi) The occasional use of emergency port surcharges to take into account temporary problems of particular ports is compatible with three-part tariffs. If port costs are averaged at the national level, the use of surcharges for individual ports may even lead to greater economic

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efficiency. If the tariff itself reflects cost variations among individual ports, surcharges should be incorporated into the tariff if it is seen that the conditions giving rise to them are likely to persist.

vii) Conferences may experience greater problems in preparing a three-part tariff which takes into account cost variations among ports than one which simply breaks existing rates into three columns. Even when port costs are averaged at the national level, the shipping lines of a particular developing country may attempt to impede any increase in average rates to and from their country's ports. Shipping lines from developing countries with exceptionally low-cost ports may argue strongly that the corresponding freight rates should reflect this efficiency. Because of these divergent forces, it is likely that the initial three-part tariff would present rates which differ little from rates prevailing prior to its application. Over time, however, changes would be incorporated and the three-part tariff would begin to serve its objectives.

viii) Users and users' councils would find more useful for their negotiations with conferences a three-part tariff which does not present average port costs over broad port ranges. As the information provided in the tariff would be more specific, interested parties would be in a better position to verify its accuracy and to evaluate the justification by conferences for rate changes.

ix) There would be no important problem associated with the physical production, distribution and updating of a three-part tariff which averages port costs at the national level. If a single rate book covers two or more origin or destination developing countries, each of these countries would have its own first or third column. Should this prove unwieldy, there would be a separate tariff volume for each country served, which is

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already the case in many trades. More complicated would be the presentation of a tariff taking into account cost variations among the ports of the same country. In this case it would probably be feasible to present absolute rates for a base port or ports and to express the rates for the remaining ports as a percentage of these rates <sup>15/</sup>. Where a commodity moves only through a non-base port, the absolute rate could be established for the port through which it moves.

c) A three-part tariff which reduces rate discrimination among commodities

As has been noted, the application of a three-part tariff would make clearly apparent the degree of rate discrimination which is presently embedded in all liner conference tariffs. While the use of a three-part tariff would not in itself require any reduction in present discrimination among different commodities, conferences would be under strong pressure from shippers of high value goods, and perhaps from some member lines as well, to modify the freight rate on particular commodities, especially those rates which deviate the most from the "average" freight rate. These pressures would probably be particularly strong when conferences encounter difficulties in reaching a consensus among member lines on how to break down existing rates for assignment to each of the columns of the three-part tariff. If such difficulties were encountered, it might well be that the easiest way to reach agreement would be simply to change the rate itself.

Under the full cost pricing model described in chapter 2, decreases in some rates must be compensated by increases in other rates, especially when the amount of cargo which moves under the decreased rate is significant. Under a three-part tariff, it is likely that the first

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<sup>15/</sup> See UNCTAD resolution 66 (III), paragraph 56 of the annex.

freight rates which would be examined as candidates for an increase would be those whose middle (line-haul) column is exceptionally low.

For these reasons, one of the probable consequences of applying a three-part tariff is that discrimination among individual commodities would be reduced over time. Freight rates, in other words, would tend to reflect the sum of real port costs plus average costs of the ship while at sea, and the importance of the value of the commodity would tend to diminish as the primary consideration in establishing individual rates.

An analysis of the effects of a reduction in rate discrimination must necessarily be speculative, especially since users themselves might well appreciate the advantages—even to shippers of high valued commodities—of maintaining some degree of discrimination if this is necessary in order to maintain a satisfactory level of service. Nevertheless, in view of the probability that rate discrimination would decrease over time, some of the implications should be anticipated:

i) For developing countries' imports, freight rates on finished industrial products would tend to fall relative to rates on more widely accessible or lower valued raw materials and intermediate goods. The present freight rate structure on developing countries' imports parallels to some extent the structure of import duties and hence reinforces the protection given to national industries. A reduction in rate discrimination would tend to reduce this protection and might also influence internal relative price structures, perhaps affecting adversely the purchasing power of lower income groups.

ii) For developing countries' exports, a reduction in rate discrimination might assist in increasing exports of industrial products while reducing the net income of producers of traditional raw materials.

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iii) In many trades, there are separate conferences which set freight rates in each direction, but the two conferences, which frequently have the same secretary, generally work together in view of the necessity to consider the round trip of each liner vessel. In other trades, a single conference sets both "outward" and "homeward" freight rates. A reduction in rate discrimination would tend to increase the average freight rate on the exports of many developing countries and to decrease the average rate on imports.

In evaluating the quantitative significance of the possible effects described above, a number of considerations should be kept in mind. First, a reduction in rate discrimination is unlikely to produce changes of importance in trading patterns, because changes in rates are not expected to be large and the rates themselves are only one factor among many which determine these patterns. Second, any relative changes in the landed price of a developing countries' imports can be compensated by marginal changes in the structure of import duties. Third, there are severe limits on possible increases in freight rates on raw materials and other commodities transported in relatively large quantities because of the potential competition from non-liner maritime carriers. Conferences value these "bottom cargoes" and will make every effort not to lose them to tramp ships.

## 5. Conclusions

In summary, the three-part tariff for ocean liner conferences appears promising and potentially could receive the support of the developing countries as an instrument which would increase significantly the information available to users and users' representatives, while at the same time reducing many of the disadvantages of averaging freight rates over ranges of ports of developing countries. It is also likely that other countries would find no difficulty in supporting the three-part tariff, if its usefulness is demonstrated, because its application would not change the traditional distribution of responsibility between shippers and shipping lines defined by liner terms.

Nevertheless, considerable work still needs to be carried out before the three-part tariff can be considered formally in an appropriate international forum. In particular, more detailed analysis is required in order to determine how best to treat the cost of ship's time in port in the three-part tariff, and how to assure that common norms in this regard would be applied by each of the countries served by a single conference.

Hopefully, this paper will provoke comments, criticism and suggestions which will enable CEPAL to prepare a revised version for formal consideration.

