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Competition in Container Terminals

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Intense public concern as to how government will select the operator for Terminal 9 on Tsing Yi Island has focused attention on the fact that the existing terminals at Kwai Chung are overly concentrated in terms of ownership: HIT owns 10 berths, MTL four berths, HIT and MTL jointly own four berths, and Sealand owns one berth. It is feared that excessive concentration may reduce competition and even lead to collusion.

It is well known that insufficient competition reduces efficiency and innovation. Collusion among firms is even worse, for it results in price gouging by the few. For this reason, ensuring or promoting competition to safeguard the overall economic interests of the community is a legitimate public policy concern. From such a perspective, the key policy issue becomes whether the government should exclude any existing operator from operating Terminal 9. The debate over whether the selection method should be made by open tender, restricted tender, or private treaty grant is directly related to this question.

The concentration of terminal ownership in Kwai Chung should be of some concern, but this alone does not imply that there is insufficient competition and the presence of collusion.

The absence of barriers to entry is a major consideration determining whether there is sufficient competition in an industry. In Hong Kong, there is an agreement between the government and the terminal operators, known as the "trigger point mechanism," whereby additional terminals will only be built if forecasts of future demand for terminal services exceed available capacity. Since the amount of excess demand is determined in part by the level of handling charges set by terminal operators, this mechanism provides existing operators with a tool to limit competition by reducing the rate of entry.

The incentive to collude depends on the costs of and gains from collusion. Since collusion is not illegal in Hong Kong, the only cost of collusion to members is the cost of enforcing cartel agreements. Cartels are inherently unstable because members have an incentive to cheat by lowering their own prices to gain market share at the expense of the others. In the absence of effective policing, the cartel breaks down. The policing cost will rise as the number of parties to the agreement increases, because it will become more difficult to ascertain who is chiselling on the cartel. If the cartel has one dominant member, it is more likely to be stable because that member has a strong incentive and is in a strong position to enforce discipline, as in the case of Saudi Arabia in the OPEC cartel.

Gains from cartelization are determined by how price inelastic the demand for container terminal services in Hong Kong is. In other words, the incentive to cartelize will be lowered if, in doing so, there will be a substantial reduction in throughput when charges are increased. Whether this is the case depends on whether there are significant alternatives to container terminal services in Hong Kong within the region. Cargo can always be routed through different ports; the issue is whether it pays to go through another port.

Comprehensive statistics on charges are not publicly available for periods long enough to determine definitively the price elasticity of demand. But recent figures on the growth of TEUs clearly indicate that midstream operations have been increasing much faster than at Kwai Chung.

In 1991, midstream operations handled 1573 thousand TEUs, a 31.3 percent increase over the previous year. The comparable figures showed that container terminals in Kwai Chung handled 4514 thousand TEUs in 1991, a 17.8 percent annual increase. In the first five months of 1992, midstream operations grew at an astonishing 58.1 percent over the same period last year, while Kwai Chung grew a mere 10.6 percent.

The rapid growth of midstream operations indicates that the main effect of capacity constraints at Kwai Chung is not to divert traffic to other ports, but to force users to rely on a different service. Those who wish to use the terminals will have to pay a premium.

The fear of insufficient competition or collusion is not unfounded. An open tender will not be an equal competition because a dominant incumbent operator will be bidding on the basis that it can expect to expand its domination over the market. This would allow the operator to secure a more stable cartel. The potential increase in profits will not only include those derived from Terminal 9, but also from the existing terminals because of more effective cartelization.

A newcomer, on the other hand would make it less likely to create such a secure cartel. His bid will be less than that of the incumbent, not only because the level of cartelization will be less, but also because he can at most capture the profits derived from Terminal 9. One would expect an open tender to fetch a higher land premium because it merely transfers part of the cartel profits from the operators to government. But society will have to pay the price of cartelization of this industry.

The fostering of increased competition in container terminal services should not be equated with open competition in the tendering process. The claim that existing operators can benefit from economies of scale if they operate CT9 and that they would therefore be able to pass on the benefits to customers is specious. If economies of scale really exist, then even if a newcomer were awarded CT9, it would subsequently be willing to merge with the existing operators to exploit those gains. The fact that a small operator can exist profitably today in the container terminal business and chooses not to merge argues against the importance of economies of scale.

The case for greater competition is not necessarily an indictment against the performance of the existing operators. Many believe that they have done an excellent job by most international standards. The institutional arrangements which the government and industry have created in the past in building the industry have served Hong Kong well. In particular, the encouragement of private initiative with little government regulation is an excellent model for operating container terminals.

Some have claimed that an additional operator will not introduce competition into an industry that is sufficiently cartelized. They advocate government regulation as a more effective alternative. But regulating a cartel is very different from regulating a monopolist. Because of the interaction between different operators, one has to regulate in great detail, and existing schemes of control like price caps or rate of return caps are not likely to function well in an oligopolistic environment. The regulatory path is a poor substitute for competition in promoting vitality, efficiency, and growth. Only when more operators join the industry over time can we look forward to a healthy development of that industry.