

Distortions on shipbuilding markets: tackling pricing issues

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Agenda

- Market distortions and shipping
- Market distortions and anti-dumping regulation
- Shipbuilding dynamics
- Shipbuilding and injurious pricing
- Conclusive remarks

Market distortions and competition

- A “market distortion” is an event in which an external element (e.g. government body, economic shocks, market power) affects the equilibrium between supply and demand, provoking an effect on the determination of their equilibrium

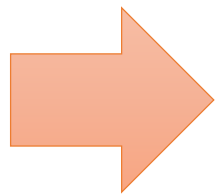


Possibility for regulated markets, price discrimination or unfair competition

- In this situation the price in which the good is sold is not equal to the marginal cost (i.e. optimal situation in case of perfect competition):
 - Either because one of the parties involved in the exchange is capable of “bargaining” a better situation or because the price at the marginal cost does not guarantee a sustainable situation (e.g. “market failures”)
 - Possibility to create distorted scenarios in terms of optimal resource allocation

Market distortion and regulation

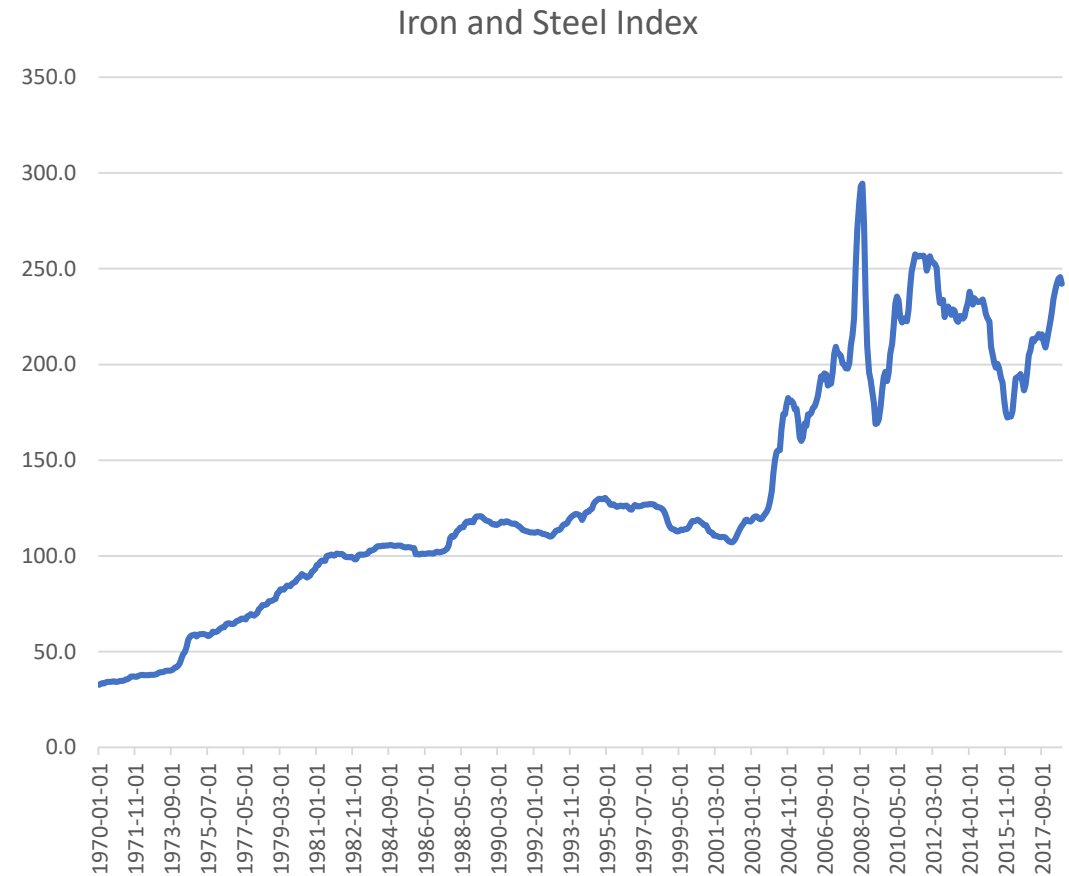
- Market distortions are typically either corrected (e.g. cartels) or promoted (e.g. public welfare) by relevant regulators
- The regulation is normally based on the attempt to achieve an optimal economic and social status
 - E.g. distortions could be guaranteed in order to protect local industries (e.g. subsidies), to create advantages for companies (e.g. tariffs, export credits), or to protect companies from macro-economic shocks (e.g. business cycles)



Distortions are neither good nor bad but they may cause advantages for specific industries and they could have a "cascading" effect on interconnected markets

An example: steel industry

- As identified by Tarr (1979) the steel industry is often characterised by market distortions caused by the cyclical nature of the market
- Thus, distortions can influence a market development



Source: FRED, 2018

Market distortions and shipping industry

- Agreements limiting the competition within the market have always been a characteristic element of the shipping industry as whole, for instance:
 - Conference (banned from EU in 2008)
 - Investment agreements
 - Cooperation (e.g. 75% of deployed capacity on Asia-NA and 96% in the EU-Asia route [Drewry, 2018])



Reasons for reducing the level of competition are generally connected to:

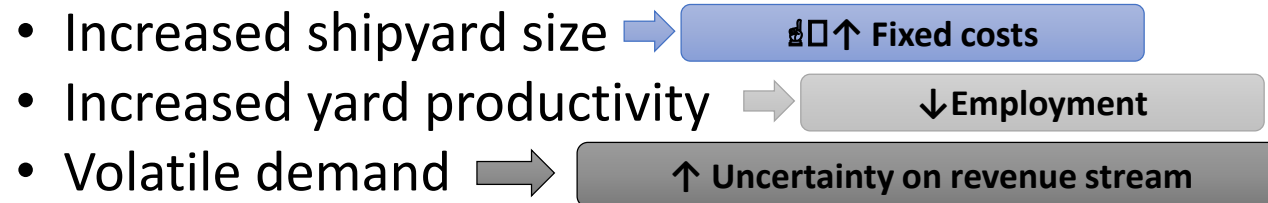
- High (fixed) investment costs
- - High level of volatility

- Shipbuilding has historically followed this trend given its business characteristics and the role in the regional economy:
 - Cluster effects
 - Connection with the steel industry
 - Mixed naval and commercial ship production

International regulation and shipbuilding industry

- Shipbuilding industry has always been heavily subsidized (e.g. Stopford, 2003) since it has always been:
 - High employment generator
 - Japan shipbuilding association estimated an indirect employment generation of about 30% of the direct employment
 - Positive impact on related sectors (e.g. steel)
 - Strategic national interest (e.g. navy)
 - Connections with other technological sectors

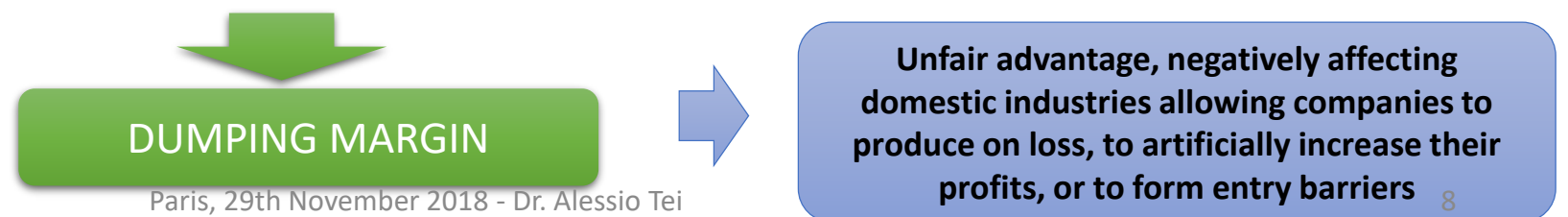
- Moreover, recent industry evolution has increased the need for special interventions:



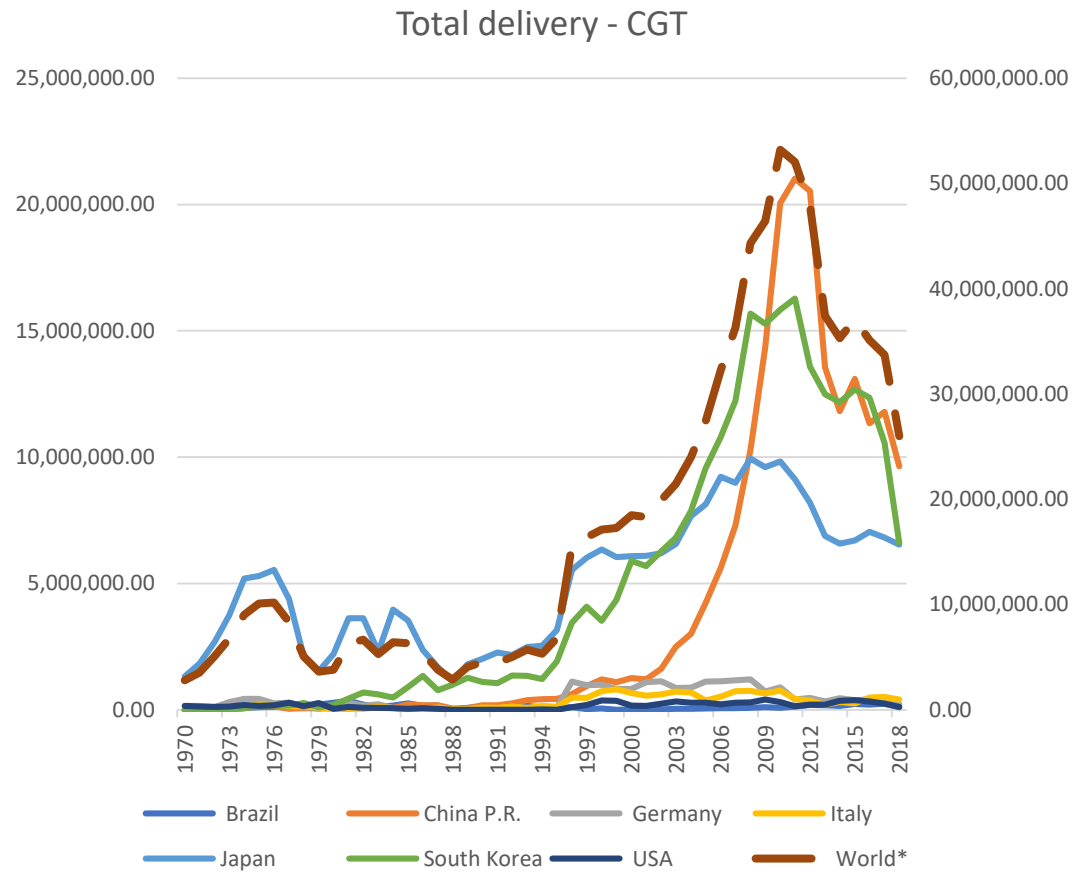
Restructuring actions occurred in main markets (e.g. Europe ['80s-'90s], Japan ['90s-'00s], Korea ['00s-'10s])

Distortions and anti-dumping regulation

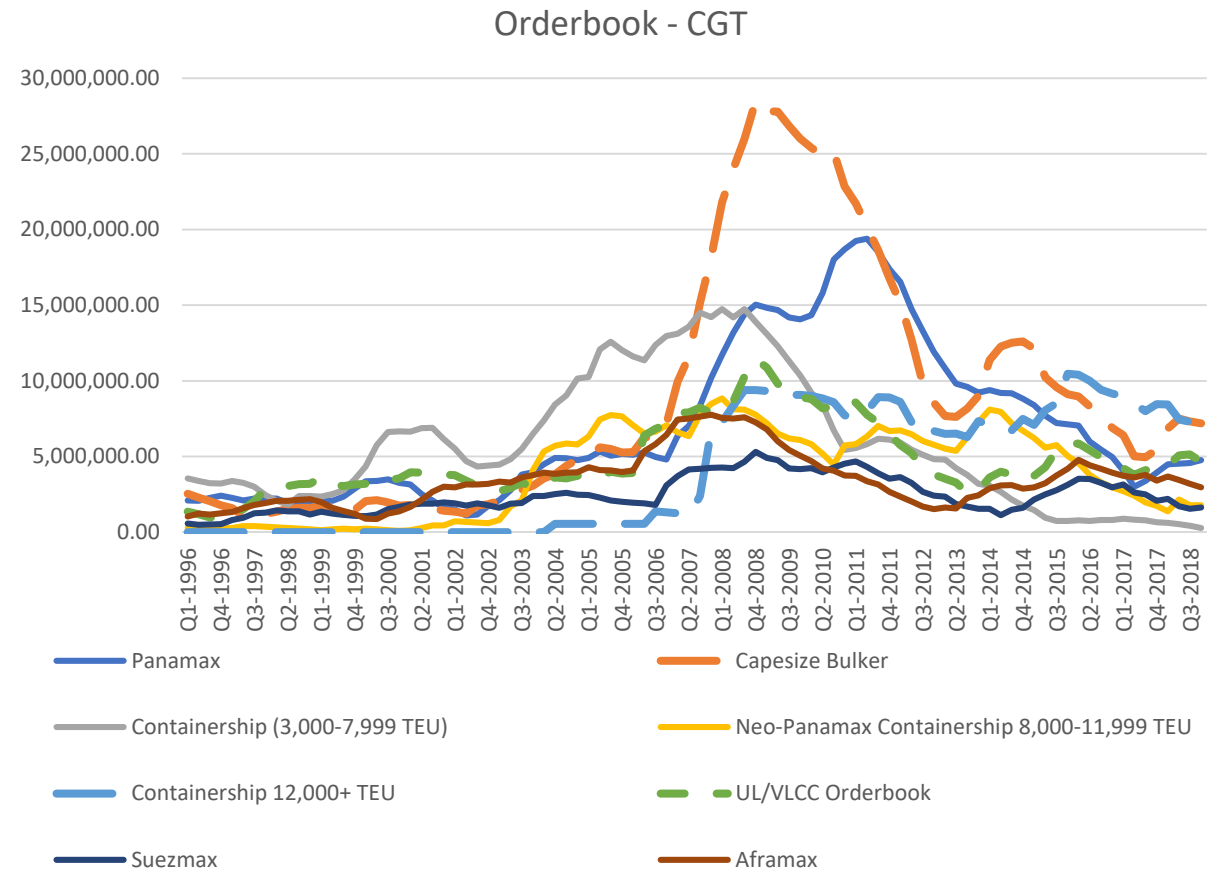
- Market distortions are considered dumping actions whenever the protection of the internal market (and related companies) generates unfair advantages in respect to “foreign competing” industries
- International rules establish unfair pricing as practices applied to **goods** that are **imported** from a foreign country in which the importer sell the good to a lower price
 - Either because they can enjoy a market domestic advantage (e.g. market power)
 - Or certain favourable regulatory regimes (e.g. subsidies, entry barriers)



A translation to the shipbuilding industry

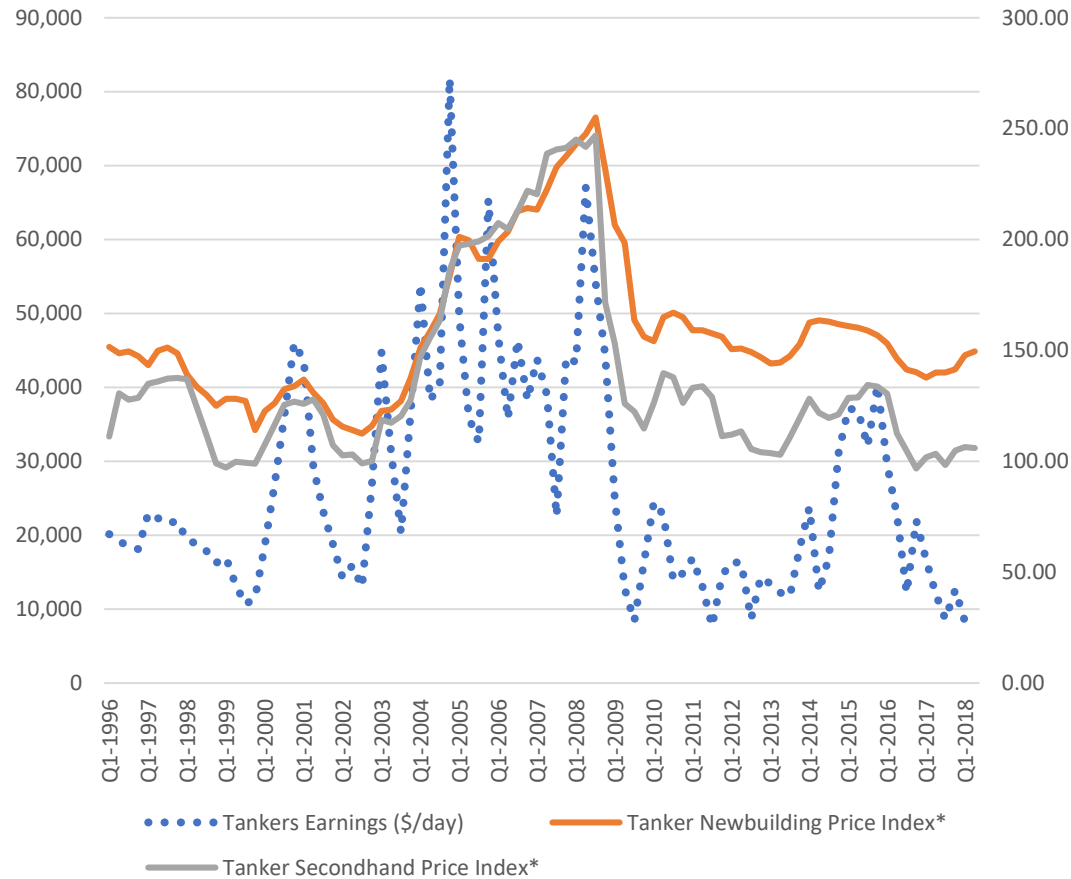


Source: Clarkson-SIN, 2018

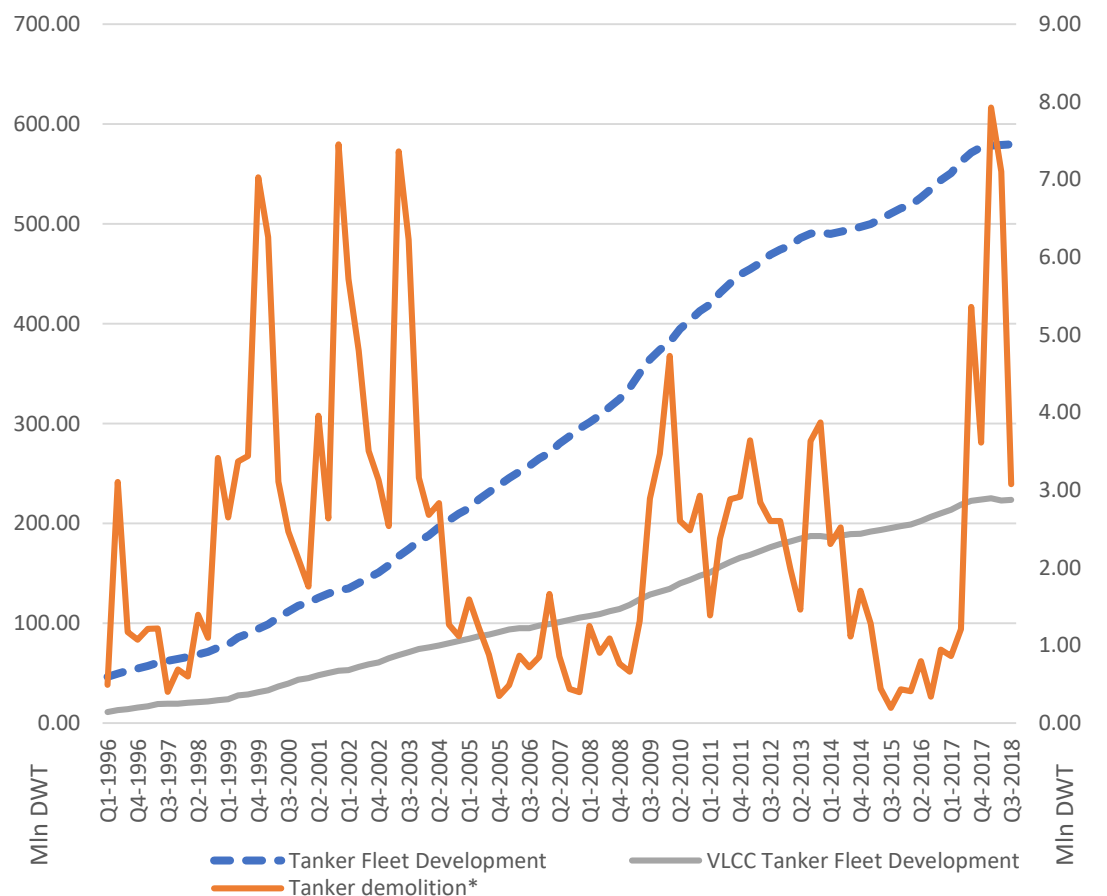


Source: Clarkson-SIN, 2018

The trend in the shipbuilding sector



Source: Clarkson-SIN, 2018



Source: Clarkson-SIN, 2018

The shipbuilding market

- The shipbuilding market, given the cyclical nature and cost structure characteristics, has often been “protected” by relevant subsidies (Glenn, 2006):
 - In the period 1951-1972, 1/3 of Japan Development Bank loans were headed to shipbuilding related activities
 - Until the '90s, a ceiling of 28% of operating subsidies was characterising EU countries
 - And also the phased-out process of EU subsidies was characterised by different domestic market behaviours
 - WTO disputes over Korea (e.g. pre-shipment loans) and EU (e.g. temporary defence measurement)

Anti-dumping and shipbuilding

- Thus, from an economic perspective shipbuilding is characterised by conditions that promote market distortions but is this dumping?
 - According to the general definition is hard to demonstrate it, given the missing *imported goods*
 - Shipbuilding provides a “good” for an international market and it is hard to identify an import and export process
 - The difficult determination of the dumping margin
 - Deviation from the market conditions should not be temporary (i.e. determined by specific cyclical events or normal business practices) and they should not create “entry barriers”
 - Difficulties to identifies aids (or subsidies) to specific productions
 - Yard multiple-productions
 - R&D funds
 - Naval and Commercial purposes
 - General economic aids

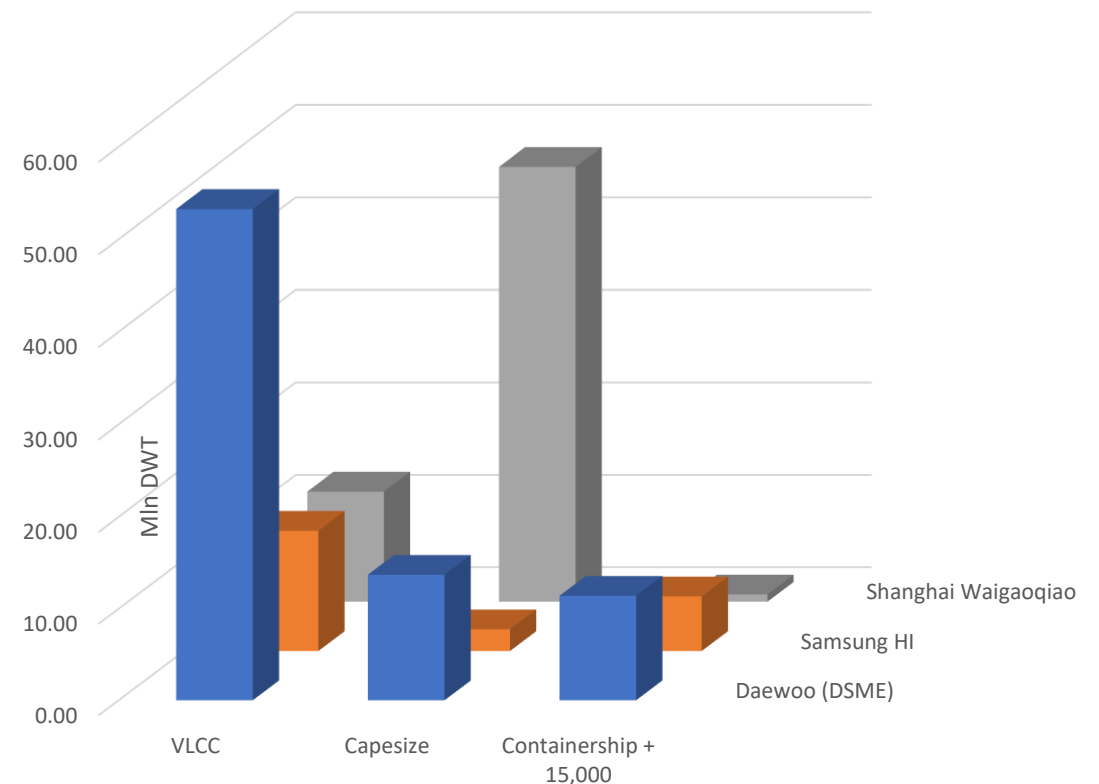
The shipbuilding market

- Market concentration
 - HHI for Capesize equal to 396
 - HHI for VLCC equal to 910
 - HHI for cruise equal to 1,398
 - HHI for +15,000 TEU equal to 1,600
- But indexes do not consider the presence of the same shipbuilder in multiple markets and the possibility to substitute different ship kinds



Can anyone affect the market or (unfairly) produce below the market price level?

Competitive position of sample of shipyards

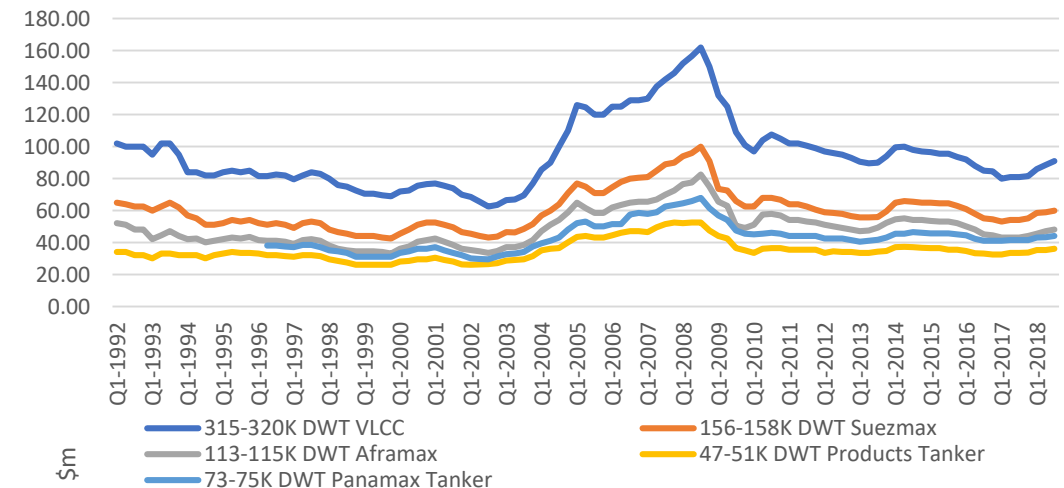
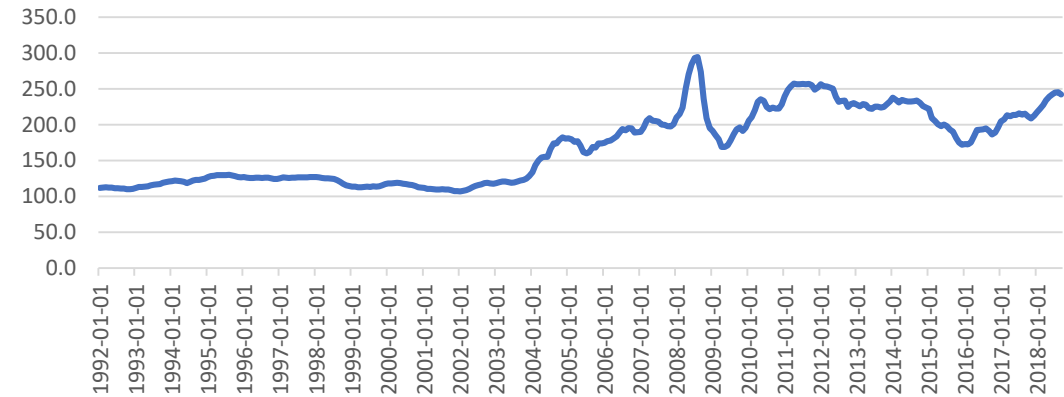


Source: Clarkson-SIN, 2018

Current dynamics in the shipbuilding industry

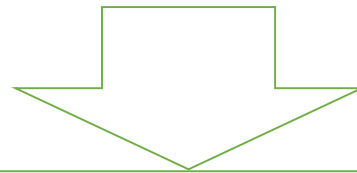
- Shipbuilding is also characterised by:
 - Shipowners' investment decision lag (e.g. Ferrari et al, 2018)
 - Dynamics of main production inputs, i.e. labour and steel
 - Rigid cost structure
 - Ship payment schemes / procurement strategies
 - Integrated local markets (e.g. PPP evaluations)

Steel and Iron price index



Needs for a specialised discipline

- So far, several attempts have been made to introduce an international regulation on anti-dumping practices in the shipbuilding industry but:
 - OECD Agreement of 1994 (i.e. first definition of injurious pricing) not successful in identifying an effective regulation
 - OECD 2002 outcome has been a “gentlemen” agreement without enforceable rules
 - WTO and GATT regulation hardly applies to the characteristics to the shipbuilding practice



There are market distortions but it is hard to identify their “dumping” characteristics unless a proper “ad hoc” regulatory system comes into place with:

- Definitions tailored on shipbuilding reality
- Specific assessment on the distortive effects on shipbuilding market(s)

Conclusive remarks

- Market distortions are an essential element of the shipping world, shipbuilding included.
 - Despite this, distortions are not only generating negative effects but are necessary to stimulate innovation and shipbuilding investments
- Distortions can cause dumping margins and unfair competition without an agreed international setting that establishes a fair levelled playing field
 - Probably there is dumping in the industry but current rules hardly allow to prove it



There is a need for a better economic and business market representation (i.e. definition of the relevant market, economic modelling) as well as clear common legislative framework in order to clearly separate distortions from dumping strategies

Thank you for you attention!

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