COMMON FARE: AN EXAMPLE OF "BLANKET" RATES IN HAWAI'I WATERBORNE TRADE

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ABSTRACT

"Blanket" rate structures apply uniform rates to a geographical region in spite of differences in the costs of carrying the goods. They are generally utilized by carriers to achieve some strategic objective, whether rate simplification, to be more competitive, or to meet some political objectives. While blanket rates are common in land transportation, the Hawai'i waterborne trade offers a unique example of this pricing mechanism. Further, given new and potential competitive factors in this trade, this is a unique case study for those interested in transportation pricing and the economic impacts of changes in the competitive structure in an isolated market.

INTRODUCTION

"Blanket" rates are rate structures that apply uniform rates to a geographical region in spite of differences in the costs of carrying the goods. They are generally proposed by carriers to achieve some strategic objective, whether rate simplification, to be more competitive, or to meet some political objectives. While blanket rates are common in land transportation, the Hawai'i waterborne trade offers a unique example of this pricing mechanism. Further, given new and potential competitive factors in this trade, shippers and the state government should be aware of the implications of both the existing situation and the potential impacts of impending changes. This is also a unique case study for those interested in transportation pricing and the economic impacts of changes in the competi-tive structure in an isolated market. Hawai'i is often described as the most isolated populated landmass. As such, there are numerous ways in which it is unique from other states, including the costs of getting goods and people between it and other locations. Hawai'i has only air and water

transportation to connect it to the rest of the United States while other states also have access to rail, highway and pipeline transporta-tion. This isolation gives birth to unique cost and competitive structures and resulting pricing structures with resulting profound impact on both businesses and consumers.

New competitors are about to enter this market. The purpose of this paper is to provide an understanding of the structure to improve business' ability to compete and provide the state and county governments with a tool for addressing the new competitive and economic realities. It also provides students of trans-portation a unique insight into the reasons for, the consequences of, and potential impacts of change in, voluntary waterborne blanket rates: The Hawai'i Common Fare.

HAWAI'I'S UNIQUE SITUATION

Due to Hawai'i's location and its comparatively small population, most cargo to Hawai'i is shipped from the continental U.S. (i.e., the main-land). Even freight from foreign countries, like cars from Japan, are often shipped from Japan to the mainland, and then transshipped to Hawai'i on one of the American-flag carriers serving Hawai'i. This places Hawai'i in the unique position of: 1) being served by carriers in heavily regulated trades, 2) also having limited competition, and 3) virtually no competition from foreign-flag vessels. This gives rise to unique pricing structures and one such unique pricing mechanism is the Common Fare.

Hawai'i receives most of the goods it consumes from sources outside Hawai'i. The majority of the goods flowing to and from Hawai'i, as well as among the islands, are transported on water carriers, and the majority of the consumer goods are transported in containers. When fully

As an aside, a Common Fare approach can apply to passengers and/or freight. Before U.S. airlines were deregulated in 1978, a passenger Common Fare structure existed between the mainland and Hawai'i ("For the Common Fare," 1960). However, since deregulation, this practice has fallen into disuse as some airlines—often new entrants—have "cherry-picked" the most profit-able routes, while not serving the less profitable ones. Over time, the heaviest trafficked (most profitable) routes have seen declines in their freight rates

cellular containerships bring cargo from the mainland, all containers are unloaded from the vessel on O'ahu, where more than 70 percent of the population is located (US Census Bureau, 2000). Those destined for the Neighbor Islands are reloaded onto a barge and then shipped to the desired island. Consequently, the costs involved for Neighbor Island shipments are always more than the costs to simply ship the containers to O'ahu due to the additional loading and unloading and vessel movement costs. Nonetheless, the tariff (i.e., freight rate) for each container charged by the containership company is generally the same, no matter the desti-nation.[1] This pricing phenomenon is referred to as "Common Fare," "Common Rate" or "Standard Tariff" (henceforth referred to as "Common Fare"). This Common Fare pricing is unique in the United States for in no other state, including Alaska, are all containers transshipped on a particular origin-to-destination movement and the customer not charged for the additional movement and associated costs. Further, this is a voluntary pricing practice by the carriers ("Common Rate Sought," 1972). In this article "Common Fare" refers to any pricing approach where additional costs, such as transshipment or additional distances, are not reflected in the pricing structure.

The existing containership carriers between the mainland and Hawai'i use the Common Fare for Neighbor Island shipments. Further, no current containership company has service (denoted by bills of lading) to only O'ahu without also serving the Neighbor Islands. This means that people that ship goods between the mainland and O'ahu (with O'ahu being the origin or destination) are subsidizing the freight movement of containers to the Neighbor Islands. As discussed below, this subsidy amounts to about $200 per container.

reflecting both competition and the allocation of carrier costs among greater volume. Hence, the rates between each airport pair reflect the respective costs and competitive situation. Due to the Common Fare, this is not the case for ocean transportation freight.

REGULATORY BACKGROUND

Before getting further into the details of this unique rate structure, it is helpful to understand the regulatory environment in which this rate system exists. Movement of cargo between two United States ports, including traffic among the Hawaiian Islands and between Hawai'i and the mainland, is covered by the Merchant Marine Act of 1920. Vessels transporting cargo in this domestic, or cabotage, trade must be built in the U.S., crewed by U.S. citizens (with some excep-tions.), fly the U.S. flag, and be owned by a U.S. company.[2] To partially offset the higher costs of using U.S.-flag ships, carriers in the domestic trades are permitted to apply for Title XI mortgage insurance whereby the U.S. government will guarantee up to 87.5 percent of the construction price of a new vessel. The guarantee means that the shipowners are assured of obtaining low interest rates on their mortgages. This assistance aside, domestic carrier operating costs are significantly higher than those of most foreign flag vessels and these costs are passed on to the shippers, and ultimately the consumer.

At the present time there are two common carrier containership companies serving the route between the mainland and Hawai'i, Matson Navigation Company, Inc. (Matson) and Horizon Lines (Horizon) plus a few smaller barge lines. These companies carry only interstate containers (which are defined as having bills of lading with origins and destinations in different states). Young Brothers is the only common carrier with a state Public Utilities Commission (PUC) Certificate of Public Convenience and Necessity to carry intrastate containers (with origins and destinations in Hawai'i) between O'ahu and the Neighbor Islands.[3] Young Brothers carries both intrastate and interstate

containers. The PUC regulates only the intra-state containers.

When Horizon moves interstate containers be-tween the mainland and a Neighbor Island, the container is transshipped in Honolulu and is carried between O'ahu and the Neighbor Island by Young Brothers. Matson also uses Young Brothers for interisland interstate movements; in addition, it has its own barges for interisland interstate movements. (Matson cannot, for example, carry containers originating in Hono-lulu to a Neighbor Island.) (Chamber of Commerce of Hawaii. Ad Hoc Committee on Interisland Transportation, 1978; Hawaii, Governor's Task Force on Interisland Surface Transportation , 1979)

A new carrier, Pasha Hawaii Transport Lines, LLC (PHTL), a subsidiary of the Pasha Group, obtained Title XI mortgage guarantee and has built a roll-on/ roll-off vessel and entered the mainland-Hawai'i trade in late March 2005. A potential carrier, Santa Maria, has stated its intention to build a small containership that would also enter the Hawai'i trade; this company has not yet received approval for the use of Title XI mortgage guarantee. Santa Maria may provide service between Hawai'i and the main-land or it may prefer to operate between O'ahu and the Neighbor Islands. Still another potential entrant, Hawaii Superferry, has stated its intention to build two new 340 foot catamarans capable of speeds up to 45 miles per hour for an interisland ferry service carrying both passen-gers and freight. This firm has not yet received approval for the use of Title XI mortgage guarantee; however, it has begun construction of the first vessel. Any new carrier, particularly if its service is selective and "cherry picks," will have serious ramifications on existing carriers, and the Common Fare.

HISTORICAL TRANSITIONS

Captain William Matson made his first sailing to Hilo from California in 1882. In the years that followed, Matson Lines established itself as the dominant common carrier between the Mainland and Hawai'i (Worden, 1981). Since Matson Lines was owned by the major sugar factors, the Common Fare was introduced to both help develop the Neighbor Islands as well as to attract backhaul cargoes given the dominant Hawai'i to mainland sugar exports (Mund & Hung, 1961; Mifflin, 1983; B. Mulhulland, personal communication, July 27, 2003). Diver-sifying the state's population and economy has long been a political issue, and since the Common Fare assists in this effort, carriers have been "encouraged" to maintain this practice (Hewlett, 1970; Chamber of Commerce of Hawaii. Ad Hoc Committee on Interisland Transportation, 1978). In the past century many things have changed. The regulation of water-borne transportation on both the interstate and intrastate levels has been altered. Vessel technology as well as the technology of the cargo handling equipment has changed. The economic drivers of the Hawai'i state economy have transitioned from an agricultural economy to one based on tourism. The mix of waterborne cargos as well as the dominant direction of cargo flow have been modified (Department of the Army Corps of Engineers, 1961, 1962, 1987, 1992, 2000, 2004). In recent decades the Neighbor Islands have exhibited a higher growth rate of several economic factors when compared with O'ahu (Bank of Hawaii; Smith, 1992). With all these changes, the rationale for the Common Fare has been weakened, if not eliminated.

THE IMPACT OF THE COMMON FARE

Since there are no additional charges for containers transshipped from O'ahu, the main-land to Honolulu containers "cross subsidize" those destined for the Neighbor Islands. The extent of this subsidy and the impact on shippers and consumers dramatically affects cost and competition.[4] This section addresses those factors.

Because the two containership companies serving Hawai'i from the mainland are common

carriers, all their tariffs are published. However, through decades of "evolution," tariff books have become a maze of information on different commodities, different sizes of containers, different types of containers (e.g., refrigerated, dry box, liquid tank), and different types of service (e.g., port-to-port, door-to-door). The result is a myriad of different freight rates, expressed in hundreds of pages of tariffs, that exist under various scenarios. It is virtually impossible to secure precise figures on the actual freight rates paid by various shippers. After discussions with shippers and carriers it was concluded that a charge of $3,200 for the movement of any container from the mainland to any port in Hawai'i is a representative Common Fare rate. Further, for any container in an intrastate movement (A container that originates on one island, such as O'ahu, and is The percentage of containers from the mainland to Hawai'i that are transshipped in Honolulu to the Neighbor Islands is steadily growing and at the current rate of growth will soon account for one third of containers from the mainland (Department of the Army Corps of Engineers, 1987, 1992, 2000. 2004; Hawai'i Department of Transportation Harbors Division, 2004). Young Brothers is the only interisland intrastate common carrier serving O'ahu. Assuming that one-third of the containers are transshipped to the Neighbor Islands, and given the $600 representative interisland rate for the interisland movement, then each container moving from the mainland to O'ahu contributes $200 to the interisland movement of the one out of three containers that is transshipped. In other words, shippers who move containers from an origin on the mainland to a destination on O'ahu are cross subsidizing (or being overcharged) to the tune of $200 per container.

Given the $3,200 representative rate of moving a container between the mainland and any major Neighbor Island port, when the cross subsidy of $200 is subtracted from this amount, the actual cost to a shipper of the mainland to O'ahu movement is $3,000.

THE COMMON FARE STAKEHOLDERS

transported to another island.) the representative rate is $600. In other words, a "representative" shipper would pay $3,200 to ship a container from the mainland to any port in Hawai'i. The same shipper would pay $600 to ship a container between two ports in Hawai'i. Since shippers and carriers agree that these rates are representative of the rates actually charged, we can assume that the rates cover the full costs (with a reasonable profit) of the service. In either case, the cost to the shippers of a container destined for a Neighbor Island will be only $3,200 if carried under the Common Fare, but would incur an additional $600 charge if off-loaded on O'ahu and then sent to a Neighbor Island under a new bill of lading.

The impacts of the cross subsidy on the different categories of stakeholders in the Common Fare environment vary. There are both current win-ners and losers associated with differing future alternative strategies. Key variables are whether carriers that serve O'ahu also serve the Neighbor Islands and whether shippers/consignees can take advantage of the Common Fare practice to ship full container loads (FCL) from the main-land to the Neighbor Islands.

Table 1 identifies 19 stakeholders and shows whether the Common Fare works to their advantage or disadvantage. In general, the Com-mon Fare puts those interests on O'ahu at a disadvantage and those on the Neighbor Islands at an advantage.

It should be noted that the actual situation for the shippers/consignees is more complicated than described. Theoretically, an O'ahu-based manufacturer/distributor may focus on ex-panding its business by shipping more goods from its warehouses on O'ahu to the Neighbor Islands. However, in actuality, we have found few companies in this category. This is true because there is no point in fighting against competitors on the mainland who have sub-sidized transportation service to the

Neighbor Islands (Garrod, 1975). Instead, distributors on O'ahu who are selling products available from the mainland typically have a two-part strategy to serve the Neighbor Islands: (1) they will order products from the mainland to be delivered to the Neighbor Islands to take advantage of the transportation subsidy if there is sufficient time to take advantage of this longer, but less costly, supply chain, and (2) if time doesn't permit the low cost alternative, they will ship products from O'ahu to the Neighbor Islands paying the interisland intrastate freight rate.

POSSIBLE CHANGES IN THE COMMON FARE STRUCTURE

The major Neighbor Islands are expected to continue to grow at a faster rate than O'ahu (Bank of Hawaii; State of Hawaii Department of Business, Economic Development & Tourism, and Research and Economic Analysis Division), so we can anticipate that the amount of cross subsidy will also grow over time. In other words, the amount of "overcharge" to the containers going to O'ahu will continue to increase. Since there is no legal requirement to maintain the Common Fare approach and the original justifications for this unique system have mostly disappeared over time, under what conditions would this freight rate system end?

One trigger is potential actions by the carriers. They could increase rates differentially so that containers moving from the mainland to the Neighbor Islands (versus O'ahu) would face higher rate increases. This would reduce, or eliminate, the cross subsidy to the Neighbor Island shippers.

As mentioned above, a more dramatic event would be a new entrant— or the threat of a new entrant— into the mainland-Hawai'i trade that served only O'ahu and not the Neighbor Islands. Using the sample calculations above, the new carrier could reduce its container rates from the mainland to O'ahu by $200 just by eliminating the cross subsidy. Existing carriers could meet the new carrier's rates by lowering their own and even do away with the Common Fare approach in order to put themselves on a "more level footing." A new entrant offering direct sailings to a major Neighbor Island port could trigger parallel responses.

TABLE 1
IMPACT OF COMMON FARE ON STAKEHOLDERS

Category	Disadvantage	Neutral	Advantage
Container Waterborne Carriers			
Between Hawai'i and Mainland			
-also serve Neighbor Islands	X		
-only serve O'ahu			X
Between O'ahu and Neighbor Islands			
-carry only interstate cargo	X		
-carry intrastate cargo	X		
Shippers			
On Mainland serving Hawai'i			
-serve O'ahu	X		
-serve Neighbor Islands			X
On O'ahu			
-serving the mainland	X		
-serving the Neighbor Islands	X		
On the Neighbor Islands			
-serving the mainland			X
-serving O'ahu			X
Receivers/Consignees			
Mainland Businesses			
-receiving from O'ahu	X		
-receiving from Neighbor Islands			X
O'ahu Businesses			
-receiving from the mainland	X		
-receiving from the Neighbor Islands			X
Neighbor Island Businesses			
-receiving from the mainland			X
-receiving from O'ahu	X		
Non-Users of Waterborne Transportation			
Local Businesses Selling on Their Own Island			
-on O'ahu			X
-on Neighbor Island	X		
State Elected Officials			
-considering local and statewide impacts	?	?	?

Legend: ? signifies unknown (combination of others)

The details of changing the rate structure could be quite complicated for the following reason: the existing tariff is very complex. There are a variety of items that could be changed (e.g., general tariff rate, terminal handling charge, Neighbor Island surcharge); and it may be easier to increase rates differentially rather than reduce the rates to O'ahu.

THE IMPACT OF CHANGE

If the Common Fare ended, the effects would vary greatly depending on the individual stakeholder's situation. Shippers between the mainland and the Neighbor Islands would pay more for transportation. In theory, consumers on O'ahu would pay less for their shipments. (Shippers have noted that they have no guarantee that such decreases would occur.) Manufacturers/producers on O'ahu shipping to the Neighbor Islands would now theoretically have a "level playing field" with their competitors on the mainland in terms of the transportation cost between O'ahu and the Neighbor Islands. In contrast, companies located solely on a Neighbor Island would now face more competition from O'ahu-based firms wishing to extend their reach to the Neighbor Islands. Carriers between the mainland and Hawai'i would be better able to deal with competitors that only served O'ahu but not the Neighbor Islands (or the threat of such competitors).

A few examples will provide a more detailed view. Starting with the representative values above, assume that the container rate from the mainland to O'ahu is reduced from $3,200 to $3,000. Interisland rates for all containers from the mainland will be $600, so the rate from the Mainland to a Neighbor Island will now be $3,600 (up from $3,200).

The question is: How important is a decrease of $200 or an increase of $400 to shippers? One way of addressing this is to compare it with a recent increase in freight rates from the mainland to Hawai'i introduced by Matson and matched by Horizon. The rate increase (effective January 11, 2004) was $150: $125 per container, plus the Terminal Handling Charge increase from $200 to $225 per container (Matson Navigation Com-pany, 2003). In addition, shippers also pay a 7.5 percent fuel surcharge that will cause the shippers to pay more as this percentage will apply to a larger base after the rate increase. Rate increases typically occur on this trade route annually or more frequently. Therefore, the total impact of the Common Fare is equivalent to the amount of rate increases shippers now experi-ence every few years.

The impact on a given shipper/consignee will depend on the specific amount of the increase to the product involved and the alternatives open to competitors and customers. The freight rate from the mainland to Hawai'i typically accounts for between 3 and 25 percent of the delivered price of a product.[5] Note that for a higher value product where the ocean transportation accounts for 10 percent of the delivered price, a 50 percent increase in freight rate results in only about a 5 percent increase in delivered price. For a lower value product where the ocean transportation accounts for 20 percent of the delivered price, a 50 percent increase in freight rate results in approximately a 10 percent increase in delivered price. (A container of electronic goods is less affected by the transportation cost than a container of peat moss.) If we consider the impact of a 10 percent increase of the higher and lower valued goods, the results are about 1 percent and 2 percent, respectively. For example, for a 40 foot container full of 12 oz. soda cans, the freight rate from the mainland to the Neighbor Islands is about six cents per can. Any normal freight rate increase would amount to less than a penny per can in the delivered cost.

A key issue is to what extent businesses can pass on higher costs to their customers (the elasticity of demand). Since most commodities shipped in ocean containers to Hawai'i have little alternative forms of transportation (i.e., air freight is too expensive), as long as all carriers/ businesses raise their rates together, the consumer has little option except to pay

more (or stop using the product).

Another key issue is whether factors other than transportation rates play a more important role in the delivered price of the product. A manufacturer with a major presence and a large warehouse on O'ahu may choose to subsidize product sales to the Neighbor Islands so that it is less expensive for a Neighbor Island business to order from him/her than ordering from the mainland. Where perishable produce is involved, a Neighbor Island business may prefer to pay the interisland intrastate barge rate in order to obtain fresh, high quality product quickly from O'ahu rather than waiting for less expensive product from the mainland.

Small businesses located only on the Neighbor Islands are concerned about large "Big Box" competitors with a presence on all the major islands. These firms can: (1) obtain a lower price from the supplier on the mainland, (2) obtain a lower price from the ocean carriers, and (3) sell at one price statewide by averaging their lower cost traffic to O'ahu with their higher price business in the Neighbor Islands.

Other market forces are also at work. The costs of transportation do not explain, for example, why it is possible to pay $3 more for a 14.1 ounce/400 gram box of cereal on O'ahu than on the mainland. The ocean freight rate makes up less than 20 percent of this difference. There are numerous examples of such "aberrations." Obviously the competitive situation in Hawai'i has a profound impact on costs to consumers over-and-above the costs of transportation.

In the past, various Hawai'i government officials have made public statements in favor of the Common Fare. The rationale generally being that the Neighbor Islands required differential treatment to assist their development and that it was in the entire State's interest to do so. This may now be questionable since the Neighbor Islands are The best strategy for all stakeholders is to understand the current circumstances and potential changes on the horizon with their possible impending changes to the Common Fare practice. It is important that the growing at a faster rate than O'ahu. It is reasonable to ask whether the Hawai'i state government should play a role in trying to aid the Neighbor Islands by preserving the Common Fare system. There are possible legal problems involved with attempting to constrain ocean carriers in interstate commerce through legislation (e.g., requiring carriers that serve O'ahu to also serve the Neighbor Islands). Another approach is for the state to subsidize the movement of interisland cargo. At least three other states (North Carolina, Mississippi and Massachusetts) have used state tax credits to promote the use of their state ports. There are also other alternatives. Let it suffice to say that this is an issue that affects the entire state and it is not unreasonable to expect the government to understand the implications of the current Common Fare practice.

CONCLUDING COMMENTS

Within the waterborne trades of the U.S., the Common Fare system is an anachronism that exists in its present form only in Hawai'i. Just as it disappeared from the airline rate structure, the authors feel that it will someday disappear from the ocean freight rate structure. It is impossible to predict when the Common Fare approach will end, but the introduction of a new containership carrier that serves only O'ahu and not the Neighbor Islands—or the threat of such an entrant—is the event most likely to trigger the reevaluation of the practice. The introduc-tion of the Superferry will also generate new competitive issues. A more evolutionary approach on the part of the existing container-ship operators would be the gradual introduction of surcharges for containers being transshipped in Honolulu for the Neighbor Islands, but given the potential new entrants it is more likely that the gradual approach will receive secondary consideration.

stakeholders begin the process of determining how the end of the Common Fare system should alter their business strategies and operations. Through this early recognition stakeholders will be able to position themselves

to take advantage of their new business environment. Further, this is an interesting case for transportation researchers to follow as it is unique in the waterborne trades.

ENDNOTES

1. This excludes a separate charge by the State of Hawai'i for use of the port: wharfage fees.

2. The Passenger Services Act of 1886 places similar requirements on shipowners carrying passengers from one U.S. port to a destination at a different U.S. port. Note, however, that recent accommodations have been made to permit access to non-U.S.-constructed vessels by Nor-wegian Cruise Lines (NCL) to provide domestic cruise services within the Hawaiian Islands.

3. In addition, other common carriers are Sea Link of Hawaii, Inc., a passenger and cargo carrier providing water transportation services between the islands of Maui and Molokai, and Hone Hene Corporation, a passenger and cargo carrier providing water transportation services between the islands of Maui and Lanai.

4. The authors were unable to find accurate state or federal published information on the move-ment of containers or their average tariffs in the Hawai'i trade. Nevertheless, from discussions with governmental bodies, carriers, and ship-pers, we are confident that the data utilized are well within reason.

5. Normally, carriers price on the basis of the "value of service" concept. In other words, high value goods are charged more than low value goods.

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