

# **Comment on economic issues relevant to the ESC's forthcoming review of the Port of Melbourne's rentals**

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## **1. Executive Summary**

### **1.1 Background**

1. The Essential Services Commission of Victoria (ESC) has commenced its required five-yearly review under section 53(1) of the Port Management Act 1995 (PMA) into the Port of Melbourne's (PoM) leasing of port land. A central requirement of that review is whether PoM:
  - a. has market power in relation to the process for setting or reviewing of rents or associated payments (however described) payable by a tenant; and
  - b. has exercised that power in a way that has the effect of causing material detriment to the long term interests of Victorian consumers.
2. Herbert Smith Freehills (HSF) has instructed Incenta Economic Consulting (Incenta) to comment on certain economic issues that are relevant to the ESC's tasks, and specifically the economic issues relevant to the assessment of whether:
  - a. PoM has market power
  - b. PoM has exercised that market power should it be found to exist, and
  - c. any exercise of market power that is found to exist would be likely to cause a material detriment to Victorian consumers:

### **1.2 Market definition**

3. The term "market power" refers to the ability of a firm (or group of firms acting in unison) to raise price above the competitive level without losing so many sales that the increase would be unprofitable, or use its power to reduce the quality of the product or service without changing price. In practice, the concept of market power is rarely absolute, but rather a gradation of influence.
4. Defining the bounds of the (economic) "market" is an important step in the standard assessment of market power. The (economic) market refers to the field of potential suppliers of a good or service that are thought to compete with the participant in question. The geographical dimension of the market within which PoM provides the leasing services will be an important issue for the ESC. As a practical matter, the dimensions of a market depend on the facts of the case – and, most notably, the potential for customers to substitute to other providers – which requires an economic analysis.
5. We note that the PMA defines the term "relevant market" as "the market for access to leased port of Melbourne land by means of an applicable lease". In our view, however, this use of the term "market" is being used in a non-technical sense (as akin to defining the services of interest) – the economic concept of a market cannot simply be determined by legislation, even in a command economy. The (economic) market within which PoM undertakes its leasing activities will extend to all land that is a close substitute to port land. Indeed, the ESC should consider whether there are multiple economic markets in

play, relating to whether the use of the land must be located within the port precinct or whether land from outside of the port is an effective substitute. For example:

- a. In the case of port-related rental tenancy it is important to separately examine rental land by activity. There may be no local substitutes for activities that require wharf access;<sup>1</sup> however, for all activities that do not require direct wharf access, there will be off-port substitutes in the vicinity of the port or further away at logistics / distribution hubs.
  - b. In the case of import containers for example, locational decisions will depend on such considerations as relative land cost, and initial transportation cost of containers compared to distribution costs of unpacked goods. Non-port land will therefore impose some constraint on rentals at a port.
6. Once the economic market(s) have been established, a standard assessment of whether PoM has market power would involve a consideration of:
- a. the structure of the market, drawing on economic theory that links the outcomes from a market to degrees of market concentration, whilst also considering the potential for new entry
  - b. the conduct of the parties, and asking whether this is consistent with what would be expected in a (workably or effectively) competitive market – it is here that how PoM conducted itself during the process of negotiation could be a key issue
  - c. the performance (or outcomes) of the market, such as price trends and other relevant outputs,<sup>2</sup> and again asking whether the observed performance is consistent with what would be expected in a (workably or effectively) competitive market.

### 1.3 Importance of contracts where there are “sunk costs”

7. Contracts are an important market mechanism for dealing with situations where there are sunk costs associated with the building of long-lived assets or improvements on rented land.
8. The principal competition in leasing markets occurs at the time that parties are seeking to create new premises, or when existing premises come to the end of their economic lives. At this stage, a choice between on-port and off-port land (and, indeed, potentially land at other ports) exists.
9. Once a party has negotiated terms, a long term agreement is entered into, which acts to protect the rights of the lessee during the period that it has no realistic opportunity to move locations. This protection – which is disciplined by the original competition – extends to all aspects of the lease agreement, including the market rent review clauses.

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<sup>1</sup> Although a degree of competition is exerted by alternative ports via their role as components of competing logistic supply chains that are discussed further below.

<sup>2</sup> Depending on the context, indicators like profitability, innovation and trends in quality may also be considered.

10. Thus, if competition existed at the time the lease was entered into, the effect of that competition in disciplining the terms and conditions of the lease would endure for the duration of the lease agreement.

#### **1.4 Exercise of market power**

11. The inquiry into whether market power has been “exercised” should focus on whether the outcomes observed in the market are different to what would have been observed in a (workably or effectively) competitive market.
12. A principal focus that we would expect is whether the rents included in new leases by PoM are materially higher than the “reasonable market rent” that is consistent with a workably or effectively competitive market. An important issue in this regard is to distinguish between the “locational premium” that is observed for land in all areas that are close to major transport hubs and any “monopoly rent”. A second focus may be whether any actions of PoM that are inconsistent with what would be observed in a (workably or effectively) competitive market may have had an adverse impact on investment by port users.
13. A further issue relevant to whether PoM has exercised market power is how the mechanisms in place to mitigate market power have operated in practice. To this end, relevant matters include that:
  - a. the Port Concession Deed (PCD) has a specific definition of “reasonable market rent” and imposes certain obligations on PoM
  - b. PoM has a documented process for the setting and reviewing of market rents, which includes the requirement for a third valuer be appointed by the Australian Property Institute President in the event of continued disagreement between PoM and the tenant, and
  - c. the most important tenants at the port are very large, sophisticated and geographically diversified businesses with substantial experience with property rental markets throughout Australia and the world
    - i. the nature of PoM’s major customers means that PoM is likely to face a degree of countervailing market power, which would act to offset any market power that PoM is found to possess
    - ii. in addition, the nature of PoM’s major customers also means that they would be well-placed to make use of the safeguards contained in PoM’s documented process for setting and reviewing market rents.

#### **1.5 The question of “material detriment to Victorian consumers”**

14. The principal “material detriment” that could occur to “Victorian consumers” from an exercise of market power by PoM in relation to port land rentals is that PoM’s actions would cause the prices for the goods that transit through the port to be higher than otherwise. In this circumstance, whether there has been a “material detriment” would

depend on the effect of the higher rentals on the final price of goods to Victorian consumers – that is, the proportional impact – and whether such changes in prices would be material (or even perceptible) to consumers.

15. In our view there is no scope for such outcomes since:
  - a. the ultimate markets for the products that transit the port are served by overlapping supply chains (some of which will use the Port of Melbourne, some of which will not), so that price rises that are not reflective of efficient costs observed in the industry more broadly cannot be passed through to final customers, and
  - b. even if there was a pass-through of rent that exceeds “reasonable market rent” it would be immaterial to final consumers in Victoria.
16. Expanding on the second point, our results show that if we compare PoM’s rental charges for container-based imports with the final prices paid by Victorian consumers for products,<sup>3</sup> PoM’s *total* rental charges as a proportion of those final prices is one twenty-fourth of 1 per cent. Accordingly:
  - a. if 50 per cent of the rental charges were considered excessive and fully passed through to Victorian consumers, the proportion of this of final prices would be one forty eighth of 1 per cent, and
  - b. if 10 per cent of rental charges were considered excessive and fully passed through to Victorian consumers, the proportion of this of final prices would be one two-hundred and fortieth of 1 per cent.
17. Our conclusion is that whatever assumption were to be made about the scale of potential “excessive rentals,” they would constitute a trivial proportion of final consumer prices, and could therefore not be considered a “material detriment to Victorian consumers”.
18. A second detriment that could hypothetically occur is a scenario where PoM has market power and has exercised that market power in a manner that adversely affected the investment by port users, which may in turn affect the reliability or breadth of supply of products to Victorian consumers. However, even assuming that an adverse effect on port user investment were established – which is a factual question – the presence of overlapping supply chains noted above would be expected to mitigate the effect felt by Victorian consumers, which would need to be considered when assessing detriment.

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<sup>3</sup> More specifically our estimates are for grocery products imported using containers, which is likely to be conservative relative to other imported goods (like whitegoods and electronics) which are likely to have a higher gross profit margin applied.



## 2. Meaning of market power and the exercise of market power

### 2.1 Introduction

19. “Market power” is a term that refers to the ability of a firm (or group of firms acting in unison) to raise price above the competitive level without losing so many sales that the increase in price would be unprofitable. It is rarely the case that a firm will possess absolute market power, but rather there will be a gradation in its ability to raise prices as few services and only agricultural and mineral products can be perfect substitutes. In the case of port-related rental tenancy there may be no local substitutes for wharf access, but there will be competition exerted by alternative ports, and the competing logistic supply chains that are discussed in more detail in section 3.2 below.
20. In the case of a seaport there will be activities that do not require direct wharf access. There will exist off-port substitutes in the vicinity of the port or further away at logistics / distribution hubs. Moreover, as the activities that take place are part of a larger logistic chain – and where most of the investment (including land) is used for warehouses, distribution centres, transportation hubs and spokes – the port may not even be the preferred location for related activities, but rather may start at a point of disadvantage to other locations (for example, the preferred location for distribution centres may be closer to the final customers so that the cost of transporting products after the containers are unpacked is reduced).

### 2.2 Applying a conventional market power analysis within the confines of the PMA

#### 2.2.1 Definition of the (economic) market

21. Ordinarily, if one were assessing whether PoM has market power in relation to the leasing of the land it controls within the port precinct, an important element of the analysis would be to define the economic market or markets within which the land leasing activity exists, which would depend on the degree to which off-port land is an effective substitute for on-port land. Even though land at the port may be more desirable for a particular activity, off-port land will still be an effective substitute if the rents are not materially higher (after adjusting for any detriment caused by locating outside of the port precinct). We think this analysis would likely yield a number of markets within which the port land exists, some of these markets may include off-port land (i.e., where greater substitution activities exist) and some will encompass activity that can only be done within the port precinct (e.g., activities that require wharf access).
22. However, we are aware that the PMA defines the “relevant market” to mean the “market for access to leased port of Melbourne land by means of an applicable lease”, which is applied in the relevant clauses as follows:

*whether a port lessee or the port of Melbourne operator has power in the relevant market that it may exercise in relation to the process for the setting or reviewing of rents or associated payments ...*

*whether a port lessee or the port of Melbourne operator has exercised that power in a way that has the effect of causing material detriment to the long term interests of Victorian consumers (a **misuse of market power**);*

23. Clearly, when assessing whether PoM has “power” with respect to the setting of rents, the extent to which substitutes are available for on-port land should be considered.
24. In our view the PMA’s definition of “relevant market” appears intended to define the activity that is to be the subject of inquiry. However, a proper assessment of whether PoM has market power requires the economic market or markets to be determined as per the conventional approach to assessing market power.
25. Our preliminary review indicates that there is likely to be a material body of zoned industrial land available outside PoM (but within its proximity), which could potentially provide a viable alternative for many non-wharf access activities at the port.<sup>4</sup>
26. We also note that the land that may be the best substitute for port land will depend on the use in question, and may not be the land immediately close to the port precinct. The use of the port and surrounds is part of an integrated supply chain that ends up with products either delivered to wholesale/retail outlets or direct to customers, which involves multiple steps of transport. If products (whether they be containers or other forms of freight) are to be moved from the port area, the next best site for the relevant activity may be somewhere closer to the location of final customers so that cost savings occur in the subsequent transport legs.

## **2.2.2 Determining whether there is market power within the economic market**

27. Having established the dimensions of the economic market(s), a standard assessment of whether PoM has market power would involve a consideration of:
  - a. the structure of the market, which would require:
    - i. drawing on economic theory that links the outcomes from a market to degrees of market concentration
    - ii. looking at the extent of industrial land that could be considered as an appropriate substitute to different uses at the port, and
    - iii. considering the potential for new entry.
  - b. the conduct of the parties, which would require:
    - i. asking whether PoM’s behaviour is consistent with what would be expected in a (workably or effectively) competitive market

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<sup>4</sup> See, for example, Department of Environment, Land, Water and Planning, (2020), *Melbourne Industrial and Commercial Land Use Plan*, Map 2, p.23

- ii. what processes have been established to regulate the interactions between the port and its users, and
  - iii. how PoM has conducted itself during the process of negotiation could be a key issue
- c. the performance (or outcomes) of the market, which would include:
- i. trends in price, quality and other relevant outputs,<sup>5</sup> and,
  - ii. again asking whether the observed performance is consistent with what would be expected in a (workably or effectively) competitive market.

### 2.2.3 Importance of contracts for protecting against the appropriation of “sunk costs”

28. Contracts are an important market mechanism for dealing with situations where there are sunk costs associated with the building of long-lived assets or improvements on rented land:
- a. Competition exists when parties are seeking to create new premises, including when existing premises come to the end of their economic lives. At this stage, a choice between on-port and off-port land (and, indeed, potentially land at other ports) exists.
  - b. Once a party has negotiated terms, a long term agreement is entered into, which acts to protect the rights of the lessee during the period that it has no realistic opportunity to move locations. This protection – which is disciplined by the original competition – extends to all aspects of the lease agreement, including the market rent review clauses.
  - c. Thus, if competition existed at the time the lease was entered into, the effect of that competition in disciplining the terms and conditions of the lease would endure for the duration of the lease agreement.
29. We note that there is a large literature in regulatory economics directed to the capacity for long term contracts to protect parties in the presence of sunk costs. While quite a lot of that literature is focussed on the limitations of contracts, the leasing of land is the stereotypical example of the situation where long term contracts do work (i.e., where there is a capacity to contract for the life of the asset / improvement, and where reviews of price during the course of the contract are feasible).

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<sup>5</sup> Depending on the context, indicators like profitability, innovation and trends in quality may also be considered.

## 2.3 Exercise of market power

30. An inquiry into whether market power has been “exercised” by PoM should focus on the question of whether the outcomes observed in the market are different to what would be expected to be observed in a (workably or effectively) competitive market.
31. If PoM were judged to be “exercising market power” it would be necessary to show that rents are materially higher than the “reasonable market rent” taking account of any locational premium, and other aspects of the quality of the rental property. The Port Concession Deed (PCD) has a specific definition of “reasonable market rent” which takes into account the location of the land, which is important in the case of a port due to the presence of a “locational premium” that is also observed in proximity to airports,<sup>6</sup> railway stations<sup>7</sup> and other transport corridors, like freeways.<sup>8</sup> As a major conduit for the transportation of goods internationally, the market value of PoM land would be expected to contain a locational premium that must be distinguished from an exercise of market power. Moreover, the different areas of the port estate may contain materially different premia or discounts reflecting the inherent value of the land to users.
32. A second outcome that could result from the exercise of market power is that the quantity of land that is leased is reduced, which in turn causes investment by port users to be delayed or otherwise adversely affected. Whether this is the case will require a careful assessment of the facts. If PoM were to withhold capacity (land available for rental) this would have the effect of reducing PoM’s vacancy rate relative to the normal vacancy rate expected at a port.
33. In addition, when deciding whether PoM has exercised any market power that is found to exist, it will be necessary to consider the effectiveness of the mechanisms that are in place to mitigate the scope for market power to be exercised. We note that PoM has a detailed process for undertaking the process of setting and reviewing market rents, which contains mechanisms that – at first sight – should provide a constraint on PoM’s ability to exercise any market power that it may have. For example, as part of that process both the tenant and PoM will appoint their own expert valuers to provide opinions about the appropriate market rent for the land. If there is continued disagreement between PoM and the tenant, under the PCD a third valuer is appointed by the Australian Property Institute President, who must have regard to a number of factors including location and prioritised relevant market evidence.
34. In addition, most of PoM’s important tenants are very large businesses that are highly sophisticated and geographically diversified. They have extensive knowledge of rental markets throughout Australia and the world, and are skilled in negotiation. As a result,

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<sup>6</sup> Sivitanidou, Renata and Petros Sivitanidis (January, 1995), “Industrial Rent Differentials: The Case of Greater Los Angeles”, *Environment and Planning A: Economy and Space*, Volume 27, Issue 7, pp.1133-1146.

<sup>7</sup> See Debrezion, Ghebreegziabiher, Eric Peels and Piet Rietveld, (19 June, 2007), “The Impact of Railway Stations on Residential and Commercial Property Value: A Meta-analysis,” *Journal of Real Estate Finance and Economics*, Vol. 35, p.161, which found a 16.4 per cent price premium for commercial properties in railway station zones.

<sup>8</sup> Tchang, Gaston, (2016), “The impact of highway proximity on distribution centres’ rents,” *Urban Studies*, Volume 53, Number 13, pp.2834-2848.

PoM is likely to face a degree of countervailing power that offsets any market power that PoM is found to possess.

### **3. Is there potential for a “material detriment” to Victorian consumers?**

#### **3.1 Introduction**

35. In this section we investigate the questions of whether, to the extent that an exercise of market power by PoM resulted in excessive rents:
- a. there is any scope for any excessive rents, if they exist at all, to be passed on to Victorian consumers and producers? and
  - b. does the rental component of PoM’s revenues have the capacity to impose a material detriment to consumers through its impact on the final price of consumer goods in Victoria, or the farm gate price or factory door price of Victorian farmers and manufacturers respectively?
36. These issues are addressed in sections 3.2 and 3.3.
37. We also consider a further potential outcome of the exercise of market power, which is that there is an adverse impact on investment by port users, which then has a flow on effect to the reliability or breadth of supply of goods to Victorian consumers. This issue is discussed separately in section 3.4.

#### **3.2 Markets for final products are served by overlapping supply chains**

##### **3.2.1 Nature of competition in the transport task**

38. In the event that excessive rents were being applied by PoM, in order for there to be an impact on Victorian consumers, farmers or industrial exporters it would first be necessary to demonstrate that the port’s charges would be expected to be passed through to the final product prices.
39. The way that the modern logistics chains in Australia are structured means that it is highly unlikely that changes in PoM’s rents that are excessive (i.e., beyond a change that reflects the movement in reasonable market rents, which would flow through to the industry more generally) would be passed through to the prices to the final products consumed by Victorian consumers. This is because:
- a. competition in the transport of commodities takes place between alternative logistics chains
  - b. those logistics chains are structured based on minimising the total transport cost, including warehousing and related activities, and
  - c. in Australia, those chains overlap substantially, so that some products that are substitutes (in the eyes of the final consumer) may have entered via PoM, whereas others may have entered via another port, or been produced locally.

40. This first point – the nature of competition in transport – was noted by Young-Tae and Lee (2007):<sup>9</sup>

*Robinson (2002) suggests a new paradigm for examining port competitiveness in a changing environment. The new logistics-restructured environment requires us to look at ports as a segment of a whole supply chain rather than the port per se and therefore a new strategy and perspectives are needed. He suggests a new conceptual framework that incorporates the port as an element in value-added chain systems.*

41. “Chains compete, not individual ports,” they added.<sup>10</sup>

### 3.2.2 Trends in location of national distribution centres

42. There is vigorous competition between logistics / supply chains in Australia, with the location of National Distribution Centres (NDCs), driven by intense competitive pressures and efficiency concerns. An NDC is likely to supply the whole of Australia with goods in conjunction with Regional Distribution Centres (RDCs). Examples of this competitive framework are found in:

- a. Retailing – The decision by the Woolworths retail grocery chain to close an NDC in Melbourne and build a new single NDC at the Moorebank logistics hub in western Sydney means Victorian consumers will purchase the same goods sourced from Coles NDC in Somerton Victoria and sourced from Botany in NSW.<sup>11</sup>
- b. Automotive parts – DBA, a supplier of disc brakes has recently announced its decision to move its NDC from Silverwater in NSW to Truganina in Victoria, converting the Silverwater facility into an RDC.<sup>12</sup>

### 3.2.3 Evidence of overlapping logistics chains from road freight data

43. While 90 per cent of import containers are transported to NDCs, RDCs and warehouses within 40 kilometres of major container ports for unpacking, storage and / or re-packing of their contents, the re-packed goods are sent much further afield by way of road transport.<sup>13</sup> As can be seen in Figure 1 below:

- a. PoM is part of logistics / supply chains that extend to Adelaide, Tasmania, Sydney and regional New South Wales,<sup>14</sup> and,

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<sup>9</sup> Young-Tae Chang and Paul T.W. Lee, (June, 2007), “Overview of interport competition: Issues and methods,” *Journal of International Logistics and Trade*, Volume 5, Number 1, pp.99-121, at p.106 referencing Robinson, R., (2002), “Ports as elements in value-driven chain systems: The new paradigm”, *Maritime Policy and Management*, Volume 29, Number 3, pp.241-255.

<sup>10</sup> Young-Tae Chang and Paul T.W. Lee, (June, 2007), p.114.

<sup>11</sup> [www.woolworthsgroup.com.au](http://www.woolworthsgroup.com.au) “Woolworths Group starts build of next generation supply chain hub at Moorebank”

<sup>12</sup> [www.aftermarket.com.au](http://www.aftermarket.com.au) “DBA Opens New National & Global Distribution Centre | Disc Brakes Australia”

<sup>13</sup> BITRE (2021), *Regional port catchments for road freight*, Information Sheet No.107, pp.3 and 6.

<sup>14</sup> PoM also attracts a proportion of export containers from these regions, and particularly from the southern agricultural regions of New South Wales.

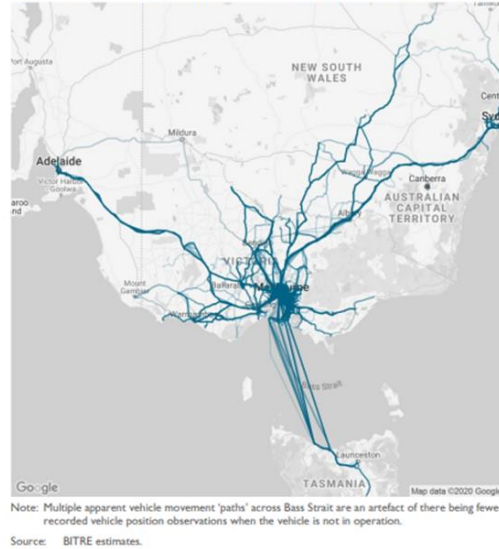
- b. Port Botany is part of logistics / supply chains that extend to Melbourne, Adelaide, Brisbane and regional areas in New South Wales and Queensland.

**Figure 1: Outbound freight vehicle movements for Port of Melbourne and Port Botany catchment areas**

Figure 2 – Port Botany outbound freight vehicle movement catchment areas



Figure 5 – Port of Melbourne outbound freight vehicle movement catchment areas



Source: BITRE (2021)<sup>15</sup>

### 3.2.4 Overlapping of supply chains occurs because location decisions for national distribution centres are finely balanced

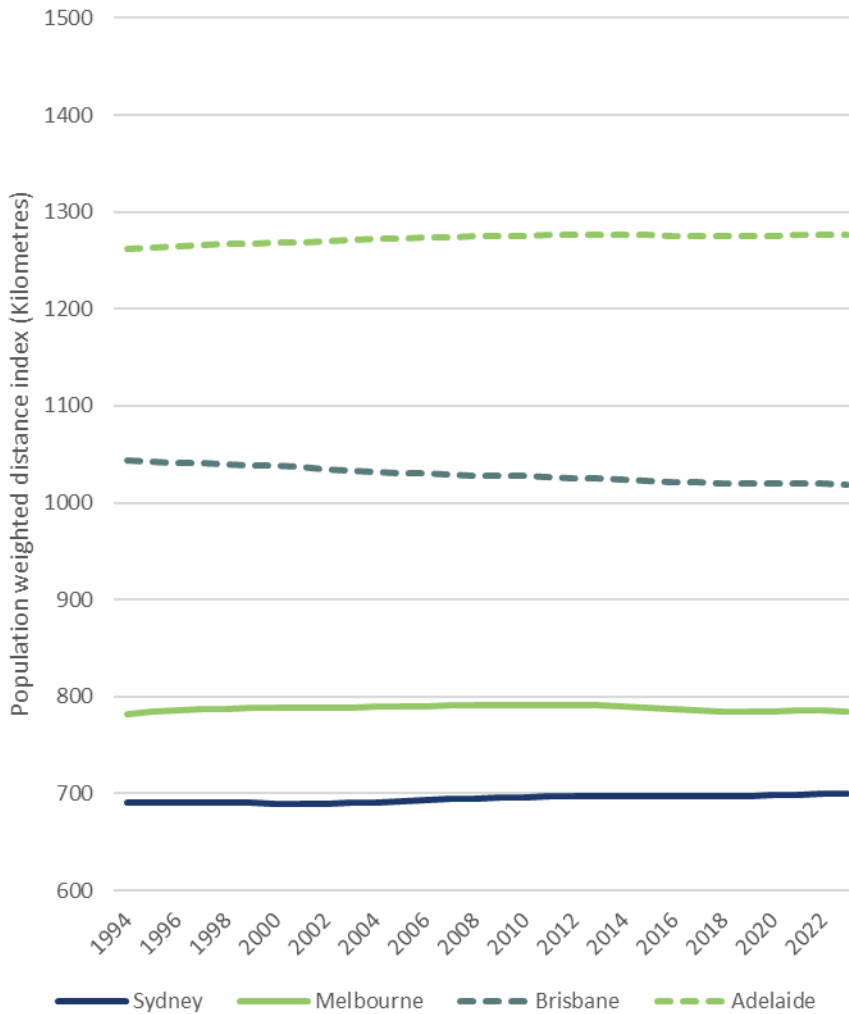
- 44. For imported goods, a fundamental determinant of the competitive advantage of supply chains that include ports is the size of the population in the port's immediate hinterland, and how close it is to other major concentrations of population that might be more efficiently served by a single NDC (like the Woolworths one in Sydney). Figure 2 shows the relativities and temporal development of the distance (in kilometres) to all of Australia's major state and territory population centres.<sup>16</sup>

<sup>15</sup> BITRE (2021), pp.3 and 6.

<sup>16</sup> That is, the weighted average distance of each city's port to its own population base (proxied by the population of the state, but assumed to lie at the logistical hub in each case) and each of the other major population centres in Australia. Perth and Western Australia are excluded owing to the relative remoteness and distance of Perth from other major ports, resulting in a high degree of self-sufficiency. The lower the number the closer the port in each case lies relative to Australia's east coast population base.



Figure 2: Weighted population index centred on ports, 1994 to 2023



Source: ABS and Incenta analysis

45. On this index Port Botany (Sydney) has a locational advantage over PoM, with an index distance of 691 kilometres in 1994 rising marginally to 699 kilometres by 2023 (i.e. the centre of gravity of Australia’s population moving slowly away from it) compared with PoM’s 782 kilometres rising to 785 kilometres over the same period.<sup>17</sup> The main implication of the figure is that in terms of the location of NDCs, which will ultimately direct container traffic, the closest competitors are PoM and Port Botany.
46. In making locational decisions between Sydney and Melbourne, supply chain participants would likely weigh the greater proximity of Sydney to major population centres against the lower industrial rentals in Melbourne. Sydney’s industrial rents are often materially higher than in Melbourne.

<sup>17</sup> In constructing this index we have excluded Perth and Western Australia given the distance from the main east coast centres of population, for the reasons set out in footnote 16 above.

### 3.2.5 Conclusion

47. What the factors discussed above show is that downstream markets and the logistics / supply chains that link Australian markets are highly competitive, and as such are striving for lower costs and efficiency. Through overlapping supply chains the consumer goods that are distributed throughout Victoria and sourced from PoM are subject to competition from goods sourced from ports located in Sydney, Adelaide and Brisbane. Thus, even if it possessed a degree of market power with respect to its land rental business, there is unlikely to be scope for any “excessive rental” to be passed through to Victorian consumers. To the extent that a member of the supply chain that uses the Port of Melbourne sought to pass through excessive increases in port rents into product prices, final customers may simply switch to substitute goods that have not passed through the Port of Melbourne (and whose prices would therefore not incorporate the excessive rent increase), with the effect that the party seeking the price increase would lose sales.

### 3.3 Even if there was a pass-through of rent that exceeds “reasonable market rent” it would be immaterial to final consumers in Victoria

48. In this section we show that rents levied by PoM would not constitute a “material detriment” to final consumers in Victoria. We first ask what might constitute a “material detriment” to consumers, and then empirically estimate what scope there is for such a detriment to arise from land rentals levied by PoM.

#### 3.3.1 The meaning of “material detriment”

49. In the event that the ESC believes that PoM possesses market power, under section 53(1)(a)(ii) of the Port Management Act the Commission is required to consider:

*whether a port lessee or the port of Melbourne operator has exercised that power in a way that has the effect of causing material detriment to the long term interests of Victorian consumers (a misuse of market power).*

50. In our view the “prices” that affect the long-term interests of Victorian consumers are the prices they pay for the imported goods that pass through PoM, or pass through other ports and are presented for sale in Victoria. Materiality is not something that is discussed in the economics literature, although one would expect that materiality would be needed to at least reach the level that it would be noticeable by the final consumer.<sup>18</sup>

#### 3.3.2 Empirical test for “material detriment”

51. The focus of our empirical test is to estimate the proportion of the total price paid by Victorian consumers for goods imported via PoM that is attributable to the PoM land rent

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<sup>18</sup> The accounting literature traditionally applied a benchmark for materiality of 5 per cent or 10 per cent, although more recently accounting bodies have avoided a prescriptive approach in favour of guidance and principles to assist judgements on whether “the primary users could reasonably be expected to be influenced by the information when making decisions...” taking account of relative sizes (see, for example, Australian Accounting Standards Board (December, 2017), Making Materiality Judgements, AASB Practice Statement). This would imply a higher value than one that is simply noticeable.

component of that price. Having estimated that value in percentage of final price terms we then calculate what proportion it might be of the final price to Victorian consumers, in the event that different proportions of land rent (taking examples of 10% and 50%) were found to be “excessive”.

52. To determine the total value of import containers (TEUs), we derived data from the following sources:
- a. Contents of an import container – This value was sourced from a 2020 estimate made by BIS Oxford Economics that was applied by PoM, and was escalated by the CPI.<sup>19</sup>
  - b. Australia landside, container terminal, port charges and services to ships – These costs were sourced from a study by Synergies based on analysis of BITRE’s *Waterline* series over several discrete periods: Pre-COVID (April 2020), COVID Peak (January 2022), Post-COVID Normalisation (July 2023), and Gaza Crisis (January 2024).<sup>20</sup>
  - c. Blue water costs – These costs were sourced from Synergies, which based its estimates on Shanghai Shipping Exchange publications.
  - d. China port and land costs – These costs were sourced from Synergies.
  - e. PoM rental per TEU – PoM provided these fees.
53. Our estimates of the components of the costs per TEU that comprise the final price paid by consumers for goods in Victoria is shown in Appendix A. This calculation shows that PoM’s *total* rental charges as a proportion of those final prices is one twenty-fourth of 1 per cent. Accordingly:
- a. if 50 per cent of the rental charges were considered excessive and fully passed through to Victorian consumers, the proportion of this of final prices would be one forty eighth of 1 per cent, and
  - b. if 10 per cent of rental charges were considered excessive and fully passed through to Victorian consumers, the proportion of this of final prices would be one two-hundred and fortieth of 1 per cent.
54. Our conclusion is that whatever assumption were to be made about the scale and extent of pass-through of potential “excessive rentals”, they would constitute a trivial proportion of final consumer prices, and could therefore not be considered a “material detriment to Victorian consumers”.

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<sup>19</sup> We expect that this is likely to provide an under-estimate of the increase in the price of imported through the Covid19 pandemic and subsequent period.

<sup>20</sup> Synergies Economic Consulting (July, 2024), *Analysis of international import supply chain costs*, Report to Ports Australia.

### **3.4 Potential adverse effect on port user investment**

55. A second detriment that could occur is that PoM may have exercised its market power in a manner that adversely affected investment by port users, which may in turn affect the reliability or breadth of supply of products to Victorian consumers.
56. However, even assuming that an adverse effect on port user investment were established – which is a factual question – the presence of overlapping supply chains noted above would be expected to mitigate the effect felt by Victorian consumers, which would need to be considered when assessing detriment. That is, only PoM and supply chains that it is a component of could be affected, not goods that are brought in by alternative supply chains.