
The Shipping Policy of the European Union¹

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INTRODUCTION

Over the last decennia, shipping has gradually been included as an important asset in the economic policy and law making of the European Union and of Member States. This was overdue since transport, and particularly shipping, is a key factor in economic life and a fundamental element in international trade relations. It would be worth mentioning here that the EU is the biggest trading area in the world accounting for more than 20% of world trade. Ninety per cent of the Community's external trade, and about 30% of the intra-community one, is carried by sea. Finally, 40% of Europe's external trade is carried by vessels of European ownership and/or control. The European shipping industry has invested 80 billion US dollars in mobile assets, while, in 1994, the industry's turnover was estimated at 50 billion US dollars.

Notwithstanding this, European shipping faces two main threats to its future survival: protectionist policies by third countries and high costs of operation that have resulted in reduced market shares and accelerated flagging-out. Thus, from 9,742 ships of 110 million GRT in 1985 (27.7% of world tonnage), the EU-flag fleet (including Norway) numbered, in 1996, only 6,902 ships of 82 million GT (17.6% of world tonnage). According to studies carried out for the European Commission, the operational costs of a Community registered vessel could be reduced by 3.5 to 22% in the case of a containership and by 15 to 44% for a bulk carrier, by flagging out. These developments can also be ascertained by looking at the relevant maritime employment statistics of Figure 2: The number of EU seafarers under national flag has declined from its 1983 level of 235,146 to 138,341 in 1995.² In the same period, the number of non-EU seafarers employed on board European flag vessels has increased from 31,867 to 53,388.³ It is estimated that 51% of this reduction in EU seafaring employment is the result of flagging-out. An additional 27% can be attributed to the loss of market share in general, and the remainder to reduced manning levels and increased productivity.

The grim prospects of European shipping in its present operating environment, and the European citizens' increased awareness of the importance of being able to rely on a safe, modern and

¹Despite the ambitiousness of its title, this paper does not address a number of important issues, such as liner shipping consortia, shipbuilding and port policies and other areas in which the EU has produced substantial work. The paper is written in the context of the author's involvement in the deliberations of EU Commissioner Neil Kinnock's *Core Group on Maritime Transport* that culminated in the Commission Communication *Towards a New Maritime Strategy*, COM(96) 81 final 13-3-96. Sincere thanks are expressed to Wolfgang Elsner, Head of the Maritime Transport Policy Unit of the European Commission for his constructive comments. Views expressed herewith by no means commit the European Commission and are those of the author only.

²Including Norway

³European Community Shipowners' Associations, Annual Report 1995-1996

efficient ocean transport system (including its economic and military security implications) to serve their trading requirements are constantly feeding the debate as to the need for concerted action at European level.

However, care should be taken with the often used argument that Europe needs a shipping industry to serve its trading requirements. To third countries, this argument can be perceived as protectionist, given that Europe's trading requirements ought to be served by the most efficient means of transport and this does not necessarily have to be of European ownership. European shippers would also be inclined to use the same argument, as they have no commitment, obligation or incentive to use European ships, unless the latter are efficiently serving their particular trading requirements.

Industrial policy and international trade considerations should thus constitute the basic platform from which a consistent shipping policy is designed and promoted. In such a context, "consistency" means that the envisaged policy -having taken into account the intrinsic characteristics of the shipping industry- should be able to provide plausible answers to questions regarding oligopolistic markets, limit pricing, collusion, predation, determination of market shares, barriers to entry, dominant firms, market power and concentration, mergers, co-operative R&D, vertical/horizontal integration, market performance and similar issues that permeate discussions on industrial policy.

Finally, any envisaged independent shipping policy should not fail to take into account the fact that the European shipping industry is relatively too small, compared to other industrial sectors, to be able to claim for itself radical policy measures or reforms that might set a precedent endangering the conventional wisdom of Europe's industrial policy.

POSITIVE MEASURES

The term "positive measures" is often meant to encompass all concerted action within an assistance programme, at governmental or European level, predominantly focused on the fiscal treatment and employment issues of shipping, aimed at equalising operating conditions of European shipping to those prevailing in competing third countries. As such, "positive measures" constitute an inward-looking policy *vis a vis* the Community's outward-looking efforts for further liberalisation of trade in shipping services on a global basis.

In an era of squeezed government spending and of "reinventing government", a first test of the plausibility of any "positive measure" would be its "self-sustainability", i.e., whether or not the tax revenues collected on the economic activities stimulated by support to the industry outweigh the direct and indirect outlays incurred by the government to establish, operate and manage the support programme.

Furthermore, the costs of any contemplated "positive measures" should be weighed against the benefits such measures are expected to have on the future growth of merchant shipping, the repatriation of flagged-out vessels and in turn on employment, household earnings from employment (and their knock-on effects), tax and foreign exchange revenues.

In addition, the links between shipping and its related activities, such as shipbuilding, shipbroking, insurance, banking, etc., should be established in a structural way that would allow the calculation of the impact of the positive measures on employment, income, tax revenues and foreign exchange from these shipping-related economic activities.

Finally, the evaluation of any "positive measures" should be contemplated on an *opportunity cost*

basis, i.e., what would be the net benefit to society if the resources made available for the implementation of the “positive measures” were instead channelled to other sectors of the economy, according to national priorities.

One of the major problems accounting for European shipping’s often proclaimed limited competitiveness is to be found in its wage differentials with third countries. In the United States, operating cost differentials have been tackled with by a combination of two measures: i) a cargo preference scheme for government-impelled cargoes carried by US-flag ships and constituting a set-aside cargo basis aimed at ensuring a minimum ship space utilisation, and ii) an Operating Differential Subsidy Scheme (ODS) aimed at equalising certain ship operating costs (mainly manning) to those pertaining in third countries, and in this way levelling the international playing field. Within this framework, US-flag shipowners pay virtually no corporate taxes (as their gross income before the ODS is negative over a number of years), and seafarers pay an average of 12 per cent income tax.

In a recent effort to measure the impact of federal support for the private merchant marine in the United States⁴, it was found that for each job in the maritime sector an additional 5.4 jobs were created in the economy, mainly in maritime related industries, and for each dollar of household income generated by the merchant marine 4.6 dollars of additional income was created in the economy.

The same study concluded that in the absence of the above assistance programme to the industry, the US-flag shipping would have disappeared (registered possibly under foreign flags), foreign crews would have substituted US seafarers, US shipping revenues would have declined, and foreign operators would have substituted foreign produced goods and services for some of the US produced goods and services that were consumed by the US-flag merchant marine.

The Union is well aware of the cost disparities between member States’ shipowners and those of third countries, and the resulting loss in competitiveness. In an attempt to readdress this problem, the Commission is currently revising its 1989 state aid guidelines⁵ on shipping which may also include a revision of the cost-gap method and a new approach towards an aid practice benefiting Community shipowners, however the latter may be defined.

STATE AIDS TO SHIPPING

In general, state aids tend to discriminate against the most efficient producers and thus threaten European integration. A good example of this was the steel industry of the early 1980s. The Davignon plan (providing for production quotas and minimum prices) discriminated against the more efficient German producers who would only consent to a restriction in cheap third country steel imports under the condition that their European partners would phase out their subsidies.

State aids to industry are thus in principle prohibited by the Treaty (article 92(1)) with the exemptions provided for in 92(2) and 92(3) which give the Commission the power to declare certain categories of aid as compatible with the common market. In general, this is the case when aid is intended to facilitate the development of certain economic activities (or regions), while it does not adversely affect trading conditions to an extent contrary to the common interest. In an attempt to define “common interest” in the case of shipping, the Commission considers that a

⁴see Nathan Associates Inc. (1995) *Economic Analysis of Federal Support for the Private Merchant Marine*. Submitted to the American Maritime Congress, January 1995.

⁵SEC(89) 921 final

strong Community fleet is essential both for economic and strategic reasons.⁶ As the leading world trading entity, the Community should not be excessively dependent on third country fleets for its imports and exports, thus losing control and influence on the price and quality of transport to and from its territory.

State Aid granted to shipping companies can take the form of:

- ◇ direct subsidies for vessel operation;
- ◇ total or partial cover of financial losses;
- ◇ loan guarantees for the purchase of capital goods;
- ◇ tax relief on earnings arising from maritime activities and on seafarer's income;
- ◇ reduced rates of contribution for the social protection of seamen;
- ◇ capital contributions on terms which would be unacceptable for a private investor operating in normal market economy conditions.

For example in November 1996, and in accordance with its strategy to encourage EU ships fly European flags -and thus preserve competitiveness and safeguard maritime employment and know-how-, the Commission approved as compatible with the Treaty German aid schemes for ship operating companies, aimed at equalising manning cost differences between German-flag ships and those plying under flags of convenience. The subsidy amounts roughly to DM 200,000 per ship and a small part of it is earmarked for the training of seafarers.

However, the Commission is not particularly fond of state aid programmes and at any rate their desirability and compatibility with EU law will always be scrutinised depending on the situation of the Community fleet and in view of the fact that measures taken by individual Member States, in order to improve the situation of their fleet, may produce adverse effects on competition between Member States' fleets. It should also be kept in mind that state aids to shipping are relatively easy for Member States with small merchant marines and substantial budgetary resources, but rather awkward in Member States with a large fleet and seagoing labour, but inadequate economic means that have to be allocated in a number of other pressing national development requirements.

Notwithstanding this, and given the positive opinion of both the European Parliament and the Economic and Social Committee, state aid measures *can* be approved by the Commission, but they have to be introduced within a general framework aimed at minimising the distortive effects of such an intervention. In addition, this type of assistance to shipping should be clearly distinguished from that to shipbuilding, and must be transparent, well documented, adequately justified, but also temporary and if possible on a declining scale. Finally, state aid to shipping must not specifically contribute to increasing or maintaining capacity in sectors with manifest overcapacity.

The issue of "transparency" of state aid measures is of great importance in the law-making of the EU. For example, in September 1996, the Irish Presidency introduced a discussion paper on "*State Aid Control*". The paper suggests more transparency, improvement of the legal rules and a general promotion of a reduction in the levels of state aid. The issue of transparency has recently been amply exemplified in the Commission investigation of the Bremer Vulkan case where shipbuilding aid, intended for the restructuring of the eastern German yards *MTW-Schiffswerft* and *Volkswerft*, was diverted to subsidiaries of the BV Group, including DSR-Senator Lines.

It is perhaps worth mentioning at this point the work that has been carried out over the past few years by OECD. The aim of the Organisation's *Maritime Transport Committee* is to increase the

⁶it is interesting to remember, however, that during the times of the disappearance of the European textile industry, manufacturers also invoked "strategic" arguments, as they were producing uniforms for the army!

transparency of measures affording financial/fiscal state aid to shipping, in an effort to eventually reduce/eliminate the trade-distorting and discriminating effects of such practices.

In the context of OECD's June 1992 Agreement on "*Treatment of Financial and Fiscal Support Measures for International Shipping Provided by Member Countries*", the Organisation has compiled a comprehensive inventory of support measures existing in Member Countries. The "problem areas" are identified through a "complaints procedure" by which Member Countries are encouraged to report practices of other Member Countries perceived to be discriminatory and distorting competition. One of the benefits of such an approach is the increased transparency achieved by obliging the allegedly offending Member Country to justify the reasoning behind the introduction of the support measure.

FLAGGING-OUT

Over the past 15 years, the merchant tonnage registered in open registry countries has increased substantially, currently representing more than 40% of world tonnage. In the same period, OECD registered tonnage has declined from 50% of world tonnage in the beginning of the 1980s to 30% ten years later. These developments can also be observed in Figure 1. Given the relative stability of market shares in other national groups, it can be deduced from this figure that most of the gains in open registry tonnage are mainly the result of OECD flagging-out.

Flagging-out is an operational decision of certain shipowners aimed at streamlining operating costs and other conditions to those prevailing in competing third countries. As such, flagging-out cannot be condemned *ipso facto*, particularly if the countries offering open registry facilities comply adequately with international regulations concerning safety and the protection of the marine environment. In this sense, a Dutch-owned ship registered in the Dutch Antilles and employing Filipino crew is not much different than Philips manufacturing in Singapore, assembling in Malaysia and distributing to the international market from Ireland. Both companies aim to take advantage of the opportunities afforded by the ever-present globalisation of all forms of economic activity, combining in an optimal way factors of production to achieve a competitive advantage.

It is evident, however, that flagging-out affects adversely the EU economies by reducing employment, fiscal revenues, know-how and the knock-on effects on shipping-related activities. This is the more so in cases where the flagging-out of ships is accompanied by the relocation of management activities.

Although the Commission has, on occasion, been quite justifiably reluctant to draw the link between flag and quality of shipping services, from the relevant statistics it appears that the heaviest casualty record is to be found among open registries. According to LMIS⁷ statistics on world-wide casualty analysis for 1993, the 15 flags with the largest number of casualties world-wide accounted for 61% of the total. Among those, the Panamanian flag had 158 casualties (11% of total), followed by the Liberian one with 6% of all casualties.

Metaxas⁸ was among the first to note that although low short-term freight rates -as a result of FOCs facilitating the registration of inexpensive tonnage under their flag- are definitely to the benefit of the shipper⁹, long-run social costs are rising and this is a worrying phenomenon.

⁷Lloyd's Maritime Information Services

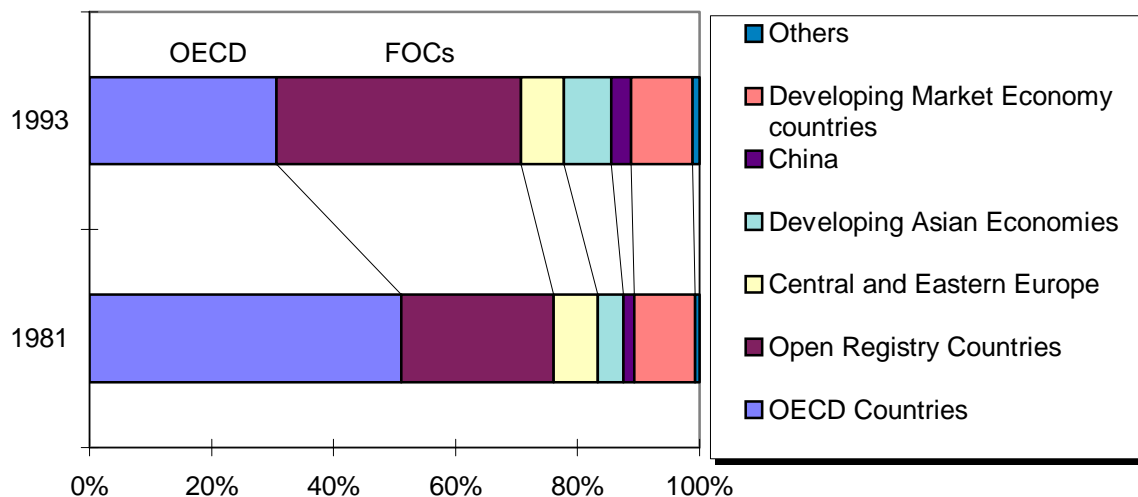
⁸B.N. Metaxas (1986) *Flags of Convenience*, Gower, p.52 ff.

⁹not necessarily the final consumer

However, the poor casualty record of these registries ought to be explained not so much by the existence of a high percentage of substandard tonnage among their fleets, but by the many times equally poor management performance of the beneficial owners and their staff and crews.

The point that is made here is that safety and environmental awareness cannot be imposed on people by regulations only -which tend to be circumvented- but they are rather developed through a long process involving education and more importantly the existence of an operating business environment that unquestionably attributes higher societal values to a cleaner and safer environment. In this light, the reflagging of ships and management back to European registers, apart from the narrow economic benefits this would entail, would have some wider social benefits too.

Figure 1: Tonnage Shares of National Groups



Source: OECD Maritime Transport 1993

The Commission together with a number of OECD and many other developing countries have been viewing the phenomenon of open/dual registries with considerable scepticism if not with disdain. In addition to some well founded concerns regarding the laxity of the safety/environmental/operational and other rules and regulations pertaining under such regimes, considerable discussion has also been focused on the assertion that flagging-out distorts competition between EU shipowners and, on the other side, frustrates the plans of developing countries to promote their own shipping industries.

However, seen from a different perspective, flagging-out aims at restoring a level playing field by equalising the operating conditions of EU shipowners with those prevailing in competing third countries. On the other hand, the fact that despite the sometimes substantial economic benefits of flagging-out a number of European shipowners have opted to remain under their national registers means that, at least for them, the economic/non-economic benefits of doing so outweigh those of flagging-out, at least in certain specific areas of shipping. In this light, the argument of “distortions to competition” cannot hold much water, particularly when it is acknowledged that the

establishment of a level playing field internationally with third country competitors is by far more important.

The main objective of Europe's shipping policy, with regard to flagging-out, should be to entice European shipowners to fly the flag of a Member State, to the extent possible, or at least to conduct their management activities from within a Member State. The latter option might be even more important as it has been shown that the greatest part of the value-added generated by shipping and related functions originates from shore-based activities.

The policy direction in this regard is rather straightforward: Member States, in co-operation with the Commission, should evaluate the long-term economic and social costs of flagging-out (including its effect on freight rates, consumer welfare, safety and the environment) and weigh them against the cost of the minimum meaningful positive measures necessary to entice European shipowners back to their national registers. If the former costs exceed the latter, Member States and the Commission should strive to design the minimum necessary package of positive measures (preferably on the basis of existing experience in some Member States) aimed at equalising operating conditions.

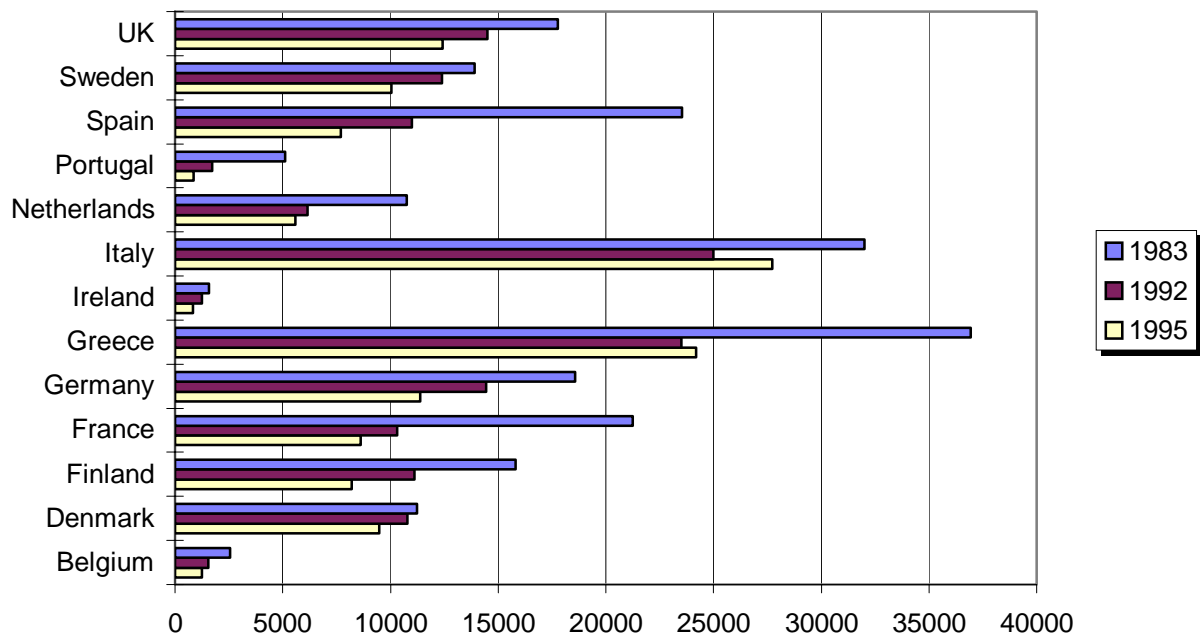
In this framework, important questions deserving a quantifiable answer might include: i) to what extent flagging-out reduces employment in sea/shore activities? ii) to what extent flagging-out reduces the consumption of European intermediate goods and services necessary for the production of shipping services?

MARITIME EMPLOYMENT AND TRAINING

Figure 2 amply demonstrates the rapidly declining employment figures in the European shipping industry during the past few years. The subsequent effects of this trend on the preservation of the necessary maritime know-how, the safe operation of ships and R&D have given considerable cause for concern among market participants, governments and the Commission.¹⁰ This situation has often called for "positive measures" in order to reverse this trend.

¹⁰see also BIMCO/ISF: 1995 Manpower Update, *The World-wide Demand for and Supply of Seafarers*.

Figure 2: Seafarers on Board EU Flag Vessels



Source: European Community Shipowners' Associations. Annual Report 1995-1996

It has often been argued that, from a cost-benefit analysis point of view, the creation of employment is not a social benefit *per se*, but only the goods and services that this employment produces (and society is willing to pay for), plus the value that society attributes to the preservation of the necessary know-how. Notwithstanding this, however, it could be equally well argued that, with more than 20 million people unemployed in Europe, enhancing the possibilities of creating additional sectoral employment must have a value to society in its own right, particularly if one takes into account the social costs concurrent with unemployment, too well known to be mentioned here.

Despite its positive and measurable impacts, the creation of employment cannot be a strong argument for maintaining and promoting international ocean transport. This is due not only to the, nowadays, relative unattractiveness of the seafaring profession (often leading to considerable wastage rates and thus reduced willingness of shipowners to train cadets on board), but mainly due to the fact that shipping is a capital-intensive industry whose Labour/Capital ratio compares rather unfavourably to that of other industries. This disadvantage is compounded by the increase in size and automation of modern ships that significantly reduce labour requirements.

For example, in 1960, the Labour/Capital ratio of the Greek bulk shipping industry was 2.8 men per 1000 GRT while presently this ratio does not exceed the value of one. In liner shipping, this effect is even more pronounced: In 1968, a first generation container vessel of 740 TEUs was employing ten licensed officers and 24 ratings while in 1992, a fourth generation container vessel of 4400 TEUs was employing only seven multipurpose officers and seven qualified ratings.

However, there are good reasons to believe that most EU Member States attribute a high societal value to the preservation of Europe's maritime know-how. In a recent study undertaken by the University of Wales -on behalf of the UK Department of Transport, the Chamber of Shipping and

the Marine Society- it was found that, in the UK alone, there are approximately 17,000 shore-based jobs which employers would prefer to fill with ex-seafarers. For 70% of these, seafaring experience was considered essential.¹¹ Apart from the shipping companies themselves, shore-based activities requiring seafaring experience include shipbuilding, chartering and shipbroking, banking and finance, marine insurance, ports, dredging companies, shipping agencies, equipment suppliers, P&I Clubs, Classification Societies, etc.

In this context, the importance of a much wider vocational education for seafarers, preparing them for the shore activities that they in all likelihood will be involved in after their usually short sea-going career, could not be overemphasised. As mentioned above, shore-based activities are to a significant extent undertaken by ex-seafarers and, therefore, a shortage of the latter can have detrimental effects on safety, the efficient management of shipping companies and the preservation of the necessary shipping know-how.

This type of education could be jointly funded by shipowners, government and possibly by Community resources¹², and, apart from being self-fulfilling for the seafarer, it should contribute in making the seafaring career more attractive. Furthermore, the level of education and training facilities should be upgraded and education/research programmes co-ordinated among Member States. This would make the transferability of sea-going labour between Member States easier and it would tend to even out disparities in remuneration and thus in the cost structures of European shipowners. The curriculum should comprise subjects such as maritime economics, law, logistics and multimodal transport arrangements, port operations and economics, and in general subjects pertinent to the efficient management of a modern shipping company.

The Commission has recently initiated a research programme under the name METHAR, aiming, among others, to the harmonisation of maritime education and training systems in Europe and to the adaptation of educational programmes to the needs of the industry. The results of this study are intended to be used as guidelines for the possible development of positive measures with regard to seafaring training.

SHORT SEA SHIPPING

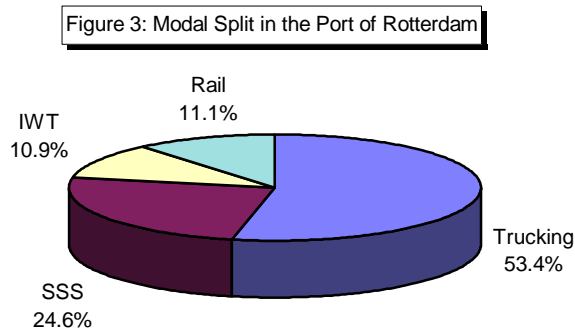
The continuation and further enhancement of European shipping know-how and related “hard” and “soft” infrastructure can be achieved by the effective promotion of short sea shipping and the meaningful inclusion of this transport mode in trans-european transport networks. Such a policy has been advocated both in the *White Book* on transport, the *Fifth Action Programme* and the *Green Paper* on environment, mainly as a result of the unsustainable situation with regard to road transport.

So far, modal split in Europe has been heavily biased towards road transport and this trend seems to be increasing even for longer distances where rail transport should have a better role to play. Figure 3 presents the transshipment modal split at the port of Rotterdam where, as can be seen, road transport represents 53.4 % of total transshipment flows. Similar experiences are witnessed in other west European ports. For the Union in general, the share of road freight transport in total inland

⁵see Gardner, B.M. and S.J. Pettit (1996) *A Study of the UK Economy's Requirements for People with Experience of Working at Sea*. University of Wales, Cardiff. A similar project is currently going on at the Dutch Ministry of Transport -Directorate General for Shipping and Maritime Affairs- with an aim to identify future demand-supply imbalances and the requirements on Holland's maritime education system; generally acknowledged as one of the most advanced in the world.

¹²such as the European Social Fund and the LEONARDO Programme

transport has increased from 50% in 1975 to 70% in 1995. The European Commission estimates that, with the completion of the internal market and the enlargement of the Union, traffic volumes will probably double by the year 2020.



Source: Erasmus University Rotterdam

The heavy demand on road use, compounded by the underpriced, fixed-cost-based, supply of road infrastructure, and the increasing unwillingness of many governments to invest in new road capacity (0.8% of Community GDP in 1995, compared to 1.5% twenty years ago) create a number of significant problems, particularly with regard to congestion, safety and environment. Some illustrative figures, often quoted by the EC, could further highlight this point. Thus:

- The death toll in road transport amounts to 55,000 people per year (1.5 million injured);
- Every day, 4,000 km of Community motorway are totally congested;
- Yearly congestion costs amount to 120 billion ECU, or 2% of Community GDP;
- The external costs of accidents, air¹³ and noise pollution have escalated to 130 billion ECU/year;
- In total, transport externalities represent roughly 4% of Community GDP.

Externalities such as these, however, are rarely internalised in the pricing of road infrastructure, the more so when the latter has lost most of its “public interest” character and is increasingly becoming a private consumption good. Thus, the anticipated emphasis towards a “variable cost” approach in the pricing of road use (user pays principle) by many European governments¹⁴, is expected to make competition among transport systems fairer and more efficient. This situation could then indeed enhance the competitive advantage of short sea shipping.

Short sea shipping is considered to be:

- the most economic mode in terms of consumption of energy per ton/km;
- the most appropriate mode to serve the peripheral areas of Europe, particularly in the north and south, but also in areas such as Ireland, the Baltic and the Black seas. Moreover, Europe possesses about 35,000 kilometres of coast line with an abundance of over 600 ports situated near to industrial centres;
- the mode with the least requirements for infrastructure investment;

¹³Excluding global warming

¹⁴already emphasized in the Commission’s green paper “Towards a Fair and Efficient Pricing in Transport”

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- the environmental friendly mode *par excellence*;
 - the type of shipping most likely to stimulate the European shipbuilding industry;
 - the type of shipping with the most favourable labour/capital ratio and thus impact on employment (both at sea and on shore). In other words, the employment created by one dwt investment in short sea shipping is significantly higher than that of ocean shipping.

Having said that, however, there are a number of outstanding issues that tend to reduce the economic attractiveness of this mode of transport and on which the Commission should further focus its action. Namely,

- As a result of the very nature of its operations (short distances), the proportion of terminal costs (mainly the cost of ship's time at port) in the total cost of operation in short sea shipping is relatively high. It has been estimated that short sea ships spend more than half of their time at ports;
- The above shortcoming is compounded by the lack of required infrastructure, in some Member States, for efficient and expedient interconnections with the hinterland, bureaucratic administrative procedures at ports, and restrictive labour practices;
- By the very nature of its operations, short sea shipping is less adaptable to door-to-door requirements and new logistical developments;
- Cargo-handling, warehousing and other port charges are priced comparatively highly, particularly in some south European ports;
- The inadequate information/advertising and lack of reliable statistics do not help shippers evaluate the alternatives that this mode of transport offers them.

SAFETY AND ENVIRONMENT

The most appropriate way to improve safety at sea and the protection of the marine environment is through action on an international basis, given that the "playing field" of shipping is international *par excellence*. Regional measures can only distort the overall picture of international safety at sea and in some cases they may result in retaliatory measures with self-evident negative commercial consequences. This is the more so when regional/unilateral measures to safety and pollution can be seen by third countries as hidden barriers to entry rather than what they actually are. Something like this entails the danger of breaching GATT principles of non-discrimination, Market Access and National Treatment and it can induce retaliatory action that can compromise progress towards further liberalisation in goods and services, some of which perhaps more important than shipping.

In recent years, the work of the EU in the area of maritime safety and the protection of the marine environment has been significant. A major objective of this work has been the convergent implementation and uniform enforcement of international rules and regulations¹⁵, and might include in exceptional cases carefully selected non-binding regulations of IMO which will be made compulsory through EC legislation. Although such action will remain the exception rather than the rule, the Commission firmly believes that these binding requirements should be enforced on *all* ships indiscriminately when trading to and from EU ports, and that third country ships should not receive a more favourable treatment than the EU-flagged ones.¹⁶

¹⁵see for example the Commission Communication on *A Common Policy on Safe Seas*, COM(93)66 final, 24.02.93.

¹⁶see COM(96) 81 final, *op. cit.* p.2.

However controversial, this matter is of great concern to many. At a national -or sometimes even regional- level, the enforcement of laws and regulations is relatively effective: if the factory chimney pollutes, the police arrives and penalties can be quite hefty. At an international level, however, regulations are cumbersome to design, easy to circumvent and extremely difficult to police. To quote William O'Neil, Secretary General of IMO,

*...over the last three and a half decades, IMO has adopted several shelves full of rules and regulations. They have certainly helped to improve the situation, but regulations are only effective if they are put in practice and are enforced. There is no doubt that many IMO Conventions and other standards are not implemented as rigorously as they should be. Before adopting still more regulations we should therefore concentrate on assuring that the ones that already exist are in fact applied to all ships throughout the world...*¹⁷

Furthermore, if international regulations are not enforced uniformly, they can result in distortions to competition. Suffice it to say, as an example, that, according to recent OECD estimates¹⁸, differences in repair and maintenance only can give a sub-standard ship operator a comparative advantage of 1 million US dollars per year per ship.

In addition, the external (social) costs of ship operations can neither be contained within the narrow geographical confines of a single country, nor are they always reflected in the price of the transport service. In fact, a lot of coastal States and their taxpayers face a bill -for such costs as port state control; VTS systems; waste disposal facilities; search and rescue; cleaning polluted beaches, birds and other animals, etc.- that in all fairness ought to be paid by those parties that directly benefit from ocean transportation.¹⁹

It thus becomes strongly felt by an increasing number of policy-makers that safety and environmental policies and standards are, in many areas of shipping, inextricably linked to issues of industrial competitiveness and they should be seen as such.²⁰ This assertion may pose a new challenge on IMO -the only competent international body to set standards on safety and pollution prevention- to increase its involvement in the commercial aspects of shipping. This can and ought to be done by IMO through the carrying out of a thorough Cost-Benefit analysis of the economic effects on the industry (including those on freight rates and shipping capacity), each and every time a new regulation or standard is contemplated.

Notwithstanding the above, the EU is well aware of the fact that caution should be shown with the insistence on higher standards, as they can be seen as protectionism inflicting unfair economic disadvantages on poor countries.²¹ In this respect, it is also argued by many, including of course IMO, that one cannot really expect the governments of many developing countries, which often lack resources and expertise, to implement measures with the same speed and assurance as larger

¹⁷Keynote speech delivered at the MAREFORUM 96 Conference, October 1996.

¹⁸see Organisation for Economic Co-Operation and Development (1996) *Competitive Advantages Obtained by Some Shipowners as a Result of Non-Observance of Applicable International Rules and Standards*. OCDE/GD(96)4, Paris, 1996.

¹⁹see keynote speech of A. Jorritsma, Dutch Minister of Transport, Public Works and Water Management, delivered at the MAREFORUM 96 Conference.

²⁰That was the central message that I tried to get across at the MAREFORUM 96 Conference on *Market Mechanisms for Safer Shipping and Cleaner Oceans* that took place in October 1996 at Erasmus University, under the auspices of the Dutch Ministry of Transport and the European Commission. Given their relevance to the present paper, the Resolutions of this Conference are appended at the end.

²¹see keynote speech of EU Transport Commissioner Neil Kinnock, delivered at MAREFORUM 96.

nations with centuries of tradition and expertise behind them.²²

“Speed” and “assurance” conceded, however, the EU is of the strong conviction that the effect of casual or negligent practices by flag-states can be horrific for crews and vessels and they are potentially devastating for the environment, for other shipping and for the well-being of people across the world. In this respect, weaknesses of administration are not an acceptable excuse²³ and the right to operate a ship register carries a full responsibility to do it properly.²⁴

Port State Control (PSC) is the last resort of many coastal States to monitor the implementation of safety rules and other working and living standards on board ships and thus safeguard the quality of shipping to and from their ports. The EU is committed to strengthening the effectiveness of PSC²⁵, currently considered by many as an inadequate deterrent (to the extent that it has sometimes been described as “an opportunity for a free inspection”).

On the other hand, it has also been argued that a tighter PSC system in Europe might create a two-tier situation, whereby sub-standard ships will avoid European ports and instead trade in other areas, as long as charterers will still be willing to charter their tonnage and insurers to underwrite it. This is indeed a likely scenario that does not solve the problem of sub-standard shipping, but only achieves a not-in-my-backyard situation in Europe. The EU is aware of this and it intends to address the issue by intensifying the operational links -for example through the inter-operability of PSC EDI systems- with other third countries, particularly with Australia, Canada and the United States.

In addition, the solution could well be that black-listed ships are well and widely publicised, leading to higher marine and cargo insurance premia, difficulties in financing and unwillingness of charterers to employ such tonnage. One could even imagine a situation where charterers, insurers and financiers are also black-listed when knowingly or negligently deal with sub-standard tonnage.

However difficult, such an approach to PSC is feasible and desirable. It requires resources and a harmonised approach to ship inspections across Europe, by a body of dedicated inspectors, specifically and uniformly re-trained for that purpose, eventually serving on a rotating basis in EU countries other than their own. Ideally, such training should take place at a supra-national European training school, funded by Community resources and PSC revenues from fines.

Perhaps it is worth mentioning in the present context the already well-publicised fact that more than 80% of all marine accidents is the result of human error.²⁶ People, the “software” of the industry, are receiving a renewed interest in the regulatory work of IMO, with the full support of the EU. This is done through two very important instruments, namely the International Shipmanagement Code (ISM) and the amendment of the International Convention on Standards of Training, Certification and Watch-keeping for seafarers (STCW).

While the ISM Code aims at developing and sustaining a new safety culture in the corporate thinking of shipping companies, the STCW amendments are intended to improve the quality of personnel at sea. Both instruments represent a very positive step for IMO who, for the first time, has been given the authority to monitor whether or not a number of important obligations imposed

²²O’Neil, *op. cit.*

²³particularly in view of the Union’s commitment to provide technical assistance to developing countries to enable them upgrade their maritime administration.

²⁴Kinnock, *op. cit.*

²⁵see also Council Directive 95/21/EC, 19.06.95 (Port State Control).

²⁶care should be shown, however, with such unqualified statements; where does human error stop? Is it not, for example, structural failure also the result of human error in ship construction/design?

by the two instruments on shipping companies, governments and training institutions have been complied with.

EXTERNAL RELATIONS

In its external shipping relations, the Union's prime objective is to promote shipping policies that safeguard and promote open trade and free competition on a fair, non-discriminatory, and commercial basis in international shipping, regardless of flag of registration. This objective is pursued in conjunction with the Union's firm insistence on compliance with international rules and standards regarding safety, environment and living and working conditions on board ships.

The Community's approach to the operating environment of international shipping can be adequately reflected through its 1986 Regulations which are considered as the pillars of EU shipping policy. Namely,

- Regulation 4055/86, applying the principle of freedom to provide services for maritime transport;
- Regulation 4056/86, concerned with the application of EU competition rules to maritime transport;
- Regulation 4057/86, addressing unfair pricing practices in maritime transport, and
- Regulation 4058/86, regarding co-ordinated action to safeguard free access to cargoes in seaborne trade.

Regulation 4057/86 in particular, affords the Community its basic "anti-dumping" legislation in maritime transport and it lays down the procedures to be followed in order to respond to unfair practices by third country shipowners engaged in international cargo liner shipping. The Regulation has so far been used only once against the Hyundai Merchant Marine²⁷, but due to the subsequent transferring of Korean interests to a French company, duties were levied only for a limited time. Accordingly, some European shipowners have advocated towards the necessity of making this Regulation more watertight, given that, in its present form, it may afford protection to countries the Community has no interest in protecting. Nowadays, however, the danger of individual dumping is significantly reduced as a result of the "multi-trade" character of liner shipping services and the consequent formation of global alliances in most of the east-west trades. Notwithstanding this, the Commission has, in a number of occasions, used the Regulation as a "deterrent" against "potential" dumping.

Regulation 4055/86 is concerned with *free access to cargoes and freedom to provide services*. This is an internal market opening regulation whose underlying principle is that countries should not reserve national trade for their own transport companies. This practice was exercised by some countries mainly as a means to protect their shipping industries from international competition allowing them in this way to grow and acquire an increased market share in international ocean transportation.

In October 1994, the Commission issued its third report on the implementation of Regulation 4055/86, reflecting the situation as of June 1994. The Commission presented all the outstanding problems concerning unilateral restrictions still in force in Member States (France and until recently Portugal) and a limited number of bilateral cargo-sharing agreements some Member States (Germany, Belgium, Luxembourg, Spain, Italy, Portugal) still had with third countries, particularly with regard to the application of the UN Code of Conduct for Liner Conferences. The Commission

²⁷see *Hyundai Merchant Marine*, Council Regulation (EEC) No. 15/89, O.J. No., L4, 6 January 1989.

has opened infringement procedures for many outstanding cases where the situation warranted it.

Cargo reservation should be distinguished according to the different shipping sectors it is exercised. In bulk shipping it mainly takes the form of unilateral or bilateral arrangements and it is occasionally justified on the grounds of the strategic importance of the transported commodities. In liner shipping, cargo reservation is enforced predominantly through the cargo-sharing arrangements of the *UN Code of Conduct for Liner Conferences*.

In both cases (bulk and liner) such arrangements, apart from distorting competition with a marked effect on freight rates, are not in conformity with the fundamental principles of *Most Favoured Nation* (MFN) and *Market Access* (MA) of the GATT/GATS system of trade negotiations. However, the very same system of trade liberalisation can provide a number of opportunities to developing countries, which are mainly those adopting such protectionist policies, to be exempted from the liberal MFN and MA provisions of the GATT on reasons of “national objectives”, balance of payments problems, infant industry protection arguments and similar concerns.

These prospects confront European shipping with the potential danger of making concessions to liberalise their already liberal shipping regime that are not only unreciprocated but could result in even greater protectionism than the one existing today. Having said that, however, the word “liberal” needs further qualification for the sake of fairness: distortions to competition can result not only from government measures, but also from the anti-competitive collusive agreements of private enterprises. Governments may abandon certain trade restrictions and, then, turn a blind eye to such restrictive *business* practices. If the parties to such agreements control an important segment of the market, the result of such practices is the same as that of government measures meant to protect national industries against foreign competition²⁸.

The prohibition and gradual elimination of such restrictive practices -public or private- should be one of the main targets of Community shipping policy. Business practices like these reduce consumer welfare by maintaining freight rates above what would have prevailed under free competition, distort competition, contribute towards perpetuating operational inefficiency, hinder growth and economic integration and are thus in conflict the very same principles of the underlying philosophy of the Treaty.

With few notable exceptions, restrictions to market access through policies of cargo reservation should not be seen in isolation, but as policies befitting the general economic philosophy of the country which applies them. Protectionist policies of this type are usually associated with countries at a low level of economic development and a strong and sometimes dominant public sector. Cargo reservation policies are expected to diminish, not so much because of international political pressure or fear of reprisals, but because and when countries exercising such policies feel that the time is ripe and that liberal shipping policies would benefit their economies and are in conformity with their new economic philosophy. This prediction is vindicated by the thrust that many developing countries have thrown towards achieving greater and faster progress within the GATT system of multilateral trade talks.

On the basis of the above considerations, it is believed here that the Commission, notwithstanding its commitment to effectively enforce the first phase policy of the four 1986 Regulations, should strengthen its efforts towards making greater progress in the liberalisation of shipping services world-wide, and in this way capitalise on third countries’ commitment towards free trade in general.

²⁸COM(96) 81 final *op. cit.* p.21.

In the context of GATS²⁹, Europe's shipping policy should be safeguarded by agreement on standstill and roll-back provisions and by striving to ensure the application of the Most Favoured Nation (MFN) principle to the fullest extent, however difficult the latter might prove to be. In addition, the Community should see to it that an adequate number of countries are thus committed (critical mass) and that the above principles apply equally to all shipping related activities, i.e. shipping, port and auxiliary services.

CONCLUSIONS

Despite its generally acknowledged importance in the economic life of the EU, European shipping is at crossroads: flagging-out is increasing alarmingly, market share is declining and the maritime-related employment figures give cause for concern. It seems that European shipping is taking its place in the long queue of industries facing the dire effects of globalisation, thus constantly feeding the debate as to the need for concerted action at European level. A short SWOT³⁰ - analytical presentation of the outlook of European shipping would look like this:

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|-----------------------|--|
| STRENGTHS: | Advanced technology, training and the existence of a centuries-old maritime know-how |
| WEAKNESSES: | High operating costs |
| OPPORTUNITIES: | Further liberalisation of international trade in shipping services |
| THREATS: | Protectionist policies of third countries and regionalisation of trade |

The EU shipping policy is developed along the three axes of positive measures, external relations and safety. With regard to positive measures, the Union is, *inter alia*, currently revising its state-aid guidelines in the firm belief that European shipping serves the "common interest" and it may, therefore, under certain conditions, be exempted from the prohibitions of article 92(1) of the Treaty, concerning state aids to industry. It is thus felt that a strong Community fleet is essential, both for economic and strategic reasons, and, as the leading world trading entity, the Community should not be excessively dependent on third country fleets. It is expected that the forthcoming state-aid guidelines of the Commission will adequately stress its conviction that the whatever assistance to the industry is afforded by Member States, should be transparent, well documented, adequately justified, but also temporary and, if possible, on a declining scale. Furthermore, it should not specifically contribute to increasing or maintaining capacity in sectors with manifest overcapacity.

In its external shipping relations, the Union's prime objective is to promote shipping policies that safeguard and promote open trade and free competition on a fair, non-discriminatory, and commercial basis in international shipping, regardless of flag of registration. This objective is pursued in conjunction with the Union's firm insistence on compliance with international rules and standards regarding safety, environment and living and working conditions on board ships.

Despite the limited, so far, progress on the multilateral liberalisation of shipping services, the Union firmly believes that further progress on this front is imperative. A policy thrust towards further liberalisation enjoys the merit of "neutrality", de-emphasises the arguments on the

²⁹The GATS talks on shipping did not succeed and were effectively postponed to the year 2000.

³⁰Strength-Weakness-Opportunity-Threat

importance of shipping (that could be put forward equally well by any country developed ones included), enhances the cross-trading possibilities of the European fleet and places the emphasis on the importance of trade liberalisation; a principle that is increasingly becoming a *sine qua non* to most countries that have to operate in today's global economy.

The prohibition and gradual elimination of restrictive practices should be one of the main targets of Community shipping policy. Such practices can result not only from government measures, but also from the anti-competitive collusive agreements of private enterprises. Public or private, restrictive practices tend to reduce consumer welfare, lead to high freight rates, distort competition, perpetuate operational inefficiency and hinder growth and economic integration.

The EU policies on maritime safety and the protection of the marine environment are very comprehensive. They mainly stem from two convictions: a) that the quality of shipping to and from European ports should reflect the European citizens' increased environmental and safety awareness and quality of life in general, and b) that substandard shipping is a distinctive threat to the competitiveness of the European shipping sector.

Attributing high importance to the convergent implementation and uniform enforcement of international rules and regulations, and concerned with the non-binding character of many IMO regulations, the Union might wish to consider making some of the latter compulsory through EC legislation and apply them indiscriminately to all ships visiting its ports. This, together with the Union's commitment to provide technical assistance to third countries -thus helping them upgrade their maritime administration-, its support to IMO's Flag State Implementation sub-committee, and its conscientious efforts to improve the effectiveness of Port State Control internationally can go a long way towards eliminating sub-standard shipping not only in Europe but across the world.

After a rather long gestation period, the last ten years or so have seen an impressive body of work in the shipping law-making of the EU. The principal philosophies behind the Union's shipping policy have found significant consensus. Firm commitment is now needed to move ahead, together with the necessary "fine-tuning" requiring sincere dialogue with all parties concerned.

But, evidently, this is not the end. Significant challenges still lay ahead. I feel, for example, that capital concentration in liner shipping is an issue that eventually will have to be re-addressed. The impetus to do so will come from the development of regional ports in the Mediterranean, Asia and Latin America; the increasing volumes of regional trade; the un-sustainability of road transport in Europe; the possibilities offered by short sea shipping and the deregulation of European railways. These developments may eventually lead to a re-evaluation of the *rationale* behind the hub-and-spoke system in ocean transportation and thus the structure of the liner shipping industry. But, of course, these are "food for thought" and maybe the challenges for the 21st century.-

APPENDIX

MAREFORUM 96: *Market Mechanisms for Safer Shipping and Cleaner Oceans*, Erasmus University Rotterdam, 10-12 October 1996. The Conference took place under the auspices of the European Commission. It attracted leading shipping personalities from industry and government, including EU Transport Commissioner Neil Kinnock and the Secretary General of IMO, W.A. O'Neil. Given their relevance to the present paper, the Conference Resolutions are annexed here.

Resolutions

- Safety and environmental policies and regulations are inextricably linked to issues of industrial competitiveness and they should be seen as such. An economic framework should be established integrating safety and environment, whereby the industry is led towards self-regulation.
 - Care should be taken so that the insistence on higher standards of, for instance, training and employment, is not seen as protectionism (fortress Europe), inflicting unfair economic disadvantages on poor countries. These countries often lack resources and expertise to implement measures with the same speed and assurance as larger nations, having centuries of tradition and expertise behind them.
 - Casual or negligent practices by flag states cannot be tolerated and weaknesses of administration are not an acceptable excuse. The right to operate a register carries a full responsibility to do it properly. There should be no concession to those who gain from the right and show contempt for the responsibility. In this respect the role of IMO's FSI sub-Committee is of paramount importance.
 - The problem of "safer shipping and cleaner oceans" is in essence an economic one and has to do with the availability of economic advantages of non-compliance. Coordinated action is thus needed.
 - Prices charged to transport users should reflect the real costs generated by transport, which are currently born by others or by society as a whole.
 - The operational business environment, business ethics and codes of practice have a decisive impact on the safety performance of a company and the ships it operates. The selection of the flag is decisive for the ships' cost levels and may influence its safety performance.
 - IMO is the sole competent international body to set standards on marine safety and pollution prevention and control. However, the ever-growing body of IMO's legislative work has to be rationalised and self-reevaluated. Before adopting still more regulations IMO should therefore concentrate on assuring that the ones that already exist are in fact applied to all ships throughout the world.
 - Human error is an extremely complex subject and it cannot be eliminated by introducing a few training courses. In many cases, it will require a complete change in corporate thinking, the introduction of totally new attitudes, the adoption of a genuinely safety culture. This effort will also have to be sustained indefinitely and, to be effective, it will have to involve the industry as a whole.
 - IMO's ISM code is an issue as central to shipping company management as is the making of profit. Companies not being able to comply will have serious problems and only themselves to blame. Both ISM and the STCW revision will impose a number of important obligations on shipping companies, governments and training institutions. Through the STCW amendments, IMO has for the first time been given authority to monitor whether or not they have been complied with.
 - Universal application of legislative instruments, port state control and flag state control should be emphasised. Focus should be placed on sub-standard shipping and thus right targeting is important. Proper maintenance and the overall condition of the ship should be the main criterion, not age.
 - Safety and environmental protection in the transport chain is not a matter only for the shipowner; all other parties involved, such as classification societies, P&I clubs, banks and insurance companies should also play a role and assume their responsibilities within what could be called the maritime environment and safety cluster.
 - The industry should conscientiously try to raise the public image of shipping which is unduly
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bad.

- The shipowner is the only responsible party for the safety of his ship. Bankers, insurers and P&I Clubs do have an influence but they are restricted in their possibilities by commercial interests due to their supplier/customer relations. Excess supply in the insurance and P&I markets can be a problem with regard to ship safety. Competition weakens the position of the insurer. Focus should also be placed on ancillary services, such as stevedoring, tug assistance, bunkering, etc., i.e. what could be called the port cluster.
- Classification societies do have a very important function. They should conduct closer and better inspections to older ships. However, too many inspections are currently being undertaken on behalf of various actors in the market. This is caused by a lack of trust in classification societies. As a result, there is a significant lack of information and transparency, which would, among others, help shippers to be more selective in the tonnage they charter. In addition, the flow of information is very important for the proper functioning of the market. Information systems could contribute to an environment where safety is enhanced. Effective information systems can help in targeting sub-standard ships at an earlier stage.
- Regulation increases the costs of the quality shipowner but not those of the sub-standard one.
- Stable relations between quality conscious shippers and shipowners could be developed to stimulate safer shipping.
- MAREFORUM 96 was an excellent initiative to start the debate; the momentum has now to be maintained.