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## Current Challenges in European Shipping Policy<sup>1</sup>

H.E. Haralambides  
Center for Maritime Economics and Logistics (MEL)  
Erasmus University Rotterdam

### PREAMBLE

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 most important trading area in the world accounting for more than 20% of world trade and that 90% of the Community's external trade, and about 30% of intra-community trade, is carried by sea.

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. These developments can be easily ascertained by looking at the related maritime employment figures: The number of EU seafarers under national flag has declined from its 1983 level of 213,281 to 139,579 in 1995 (including Norway).

The grim prospects of European shipping in its current operating environment, and the European citizens' increased awareness of the importance of being able to rely on a safe, modern and efficient ocean transport system (including its economic and military security implications) to serve their trading needs call 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 that 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.

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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, cooperative 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 a 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 for the industry outweigh the direct and indirect outlays incurred by the government to establish, operate and manage the programme.

Furthermore, the costs of any contemplated "positive measures" should be weighed against the benefits of the impacts that 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

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*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 States, 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.

## **STATE AIDS TO SHIPPING**

State aids to industry are in principle prohibited by the Treaty (article 92) with the exemptions provided for in 92(3)(d) which gives the Council the power to declare certain categories of aid to be compatible with the common market. The Commission is not particularly prone to state aids programmes and at any rate their desirability and compatibility with EU law will always be scrutinised. Furthermore, a "state aids" approach to "positive measures" is inward-looking and despite its aim at equalising operating conditions of EU shipowners with those of their third country competitors, it is interventionist in nature and thus to some extent in conflict with the industry's efforts to self-regulate according to the prevailing international competitive forces.

In general, state aids would 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

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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.

Notwithstanding this, a state aids approach to "positive measures" for shipping could be seen favourably by the Commission (given the positive opinion of both the European Parliament and the Economic and Social Committee), but then it should be contemplated 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.

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.

A harmonised fiscal approach to European shipping might thus involve, at some stage, the implications of Community funds. These could initially be earmarked for areas such as fleet modernisation, restructuring, reimbursement of seafarers' repatriation costs, pensions, etc.

It has often been suggested that a harmonised system of financial support to shipping could be achieved, *inter alia*, within the EUROS register by a refund of seafarers' income tax and social security contributions to shipowners. In shipping, such a policy could be quite justifiable particularly in countries involved substantially in cross trading where the seafarer makes limited appeal to the country's social infrastructure and provision of public goods for which he would otherwise have to pay. This is markedly the case of Greece, a cross trader *par excellence*, while in the UK similar exemptions apply to seafarers (and to other expatriates) that spend more than eight months per year outside the country. Similar arrangements exist also in Italy and Portugal, while Danish seafarers employed in deep-sea shipping are totally exempted from income tax.

## **FLAGGING-OUT**

Flagging-out is an operational decision of 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. It is evident, however, that

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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.

The main objective of Europe's shipping policy should be to entice European shipowners to fly the flag of a Member State (or eventually a European parallel flag like the proposed EUROS), to the extent possible, or 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. In this context, it has been proposed that the paramount shipping policy objective should be the increase of value-added from shipping and related activities *vis a vis* a policy towards maintaining ships under the national flag. According to this view, if increased value-added can be achieved by flagging-out so be it.

The Commission together with a number of OECD and many other developing countries have seen the phenomenon of open/dual registries with considerable scepticism if not with clear 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. 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 policy direction in this regard is rather straightforward: Member States, in cooperation 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

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what extend flagging-out reduces the consumption of European intermediate goods and services necessary for the production of shipping services?

## **MARITIME EMPLOYMENT AND TRAINING**

The rapidly declining employment figures in the European maritime industries during the past fifteen years and their subsequent effects on the preservation of the necessary maritime know-how have given considerable cause for concern among market participants, governments and the Commission. This situation has often called for "positive measures" in order to reverse this trend.

Strictly speaking, however, and from a benefit-cost 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, it could be equally well argued that with 30 million people unemployed in Europe, the creation of 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, 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.

As an 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.

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 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. Shore-based shipping activities are to a significant extent undertaken by ex-seafarers and a shortage of the latter can have detrimental effects on the efficient management of shipping companies and on preserving the necessary shipping know-how.

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This type of education should be jointly funded by shipowners, government and possibly by Community resources, and apart from being self-fulfilling for the seafarer it can contribute in making the seafaring career more attractive. Furthermore, the level of education and training facilities should be upgraded and programmes coordinated 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.

## **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. 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 Sea. Moreover, Europe possesses about 35,000 kilometres of coast line with an abundance of over 600 ports situated near to industrial centres;
- 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;

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- 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**

From the relevant statistics it appears that the heaviest casualty record is to be found among open registries. 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. It is believed that a different picture would emerge if a casualty analysis was performed on the basis of the beneficial ownership of open registry fleets rather than the mere flag-of-registry type of analysis.

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 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 Registries -apart from the narrow economic benefits this would entail- has some wider social benefits too.

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.

## **EXTERNAL RELATIONS**

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,

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- 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 coordinated 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 Marine, but due to the subsequent transferring of Korean interests to a French company, no duties were levied. Accordingly, some European shipowners have advocated towards the necessity of making this Regulation more watertight. However, it should also be mentioned here that the Regulation has, in a number of cases, been effectively used by the Commission as a "threat" against "potential" dumping.

Regulation 4055/86 is concerned with *free access to cargoes and freedom to provide services*. This is an anti-protectionist regulation whose underlying principle is that countries should not reserve national trade for their own transport means. This practice is being exercised by a number of 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 position as of June 1994. The Commission presents all the outstanding problems concerning unilateral restrictions still in force in Member States (France and until recently Portugal) and the bilateral cargo-sharing agreements some Member States (Germany, Belgium, Luxembourg, Spain, Italy, Portugal) still have with third countries. The Commission has opened infringement procedures for all these outstanding cases.

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

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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 the like.

These prospects confront European shipping with the distinct 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 currently.

The prohibition of such restrictive business practices 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 between European shipowners, contribute towards perpetuating operational inefficiency, hinder economic integration and thus defeat 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 efforts to effectively enforce the first phase policy of the four 1986 Regulations, should drive its thrust towards the achievement of greater progress in the GATS talks of liberalisation of shipping services and in this way capitalise on third countries' commitment towards liberalisation in general.

This approach enjoys the merit of "neutrality", de-emphasises the arguments on the 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 becoming increasingly a *sine qua non* to most countries that have to operate in today's global economy.

Admittedly, this is the hard way of achieving further liberalisation of shipping services but on the other hand it can afford shipowners some countervailing power *vis a vis* the limitations to self-regulation imposed on them by Europe's competition policy.

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In the context of GATS, Europe's liberal shipping policy should be safeguarded by agreement on standstill and roll-back provisions and by striving to ensure the unconditional application of the Most Favoured Nation (MFN) principle, 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

The above reflections are meant as broad guidelines aimed at contributing to the formulation of a future Community maritime policy, and are structured on the basis of the "three pillar approach" of *Positive Measures-Safety-External Relations* of the Commission.

Current deliberations on the issue of Europe's maritime policy stem from the increasing awareness that a great part of European shipping is faced with grim future prospects, as a result of its high operating costs and of the protectionist shipping policies of third countries.

Within its terms of reference, the only safe scenario that could be attempted to be highlighted in the context of these reflection points could not be anything more than an educated guess, on the basis of past and current developments in the shipping industry and on figures that speak for themselves. It is thus believed that within its current operating environment, European-flag shipping will continue to opt for "cheaper" registries and European-controlled shipping will continue losing market share in world tonnage.

Under the assumption that European citizens and consumers attribute a positive value to the existence of a European shipping industry and its related know-how, this situation calls for corrective action at a policy level, and a *laissez faire* attitude (internally or externally) would be socially undesirable.

An internal *laissez faire* policy to shipping would undoubtedly afford shipowners more leeway for self-regulation and for formulating business behaviour in accordance with the prevailing global forces that shape their operating environment. However, if unchecked, in a capital-intensive industry such as shipping, this policy scenario may lead to sub-optimal solutions, conflicting European industrial policy and compromising consumer welfare.

An external *laissez faire* policy scenario to shipping would thus be also inappropriate, as this would unavoidably lead to the gradual disappearance of a large part of European shipping and everything else that comes with it.

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According to the above, the two pillars of "positive measures" and "external relations" should be carefully weighed in the formulation of a future maritime policy for Europe. It is believed here that notwithstanding the Community's efforts for more liberalisation in shipping, the emphasis should be given to the first pillar of positive measures. This is so not only because liberalisation is a positively developing global process any way, but mainly because further liberalisation will mostly come about when countries exercising protectionist policies are convinced that they have more to gain from liberal shipping regimes than otherwise. In such a scenario, and in the absence of positive measures, the operating cost differentials of European shipowners are likely to be higher than what they currently are.