

ON THE REASON AND SIGNIFICANCE OF THE CORE CONCEPT OF IAMU

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ABSTRACT

The international shipping has been undergoing significant changes in the past three decades. The latest one is described as globalization. It is generally considered that the wave of globalization is big enough to change the present system of international shipping to something fundamentally different.

At the time of change, it is useful to look into what is changing and what is not, and to find out whether the very basic principle of the existing system is also changing or not.

To have a clear understanding and perspective on the future of the international maritime sector including maritime education the existing basic principle. The author argues that the basic principle of the international shipping is *intact*, and that it will continue to be so toward the foreseeable future.

The system which is intact is the legitimate institution which generously permits FOC (Flag of Convenience) to exuberate. The key issues in the international maritime society today, namely safety and protection of environment, are the logical yet unwelcome results of this legitimate institution.

To cope with the intolerable degree of maritime casualties, in other words,

deterioration of the quality of international ocean shipping, STCW95 and ISM Codes are introduced to take full effect in 2002. Whether these countervailing measures to remedy the ill effects of FOC were the truly effective cure, or only a symptomatic treatments are yet to be seen.

The author intends to clarify the basic principle of the existing international maritime system, and the mechanism of deterioration of quality of shipping services, inherent to flagging out, thence to consider the logical direction to cope with the vicious dynamism built-in to the existing international shipping system.

[I] THE REALITY OF INTERNATIONAL SHIPPING MARKET

The international shipping market has been dominated by the traditional developed shipping countries (TDSC) throughout the post World War II era till today. Although the national flag fleets of the TDSC have been declining in terms of size, and the number of vessels registered thereto, in terms of actually *controlled* fleet, the share of TDSC is soundly maintained and still keep the dominant position in the world shipping marketplace. For example, "[T]here has been no reduction in the EC share in global ownership since 1990." <1>

One of the most comprehensive study on the current international shipping reality is the EC Commission Report, which, for example, states “[T]he main reason for flagging out is overall cost savings, with crew costs, tax and fiscal costs being cited most often.”^{<2>} The similar situation can be seen in other country like Japan. The implied reality is that flagging out develops irrespective of the national shipping policy of her mother country because of the economic rationale inherent to FOC.

It is often pointed out that the international shipping market is one of the most open markets of all the industries. In other words, the theoretical principles of economics work in the purest form in this real market. Hence it is one of the most competitive market of all. With the near collapse of the freight conference system, the competitive environment in the international shipping markets not only of tramp, but also of liner has been getting severer and severer, thus the inevitable pressures for shipowners to minimize their costs in producing their commodities(i.e. *the service of carriage of goods by sea*) to be supplied to the market.

As we see closer in the later section, in most cases, the biggest cost item for shipowners is crew cost, then followed by maintenance and repair costs(including docking expenses) and insurance costs. It is worthy to note that all those are cost items of so called operating expenses. Owners do not consider capital cost as the item suitable for cost reduction because of the terms and conditions of ship finance agreement with banks and other financiers. Therefore they concentrates their cost saving effort in operating(running) expense items.

TDSC have always been dominating the international shipping market because of the high credibility of the shipowners of TDSC in the international ship finance market, which has facilitated TDSC owners to obtain far better finance terms than those of developing

countries at the time of their acquiring ships, hence TDSC owners have been enjoying far more competitive capital cost. By flagging out, they can achieve the best competitive wage cost level equivalent to or less than those of the owners of developing countries, thus they have realized the cheapest operating cost as well. The combination of the two realizes the best cost competitive vessels in the international shipping market. The logical conclusion is that FOC is the system that realizes the best cost competitive ships to the shipowners of TDSC.

As there is so far no sign of questioning the concept of FOC per se in the international maritime society, and as the institution of FOC has the best possible economic rationale to owners of TDSC, it is reasonable to conclude that FOC system will continue to be the fundamental feature of the international shipping system also towards the new millennium. The old principle still prevails.

[II] THE LEGITIMACY OF FOC AS AN INSTITUTION

A. FREED FROM CONTROLS

The tanker who was built in country A, registered in country B, owned by a company in country C, chartered by a company in country D, carrying a cargo shipped by a shipper in country E to a consignee in country F who had resold the cargo to a company in country G, was under the command of a Master of country H, with a chief engineer of country I, and junior officers from countries J and K, and ratings from country L, ran aground off the coast of country M, which had caused an extensive oil pollution affecting the coasts of countries of not only M, but also N, O, P.....

This is nothing out of ordinary in the international shipping today. This is the symbolic illustration of the reality of the

international shipping today.

It is well recognized that a off-shore shipowning company is a paper company without substance. The laws of off-shore country permit that the actual shipping business of the actual parent company domiciled in the foreign country in its entirety can be carried out anywhere. There are no restrictions on where the company account is to be kept, where the shore staff are to be deployed. The nationalities of seafarers serving on board the vessel registered to the off-shore country are not necessarily be the nationals of that FOC country. This means that seafarers on board the FOC vessel do not have any substantial relationship with the national economy including the domestic labor market of that FOC country. As far as their labor relationship is concerned, the seafarers on board FOC vessels do not have any practical ties with off-shore country, nor with his mother country.

The link is barely maintained by a thin string of ship registration.

B. THE PRODUCT WITHOUT COUNTRY OF ORIGIN

The concept of "country of origin" is not questioned at all in the international shipping. Look at the case such as described in the preceding paragraph. The point here is not that it seems difficult to specify where the country of origin is, but to confirm the fact that nobody takes up the question the "country of origin" of the service transacted in the international shipping market.

The reality is FOC merchandise does not have country of origin, in other words it belongs to no country, let alone the registration of ship itself.

It can be said that FOC is the system of reproduction of stateless shipping services. Thus the responsibility of guaranteeing the

service quality rests nobody.

C. THE PARADIGM OF INTERNATIONAL SHIPPING MARKET

The basic principle of international shipping today is clearly stated by OECD as follows:

"the principle of free circulation of shipping in international trade in free and fair competition forms a guarantee of adequate and economic world shipping services and of maximum economic benefit for shipowners, shippers and consumers"<3>

This principle was first established by OEEC (Organization of European Economic Council, predecessor of OECD), and was succeeded by OECD in 1961 when it was formed by 20 West European Countries including Turkey in the form of Code of Liberalisation of Current Invisible Operations.<4>

The OECD principle is specifically described as follows:

1. The provisions of the Annex C. C/1 are intended to give residents of one Member State the unrestricted opportunity to avail themselves of, and pay for, all services in connection with international maritime transport which are offered by residents of any other Member State.

(in order the freedom of transactions and transfers in connection with maritime transport should not be hampered)

2. by measures in the field of exchange control,
3. by legislative provisions in favor of the national flag,
4. by arrangements made by governmental or semi-governmental organizations giving preferential

- treatment to national flag ships,
5. by preferential shipping clauses in trade agreements,
 6. by the operation of import and export licensing system so as to influence the flag of the carrying ship,
 7. by discriminatory port regulations or taxation measures.
 8. the aim always being that liberal and competitive commercial and shipping practices and procedures should be followed in international trade and normal commercial considerations should alone determine the methods and flag of shipments.<5>

In view that OECD membership covers all the EU countries plus big shipping countries like the U.S., Norway, Japan, Australia, Canada, Korea, the sets of the OECD principles forms the paradigm of international shipping today.

Almost simultaneously with the OECD Code took effect, The International Convention on the High Seas was adopted in 1958, and took effect in 1962, which established the principle of "Freedom of High Seas". The Convention stipulates the right to any country the freedom of navigation by ships flying her flag in high seas.

Conclusively and concisely, it can be said that *prohibition of flag discrimination* is the core concept of international shipping of today.

Thus the concept of "country of origin" of the ship becomes of no meaning, and only the "normal commercial considerations" of service quality of the shipping company with whom a shipper books his shipment, and the level of freight rate are the two key factors in his decision making as a player in international shipping market.

It is to be noted that "service quality" of the shipping company does not usually mean the "physical condition of a ship", but the

commercial service level of the shipping company on the shore in relation with the shipper.

D. FOC ACCOMMODATED

"The shipping policy of Member countries should be directed to safeguarding and promoting open trades, and a situation of free competition on a fair and commercial basis in international shipping in their mutual relations, as well as in their relations with non-member countries", says OECD.<6> With the prohibition of flag discrimination, the paradigm of international shipping is positively friendly to FOC system to exacerbate. Here the fact that FOC system offers the best competitive economical edge to shipowners should be recalled.

It is also noteworthy that the principle of OECD has been made up on the basic concept of minimizing the interference of the national governments, thus trying to maximize the free and fair competition on commercial basis.

[III] THE BLACKHOLE – QUALITY OF SHIPS

The international shipping market has significantly been one-sided to the commercial values as we have seen so far. And it has been encouraged as norms by the basic principles of the market, i.e. OECD Codes. FOC has flourished in pursuit of cost competitiveness by the owners under such environment.

It is now clear that the system of international shipping has been ill-facilitated with the most important countervailing values to commercial rationale. That is quality safeguard mechanism of the quality of ships and the service they render to the market.

It is very much symbolic that the pursuit for more commercial competitiveness has been made first of all in the form of sacrificing the

quality of services, i.e. by down grading the quality of seafaring human resource through flagging out, without paying almost no attention to the quality level of the vessels.

The lack of the countervailing mechanism to assure the quality standard has been the key characteristics of the international shipping.

[IV] COST STRUCTURE OF SHIPOWNERS

The cost items of shipowners are two folds, (1) capital cost which is repayment of principal and interests, (or sometimes depreciation is used), and (2) operating (running) expenses such as crew wages, repair and maintenance/docking expenses, insurances including P & I, and shipboard stores.

As mentioned briefly before, cost item (1) can not be changed once it was fixed at the time of purchase between the shipowners and the financiers. The finance agreement stipulates repayment schedule over the whole period of the finance of the ship purchase which usually covers 5 to 10 or even more years. It is practically very difficult to reschedule for the purpose of cost saving solely for the benefit of owners. The practical truth is that once capital cost is fixed for a vessel, it is valid for the rest of her whole life.

The operation (running) costs are different. These cost items are the objects of the cost saving measures for shipowners. The diagram-1 is the typical model of the operating (running) cost structure of a panamax bulk carrier. This clearly illustrates the economical reason why owners set their priority in their cost saving efforts on crew costs without almost no exception. It is the biggest single cost item in the operating, and can be easily achieved by flagging out the vessel and by replacing the existing crew with cheaper crew of the different nationality.

It is also noteworthy that the ratio of operating (running) costs versus capital cost of a ship generally increases as the size of a ship comes smaller. As the number of vessels in the smaller size category is significant, so has been the demand for flagging out.

[V] THE CONSEQUENCES ON THE HUMAN ELEMENT

The international maritime system is now presented as a system which permits the principle of commercialism to prevail without effective countervailing power to check its quality standard of human resources. FOC countries permit shipowners registered in their countries to employ seafarers of any nationality at the wage levels of their mother country, which is nothing to do with the domestic labor market conditions of the flag states. Under such circumstances, polarization between the seafarer demanding countries and seafarer supplying countries has developed. The main consideration has always been the level of the crew cost of seafarers.

This process has developed with the gaining momentum up to this day in the global shipping market place where there is no institutional requirement for quality assurance for seafaring human resources. Under the principle of flag state sovereignty over a ship who flies the flag of that state which does not have adequate rules and regulations, nor the ability to secure the maintenance of quality standard of seafarers to be placed on board ships registered thereat, thus the international shipping market place has been left with the fatal blackhole unattended as if it has been assumed with optimism that unlimited availability of quality seafarers has innocently been taken for granted like water or air.

The truly unwelcome consequence of this whole-hearted devotion to the commercial principle in the international shipping system is the deterioration of moral discipline in the market place toward the maintenance and

enhancement of quality standard of seafaring human resources at all levels. The frequently quoted remarks that more than 80% of maritime accidents are due to human errors is a most eloquent statement of proof that the seafaring human resource is the most crucial element of all for safety, and reliable quality service in ocean shipping. Today's cries for safety could be the reflection of the recognition that the delicate system of sound virtuous circle in the reproduction mechanism of the international shipping has reached the extent that its autonomous functioning has been seriously lost.

[VI] REPRODUCTION OF SEAFARING HUMAN RESOURCES – MARITIME EDUCATION AND TRAINING

Another consequence of flagging out is the ubiquity of mixed crewing environment on majority of the world fleet today. The impact of this to the reproduction of seafaring human resources, i.e. maritime education and training, should not be overlooked.

The development of mixed crewing means the increase of employment opportunities for national seafarers at the international seafarers labor market where there are a number of different systems, cultures abundant. The traditional national shipping know-how, communications including languages, are not enough under mixed crewing environment on board.

On the other hands, when we look into the supply side of the maritime human resources, almost all the maritime universities, academies, and faculties are national or public institutions, subject to governmental budget, to the rules and regulations of higher education law of respective countries. All the resources especially academic staffs, teaching materials are national. They are tightly knit in the web of national bureaucracy. All in all, they are the institutions only capable

to adapt themselves to the rapid change of the international maritime environment only very slowly.

The objective observation leads us to the following points, all of which requires the urgent action :

- (1) the level of standards of maritime seafaring human resources has been deteriorated, and should be improved as soon as possible,
- (2) the total reproduction(education) mechanism of world seafaring human resources needs to be reviewed and reorganized as a whole,
- (3) the traditional national framework is not sufficient to satisfy the needs of international maritime environment of today and of the future.

As the producer of the seafaring human resources, the maritime universities, academies, and faculties are the most appropriate parties to meet this requirement, with the full utilization of their academic and scientific capabilities, academic staffs, expertise based on the long time experience, and above all, their solid moral and ethical discipline kept within themselves.

To cope with the difficulties to meet the globalization of international maritime environment at individual institution level, the logical subscription is the introduction of the concept of *alliance* into the relationship among the maritime universities, academies, and faculties so that the optimum utilization of respective resources can best be achieved through the international cooperation and coordination.

Logical consideration even takes us further from alliance to the fully merged single entity beyond the horizon.

[NOTES]

<1> "Towards a New Maritime Strategy", pp.5, Annex-A, Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions, COM(96) 81 final, 13.03.1996
<2> op.cit., pp.6, Annex A
<3> "RECOMMENDATION OF THE COUNCIL concerning Common Principles of Shipping Policy for Member Countries" OECD
13th February 1987, C(87) 11(Final)
<4> "OECD Code of Liberalisation of Current Invisible Operations", OECD, 1961
<5> "Operations covered by the OECD Code of Liberalisation of Current Invisible Operations", Annex to the Code, C.Transport, Remark to C/1, Note 1.
<6> op.cit., "RECOMMENDATION"

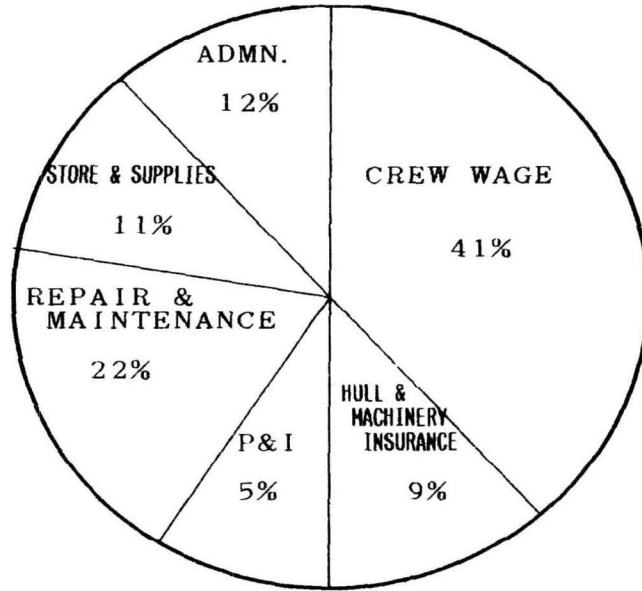
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- [1] EU, "TOWARDS A NEW MARITIME STRATEGY", COMMUNICATION FROM THE COMMISSION TO THE COUNCIL, THE EUROPEAN PARLIAMENT, THE ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS, BRUSSELS, 13.03.1996, COM(96) 81 final
- [2] Prof. Masanaga Bujyo, "The Establishment of the Uniform Off-shore Shipping and its Mechanism", Maritime Economic Research No.29, 1995
- [3] Prof. Isamu Matsumoto, "EU Common Maritime Policy and Competition Law" Taga Shuppan, 1999
- [4] Mr. Ryoichi Sonoda, *Towards the Formation of the OECD Common Maritime Policy*, Japan Maritime Research Institute Journal No. 405,

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- [5] BIMCO/ISF, "200 MANPOWER UPDATE"
-The Worldwide Demand for and Supply of Seafarers, Summary Report, April, 2000, University of Warwick

[DIAGRAM-1] OPERATING COSTS - PANAMAX BULK CARRIER



[A] OVERALL ANALYSIS:

1. CREW WAGE	US\$1, 830/DAY
2. HULL & MACHINERY INSURANCE	425
3. P & I	205
4. REPAIR & MAINTENANCE	985
5. STORE & SUPPLIES	480
6. ADMINISTRATION EXPENSE	550
TOTAL OPERATING COSTS	US\$4, 475/DAY
	→ US\$1, 633, 375/YEAR

[B] CREW WAGE ANALYSIS

MODEL MANNING BUDGET	10 INDIAN OFFICERS 15 FILIPINO RATINGS	10 SLI LANKAN OFFICERS 15 SLI LANKAN RATINGS
WAGES, VACATION, OVERTIME	45,700	32,400
TRAVEL, OVERLAP, STAND-BY, AGENCY	6,850	5,350
VICTUALLING	4,550	4,550
TOTAL US\$ PER MONTH:	57,100	42,300
TOTAL US\$ PER YEAR :	685,200	507,600
YEARLY DIFFERENCE :		▲ 177,600