

## ON FLAGS OF CONVENIENCE VESSELS

By TOMOHEI CHIDA\*

### 1

Since a group of vessels came to be known as “flags of convenience vessels” in the late 1940s<sup>1</sup>, these fleets have continued to grow and to pose various social and economic problems in the face of mounting criticism. Now they have come to constitute almost one third of the world tonnage and are playing a very important part in the world shipping market. In this paper, I do not intend to discuss the merits or demerits of flags of convenience, nor do I want to make any specific proposal for the solution of any problems they pose. Rather I would like to examine the characteristics of flags of convenience in their historical context, in the hope of finding some clues to the solution of the problem.

No one doubts the existence of flags of convenience vessels, or denies the fact that they have caused—and are still causing—various thorny problems. No one disputes the fact that Liberia, Panama and several other countries are flags of convenience countries. Yet it is no less a fact that we have no uniform definition of the term “vessels under flags of convenience” or “countries of flags of convenience”, although many have attempted to give a definition to them. Moreover, even the definition one uses changes with the time. The ITF (International Transport Workers’ Federation) is an example. It was asserted after repeated discussions at a meeting of the ITF that the best way would be to just list up particular names of countries as flags of convenience countries instead of giving a definition. However, the many definitions of the term we hear today, although they differ from one another in many other details, have one thing in common—that vessels under flags of convenience are distinguished from others by the fact that they have no “genuine link” with the states of their registry. But the requirements for the existence of genuine link differs according to definers.

The absence of and the difficulty of arriving at a uniform definition seem to suggest the whereabouts of the key to unlocking the characteristics of vessels or countries of flags of convenience.

What are the reasons that make it difficult to arrive at a uniform definition? Most definers seem to presuppose in various degrees a particular problem or problems which vessels under so-called flags of convenience have caused so far. Then they try to find peculiarities which exist in common among those countries registering these vessels under their flags for the purpose of definition. The typical example would be the definition given by the Rochdale Report. It actually mentions eight such peculiarities. However, the nature

\* Emeritus Professor (*Meiyokyōju*).

<sup>1</sup> S.G.:Sturmev, *British Shipping and World Competition*, London 1962, p. 211.

of the problem as reflected in the eyes of the definers differs from one person to another. (For instance, the ITF sees them as a threat to the employment of seamen in traditional maritime countries, while developing countries at UNCTAD take the view that any attempt to register vessels under flags of convenience would only serve the interests of traditional maritime countries, thus preventing the growth of their own fleets, but the problem most definers have paid attention to is the sub-standard vessels of these flags.) What is more, the problems themselves change through time, and new problems arise, while existing ones lose their importance. Changes in the nature and the importance of these problems have multiple causes, including the rapid increase in the number and the tonnage of flags of convenience vessels and the improvement of the technical requirements of vessels, the divergent reactions of flags of convenience countries and their users to the problems caused by such vessels (e.g., the screening program applied by major oil companies, one of the main users of flags of convenience, and the self-regulations on the part of flags of convenience countries such as the tightening of government inspection for vessels flying the Liberian flag) and the changed environment of maritime transport (e.g., the strengthened regulations on sub-standard vessels of IMCO and ILO, increased subsidies of traditional maritime nations to their merchant fleets to help them compete with vessels of flags of convenience, and increased importance of the North South problem in shipping). These divergent interests color their definitions, hence the lack of uniformity in definition.

## 2

Next, I would like to trace the development of the problem posed by flags of convenience vessels.

When the registration under flags of convenience was limited to a small group of world shipowners from the post-war years up to the early 1960s, other shipowners charged them with committing unfair competition, and their criticism was largely directed against the low cost of operation which flags of convenience vessels enjoyed. Subsequently, an increasing number of shipowners joined the ranks and took advantage of flags of convenience to fight against intensifying international competition, and the criticism gradually subsided to such an extent, in fact, that today those shipowners of traditional maritime countries who are barred from the use of a flag of convenience for one reason or another protest against such restrictions.

The staunchest opponent to flags of convenience has been the ITF and its opposition was often in cooperation with dockers' unions, because the owners of vessels registered in traditional maritime countries found it extremely difficult to maintain crews from these countries and improve their working conditions and yet compete with the vessels of flags of convenience. To head off the onslaught of competition from such vessels, the ITF sought to bar vessels of flags of convenience from the merchant shipping on grounds of the sub-standard level in safety and, in particular, working conditions of the seamen on these vessels. This movement seems to have made hardly any dent in the problem; rather, the number of vessels flying flags of convenience kept increasing in spite of ITF's strong and persistent opposition. Then the ITF changed its tactics and directed its offensive to the improvement of the working conditions of the seamen on board flags of convenience vessels by mandating

the issuance of so-called blue certificates in 1970 (or 1971). The blue certificate is a collective agreement concluded between the ITF and the shipowners of flags of convenience vessels. This may have been a second-best alternative, but, in my view, it amounted to the sanctioning of the existence of flags of convenience. Therefore, it represented a sharp departure from its traditional policy—from an outright debarment of vessels under flags of convenience to the regulation of working conditions on them.

At its Manila meeting, UNCTAD raised an entirely new problem involving vessels under flags of convenience. Put simply, the developing countries charged that shipowners of the traditional maritime countries were impeding the development of the merchant shipping of developing countries by strengthening their competitive power in the world shipping market through the benefits gained from the use of vessels under flags of convenience; the developing countries therefore demanded the phasing out of vessels under flags of convenience operated by shipowners of the developed countries.

These are but a few examples, and they seem to suggest that the reasons for claiming the debarment of vessels under flags of convenience have easily been so generalized as to blur their distinguishing marks. A case in point is the stereotype which labels all vessels of flags of convenience as sub-standard. As is evident from arguments advanced at IMCO and ILO<sup>2</sup>, sub-standard vessels can also be found among those registered in non-flag-of-convenience countries, while not all of vessels under flags of convenience are sub-standard. Nobody can deny the fact that flags of convenience fleets in general have so far showed worse casualty records because of their sub-standard levels in various aspects. But, at a closer examination, those fleets registered in some traditional maritime countries have had an equally bad record, on the other hand some groups of vessels under flags of convenience, particularly those owned by major oil companies, have shown better results even compared with the fleets of traditional maritime countries<sup>3</sup>. Thus, as far as the sub-standard is concerned, the differences are only in degree, not of substance. Furthermore, the differences are of a nature that can be remedied, given stricter international regulation and a willingness on the part of the countries of flags of convenience and their shipowners. Thus there is a view which insists that the question of being sub-standard is logically a concern more of the shipowner than of the flag of convenience country.<sup>4</sup> However, it is an undeniable fact that laxity of regulation on the part of the country of the flag of convenience is responsible for attracting the owners of sub-standard vessels. By the way I would like to add that such international regulations on sub-standard vessels may be, in a sense, taken as making up the lack of a genuine link which is widely considered as the main cause responsible for sub-standard vessels under flags of convenience.

The same is true of the competitive position of vessels under flags of convenience. To register a vessel in a flag of convenience country essentially means that the vessel takes on a foreign nationality. The owner elects to register his vessel in a foreign country because it offers more advantages than his own country. Therefore, it is natural that the registry of his vessel in a foreign country strengthens its competitive edge. Here again, the competitive advantage offered by a flag of convenience is common to all vessels registered in

<sup>2</sup> E. Argriffs, "Flags of Convenience and its Impacts", in *International Labour Review* Feb. 1974, p. 115.

<sup>3</sup> F.M. van Poelgeest, *Substandard tankers*, Report published by the Netherlands Maritime Institute 1978, p. 31.

<sup>4</sup> Tankers and the Flags they fly, *EXXON Background Series* 1979, p. 20.

foreign country. It is not confined to vessels under flags of convenience, so the difference is only in degree, not of substance. Registry in flags of convenience countries differs only in that they afford compound benefits, while a single kind of benefit can normally be expected to gain from other foreign registry. Therefore the registry in flags of convenience countries can satisfy at a time different shipowners expecting different benefits from foreign registry, so that it has succeeded in attracting a great number of shipowners, hence large tonnage has come to be registered.

From the standpoint of the shipowner, the characteristics of flags of convenience are the sources of benefits, and problems arise from the fact that shipowners try to pursue excessively these benefits by the use of flag-of-convenience. As we have seen in the foregoing, the different aspects of such characteristics, taken individually, have become so widespread as to make them no longer distinguishable as the inherent characteristics of flags of convenience. There are other similarities. If one attempts to define vessels under flags of convenience and the country which accepts the registration of such vessels on the premise of such characteristics and the problems they cause, he cannot avoid exceptions. To sidestep these difficulties, the definer tries to add detailed requirements (for example the definition given by the Rochdale Report) or to establish a new category such as "quasi-flags of convenience".<sup>5</sup> Typical of these is the low tax burden which vessels of flags of convenience are apt to seek. But if a low tax burden is the only reason for registering in a country of flag of convenience, then the owner may obtain the same benefit from registering his vessel in a tax haven country such as Bermuda. So the definers cannot but classify Bermuda as a quasi-flag of convenience country.

The same can be said of a definition emphasizing the lack of a genuine link between the state and the ships. As long as the requirements are not firmly established, the same confusion could arise from this definition. Moreover, the strengthened international regulations and the self-regulations on the part of the flags of convenience countries would increasingly make it difficult to define the registry under flags of convenience on the ground of the lack of a genuine link. In my opinion, the requirement for the existence of a genuine link is not an effective tool for solving the economic and social problem of flags of convenience.<sup>6</sup>

### 3

The foregoing argument seems to suggest that the treatment of flags of convenience as an independent category lies at the root of the difficulty of defining under flags of convenience countries. I would consider flags of convenience as just one of the forms of registering vessels in foreign countries. As noted earlier, the owner of a vessel expects to gain benefits by registering his vessel in a foreign country. Although the benefits the shipowners look for may differ from one owner to another or from one country of registry to another, registration in a flag of convenience country is expected to offer compound benefits, and this can give rise to multifaceted problems.

<sup>5</sup> cf. Polytechnic of Central London, *Flags of Convenience in 1978*, (*Transport Studies Group Discussion Paper No. 8*), pp. 37-40.

<sup>6</sup> UNCTAD (TD/B/C. 4/AC. 1/5), *The Repercussion of Phasing Out Open Registries*, para. 4.

By registering its vessels in a country of flag of convenience, a shipping company can gain benefits which are similar to those enjoyed by a multinational shore industry. Whether or not such a shipping company can be called a multinational in its strict sense, may be questionable, as it can build vessels within its own country and with the own funds raised in his own country. It has only to register such vessels in a country of flag of convenience, because it does not entail the transfer of its capital as is the case with a multinational shore industry. This notwithstanding, the owner of such vessels can enjoy most of the benefits of a multinational corporation. It is relatively easy to hire foreign crew, and the vessels enjoy the freedom of navigation and trade. The only hurdles they must clear are man made ones (statutory regulations, resistance by seamen's unions and so on). Flags of convenience give shipping companies, in addition to tax advantages, wider latitude for seeking out cheaper labor and capital from world markets, more lucrative trade, competitive shipyards, and so on. It is clear that the established practice in the shipping market of chartering vessels makes these shipping companies easy to pursue these advantages originating from registry under flags of convenience. If these vessels of flags of convenience are operated by experienced shipping management from traditional maritime nations, such an arrangement will go a long way toward achieving an optimum allocation of resources in this sector. The lack of experienced management in developing countries seems to be the reason for these countries to seek for the introduction of cargo sharing scheme and to attempt the phasing out flags of convenience vessels. If they had the management know-how, their fleet with lower labour cost and other advantages would grow without such protective measures by competing in the world shipping market with the fleets of traditional maritime countries.

Thus it is clear that vessels of flags of convenience are a product of the free market economy. This explains the rapid increase in the tonnage of vessels in general flying flags of convenience, and the even more dramatic increase in the tonnage of tankers and bulk carriers operated in the competitive market in particular, which coincided with the accelerated worldwide liberalization of the world economy since the 1960s. Conversely any constraints imposed upon free enterprises would result in a shrinkage of bottoms of flags of convenience.

#### 4

I would like to conclude this paper by mentioning the future prospects of flags of convenience vessels, based upon what I have already described.

The exclusion activities of flags of convenience have been attempting, as we can see by referring to the example of UNCTAD, because the vessels under these flags have been raising many problems.

Although it seems to run against common knowledge, I think many methods of exclusion of these vessels do exist. For instance, if the seamen's unions of the world did not require their seamen to board ships under flags of convenience, exclusion could be easily achieved. To give more examples, if all the developing countries were to cooperate not to simultaneously register all ships under flags of convenience, exclusion could also be achieved, and if all the shipowners in the world agreed to discontinue simultaneously to

relying on registration of their ships under flags of convenience, exclusion could also be achieved.

We can learn from the history of this particular field that different interests regarding flags of convenience exist among the individual seamen's unions of the countries concerned, and we can also learn that these conflicting interests as to flags of convenience, especially among the developing countries, make their mutual cooperation impossible. As a result, exclusion of flags of convenience cannot be easily achieved. As I described above, if all the shipowners in the world cooperate exclusion can be achieved. However, should one single shipowner use the registry under flags of convenience, all the other shipowners are obliged to follow as the shipping market especially for tankers and bulk carriers is highly flexible and competitive.

It is probably unnecessary to reiterate this, but for general reference it may be said that under these circumstances recent methods to solve the problems resulting from registry under flags of convenience revolve around regulation rather than exclusion. As I mentioned earlier, regulations approaching the matter from various angles and methods are now being presented. I suppose that flags of convenience will continue to exist until the disadvantages caused by these regulations becomes more widely generalized. Considering past and present day trends, I think that regulations will tend toward strengthening, rather than weakening, in the future. As I see it, these are the future prospects regarding flags of convenience.

I believe that flags of convenience shall not have a brilliant future. For the merits of flags of convenience for their users will tend to decrease as regulations are further strengthened. Primarily, flags of convenience have played a vital role as an effective means of strengthening international competitive power of shipping companies. But international competitive power itself is relative. As the merits of the national flags decrease, so the relative merits of national flag increase, and vice versa. One recent trend which I think deserves special attention is the subsidies for national shipping given by the traditional maritime countries in order to inhibit the transfer of their ships to flags of convenience. A typical example is the case of Greece.

Meanwhile, I suppose that regulations concerning flags of convenience will be further strengthened in the future. In that case, however, it may be dangerous to consider flags of convenience as a phenomenon to be treated as one independent category, because doing so allows for the danger that regulations against flags of convenience will be stipulated without limitation. In fact, the utilization of flags of convenience has the partial merit of enabling adequate allocation of resources. In order to take advantage of the merits of flags of convenience while imposing the necessary regulations, certain standards need to be formulated for these regulations. To set up its standards, I believe that the special features of flags of convenience, which I mentioned earlier, will be helpful.