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The development of ship registration policy in china: Response to flags of convenience

Jihong Chen[a,*], Kevin X. Li[b], Xiang Liu[c], Haobo Li[a]

[a] College of Transport and Communications, Shanghai Maritime University, Shanghai, China
[b] Department of International Logistics, Chung-Ang University, Seoul, Republic of Korea
[c] Department of Civil and Environmental Engineering, Rutgers, The State University of New Jersey, New Jersey, USA

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ABSTRACT

In order to expand registered fleet tonnage and strengthen ship management, China began to introduce a special tax-free ship registration (STFSR) policy in July 2007. However, more than eight years following its implementation, the policy ended in complete failure at the end of 2015. This paper comprehensively evaluates the main content and implementation process of the Chinese STFSR policy, analyzes the effects of the policy, and summarizes the concrete reasons for the policy's failure and lessons to be learnt. A new governance framework is being designed and future directions are being developed to explore how the government can implement a successful ship registry policy. This research is intended to provide new ideas and information to the Chinese shipping industry's policymakers and stakeholders in order to handle the "flagging out" problem, thereby mitigating the current adverse situation of ship flagging overseas while strengthening the management of ship operation.

1. Introduction

A flag of convenience (FOC) or open registry is an idiosyncratic but ubiquitous phenomenon in the world shipping industry. FOC is a special shipping business practice whereby a merchant ship is registered in a country other than that of the ship's owners, and the ship flies that country's flag. The closely-related term open registry is used to describe an organization that will register ships owned by foreign entities. The two terms of the convenience flag and the open registry seem similar, but there are still subtle differences. International Transport Federation (ITF), an international trade union federation of transport workers' unions around the world, would sometimes declare a particular open registry a "flag of convenience" to signal member unions to boycott ships registered in those countries. However, some open registry systems, for example, Hong Kong, Singapore, which are known for relatively fair labour practices and high-quality ship management, have not been designated "flags of convenience" by the ITF. Therefore, the terms "open registry" and "flag of convenience" are not exactly synonymous from the point of view of organized labour and ship management.

About 71% deadweight tonnage (DWT) of the world's ships sails under foreign flags [1]. To save cost and ease business operations, the shipping industry widely adopts the practice of "flagging out", which means that they register ships in foreign countries other than the countries where their owners. As a result, most countries with maritime transportation suffer from this problem. China has a large shipping fleet, but most of its ships also are flagged in other states [2]. China's flagging out problem has become increasingly serious since the 1990s, as increasing numbers of ships owned by state-owned and private enterprises in China use foreign flags. About 20% DWT of ships owned by state-owned and private enterprises in China were registered overseas in 1990, rising to more than 50% in 2015 [1].

In order to alleviate the serious flagging out situation and improve control over the fleets, the Chinese government implemented a new ship registration policy in July 2007, known as the special tax-free ship registration (STFSR) policy. Under this policy, international oceangoing ships of shipping enterprises with Chinese investment, in which the Chinese state or private capital accounts for no less than 50% (herein after referred to "SECI"),which had already registered in other states could re-register under this new policy, and thereby enjoy the preferential government exemptions from import duties and value-added tax [3]. The policy was in effect for more than eight years, culminating in complete failure in December 2015.

The purpose of this paper is to comprehensively evaluate the special ship registration policy of China, summarize the reasons for the policy failure and advance China's future governance of ship registration

* Corresponding author at: 1550 Haigang Avenue, Lin Gang New Harbor City, Pudong, Shanghai 201306, PR China.
E-mail address: jhchen@shmtu.edu.cn (J. Chen).

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management by providing the government with references for policy-making decisions in the future. The specific objectives of this paper include:

- Analyzing the main content and implementation framework of China's STFSR policy and carrying out a comprehensive analysis of the policy's implications.
- Evaluating the effects of this policy by discussing the specific reasons for the policy's failure and lessons learned.
- Advising on possible future governance directions for China's ship registration policy and offering specific policy recommendations.

In this paper, the methods of case study and comparative analysis are used to evaluate STFSR policy and design new governance framework and future directions for China. Case study methodology is applied to analyze the background, framework, development, current conditions and lessons learned of the China's STFSR policy. Related data are collected and comparative studies conducted to discern patterns and formulate principles that might guide future ship registry policy action in China. The paper begins with a comprehensive literature review, followed by the policy background and framework analysis. The paper then identifies the specific lessons learned from the frustrations of China's STFSR policy and offers future governance directions and policy recommendations. Finally, the paper summarizes its principal conclusions.

2. Literature review

The ship registry and vessel flag problem in global maritime transportation has long been a focus of interest to the international shipping community. A number of previous studies have already addressed important aspects of ship registry policy in global maritime transportation. A summary of this academic work is presented below.

In the world shipping industry, the flagging out problem has been controversial for decades [4]. Especially following the Second World War, this problem became increasingly serious, causing widespread concern in the international community. Various doubts about the legitimacy of FOC have necessitated the exploration of reasonable governance mechanisms for this problem [5,6]. International conventions attempted to restrain FOC behavior using the concept of a "genuine link" and urged flag states to fulfill the responsibility of ship management. Unfortunately, this did not have any substantial effect [7,8]. Due to flag states' ineffective supervision, port state control was introduced to the international shipping supervision system [9,10].

There has been significant academic discussion of the reasons for, consequences of and legal governance of flagging out. Scholars have cited economic cost, seafarers, ship finance [11,12], and political factors as motives for flagging out [13]. Because of these advantages, some scholars believe that the escalating adoption of FOC or open registration will be a long-term trend [14,15]. However, the practice of flagging out has also been criticized by scholars, since they believe that the consequences of FOCs include a negative impact on ship safety [16], the marine environment [17], and fair market competition [18]. As for the legal governance of FOCs, scholars studied the problem from the basic legal framework of FOCs and the legal shipping problems caused by the flags. Boczek constructed the basic legal framework and legal countermeasures to study the flag of convenience in the world's shipping industry from the international perspective [19]. Tache analyzed the contradiction between the principle of "genuine link" and shipping operations under convenient flags [20]. Ademuni - Odeke re-examined the legal regime of bareboat charter ship registration and flags of convenience in international law with particular reference to the 1958 Geneva Convention and the 1982 Law of the Sea Convention [21]. Kabai discussed the dilemma of the Maritime Labour Convention faced with the problem of open registries [22].

In the context of the popularity of FOCs and open registries, the choice of a ship's flag is an important decision for shipping companies. Scholars have offered different considerations and methods to model this kind of decision making. Haralambides and Yang introduced fuzzy set theory to assess the economic effects of flagging out utilizing context-dependent economic and societal factors [23]. Kandakoglu et al. proposed a multi-methodological approach based on the strengths, weaknesses opportunities, threats (SWOT) analysis; the analytic hierarchy process (AHP); and the technique for order of preference by similarity to ideal solution (TOPSIS) methods to support the critical decision process of registry selection [24]. Luo et al. used individual ship registration data to analyze flag selection behavior, including flagging out decisions using a binary choice model, and final flag choice, which employs a nested logit model [25]. Yang and Chung developed the research of flag selection for Taiwanese shipping companies under the provisions of the Cross-strait Sea Transport (CST) Agreement, and the Fuzzy Analytic Hierarchy Process (FAHP) method was applied to find the preferred registry location among Taiwan, Hong Kong, and China [26]. Mitroussi and Arghyrou introduced a net flag-out ratio (in contrast to the standard flag-out ratio) and examined the potential contribution of metrics of corruption and institutional measures as decisive factors in explaining flag choice [27].

On the basis of their different interests, ship registry systems and related shipping policies established by the governments of various countries reflect distinctive characteristics or purposes. Chang et al. explored possible policy solutions for shipping directly across the Taiwan Straits and discussed the mode of negotiation for settling the discrepancies in viewpoints between the Mainland of China and Taiwan [28]. Chiu focused on how the liberalization measures were proposed and implemented behind the formulation of governmental shipping policies in Taiwan [29]. Yang developed a comparative analysis of the competitive advantages of the national fleets of Taiwan, Korea, and Japan, and explored the effect of shipping aid policies on a national fleet's competitive advantage, employing gray relational analysis (GRA) [30]. Some research has been carried out on the characteristics of ship registry systems on FOC problem. The main research achievements can be divided into three categories: first, the FOC ship registry systems in Panama [31], Liberia [32], etc.,; second, the studies concerning Norway, Denmark, and other international or secondary ship registration [33,34]; and third, Hong Kong and Singapore's open registration service [35,36].

Most previous academic research has focused on the macro-level of the ship registry system, the reasons and consequences of flagging out, and flag choice decision making. Research on China's ship registration has mainly focused on the problem of legal governance [37]. Little research has been conducted on the innovative reforms to China's specific policy on ship registration. In particular, academic discussion has rarely attempted to fully address the new STFSR policy in China. The contribution of this paper is to fill this research gap by focusing on the content framework and major lessons of China's STFSR policy, in the interest of advancing the future reform of China's ship registration policy.

3. The policy background and framework

3.1. Policy Background and Process

China has historically implemented a restrictive closed ship registry system, which requires that a registered ship shall be owned and constructed by the nation, along with several other restrictions. For example, ships must be owned by China; that is, the Chinese state's investment in a ship must not be less than 50%, the majority of the employed crew must be Chinese, and a mandatory ship survey by the China Classification Society (CCS) must be carried out for ships to be registered [38,39]. In addition, China maintains a high tax on the import of ships and their equipment. If Chinese state-owned or private shipping companies purchase newly built or second-hand ships over-