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The Threat to Global Shipping from Unions and High-Tax Politicians: Restrictions on Open Registries Would Increase Consumer Prices and Boost Cost of Government.

“Open registries” for shipping have a beneficial impact on the global economy by competing to offer shipowners the best tax and regulatory environment combined with efficient service. This process of jurisdictional competition among ship registries has helped reduce costs in the shipping industry – with consumers reaping the lion’s share of the benefit. Notwithstanding the benefits they generate for the global economy, open registries are being attacked on two fronts. The first attack comes from the Organization for Economic Cooperation and Development (OECD), acting on behalf of high-tax governments that maintain monopolistic “national registries.” These registries tend to be much more expensive and much less efficient, so shipowners over time have been abandoning national registries to escape burdensome red tape and onerous taxation. The second attack comes from seafarer unions, coordinated and represented by the International Transport Workers’ Federation (ITF). Unions wielded enormous power prior to the advent of open registries, in large part because they used their political muscle to persuade politicians to set rules for national registries that increased union leverage. The U.S. government has wisely resisted the anti-competitive agenda of the OECD and ITF. As the Maritime Administrator at the Department of Transportation correctly noted, “...it is not the policy of the United States to dictate where ship owners invest their money or register their ships.”¹ Advocates of economic liberalization should support open registries. Free trade and free markets are good for the United States and good for the world economy.

By Daniel J. Mitchell

Introduction

Worldwide trade is important to America’s national interests, and a competitive and efficient international shipping market is vital to international trade. This is why “open registries” for shipping have such a beneficial impact on the global economy.

¹ Testimony of William Schubert, Maritime Administrator, Department of Transportation, to the Special Oversight Panel on the Merchant Marine of the House Armed Service Committee, June 13, 2002. Available at <http://armedservices.house.gov/openingstatementsandpressreleases/107thcongress/02-06-13schubert.html>.

These registries, maintained by about 30 nations, are open to shipowners from all nations. And since owners have the freedom to choose where to “flag” their ships, open registries compete to offer the best tax and regulatory environment combined with efficient service. This process of jurisdictional competition among ship registries has helped reduce costs in the shipping industry – with consumers reaping the lion’s share of the benefit.

Notwithstanding the benefits they generate for the global economy, open registries are being attacked on two fronts. The first attack comes from high-tax governments, many of whom maintain monopolistic “national registries.” These registries tend to be much more expensive and much less efficient, so shipowners over time have been abandoning national registries to escape burdensome red tape and onerous taxation. Politicians from high-tax nations, not surprisingly, resent this development since they lose a captive source of tax revenue as well as power over a segment of the economy. These politicians are working through the Organization for Economic Cooperation and Development (OECD), an international bureaucracy based in Paris, in an effort to curtail open registries and bring back the days when national registries could exercise monopoly power. This effort is rather discriminatory, incidentally, since it conveniently overlooks the handful of OECD nations that have created their own de facto open registries.

The second attack comes from seafarer unions, coordinated and represented by the International Transport Workers’ Federation (ITF). Unions wielded enormous power prior to the advent of open registries, in large part because they used their political muscle to persuade politicians to set rules for national registries that increased union leverage. But it has become increasingly difficult for unions to make unilateral demands now that open registries are such an important part of the shipping market. Simply stated, open registries give shipowners the ability to flee a government that imposes unfavorable labor regulations. Needless to say, seafarer unions would like to inhibit these market forces, which is why they have launched a campaign against what they call “flags of convenience” or FOCs. Like the OECD, the ITF effort gives a free pass to some of the open registries that are maintained by OECD nations.

For all intents and purposes, high-tax governments and unions have created an unholy alliance in an effort to cripple or eliminate open registries. This effort should be resisted, both because monopolistic national registries are inconsistent with free trade and also because open registries benefit America, the world’s biggest exporter and importer. Fortunately, the United States government, led by the Coast Guard, has resisted efforts at the International Maritime Organization (IMO) to undermine open registries. Representatives of the Coast Guard recognize the importance of shipping to America, and they have also identified and acknowledged the good safety and security records of many of the most significant open registries.

The fight to preserve open registries is part of a broader international battle between advocates of jurisdictional competition and defenders of government monopoly power. Competition between governments promotes better policy and innovation, but special interest groups resent this process since it hinders their ability to obtain unearned

wealth. But this is precisely why jurisdictional competition should be defended, whether in the field of taxation, regulation, or shipping.

The Essential Role of Ocean Shipping ... and Open Registries

International trade has become an increasingly important part of the global economy, and more than 80 percent of world trade travels by ship.² Worldwide trade flows by sea have jumped by 75 percent from 1975-2000, an increase of 2.5 billion tons.³ The dramatic increase in trade even led the OECD to admit that, “Freely flowing international trade, carried predominantly by a large and heterogeneous fleet of ocean-going vessels, has been the impetus behind the significant advances in world prosperity experienced in the second-half of the 20th century.”⁴

As both the world’s biggest exporter and the world’s biggest importer, the United States reaps disproportionate benefits as trade expands. According to testimony from a Coast Guard official, “Maritime industries contribute nearly 1 trillion dollars annually to the Gross Domestic Product of the United States with over 95% of our overseas commerce carried through our nation’s seaports.”⁵

Much of this trade depends on foreign-flagged ships – most of them from nations with open registries. An official from the Department of Transportation’s Maritime Administration noted that, “Over 97 percent of U.S. overseas trade (by tonnage) now arrives or departs on foreign vessels.”⁶ Nearly two-thirds of that trade is carried on ships from open registries, with ships from Liberia, Panama, and Bahamas accounting for the lion’s share.⁷

² “Security in Maritime Transport: Risk Factors and Economic Impact,” Organization for Economic Cooperation and Development,” July 2003. Available at <http://www.oecd.org/dataoecd/19/61/18521672.pdf>.

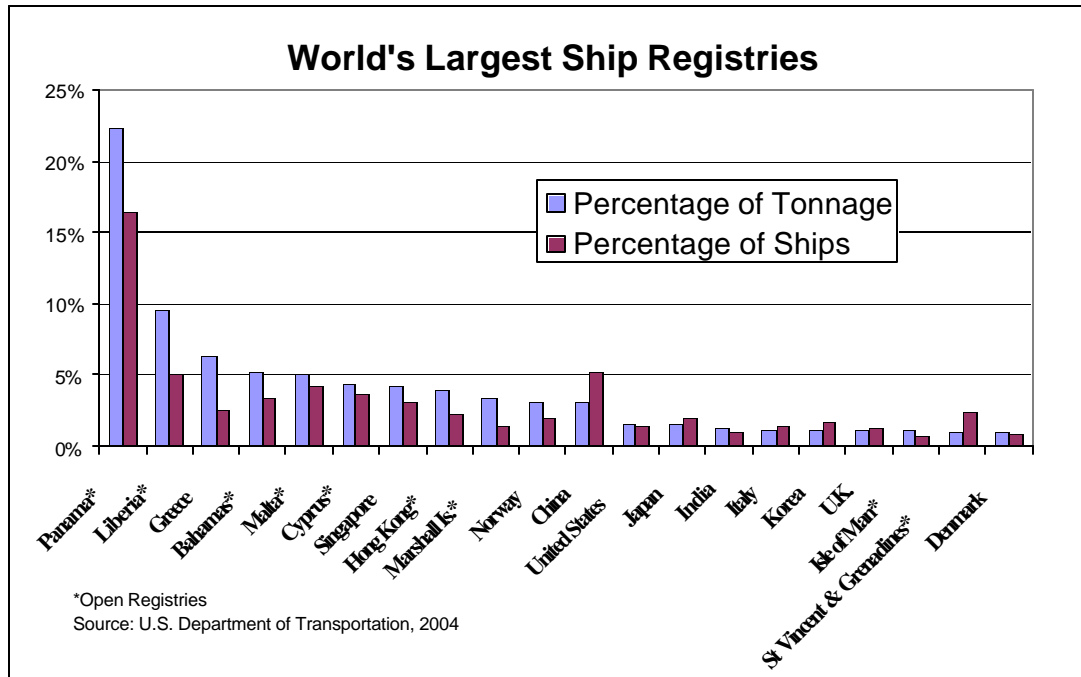
³ Martin Stopford, “Defining the future of shipping markets,” ITIC Forum 2000, October 2, 2000. Available at <http://www.clarksonresearch.com/acatalog/future.pdf>.

⁴ “Security in Maritime Transport: Risk Factors and Economic Impact,” Organization for Economic Cooperation and Development,” July 2003. Available at <http://www.oecd.org/dataoecd/19/61/18521672.pdf>.

⁵ Testimony of Paul J. Pluta, Rear Admiral, United States Coast Guard, to the Special Oversight Panel on the Merchant Marine of the House Armed Service Committee, June 13, 2002. Available at <http://armedservices.house.gov/openingstatementsandpressreleases/107thcongress/02-06-13pluta.html>.

⁶ Testimony of William Schubert, Maritime Administrator, Department of Transportation, to the Special Oversight Panel on the Merchant Marine of the House Armed Service Committee, June 13, 2002. Available at <http://armedservices.house.gov/openingstatementsandpressreleases/107thcongress/02-06-13schubert.html>.

⁷ Testimony of Yoram Cohen, Chief Executive Officer, LISCR, to the Special Oversight Panel on the Merchant Marine of the House Armed Service Committee, June 13, 2002. Available at <http://armedservices.house.gov/openingstatementsandpressreleases/107thcongress/02-06-13cohen.html>.



It is very much worth noting that the term “open registry” is used inconsistently and ambiguously. The International Transport Workers’ Federation maintains a list (see Figure 1) of 28 nations and territories that maintain open registries,⁸ but this list is somewhat subjective. The list seems designed to target smaller jurisdictions in the developing world, perhaps because, apart from their size and relative underdevelopment, they are jurisdictions in which there is no constituent union of the ITF. The ITF list includes Germany, but many other OECD nations have de facto open registries, including the United Kingdom’s home registry,^{9,10} Denmark,¹¹ Norway, and Holland.¹² The United States Maritime Administration list of open registries currently includes Hong Kong,^{13,14} and last year’s list included Norway and Singapore as open registries.¹⁵

⁸ “FOC Countries,” International Transport Workers’ Federation. Available at <http://www.itf.org.uk/english/flagsconvenience/countries/index.htm>

⁹ “More UK vessels held at ports,” Lloyd’s List, March 24, 2004. See also, Sandra Speares, “RMT warns on FoC status for UK-flagged ships,” Lloyd’s List, July 28, 2004.

¹⁰ All the Category 1 Dependant Territory “Red Ensign” Registries, which operate to the same standards as the UK Registry, apart from union membership amongst the crew, are listed

¹¹ Andrew Draper, “ITF threatens FoC status for Dane flag,” Lloyd’s List, December 22, 2003.

¹² Lloyd’s List, “Casualties fall but thorny issues remain,” February 10, 2003.

¹³ “Self-Propelled Oceangoing Vessels 1,000 Gross Tons and Greater,” Maritime Administration, 2004. Available at www.marad.dot.gov/Marad_Statistics/MFW-1-04.pdf.

¹⁴ Hong Kong is an interesting absentee from the ITF list. It was a Dependant Territory Red Ensign register until the Territory reverted to China; now it is the second registry of China, much like the Norwegian second registry. It does not require Hong Chinese as crew; and in fact Hong Kong flagged ships are crewed almost exclusively by low paid Chinese from mainland China, who are legally prohibited from access to Hong Kong and the Hong Kong courts if they need legal redress against the ship. Crew access to the courts of the flag jurisdiction in the event of personal injury or unpaid wages is one of the ITF’s principal criteria to determine FOC status.

¹⁵ “Self-Propelled Oceangoing Vessels 1,000 Gross Tons and Greater,” Maritime Administration, 2003.

Figure 1: Open Registries

Antigua and Barbuda	Cyprus	Mauritius
Bahamas	Equatorial Guinea	Mongolia
Barbados	Germany*	Netherlands Antilles
Belize	Gibraltar	Panama
Bermuda	Honduras	Sao Tome and Principe
Bolivia	Jamaica	St Vincent & The Grenadines
Burma	Lebanon	Sri Lanka
Cambodia	Liberia	Tonga
Cayman Islands	Malta	Vanuatu
Comoros	Marshall Islands	

*German International Ship Register

Source: International Transport Workers' Federation

While the definition may be ambiguous, the trend is very clear. More and more of the world's ships are flagged with open registries. In the mid-1950s, open registries had only 4 percent of the market, but that figure jumped to more than 30 percent by the mid-1980s.¹⁶ Since then, open registries have captured more than 50 percent of the world ship market, with many of the vessels having exited from costly and inefficient national registers in the industrialized world.¹⁷ This trend has been particularly true for the world's bulk fleet.¹⁸

¹⁶ S.R. Tolofari, K.J. Button and D.E. Pitfield, "Shipping Costs and the Controversy over Open Registry," *The Journal of Industrial Economics*, Vol. XXXIV, No. 4, June 1986.

¹⁷ Testimony of William Schubert, Maritime Administrator, Department of Transportation, to the Special Oversight Panel on the Merchant Marine of the House Armed Service Committee, June 13, 2002. Available at <http://armedservices.house.gov/openingstatementsandpressreleases/107thcongress/02-06-13schubert.html>.

¹⁸ Riad al Khouri, "Maritime and Air Transport: The Potential Gains from Liberalization," Third Mediterranean Development Forum, Cairo, March 1999.

Who's Who in Global Shipping

Ships and ship registries are not the only important participants in world shipping. There are several other entities and organizations that play an active role:

Classification Societies

These are organization that, in the words of the International Association of Classification Societies, "...establish and apply technical standards in relation to the design, construction and survey of marine related facilities including ships and offshore structures."¹⁹ There are dozens of classification societies, some with better reputations than others.

Port State Control Authorities

As the name implies, these are the international organizations made up of the jurisdictions with the world's major ports. There are three main port state control authorities, in Paris (serving Europe), in Tokyo (serving the Asia-Pacific region), and the United States. All three authorities monitor the quality (as defined by the deficiency and detention records of the ships calling at the ports within their geographical sphere of influence) of international shipping and then target particular flags on the basis of deficiencies and detentions recorded for ships flying that flag.²⁰

International Maritime Organization

The IMO is the Branch of the United Nations dealing with shipping issues, focusing primarily on safety, security, and pollution prevention.²¹ The IMO is the source of the conventions and treaties which set the standard for shipping internationally. Flag states finance the IMO, with Panama, Liberia, and the Bahamas being the three biggest contributors.²²

Single-Ship Companies

Shipowners generally set up separate companies to own individual ships. As one author has noted, "Because the investment in a ship is high and because each ship is traditionally considered a separate business, ship owners went a step further and began to own each ship through a separate vehicle so that they would limit their exposure and risk to the damage that could be caused by the individual ship. The 'single ship company' was born."²³

¹⁹ "What are Classification Societies," International Association of Classification Societies, London, January 2004. Available at <http://www.iacs.org.uk/pdf/Class%20monograph.pdf>.

²⁰ "Shipping Industry Guidelines on Flag State Performance," Maritime International Secretariat Services, Ltd., London, 2003. Available at <http://www.marisec.org/flag-performance/flag-performance.pdf>.

²¹ For more information, see

http://www.imo.org/includes/blastDataOnly.asp/data_id%3D7520/What_is_Poste%E8Final_Artwork.pdf.

²² "Frequently Asked Questions," International Maritime Organization, London. Available at http://www.imo.org/About/mainframe.asp?topic_id=774.

²³ George C. Economou, "In defence of the ship owner – the OECD Report on Ownership and Control of Ships," Offshore Investment, September 2003.

OECD Maritime Transport Committee

The Maritime Transport Committee is comprised of government officials (generally from the bureaucracies that handle shipping issues) from nations that belong to the Organization for Economic Cooperation and Development. Because most OECD governments have national registries, and because the OECD has an ideological bias against jurisdictional competition, this Maritime Transport Committee is hostile to open registries.

International Transport Workers' Federation

The ITF is the international federation of national unions representing a portion of the shipping workforce. Like the OECD, the ITF is very hostile to open registries since unions have trouble attracting members and wielding power in a competitive market.

UN Convention on the Law of the Sea

There are numerous international treaties and conventions dealing with shipping. The “UNCLOS” agreement is frequently mentioned because the signatories (by no means the majority of the states with registries, national or open) agree that ships must have some connection with the jurisdiction where they are flagged. Opponents of open registries argue that this somehow means that there should only be national registries and that they should be open only to citizens of that nation.²⁴

US Government

The federal government has two bureaucracies that deal with shipping. Generally speaking, the Department of Transportation’s Maritime Administration oversees and represents the US-flagged fleet and the Coast Guard is responsible for overseeing compliance with safety and security requirements for ships in U.S. waters.

Open Registries Benefit Consumers

According to the International Transport Workers’ Federation, a “flag of convenience” is characterized as one that allows foreign owners to register ships, has few barriers to market entry and exit, imposes low taxes, and allows a free market in labor.²⁵ The ITF thinks these are negative characteristics, but they more accurately should be viewed as features of a genuine market. In other words, open registries are a form of free trade and competition.

As might be expected, this system has generated impressive results, with large increases in efficiency and big reductions in price. The cost of sea transport fell by 80

²⁴ “The Genuine Link,” International Transport Workers’ Federation, 2004. Available at www.itf.org.uk/english/flagsconvenience/whatare/genuinelink.htm

²⁵ “Oslo to Delhi,” International Transport Workers’ Federation, 1998.

percent between 1970-2000.²⁶ Open registries played a major role. One expert specifically notes that, “The transfer of ownership to Flags of Convenience was...arguably the most important contributor to cost reductions.”²⁷

Another expert estimates that liberalization and competition helped reduce freight rates by 40 percent in a 10-year period.²⁸ And even the OECD was forced to acknowledge that, “The cost of sea transport as a percentage of the final sale cost of many goods has decreased dramatically over the past 10-20 years. Transport for many goods approximately .5% of FOB value now whereas this figure was 4-5% a few years back.”²⁹

To be sure, these estimates are somewhat imprecise since the ocean transportation marketplace is cyclical, with demand for vessel space and supply of available containers rising and falling depending on global conditions.³⁰ Even if the long-term trend is for costs to fall, shipping rates can climb significantly in a short period of time. Last year, for instance, was a very good year for ship owners thanks to high freight rates.³¹ But price spikes tend to be temporary as the market quickly adjusts, which is what happened toward the end of 2003.³²

Interestingly, competition from open registries has helped national registries shed some of their inefficiencies. Moreover, market pressures to increase the quality of shipping have pushed up costs for ships on highly regarded open registries. An academic study from the 1980s estimates that open registries saw their cost advantage over European registries shrink from 50 percent to 20 percent over a 10-year period.³³ Another study from the same period indicates that the cost advantage for open registries was 23 percent.³⁴ Needless to say, it is unlikely that closed registries would have become more efficient in the absence of competitive pressure.

Competition is good for consumers, whether in the market for pet food, banks, automobiles, haircuts, or shipping. When competition exists, providers have a much

²⁶ Martin Stopford, “Defining the future of shipping markets,” ITIC Forum 2000, October 2, 2000. Available at <http://www.clarksonresearch.com/acatalog/future.pdf>.

²⁷ Martin Stopford, “Defining the future of shipping markets,” ITIC Forum 2000, October 2, 2000. Available at <http://www.clarksonresearch.com/acatalog/future.pdf>.

²⁸ Riad al Khouri, “Maritime and Air Transport: The Potential Gains from Liberalization,” Third Mediterranean Development Forum, Cairo, March 1999.

²⁹ “Summary of the Workshop on Maritime Transport,” Organization for Economic Cooperation and Development, January 17, 2003. Available at <http://www.oecd.org/dataoecd/32/58/2489480.pdf>.

³⁰ Agricultural Ocean Transportation Trends, United States department of Agriculture, June 2000. Available at <http://www.ams.usda.gov/tmd/AgOTT/June2000/june2000pdf.PDF>.

³¹ Martin Stopford, “Three Cheers for Shipping,” Fortis Bank Christmas Seminar, December 11, 2003. Available at <http://www.clarksonresearch.com/acatalog/fortis.pdf>.

³² “On the crest of a wave?” The Economist, July 22, 2004. Available at http://www.economist.com/business/displayStory.cfm?story_id=2947016.

³³ Drewry, H.P., 1984, “Dry Bulk Carrier Operating Costs – Past, Present, and Future,” Study No. 122, London.

³⁴ S.R. Tolofari, K.J. Button and D.E. Pitfield, “Shipping Costs and the Controversy over Open Registry,” The Journal of Industrial Economics, Vol. XXXIV, No. 4, June 1986.

bigger incentive to provide better goods and/or services for lower prices. This is true in the private sector and it is true in the government sector. Open registries have generated enormous benefits for the world economy, with the United States reaping a large share of those benefits since it is the world's biggest exporter and importer.

Not All Registries are Created Equal

This paper is not designed to defend all open registries. Instead, it seeks to demonstrate that these registries help the global economy by encouraging greater competitiveness, while also demonstrating that open registries do not compromise safety and security. This does not mean that all open registries have sterling track records. Just as there are national registries with poor performance, there are open registries that have below-average records.

It appears that registries from industrialized world – or registries managed in the industrialized world – have the strongest performance. Liberia's registry, for instance, is managed from the United States and is widely praised for out-performing several highly regarded national flags.³⁵ The Isle of Man also is universally recognized for its good track record, while the Marshall Islands also enjoy a good reputation.³⁶

Registries from the developing world, by contrast, have less impressive records – regardless of whether they are open or closed. This is not an argument, incidentally, for discrimination against developing nations. It is true that poorer nations might experience difficulty when creating and maintaining registries. Setting up a registry – whether open or closed – is a huge undertaking, requiring inspectors, surveyors, lawyers and other professionals.³⁷ But this does not mean they are incapable of improvement. Indeed, with the help of classification societies, registries of both varieties from Belize, Russia, and St. Vincent and the Grenadines have recently taken strides in the right direction – and Malta, Turkey, and Ukraine are now participating in similar programs.³⁸

The Union Fight Against Efficient Competition

The International Transport Workers' Federation has been fighting against open registries for more than 50 years.³⁹ The campaign got started because, as the ITF claims, "...after the Second World War shipping companies increasingly looked for ways to

³⁵ David Osler, "Britannia's flag never waives the rules," Lloyd's List, August 5, 2004.

³⁶ Maritime Global Net, "Shipping Industry Hits Flags with Blobs of Doubt," November 25, 2003. Available at <http://www.mglobal.com/news/dailystorydetails.cfm?storyid=3627&type=2>.

³⁷ Lloyd's List, "Casualties fall but thorny issues remain," February 10, 2003.

³⁸ Lloyd's List, "Leading horses to water," April 16, 2004.

³⁹ "Flags of convenience campaign," International Transport Workers' Federation, 2004. Available at www.itf.org.uk/english/flagsconvenience/index.htm

escape the obligations placed on them by their flag states...⁴⁰ The ITF claims that “flags of convenience” are a threat to safety and security, but the real issue seems to be that competitive open registries have lower labor costs.⁴¹ The ITF explicitly characterizes this competitive market as a “...rush to the bottom.”⁴² In other words, competition makes shipowners more reluctant to acquiesce to excessive union contract demands.

The ITF’s main goal is to restore the monopoly power of national registries in countries where the constituent unions of the ITF have their membership base. Indeed, it would even like supra-national regulation of the industry, seeking, “The elimination of the [flag of convenience] system and the establishment of a regulatory framework for the shipping industry.”⁴³ Clearly this would undermine the economically beneficial competitive influence of the open registries, but the ITF also sees that as a way of reducing the limited competition that exists between national registries – something that is important to the ITF since it sees low-cost national registries such as China as a threat.⁴⁴ The ITF relies on three basic arguments:

- **Open registries are a violation of international law.** The ITF effort involves, “A political campaign designed to establish by international governmental agreement a genuine link between the flag a ship flies and the nationality or residence of its owners, managers and seafarers, and so eliminate the flag of convenience entirely.”⁴⁵ The ITF specifically cites a clause from the 1958 Geneva Convention on the High Seas, which states in Article 5 that “There must be a genuine link between the State and the ship, in particular, the State must effectively exercise its jurisdiction and control in administrative, technical and social matters over ships flying its flag.”^{46,47} The real debate, of course, is what constitutes “a genuine link” – a rather interesting issue since ships, although they continue to have the name of the port of registry on the hull rarely have a “home port” and instead spend the bulk of their time traveling in international waters. Not surprisingly, the ITF has a self-interested definition, asserting that, “...a genuine link requires that there be located within the flag state a substantial entity which can be made responsible for the actions of the ship and this obligation is

⁴⁰ “Section 1.3: What are Flags of Convenience?” International Transport Workers’ Federation, 2004. Available at www.itf.org.uk/english/flagsconvenience/reports/2002/section01/what-are-foc.html.

⁴¹ S.R. Tolofari, K.J. Button and D.E. Pitfield, “Shipping Costs and the Controversy over Open Registry,” *The Journal of Industrial Economics*, Vol. XXXIV, No. 4, June 1986.

⁴² “What are flags of convenience?” International Transport Workers’ Federation, 2004. Available at www.itf.org.uk/english/flagsconvenience/whatare/index.htm

⁴³ “What are Flags of Convenience (FOCs)?” International Transport Workers’ Federation, 2004. Available at www.itf.org.uk/itfweb/seafarers/foc/Body_foc.html.

⁴⁴ “What do FOCs mean to seafarers,” International Transport Workers’ Federation, 2004. Available at www.itf.org.uk/english/flagsconvenience/whatmean/index.htm

⁴⁵ “Flags of convenience campaign,” International Transport Workers’ Federation, 2004. Available at www.itf.org.uk/english/flagsconvenience/index.htm

⁴⁶ “The Genuine Link,” International Transport Workers’ Federation, 2004. Available at www.itf.org.uk/english/flagsconvenience/whatare/genuinelink.htm

⁴⁷ The open registries that are well resourced do this better and certainly more efficiently than the parochial national registries, which tend to use only their own surveyors.

not discharged by FOCs which permit ‘brass plate’ single ship companies...’⁴⁸
This argument ignores the role of the ship manager, identified by the US Coast Guard and the IMO as the key entity in the control of, and responsibility for, a ship.

- **Open registries undermine safety.** The ITF alleges that open registries have older ships and require workers to be on the job longer. The combination of these factors supposedly undermines safety, leading to accidents to both ships and seafarers.⁴⁹ The ITF cites examples of accidents involving open registry ships, but all registries suffer occasional accidents, so this is not very illuminating. The key question is whether certain registries have accident rates that are persistently above international averages. As will be discussed in a subsequent section, there is no evidence that open registries have inferior safety records.
- **Open registries are a threat to security.** A more recent component of the ITF effort is the assertion that open registries somehow compromise the war against terrorism. The specific accusation is that nations with open registries often have laws protecting the privacy of shipowners, and this might allow terrorists to use a ship either as a weapon or to smuggle weapons, or to finance terrorism. The ITF therefore argues that, “...security requires knowledge of the identity of ships’ beneficial owners...”⁵⁰ Critics respond by noting that the important issue is control of the ship. Most ships are akin to rental cars, they explain, so just as it does not help to know that Hertz owns a car that was used in a bank robbery, neither does it help to know the name(s) of the passive investor(s) who own ships. If a terrorist organization finances ships as part of its fund raising activities it is unlikely to declare its ownership interest.

The US Merchant Marine Fleet

The United States has a rather small fleet, only the world’s 12th largest fleet.⁵¹ In large part, this is because the U.S. operates a national registry with onerous labor regulations and a requirement that the ship be built in the U.S. This policy is inconsistent with America’s national defense interests. In part to ensure adequate sealift capability in

⁴⁸ “The Genuine Link,” International Transport Workers’ Federation, 2004. Available at www.itf.org.uk/english/flagsconvenience/whatare/guinelink.htm

⁴⁹ “What do FOCs mean to seafarers?” International Transport Workers’ Federation, 2004. Available at <http://www.itf.org.uk/english/flagsconvenience/whatmean/index.htm>

⁵⁰ “Section 3.2: Maritime Security” International Transport Workers’ Federation, 2002. Available at www.itf.org.uk/english/flagsconvenience/reports/2002/section03/maritime-security.html.

⁵¹ “Self-Propelled Ocean-going Vessels 1,000 Gross Tons and Greater,” Maritime Administration, 2004. Available at www.marad.dot.gov/Marad_Statistics/MFW-1-04.pdf.

wartime, the United States therefore subsidizes owners and operators of US-flagged vessels.⁵² The United States also maintains a “Ready Reserve Force”⁵³ and a “National Defense Reserve Fleet”⁵⁴ – though there is considerable doubt regarding the effectiveness of the overall American policy.⁵⁵

In many ways, however, some open registries are an unofficial part of the U.S. fleet. One critic of open registries even noted that, “Liberia has hosted a U.S.-based maritime shipping registry since 1949 ... many companies regarded the registry as a de facto second U.S. registry.”⁵⁶ Indeed, a former U.S. Secretary of State founded the Liberian registry.⁵⁷ A representative of the International Transport Workers’ Federation also links certain open registries with the United States, testifying that, “...U.S. citizen-owned vessels registered in Panama, Honduras, Liberia, Bahamas, and the Marshall Islands are under the effective control of the United States.”⁵⁸ The U.S. is not the only beneficiary of this practice. The Bahamas registry is run from London, and the Cambodian register is run from South Korea.⁵⁹

To be sure, having ships under the “effective control” of the U.S. is a sub-optimal situation. There are a number of reforms that would reinvigorate the U.S. fleet, particularly changes in tax policy and labor policy. Under current law, U.S. companies must pay tax on their worldwide income, a policy that sharply curtails their ability to compete around the world.⁶⁰ An official from the Department of Transportation has even testified on the need for, “... a complete reexamination of the tax laws which govern merchant shipping in order to create more incentives for investment by shipowners to return to the U.S. flag.”⁶¹ Labor policy may be an even bigger problem. Ships flagged in

⁵² Riad al Khouri, “Maritime and Air Transport: The Potential Gains from Liberalization,” Third Mediterranean Development Forum, Cairo, March 1999.

⁵³ <http://www.marad.dot.gov/programs/RRF.html>.

⁵⁴ <http://www.marad.dot.gov/programs/NDRF.html>.

⁵⁵ Rob Quartel, “America’s Welfare Queen Fleet: The Need for Maritime Policy Reform,” *Regulation*, Vol. 14, No. 3, Fall, 1991. Available at <http://www.cato.org/pubs/regulation/regv14n3/reg14n3-quartel.html>.

⁵⁶ Testimony of Alex Vines, Senior Researcher, Human Rights Watch, to the Special Oversight Panel on the Merchant Marine of the House Armed Service Committee, June 13, 2002. Available at

<http://armedservices.house.gov/openingstatementsandpressreleases/107thcongress/02-06-13vines.html>.

⁵⁷ Testimony of Yoram Cohen, Chief Executive Officer, LISCR, to the Special Oversight Panel on the Merchant Marine of the House Armed Service Committee, June 13, 2002. Available at

<http://armedservices.house.gov/openingstatementsandpressreleases/107thcongress/02-06-13cohen.html>.

⁵⁸ Testimony of David Heindel, 2nd Vice Chairman, International Transport Workers’ Federation, to the Special Oversight Panel on the Merchant Marine of the House Armed Service Committee, June 13, 2002. Available at <http://armedservices.house.gov/openingstatementsandpressreleases/107thcongress/02-06-13heindel.html>.

⁵⁹ “Section 1.3: What are Flags of Convenience?” International Transport Workers’ Federation, 2002. Available at www.itf.org.uk/english/flagsconvenience/reports/2002/section01/what-are-foc.html.

⁶⁰ Daniel J. Mitchell, “Making American Companies More Competitive,” *Backgrounder* 1691, the Heritage Foundation, September 25, 2003. Available at <http://www.heritage.org/Research/Taxes/BG1691.cfm>.

⁶¹ Testimony of William Schubert, Maritime Administrator, Department of Transportation, to the Special Oversight Panel on the Merchant Marine of the House Armed Service Committee, June 13, 2002. Available at <http://armedservices.house.gov/openingstatementsandpressreleases/107thcongress/02-06-13schubert.html>.

the U.S. must be built in America and use America labor.⁶² This is a grave problem since manufacturing and labor costs in the U.S. are considerably higher than international averages.⁶³

High-Tax Governments Advocate Cartel Policies

The Organization for Economic Cooperation and Development is an international bureaucracy comprised of 30 industrialized nations. Dominated by high-tax European welfare states, the OECD is infamous for its campaign to hinder jurisdictional tax competition.⁶⁴ This effort is primarily designed to help high-tax nations impose their tax laws on income earned in low-tax jurisdictions, largely because politicians from high-tax nations do not want their citizens to have the right to benefit from better tax law in other jurisdictions.

The attack on open registries is part of this anti-tax competition effort. The OECD created a blacklist of low-tax nations in 2000, and a majority of the jurisdictions with open registries were placed on this list – including eight of the nine largest open registries.⁶⁵ According to the Paris-based bureaucracy, open registries are a “harmful” form of competition because high-tax governments have a difficult time determining whether their citizens have any shipping income.⁶⁶ The OECD is demanding automatic access to information about the ownership of shipping companies, even if the companies are registered in other nations and the ships generate income abroad.⁶⁷

The OECD’s anti-tax competition campaign is an assault on sovereignty, but it also is a threat to good tax law and sound business practices. For instance, the OECD writes that, “The genesis of this problem is the ability of corporations to be either partial or whole owners of ships.”⁶⁸ Does this mean the OECD actually expects individual investors to directly own ships, notwithstanding the immense liability issues? Indeed, the OECD admits that its real concern is not open registries, but rather that revenue agents from high-tax nations do not have the right to ransack private company files to ascertain who owns each ship. The bureaucrats even attack free trade, complaining that ships can

⁶² Rob Quartel, “America’s Welfare Queen Fleet: The Need for Maritime Policy Reform,” *Regulation*, Vol. 14, No. 3, Fall, 1991. Available at <http://www.cato.org/pubs/regulation/regv14n3/reg14n3-quartel.html>.

⁶³ Allen R. Ferguson, “Reform of Maritime Policy: Building Blocks of an Integrated Program,” *Regulation*, Vol. 17, No. 2, 1994. Available at <http://www.cato.org/pubs/regulation/regv17n2/reg17n2-ferguson.html>.

⁶⁴ “Harmful Tax Competition: An Emerging Global Issue,” Organization for Economic Cooperation and Development, Paris, 1998. Available at <http://www.oecd.org/dataoecd/33/0/1904176.pdf>.

⁶⁵ “Toward Global Tax Cooperation,” Organization for Economic Cooperation and Development, Paris, 2000. Available at <http://www.oecd.org/dataoecd/9/61/2090192.pdf>.

⁶⁶ Many open registries also were placed on the OECD blacklist for additional reasons such as company formation laws and international banking.

⁶⁷ “Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes,” Organization for Economic Cooperation and Development, Paris, 2001. Available at <http://www1.oecd.org/publications/e-book/2101131e.pdf>.

⁶⁸ “Ownership and Control of Ships,” Organization for Economic Cooperation and Development, March 2003. Available at <http://www.oecd.org/dataoecd/53/9/17846120.pdf>.

be owned by, "...corporate instruments and structures that are freely available internationally."⁶⁹

Last but not least, the OECD regurgitates the ITF argument that open registries somehow are vulnerable to terrorism. In an uncharacteristic display of even-handedness, however, the OECD admits that, "...it is also possible for sophisticated and well-funded terrorists to misuse traditional registers for such purposes, and hence they are not free from risk. The higher risk for terrorists involved in working through the more tightly controlled traditional registers may well be compensated by the more effective cover that would be offered by association with respected and well-known traditional flags."⁷⁰ In any event, the OECD – like the International Transport Workers' Federation – offers very little theory and absolutely no evidence to support the accusation that open registries are more vulnerable to terrorist misuse.

The Critical Role of Jurisdictional Competition

While not the focus of this paper, readers may be interested in learning more about jurisdictional competition and why it is so important in today's economy. This has become a very controversial issue because globalization makes it harder for inefficient governments to maintain uncompetitive policies. But rather than reform, many of these governments are working through international bureaucracies to hinder jurisdictional competition. If their harmonization efforts are successful, bureaucracies like the OECD, the European Union, and the United Nations will undermine economic liberalization and cripple policy innovation.

Perhaps because of America's long experience with federalism, many U.S. officials are appropriately skeptical of "one-size-fits-all" harmonization schemes. John Bolton, currently serving as Undersecretary of State for Arms Control and International Security, wrote that this approach, "... represents a kind of worldwide cartelization of governments and interest groups. ...The costs to the United States--reduced constitutional autonomy, impaired popular sovereignty, reduction of our international power, and limitations on our domestic and foreign policy options and solutions--are far too great, and the current understanding of these costs far too limited to be acceptable."⁷¹

Not surprisingly, economists are particularly critical of efforts to stifle jurisdictional competition. Indeed, several Nobel Prize winners have commented specifically on tax competition. James Buchanan points out that "...the intergovernmental competition that a genuinely federal structure offers may be

⁶⁹ "Ownership and Control of Ships," Organization for Economic Cooperation and Development, March 2003. Available at <http://www.oecd.org/dataoecd/53/9/17846120.pdf>.

⁷⁰ "Maritime Security – Options to Improve Transparency in the Ownership and Control of Ships," Organization for Economic Cooperation and Development," June 2004. Available at <http://www.oecd.org/dataoecd/62/39/32049167.pdf>.

⁷¹ John R. Bolton, "Should We Take Global Governance Seriously?" *Chicago Journal of International Law*, 2000.

constitutionally ‘efficient’...” and that “...tax competition among separate units...is an objective to be sought in its own right.”⁷² Milton Friedman, meanwhile, writes, “Competition among national governments in the public services they provide and in the taxes they impose is every bit as productive as competition among individuals or enterprises in the goods and services they offer for sale and the prices at which they offer them.”⁷³ And Gary Becker observed that “...competition among nations tends to produce a race to the top rather than to the bottom by limiting the ability of powerful and voracious groups and politicians in each nation to impose their will at the expense of the interests of the vast majority of their populations.”⁷⁴

Legal scholars also recognize the dangers of harmonization. John McGinnis of Northwestern University Law School recently wrote that, “Jurisdictional competition among sovereign nations is a primary mechanism for empowering the ‘encompassing interest’ of a nation and reducing the ability of interest groups to take resources from the government. Under jurisdictional competition, sovereigns compete by providing efficient levels of public goods. Leaders are thereby restrained from rewarding themselves, their supporters, or influential special interest groups. A large, diverse democracy, where interest groups are held in check by jurisdictional competition, substantially reduces the incentives for individuals to seek rents through government action. Individuals will instead spend their time, on balance, in relatively more productive and peaceful activity.”⁷⁵

Eliminating competition between nations will result in a particularly perverse form of harmonization as politicians conspire to adopt least-common-denominator policies. The inevitable consequences – slower growth and less opportunity – make this a very unpalatable option.

Safety and Open Registries

Open registries generally have very good safety records. This is especially true for the three biggest open registries – Panama, Liberia, and the Bahamas, all of which perform well based on international comparisons of accident rates and detentions (which occur when a ship fails a port state inspection). To be sure, there are some open registries that are below average using these criteria, but there are many national registries that also have unimpressive records.

The International Transport Workers’ Federation often makes hysterical accusations against the safety records of open registries, but these claims evaporate under

⁷² Geoffrey Brennan and James Buchanan (1980), *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge University Press: Cambridge).

⁷³ Letter to Center for Freedom and Prosperity, 2001. Available at

<http://www.freedomandprosperity.org/update/u05-15-01/u05-15-01.shtml#3>.

⁷⁴ Gary Becker, “What’s Wrong with a Centralized Europe? Plenty,” *Business Week*, June 29, 1998.

⁷⁵ John O. McGinnis, “The Political Economy of Global Multilateralism,” *Chicago Journal of International Law*, 2000.

closer examination. For instance, the ITF charges that, “In 2001, 63 percent of all losses in absolute tonnage terms were accounted for by just 13 FOC registers.”⁷⁶ But the ITF neglects to mention that the top 13 open registries have about that share of the world’s shipping fleet.⁷⁷ In other words, the ITF accusation is about as remarkable as noting that 50 percent of people are taller than average and 50 percent of people are shorter than average.

The most neutral and comprehensive analysis of flag state quality was put together by major shipping organizations. Their study, *Shipping Industry Guidelines on Flag State Performance*,⁷⁸ looked at nearly 20 criteria and noted whether registries did or did not satisfy those criteria. The data makes a strong case for open registries. For instance, open registries accounted for less than one-fourth of the total, yet they were one-third of the nations with perfect records – and they account for 100 percent of the total if de facto open registries are properly categorized.

If a good record is defined as having five or fewer areas of non-compliance, more than 60 percent of open registries get good grades. Fewer than one-third of national registries, by contrast, score that highly. If a poor grade is defined by non-compliance in at least 10 areas, five open registries receive failing marks. But national registries do even worse, both numerically and proportionately with more than 20 closed flags achieving this dubious distinction.⁷⁹

The two most important criteria for comparing safety records presumably are accidents and detentions. And the best way of determining a registry’s safety record is to compare accidents and detentions as a percentage of the total fleet. After all, the total number of accidents has no meaning without knowing whether this is a large percentage or a tiny percentage of the total.

The most notable type of accident, of course, results in the loss of the ship. Relying on ITF data, 99 ships from 32 nations were lost in 2001.⁸⁰ This information shows that the Panama, Liberia, and the Bahamas all had above-average performance. Not only did the three biggest open registries lose fewer ships than would be expected considering the size of their fleets, but six of the nine open registries among the world’s 20 largest fleets had better-than-average results.⁸¹

⁷⁶ “What do FOCs mean to seafarers,” International Transport Workers’ Federation, 2004. Available at www.itf.org.uk/english/flagsconvenience/whatmean/index.htm

⁷⁷ “Top 20 Merchant Fleets of the World,” Maritime Administration, Department of Transportation, Jan. 1, 2004. Available at http://www.marad.dot.gov/Marad_Statistics/MFW-1-04.pdf.

⁷⁸ “Shipping Industry Guidelines on Flag State Performance,” Maritime International Secretariat Services, Ltd., London, 2003. Available at <http://www.marisec.org/flag-performance/flag-performance.pdf>.

⁷⁹ “Shipping Industry Guidelines on Flag State Performance,” Maritime International Secretariat Services, Ltd., London, 2003. Available at <http://www.marisec.org/flag-performance/flag-performance.pdf>.

⁸⁰ “Casualties for 2001,” International Transport Workers’ Federation, 2001. Available at http://www.itf.org.uk/itfweb/seafarers/foc/report_2001/pages/s15-07.html.

⁸¹ Author’s calculations based on data from the International Transport Workers’ Federation and the Department of Transportation’s Maritime Administration.

Another way to measure safety is to examine detentions, which occur when a ship fails inspection and must rectify the faults before leaving port. There are three major sources of data for detentions, and open registries receive generally good marks. Furthermore, they rarely are included on “blacklists” that are used to target fleets with sub-par performance. For instance:

- **Asia-Pacific region:** Of the 15 nations whose ships had above-average detention rates in the Asia-Pacific region, a majority were national registries – and none of the big three (Panama, Liberia, and Bahamas) were on this problem list.⁸² Indeed, looking at the world’s 20 biggest fleets, all nine of the open registries on this list had below-average detention rates – indicating above-average safety and maintenance records. Indeed, only one of these nations is on the Tokyo blacklist . Two are on the grey list and six are on the white list.⁸³
- **European region:** Of the 24 nations whose ships had above-average detention rates in the European region, only nine were open registries. Notably, none of the big three open registries was on the list.⁸⁴ Of the nine open registries with the biggest fleets, a majority earned a spot on the white list of best performers.⁸⁵
- **United States:** Ironically, it is only in the U.S. that open registries have amassed a sub-par performance, accounting for 11 of the 21 nations on the list of targeted flag states.⁸⁶ But it is worth noting that a majority of major open registries had below-average detention rates and only one open registry from the top 20 – St. Vincent and the Grenadines – was noticeably above average.⁸⁷ Moreover, six open registries already have qualified for the Coast Guard’s expedited program for high-quality fleets.⁸⁸

The aforementioned data does not prove that open registries necessarily maintain safer ships. After all, a handful of very small open registries – Belize, Bolivia, Cambodia, Honduras, and St. Vincent and the Grenadines – have bad records, appearing on the Paris, Tokyo, and U.S. blacklists.⁸⁹ Panama has the least impressive performance of the big

⁸² “Annual Report on Port State Control in the Asia-Pacific Region,” Tokyo Memorandum of Understanding Secretariat, Tokyo, 2003. Available at <http://www.tokyo-mou.org/ANN03.pdf>.

⁸³ “Annual Report on Port State Control in the Asia-Pacific Region,” Tokyo Memorandum of Understanding Secretariat, Tokyo, 2003. Available at <http://www.tokyo-mou.org/ANN03.pdf>.

⁸⁴ “Annual Report from the Paris MOU on Port State Control,” Paris, 2003. Available at <http://www.parismou.org/upload/pdf/PMOU%20Anrep2003.pdf>.

⁸⁵ “Annual Report from the Paris MOU on Port State Control,” Paris, 2003. Available at <http://www.parismou.org/upload/pdf/PMOU%20Anrep2003.pdf>.

⁸⁶ “Port State Control in the United States: Annual Report,” United States Coast Guard, 2003. Available at <http://www.uscg.mil/hq/g-m/pscweb/annalrpt03.pdf>.

⁸⁷ “Port State Control in the United States: Annual Report,” United States Coast Guard, 2003. Available at <http://www.uscg.mil/hq/g-m/pscweb/annalrpt03.pdf>.

⁸⁸ “Port State Control in the United States: Annual Report,” United States Coast Guard, 2003. Available at <http://www.uscg.mil/hq/g-m/pscweb/annalrpt03.pdf>.

⁸⁹ “Shipping Industry Guidelines on Flag State Performance,” Maritime International Secretariat Services, Ltd., London, 2003. Available at <http://www.marisec.org/flag-performance/flag-performance.pdf>.

three registries, amassing an average record by world standards. But since there are some national registries that have consistently bad grades, this simply indicates that some registries do a good job promoting safety while others either are lackadaisical or have inadequate resources.

Instead of making ideologically motivated attacks on open registries, advocates of shipping safety should be exploring policies that actually reduce accidents. There are several good options, including a thorough inspection regime enforced by detention of sub-par ships. Shipowners do not make money when their ships are sitting idle, so this is an effective means of promoting ship safety. And since many port state authorities review prior inspection history when deciding what ships to inspect, this enhances the incentive to properly maintain ships.⁹⁰ Port state authorities also can pressure registries – both open and closed – to help enforce good standards by targeting ships associated with below-average flags.⁹¹ It is worth noting, though, that even the OECD has stated that inspections and detentions should be based solely on the quality of the ship, rather than the registry under which it is flagged.⁹²

Regardless of whether certain flags are targeted, registries have an incentive to develop a good reputation. As one maritime group has written, “The shipping company, and not least its charterers, may also have general concerns about the implications for its corporate reputation of being associated with a poorly performing flag, even if the company’s ships are fully compliant.”⁹³ This is especially true if insurers begin to charge higher rates for ships associated with lower-quality flags.

Indeed, the mere fact that the shipping industry announced that it was going to analyze flag performance had a desirable impact on nations – regardless of whether they maintained open or national registries.⁹⁴ Classification societies also help to promote and maintain standards, As the OECD noted, “Classification societies play an extremely important role in the process, and must perform their tasks effectively and with great diligence.”⁹⁵ And since “loss of class” can result in higher insurance costs and reputational damage, this is not a trivial sanction.⁹⁶

⁹⁰ “Annual Report on Port State Control in the Asia-Pacific Region,” Tokyo Memorandum of Understanding Secretariat, Tokyo, 2003. Available at <http://www.tokyo-mou.org/ANN03.pdf>.

⁹¹ “Shipping Industry Guidelines on Flag State Performance,” Maritime International Secretariat Services, Ltd., London, 2003. Available at <http://www.marisec.org/flag-performance/flag-performance.pdf>.

⁹² “Policy Statement on Substandard Shipping by the Maritime Transport Committee of the OECD,” Organization for Economic Cooperation and Development,” April 11, 2002. Available at <http://www.oecd.org/dataoecd/18/37/2080990.pdf>.

⁹³ “Shipping Industry Guidelines on Flag State Performance,” Maritime International Secretariat Services, Ltd., London, 2003. Available at <http://www.marisec.org/flag-performance/flag-performance.pdf>.

⁹⁴ Julian Bray, “Flag states face much tighter scrutiny,” October 17, 2003.

⁹⁵ “Policy Statement on Substandard Shipping by the Maritime Transport Committee of the OECD,” Organization for Economic Cooperation and Development,” April 11, 2002. Available at <http://www.oecd.org/dataoecd/18/37/2080990.pdf>.

⁹⁶ “Competitive Advantages obtained by Some Shipowners as a Result of Non-Observance of Applicable international Rules and Standards,” Organization for Economic Cooperation and Development,” 1996. Available at <http://www.oecd.org/dataoecd/10/10/2754615.pdf>.

There is no theory or evidence to support the claim that open registries compromise maritime safety. Lloyd's List may have summarized the issue best, writing:

The perennial question of whether an open register can do as good a job as a traditional maritime administration is one of decreasing relevance. There are many, well-proven open registers whose ships perform well enough to keep them consistently on the white lists of port state control authority detention tables, often in a much better position than several well-known, traditional maritime flags.⁹⁷

Open Registries and the Fight Against Terrorism

Ever since the terrorist attacks on September 11, 2001, officials from intelligence services and law enforcement have proactively worked to strengthen defenses against future assaults. One potential threat is that terrorists might use a ship either as a weapon or as a means of smuggling weapons. The nightmare scenario is that a ship with a nuclear bomb is detonated at a major port. Needless to say, all shipping registries should cooperate to preclude this kind of diabolical behavior, both because it is the right thing to do and because it is in their financial interest. The OECD even acknowledged that all registries, "...would want to do what they can to reduce their exposure to possible abuses by such groups..."⁹⁸

Open registries have taken the lead in the war against terror. Liberia, for instance, became the first nation to sign a special agreement with the United States government to allow its ships to be boarded.⁹⁹ This is a dramatic arrangement. The Wall Street Journal reported that, "The agreement with Liberia, the world's second-largest shipping registry, gives the U.S. Navy the authority to board and search any ship flying a Liberian flag that U.S. intelligence believes is carrying illicit weapons or delivery systems."¹⁰⁰ The world's largest ship registry, Panama, signed a similar agreement a few months later.¹⁰¹ Moreover, Panama has clearly stated its willingness to help fight the battle against both terrorism and drug smuggling. And it is worth noting that the United States government verifies Panama's willingness to help.¹⁰²

⁹⁷ Mike Corkhill, "Challenging new regime," Lloyd's List, September 5, 2003.

⁹⁸ "Maritime Security – Options to Improve Transparency in the Ownership and Control of Ships," Organization for Economic Cooperation and Development, June 2004. Available at <http://www.oecd.org/dataoecd/62/39/32049167.pdf>.

⁹⁹ U.S. Department of State, "Proliferation Security Initiative Ship Boarding Agreement with Liberia," February 11, 2004. Available at www.state.gov/t/np/trty/32403.htm

¹⁰⁰ The Wall Street Journal, "WMD at Sea," February 19, 2004.

¹⁰¹ "Panama to let US search its ships," BBC News, May 11, 2004. Available at <http://news.bbc.co.uk/2/hi/americas/3705029.stm>

¹⁰² "US satisfied with ISPS transparency," Fairplay International Shipping Weekly, July 10, 2003.

The OECD/ITF Straw-Man Argument

The OECD and the ITF both assert that the combination of open registries and corporate structures somehow might facilitate terrorism, but this is a demonstrably false claim. Simply stated, the confidentiality rules that govern both registries and companies do not protect behavior that violates the commonly shared laws of civilized nations. Nations quite properly will protect the privacy of their shipping registries and corporations when dealing with the extra-territorial tax claims of a foreign government, but no country asserts that it has the right to withhold information on terrorists.

The OECD has stated that, “There should be proper provision for holding, sharing and making information available to appropriate authorities. In particular there should be no barriers to the flow of information to competent security and law enforcement agencies, even if this information is not generally available to the public.”¹⁰³ This is a perfectly reasonable statement, one that should be – and presumably would be – endorsed by all nations. The issue is the definition of “appropriate authority.” Thanks to bilateral treaties, there already exists an effective system for international cooperation in the fight against serious crime. The problem arises when countries try to tax income earned in other nations. Many low tax countries understandably do not trust the OECD since it seems more anxious to use international agreements to fight against tax competition rather than to fight against terrorism.

The OECD and ITF also are wrong when they imply that anonymity and secrecy are part of open registries and corporate ship ownership. Ironically, the OECD even admits this is not true, writing that, “All ship registers require some information on ownership to be provided when application is made for the registration of a ship.”¹⁰⁴ Moreover, shipowners must disclose their identities when dealing with financial institutions, which presumably must happen since it would be virtually impossible to finance and maintain a ship without access to credit.¹⁰⁵ Most importantly, there is no ability to shield one’s identity if a crime has been committed on a ship.¹⁰⁶

It also is worth noting that the OECD is throwing stones in a glass house. The bureaucracy’s own publications declare that corporate structures are used to own ships in the national registries of OECD nations.¹⁰⁷ Moreover, terrorists might actually prefer using closed registries. According to the Paris-based bureaucracy, “...traditional registers, including those of the OECD, may not be immune to being used by anonymous

¹⁰³ “Maritime Security – Options to Improve Transparency in the Ownership and Control of Ships,” Organization for Economic Cooperation and Development, June 2004. Available at <http://www.oecd.org/dataoecd/62/39/32049167.pdf>.

¹⁰⁴ “Ownership and Control of Ships,” Organization for Economic Cooperation and Development, March 2003. Available at <http://www.oecd.org/dataoecd/53/9/17846120.pdf>.

¹⁰⁵ George C. Economou, “In defence of the ship owner – the OECD Report on Ownership and Control of Ships,” Offshore Investment, September 2003.

¹⁰⁶ George C. Economou, “In defence of the ship owner – the OECD Report on Ownership and Control of Ships,” Offshore Investment, September 2003.

¹⁰⁷ “Ownership and Control of Ships,” Organization for Economic Cooperation and Development, March 2003. Available at <http://www.oecd.org/dataoecd/53/9/17846120.pdf>.

beneficial owners. The additional complexity and risk of registering vessels in traditional registers would be made up by the status and perhaps lesser attention directed toward vessels registered in these traditional registers.”¹⁰⁸

Ship control is the key issue, not ownership

In addition to throwing stones in glass houses, the OECD and ITF are not targeting the right house. From a security perspective, the critical questions are who controls the ship and what is in the cargo. In almost all circumstances, the name of the owner is irrelevant. After all, as the OECD even admits, “...owners can delegate many of their responsibilities to ship managers, who may (with or without the beneficial owner’s knowledge and/or consent) themselves undertake illegal or undesirable activities. It is therefore also important to know the details of the managers of the day-to-day operations of those vessels.”¹⁰⁹

This view is widely shared among experts. The President of the Union of Greek Shipowners noted that the shipowner was “the least relevant” component, explaining instead that, “The operator is far more important – there needs to be transparency there... If a terrorist wants to get involved in shipping, he is not going to put his name down.”¹¹⁰ This is why shipping analysts have written that, “...an undue focus on beneficial ownership – fostered by interest groups with agendas unrelated to maritime security – may obscure the fact that other information relating to the operation and management of ships may well normally be more relevant to the specific concerns which the [IMO’s Intersessional Working Group on Maritime Security] seeks to address.”¹¹¹

Not surprisingly, open registries share this view. A spokesman for the Liberian registry testified before a panel of the House Armed Services Committee that, “...the critical issues of concern are: who are the crew and who has the control of the ship –who makes decisions about the operation of the ship.”¹¹² And an article about ship security noted that, “...terrorists do not have to own the ship to do mischief. They can charter the ship and thereby avoid having to risk their own investment.”¹¹³

Moreover, even if a terrorist purchased a ship, ownership in and of itself is not a threat. The real danger is what he might do with it. As one press report explained, “If a

¹⁰⁸ “Ownership and Control of Ships,” Organization for Economic Cooperation and Development, March 2003. Available at <http://www.oecd.org/dataoecd/53/9/17846120.pdf>.

¹⁰⁹ “Ownership and Control of Ships,” Organization for Economic Cooperation and Development, March 2003. Available at <http://www.oecd.org/dataoecd/53/9/17846120.pdf>.

¹¹⁰ John McLaughlin and Brian Reyes, “Lyras warns against US transparency drive,” Lloyd’s List, March 26, 2002.

¹¹¹ Ince & Co, “Maritime Security: Information relating to the ‘ownership’ and ‘control’ of ships,” March 14, 2002.

¹¹² Testimony of Yoram Cohen, Chief Executive Officer, LISCR, to the Special Oversight Panel on the Merchant Marine of the House Armed Service Committee, June 13, 2002. Available at <http://armedservices.house.gov/openingstatementsandpressreleases/107thcongress/02-06-13cohen.html>.

¹¹³ George C. Economou, “In defence of the ship owner – the OECD Report on Ownership and Control of Ships,” Offshore Investment, September 2003.

shipowner is involved in terrorism, ... he is unlikely to put it down on paper, and anyway, such activity would be a function of his role as manager rather than owner.”¹¹⁴ This is why the proper focus should be on who has active control of the ship and the cargo that is being transported.

Common sense prevails

Fortunately, governments have chosen to focus on the real dangers. As part of new procedures put in place after September 11, 2001, all ships now must comply with an extensive set of security procedures in order to have access to major ports. These rules, known as the International Ship and Port Facility Security Code, are designed to thwart dangers including terrorism.¹¹⁵ Moreover, there are additional procedures to facilitate cooperation between individual governments in the fight against terrorism and other serious crimes. These generally include the ability to request and obtain information needed to investigate and prosecute criminal activity. As one Coast Guard official explained, his agency “...will go first to the flag state and ask for information through the appropriate legal enforcement channels.”¹¹⁶ This system works, well, though governments should take additional steps to promote even more cooperation.¹¹⁷

The decision to focus on who controls the ship was made at a meeting of the International Maritime Organization (IMO). Delegates decided that, “...any attempt to keep track of beneficial owners in the interests of maritime security would be futile and may be counterproductive.”¹¹⁸ Instead, they properly decided that knowing “...who has effective operational control of the ship” would best protect security.¹¹⁹ An ITF effort to focus on ownership was dismissed with barely one hour of debate.¹²⁰ Perhaps most important, the United States Coast Guard endorsed this approach, with one official commenting that, “the key issue is who has effective control of the vessel.”¹²¹ This decision made perfect sense, as was explained in a speech the following year:

The issue was debated on and on the motion of the US and Greek delegations it was agreed that the key issue for security was the control of the ship. This was where transparency, and competency, was required. The US Coast Guard was

¹¹⁴ John McLaughlin, “USCG dismisses pleas for secrecy,” *Lloyd’s List*, March 27, 2002.

¹¹⁵ “FAQ on ISPS Code and maritime security,” International Maritime Organization, 2004. Available at http://www.imo.org/Safety/mainframe.asp?topic_id=897.

¹¹⁶ “US satisfied with ISPS transparency,” *Fairplay International Shipping Weekly*, July 10, 2003.

¹¹⁷ “Report on Financial Privacy, Law Enforcement, and Terrorism,” Task Force on Information Exchange and Financial Privacy, Washington, DC, March 25, 2002. Available at <http://www.freedomandprosperity.org/task-force-report.pdf>.

¹¹⁸ Hugh O’Mahony, “IMO buries ownership check,” *Lloyd’s List*, May 1, 2002.

¹¹⁹ Testimony of David Heindel, 2nd Vice Chairman, International Transport Workers’ Federation, to the Special Oversight Panel on the Merchant Marine of the House Armed Service Committee, June 13, 2002. Available at <http://armedservices.house.gov/openingstatementsandpressreleases/107thcongress/02-06-13heindel.html>.

¹²⁰ Hugh O’Mahony, “IMO buries ownership check,” *Lloyd’s List*, May 1, 2002.

¹²¹ John McLaughlin, “IMO scuppering of ownership disclosure accepted by US,” *Lloyd’s List*, May 6, 2002.

clear that what they wanted to know about a ship approaching US waters was ‘who in our jurisdiction was in control of this ship?’ They did not want a 42-page partnership agreement faxed to them when the ship was 96 hours out.¹²²

Getting the most bang for the buck

Governments do not have unlimited resources to fight terrorism. Just as it would be unfeasible to place marshals on every commercial flight, it also would be prohibitively expensive to put law enforcement officials on every ship. That is why it is important to focus on real threats and to minimize those threats in ways that are cost effective for both the private sector and the government.¹²³ Imposing lots of paperwork is probably not the answer. As one shipping executive noted, “It’s a bloody nuisance. It’s losing us a fortune and won’t bring us anything.”¹²⁴ Private sector leaders also have complained about rules that would require the Coast Guard to review and approve individual security plans for a large number of ships, explaining that such a scheme, “...would not only be a wasteful expenditure of coast guard resources, but would cripple the American economy.”¹²⁵

An active campaign to locate and liquidate terrorists is presumably the best option. This largely is a job for intelligence agencies and the military. This effort can and should be complemented by a well-targeted defensive campaign to protect against terrorist attacks. This campaign should not be compromised by organizations with ideological agendas, such as the OECD and ITF. If pressured by these organizations, policy makers should consider the following trade-offs:

- Should governments devote their energies to investigating whether governments like Yemen and Somalia are permitting Al-Qaeda to control ships?¹²⁶ Or should those governments interfere with international shipping markets to help high-tax nations enforce bad tax law?
- Should governments increase their efforts to fight piracy, which has reached record levels?¹²⁷ Or should governments rig the international shipping market to give unions greater bargaining power?
- Should governments work together to ensure the integrity of the entire shipping supply chain, including the parts that take place on land such as the preparation

¹²² Jill Keohane, “Protecting Maritime Safety and Security, Instead of Protecting High Tax Nations,” Center for Freedom and Prosperity Forum, Panama, July 15, 2003.

¹²³ John McLaughlin and Brian Reyes, “Lyras warns against US transparency drive,” Lloyd’s List, March 26, 2002.

¹²⁴ Robert Wright, “Security rules ‘likely to disrupt shipping,’” Financial Times, June 24, 2004.

¹²⁵ Janet Porter, “USCG ship vetting ‘will cripple U.S. commerce,’” Lloyd’s List, June 23, 2004.

¹²⁶ Gary Jones, “Osama’s Navy,” Daily Mirror, London, February 12, 2004.

¹²⁷ “Security in Maritime Transport: Risk Factors and Economic Impact,” Organization for Economic Cooperation and Development,” July 2003. Available at

<http://www.oecd.org/dataoecd/19/61/18521672.pdf>.

and loading of cargo?¹²⁸ Or should they cater to the demands of the OECD and ITF by persecuting open registries.

- Should governments concentrate on potential risks such as the contents of containerized cargo and the identity of seafarers?¹²⁹ Or should they help the OECD and ITF prop up monopolistic national registries, even though the OECD admits that they, "...are vulnerable to potential misuse by terrorists or criminal interests."¹³⁰

Conclusion

Open registries play a vital role in the international shipping market. By promoting competition, they help reduce costs and promote innovation. This has generated hostility from both high-tax governments, represented by the Organization for Economic Cooperation and Development, and unions, represented by the International Transport Workers' Federation. High-tax governments are upset that shipowners have migrated to open registries in part to benefit from better tax law. Unions are upset since it is much easier to wield power when dealing with monopolistic national registries.

Both the OECD and ITF want to cripple open registries. These institutions have even resorted to dishonest assertions that open registries are a threat to safety and security. Neither accusation is true. Open registries have some of the world's best safety records, and they also fully support new rules to help protect ships and ports from terrorist attack.

The U.S. government has wisely resisted the anti-competitive agenda of the OECD and ITF. As the Maritime Administrator at the Department of Transportation correctly noted, "...it is not the policy of the United States to dictate where ship owners invest their money or register their ships."¹³¹ Free trade and free markets are good for the United States and good for the world economy.

¹²⁸ "Summary of the Workshop on Maritime Transport," Organization for Economic Cooperation and Development, January 17, 2003. Available at <http://www.oecd.org/dataoecd/32/58/2489480.pdf>.

¹²⁹ "Security in Maritime Transport: Risk Factors and Economic Impact," Organization for Economic Cooperation and Development, July 2003. Available at <http://www.oecd.org/dataoecd/19/61/18521672.pdf>.

¹³⁰ "Maritime Security – Options to Improve Transparency in the Ownership and Control of Ships," Organization for Economic Cooperation and Development, June 2004. Available at <http://www.oecd.org/dataoecd/62/39/32049167.pdf>.

¹³¹ Testimony of William Schubert, Maritime Administrator, Department of Transportation, to the Special Oversight Panel on the Merchant Marine of the House Armed Service Committee, June 13, 2002. Available at <http://armedservices.house.gov/openingstatementsandpressreleases/107thcongress/02-06-13schubert.html>.

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