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Item 3 (i) of the provisional agenda

**Emerging issues in transport: Inter-island shipping**

**Selected policy issues in inter-island shipping**

**Note by the secretariat\***

The present information paper on selected issues in inter-island shipping is intended to provide participants with additional information relating to the document to be considered under item 3 (i) of the provisional agenda (E/ESCAP/MCT.2/10).

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\* The present document has been issued without formal editing.

## **I. Franchising of domestic shipping services**

1. The following discussion focuses the aspect of domestic shipping policy that attempts to address the issue of provision of shipping services where an operator, for commercial reasons, would not provide the services or not provide services of a desirable level in terms of frequency, reliability and geographical coverage.

2. The franchising of domestic shipping routes involves the contracting of private operators by governments to deliver services of a predetermined quality to specified populations. Such schemes have been implemented in Pacific Island countries with varying degrees of success. The range of problems encountered have included:

- Shortage of private sector operators willing to bid for and operate the services;
- Unsuitability of vessels deployed to deliver franchised services;
- Requirements by financing agencies that vessels are insured, which conflicts with local cultural practice of net insuring vessels (or of vessels being uninsurable);
- Erratic performance of obligations by contracted service providers;
- Unwillingness or inability of governments to enforce sanctions for non-performance;
- Unwillingness of governments to commit the funds required to make subsidy payments for the full period of the franchise contract;
- Communities not meeting the original criteria for inclusion in the scheme applying pressure on governments for later inclusion; and
- Lack of implementation of contract bidding requirements by the responsible governments.

3. Taking into account these experiences, a franchise shipping scheme was introduced in the Solomon Islands towards the end of 2010. The scheme, co-financed by the European Union, the Asian Development Bank, and the Solomon Islands Government, aims to reduce barriers to market access and promote the growth of rural production for remote island communities without reliable maritime services.

4. Initially, five routes were franchised. These were selected based upon a multi-criteria analysis which included: distance from the capital city; confirmation by stakeholders that the route was not financially viable but socially and economically desirable; previous identification as a route requiring assistance; not well served by commercial services; and possessing a history of subsidized calls.

5. On the routes, operators are required to provide a specified number of voyages during the contract period. The route also includes calls at nominated destinations although; the order of rotation is not specified. Vessels in the size range of 220 to 300 gross tons are considered acceptable

in terms of safety, comfort and carrying capacity. Proposed call frequencies were between one and two voyages per month.

6. As part of the service monitoring system, vessels will be required within a set period after the completion of a voyage to submit details of the voyage, including passenger lists and fare revenue collected; freight and tariffs collected; logbook entries showing vessel positions, arrival and departure times; and fuel use. A record will be required of each call at a specified location, counter signed by an authorized signatory, usually a nominated individual such as teacher, post master, health worker or local government official.

7. Most of the administration of the scheme including procurement, safety certification, evaluation of tenders, implementation, monitoring and review of contracts lies with government agencies. However, day-to-day management is to be contracted out to a professional management or accounting firm. Functions will include monitoring and reconciliation of voyage records, passenger lists, cargo manifests, substantiation of required calls, and monitoring adherence with contract conditions and performance specifications.

8. Delegations may wish to share their current practices and experiences in providing shipping services to deprived areas and provide the secretariat with guidance on ways and means to move forward on this issue.

## **II. Subregional cabotage**

9. Cabotage (reservation of the domestic trade of countries to carriers of that country) has been shown to be a complex and sometimes emotive issue. The principle reason for its complexity is that it has significant impacts on stake holders with differing vested interests. Shippers and consumers have an interest in service quality and low prices; ship-owners have an interest in profitability; labour has an interest in income, employment levels and working conditions; providers of services to the shipping industry (including shipbuilders and repairers) have an interest in profitability and employment; and governments have various economic, social and national security responsibilities and interests that they are expected to address. Given the conflicting nature of these interests, considerable difficulty is experienced in reconciling them.

10. Most countries offer various forms of protection to domestic transport. These can include specific cabotage laws and policies as well as other legislative and regulatory provisions that directly or indirectly exclude foreigners from participation in domestic transport. Amongst others, the indirect forms can include laws and regulations related to immigration, nationality company registration, employment and labour standards as well as broader industrial policies and legislation. Consequently, any attempt to address the issue of cabotage requires a deep analysis of the complex interrelationships between the policies, legislation, regulations and legal interpretations by the courts.

11. Public sentiment towards various forms of protectionisms tends to ebb and flow. In recent decades, a period of liberalization of international trade, as well as regional cooperation and integration is prevalent. This is witnessed through the policies and regulations of such intergovernmental

organizations and initiatives as the World Trade Organization, the European Union, the North American Free Trade Agreement, the ASEAN Economic Community and the Pacific Islands Forum.

12. With respect to cabotage, the European Union is applying the principle of “freedom to provide services to maritime transport within Member States”.<sup>1</sup> In the Asia-Pacific region, ASEAN has adopted a roadmap towards integrated and competitive maritime transport,<sup>2</sup> the Pacific Islands Forum has recognized that regional cabotage could benefit Forum Island Countries,<sup>3</sup> and calls to address the cabotage issue have been made by various stakeholders in a number of other ESCAP members.

13. This section considers firstly the elements of the cabotage debate, and secondly draws upon the regional approach adopted by the European Union as a means of moving towards increased services quality and competitive freight rates.

14. While most countries in the Asia-Pacific region do have some form of cabotage legislation, some exemptions are allowed. Examples include cases where no other ships are available or where a foreign ship carries coastal cargo in the normal course of loading or unloading their international cargo. This is clearly a reflection of the reluctance of countries to open their trades to international shipping. At the regional level however, the European Union has been successfully implementing, for nearly twenty years, a maritime cabotage policy within the Union. Essentially, this allows only member States to enter the coastal trades of other member States of the Union.

15. The relevant Council Regulation, (EEC) No 3577/92 of 7 December 1992, applying the principle of freedom to provide services to maritime transport within Member States (maritime cabotage) entered into force on 1 January 1993.

16. In the preambular section of Regulation 3577/92 a number of guiding principles were recognized. These included:

- “... the implementation of this freedom should be gradual and not necessarily provided for in a uniform way for all services concerned, taking into account the nature of certain specific services and the extent of the effort that certain economies in the Community showing differences in development will have to sustain;”
- “... the introduction of public services entailing certain rights and obligations for the ship owners concerned may be justified in order to ensure the adequacy of regular transport services to, from and between islands, provided that there is no distinction on the grounds of nationality or residence;” and

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<sup>1</sup> Council Regulation No 3577/92/EEC of 7 December 1992 applying the principle of freedom to provide services to maritime transport within Member States (maritime cabotage).

<sup>2</sup> *Roadmap towards an integrated and competitive maritime transport in ASEAN*, adopted by the Thirteenth ASEAN Transport Ministers (ATM) Meeting, Singapore, 1 November 2007.

<sup>3</sup> *Forum of Principles on Regional Transport Services*, adopted by the Forum Economic Ministers, Apia, Samoa, 6 August 2004.

- “... provisions should be adopted so that safeguard measures can be taken as regards maritime transport markets affected by a serious disturbance or in the event of an emergency; whereas, for this purpose, suitable decision-making procedures should be introduced;”

17. Regulation 3577/92 defines ‘maritime cabotage’, ‘a Community ship owner’, ‘a public service contract’, ‘public sector obligations’ and ‘serious disturbance of the internal transport market’. It then goes on to describe the circumstances under which the host State may apply their conditions related to manning of vessels and the requirements that may be included in a public service obligation.

18. The Regulation also temporarily exempted maritime transport services carried out in a number of countries in the south of the Union for varying periods of time. Most were less than six years however in the case of Greece it was eleven years for regular passenger and ferry services and services provided by vessels less than 650 gross tons.

19. The Regulation allows Member States to impose public service obligations on all operators on a given route to ensure sufficient service on that route where it appears that, if they considered their own commercial interest, operators would not propose an adequate level of services. These obligations may be imposed by regulation (such as a declaration regime, a licensing system or an authorization system) or, if this does not suffice to meet essential transport needs in an adequate manner, laid down by way of public service contracts. If necessary, financial compensation may be granted to operators to cover the costs involved in meeting public service obligations. The imposition of public service obligations being a precondition for any compensation being given.

20. A regional approach, such as that implemented in the European Union addresses many of the concerns expressed by stakeholders in the cabotage debate. In particular, it provides for a gradual approach that allows regional members to impose public service obligations, permits members to specify the required proportion of regional nationals on board ships and to impose minimum wage rules in force in the country.

21. In view of the potential benefits of improved service quality and competitive freight rates the Conference may wish to provide guidance to the secretariat on ways and means to move forward on this issue.

### **III. Regulation of international trades**

22. At the international level, the main policy has been regulation of entry. One example of this is the Micronesian Shipping Commission (MSC) of the Marshall Islands, the Federated States of Micronesia and Palau (Saipan and Guam are non-voting members).

23. The objective of MSC is to encourage and promote an economical, reliable, safe and coordinated system that meets the demand for international commercial shipping throughout the three Micronesian island nations. Policy is implemented through an “Entry Assurance System” whereby an “Entry Assurance Certificate” (EAC) is required for all commercial carriers servicing the subregion. The scheme is largely financed through an annual fee for each EAC issued.

24. The criteria for granting EACs include that: (a) routes satisfy basic trade requirements; (b) tariffs charged should be reasonable for the service proposed; (c) the carrier must demonstrate capability to provide a reliable and stable service in terms of frequency, regularity and on transit time performance; (d) the service must be flexible to accommodate both specialized and conventional cargo; (e) the capitalization or investment of the operator must be sufficient to adequately sustain the proposed service; and (f) employment is provided to citizens of the three countries (including internships with the operators).

25. Reaction to the Commission has been mixed. The Secretariat of the Pacific Community (SPC) has noted that: “In carefully studying shipping patterns in the region, RMP realizes the very close collaboration amongst shipping companies render little or no competition to the PICTs resulting in a near cartel environment. Their services are selective being regular to profitable ports and erratic to others. To address this arrangement, a shipping commission along the lines of the Micronesian Shipping Commission model is planned for the central and eastern Pacific region. An important feature of these shipping commissions is the promotion of sufficient or controlled competition so that monopoly is removed but the restricted number of carriers for operations to remain commercially viable maintained.”<sup>4</sup>

26. Two Pacific Island studies have however questioned the need for such arrangements:<sup>5,6</sup>

27. As mentioned above, however, the concept has received support in the Central Pacific. In their Communiqué of the Third Small Island States (SIS) Meeting of Ministers of Maritime Transport, held at Nuku'alofa, Tonga, on 13 May 2009, the Ministers agreed: “... That the Central Pacific Shipping Commission Committee, comprising of members from Kiribati, Marshall Islands, Nauru and Tuvalu, and other interested states and territories such as FSM, Palau and Wallis & Futuna, expedite setting up a Central Pacific Shipping Commission (CPSC), involving our countries, similar to the Micronesian Shipping Commission (MSC) model. To facilitate the work, SPC and PIFS will work with the Committee to prepare a draft framework for the establishment of CPSC and report progress to the next SIS Transport Ministers meeting.”<sup>7</sup>

28. The Central Pacific Shipping Commission (CPSC) was officially launched on 4 August 2010.

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<sup>4</sup> Secretariat of the Pacific Community, Regional Maritime Programme; available from [http://www.spc.int/maritime/index.php?option=com\\_content&task=view&id=204&Itemid=1](http://www.spc.int/maritime/index.php?option=com_content&task=view&id=204&Itemid=1), (downloaded 27 July 2010).

<sup>5</sup> Australian Agency for International Development (AusAID), *Pacific Regional Transport Study. Country Reports*, Canberra: AusAID/Government of Australia, 2004.

<sup>6</sup> Asian Development Bank, *Oceanic Voyages, Aviation and Shipping in the Pacific*, 2007.

<sup>7</sup> <http://www.spc.int/maritime/images/Reports/Comunique/SIS%20ministerial%20communique%202009.pdf> (downloaded 27 July 2010).

29. Other approaches, especially for the small Island States, including the development of hub ports in Fiji, Papua New Guinea or Solomon Islands have been considered. On 13 May 2009, the Kiribati Shipping Services Limited (KSSL) signed an agreement with the governments of Nauru, Tuvalu, Kiribati and Wallis and Futuna to provide regular feeder shipping services to those countries. There is also a similar proposal for Samoa Shipping Corporation Ltd. (SSCL) to provide services to Tokelau, Niue and Cook Islands.

30. As with all regulatory regimes, there is a need to maintain a careful balance between competition within the market and contestability for the market. In this respect, there is a need to monitor both the demand for and supply of shipping services effectively in order to ensure that the maximum benefits of such services are realized.

31. In these respects, there may be merit in undertaking regular studies to assess the effectiveness of such regulatory regimes and to investigate other means of developing shipping services, such as hub-and-spoke systems.

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