



The Impact of the Flag of Convenience Regime into Shipping Industry

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ARTICLE INFO

Article history:

Received 07 May 2024;
in revised from 09 May 2024;
accepted 27 Jun 2024.

Keywords:

Flag of convenience, Maritime laws,
Ship registration, International Laws.

ABSTRACT

The term “flag of convenience” (FOC) describes the business practice of registering a merchant ship in a sovereign state different from that of the ship’s owners, and flying the civil ensign of that registrant state on the ship. This is for purposes of reducing operating costs or avoiding government regulations of the owner’s country, include tax avoidance, the ability to avoid national labor and environmental regulations, and the ability to hire crews from lower-wage countries. However, flag of convenience registries are often criticized. As a result of this lack of flag state control, flags of convenience are criticized on grounds of providing an environment for conducting criminal activities, supporting terrorism, providing poor working conditions for seafarers, and having an adverse effect on the environment. This article will discuss the process of formation and development of FOC, will analyze for researchers to clearly understand its impacts on the maritime industry.

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1. The formation history and development of the flag of convenience regime.

International law requires that every merchant ship be registered in a country, called its flag state. A ship’s flag state exercises regulatory control over the vessel and is required to inspect it regularly, certify the ship’s equipment and crew, and issue safety and pollution prevention documents. The organization which actually registers the ship is known as its registry. Registries may be governmental or private agencies.

Between 1915 and 1922, several laws were passed in the United States to strengthen the United States Merchant Marine and provide safeguards for its mariners. During this period, U.S.-flagged ships became subject to regular inspections undertaken by the American Bureau of Shipping. This was also the time of Robert LaFollette’s Seamen’s Act, 1915, which has been described as the “Magna Carta of sailors’ rights”. The Seamen’s Act regulated mariners’ working hours, their payment, and established baseline requirements for shipboard food. It

also reduced penalties for disobedience and abolished the practice of imprisoning sailors for the offense of desertion. Another aspect of the Seamen’s Act was enforcement of safety standards, with requirements on lifeboats, the number of qualified able seamen on board, and that officers and seamen be able to speak the same language.

These laws put U.S.-flagged vessels at an economic disadvantage against countries lacking such safeguards. By moving their ships to the Panamanian flag, owners could avoid providing these protections. The Belen Quezada, the first foreign ship flagged in the Panamanian registry, was employed in running illegal alcohol between Canada and the United States during Prohibition. In addition to sidestepping the Seamen’s Act, Panamanian-flagged ships in this early period paid sailors on the Japanese wage scale, which was much lower than that of western merchant powers. The use of flags of convenience steadily increased, and in 1968, Liberia grew to surpass the United Kingdom as the world’s largest shipping register. As of 2019, more than half of the world’s merchant ships are registered under flags of convenience, and the Panamanian, Liberian, and Marshallese flags of convenience account for almost 40% of the entire world fleet, in terms of deadweight tonnage.²

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² United States, Robert LaFollette’s Seamen’s Act of 1915, <https://www.u-s-history.com/pages/h988.html>.

Flag of convenience registries are often criticized. As of 2009, thirteen flag states have been found by international shipping organizations to have substandard regulations. A basis for many criticisms is that the flag of convenience system allows shipowners to be legally anonymous and difficult to prosecute in civil and criminal actions. Flag of convenience ships have been found engaging in crime and terrorism, frequently are found offering substandard working conditions, and negatively impact the environment, primarily through illegal, unreported and unregulated fishing. Supporters of the practice point to economic and regulatory advantages, and increased freedom in choosing employees from an international labor pool.

The use of flags of convenience has grown rapidly due to its economic benefits, and now, the Panamanian, Liberian, and Marshallese flags of convenience account for almost 40% of the entire world fleet, in terms of deadweight tonnage, the top ten flags of convenience registered 55% of the world's deadweight tonnage, including 61% of bulk carriers and 56% of oil tankers.

The International Transport Workers' Federation (ITF)³ have a list of 32 registries it considers to be FOC registries. In developing the list, the ITF considers "ability and willingness of the flag state to enforce international minimum social standards on its vessels," the "degree of ratification and enforcement of ILO Conventions and Recommendations," and "safety and environmental record." As of 2010 the list includes Antigua and Barbuda, Bahamas, Barbados, Belize, Bermuda, Bolivia, Burma, Cambodia, the Cayman Island, Comoros, Cyprus, Equatorial Guinea, Georgia, Gibraltar, Honduras, Jamaica, Lebanon, Liberia, Malta, Marshall Islands, Mauritius, Mongolia, Netherlands Antilles, North Korea, Panama, Sao Tome and Principe, St Vincent, Sri Lanka, Tonga, Vanuatu, and the French and German International Ship Registers.

As of 2009, Panama, Liberia and the Marshall Islands are the world's three largest registries in terms of deadweight tonnage (DWT). These three organizations registered 11636 ships of 1000 DWT and above, for a total of 468405000 DWT: more than 39% of the world's shipborne carrying capacity. Panama dominates the scene with over 8065 ships accounting for almost 23% of the world's DWT. Of the three, the Marshall Islands (with 1265 registered ships) had the greatest rate of DWT increase in 2009, increasing its tonnage by almost 15%.

The Bahamian flag ranks sixth worldwide, behind the Hong Kong and Greek registries, but is similar in size to the Marshallese flag of convenience, with about 200 more ships but a carrying capacity about 6000000 DWT lower. Malta, at the ninth position worldwide, had about 100 more ships than the Bahamas, with a capacity of 50666000 DWT, representing 4% of the world fleet with 12% growth that year.

At the eleventh position, Cyprus registered 1016 ships in 2009, 2.6% of world tonnage. The remaining top 11 flags of convenience are Antigua and Barbuda (ranked number 20), Bermuda (ranked number 22), Saint Vincent and the Grenadines (ranked number 26), and the French International Ship Register (FIS) (ranked number 27).

The 21 other flags of convenience listed by the ITF each account for less than 1% of the world's DWT. As of 2008, more than half of the world's merchant ships (measured by tonnage) are registered under flags of convenience.

2. The impact of the flag of convenience regime into shipping industry.

The benefits of the flag of convenience regime are varied, include tax avoidance, the ability to avoid national labor and environmental regulations, and the ability to hire crews from lower-wage countries. National or closed registries typically require a ship be owned and constructed by national interests, and at least partially crewed by its citizens. Conversely, open registries frequently offer on-line registration, and some guarantee completion in less than a day. The use of flags of convenience lowers registration and maintenance costs, which in turn reduces overall transportation costs. The accumulated advantages can be significant, for example in 1999, 28 of Sea-Land's fleet of 63 ships were foreign flagged, saving the company up to 3.5 million dollars per ship per year.

There are a number of common threads found in criticisms of the flag of convenience system. One is that these flag states have insufficient regulations and that those regulations they do have are poorly enforced. Another is that, in many cases, the flag state cannot identify a shipowner, much less hold the owner civilly or criminally responsible for a ship's actions. As a result of this lack of flag state control, flags of convenience are criticized on grounds of providing an environment for conducting criminal activities, supporting terrorism, providing poor working conditions for seafarers, and having an adverse effect on the environment.

2.1. Concealed ownership.

Shipowners often establish shell corporations to be the legal owners of their ships. To distinguish between the actual shipowner and the shell corporations, the terms beneficial owner or ultimate owner are often used. Webster's defines a beneficial owner as "one who enjoys the benefit of a property of which another is the legal owner". A ship's beneficial owner is legally and financially responsible for the ship and its activities.

The 2014 Report of the UN Secretary General's Consultative Group on Flag State Implementation reported that "It is very easy, and comparatively inexpensive, to establish a complex web of corporate entities to provide very effective cover to the identities of beneficial owners who do not want to be known". According to a 2003 report by the Organisation for Economic Co-operation and Development report entitled "Ownership and Control of Ships", these corporate structures are often multi-layered, spread across numerous jurisdictions, and make the beneficial owner "almost impenetrable" to law enforcement officials and taxation. The report concludes that "regardless of the reasons why the cloak of anonymity is made available, if it is provided it will also assist those who may wish

³The International Transport Workers' Federation (ITF), <https://www.itfglobal.org/en>.

to remain hidden because they engage in illegal or criminal activities, including terrorists". The OECD⁴ report concludes that the use of bearer shares is "perhaps the single most important (and perhaps the most widely used) mechanism" to protect the anonymity of a ship's beneficial owner. Physically possessing a bearer share accords ownership of the corporation. There is no requirement for reporting the transfer of bearer shares, and not every jurisdiction requires that their serial numbers even be recorded.

2.2. *Creating an environment for criminal activity.*

Flag of convenience ships have long been linked to crime on the high seas. For example, in 1982, Honduras shut down its open registry operations because it had enabled illegal traffic of all kinds and had given Honduras a bad name.

Ships registered by the Cambodia Shipping Corporation (C-SC) were found smuggling drugs and cigarettes in Europe, breaking the Iraq oil embargo, and engaging in human trafficking and prostitution in Europe and Asia. In response to these activities, in 2000, Ahamd Yahya of the Cambodian Ministry of Public Works and Transport told industry publication Fairplay "We don't know or care who owns the ships or whether they're doing 'white' or 'black' business... it is not our concern". Less than two years later, French forces seized the Cambodian-flagged, Greek-owned MV Winner for cocaine smuggling. Shortly after the seizure, Cambodian Prime Minister Hun Sen closed the registry to foreign ships, and Cambodia canceled its contract with CSC shortly thereafter.

The North Korean flag of convenience has also garnered significant scrutiny. In 2003, the North Korean freighter Pongsu reflagged to Tuvulu in the middle of a voyage shortly before being seized by Australian authorities for smuggling heroin into that country. That year thirteen nations began monitoring vessels under the North Korean flag for "illicit cargoes, like drugs, missiles or nuclear weapon fuel". In 2006, ships owned by Egyptian and Syrian interests, flagged by North Korea, and based in the United States were discovered to be engaged in smuggling migrants in Europe.

2.3. *Working conditions.*

In the accompanying material of the United Nations' Maritime Labour Convention of 2006⁵, the International Labour Organization estimated that at that time there were approximately 1200000 working seafarers across the world. This document goes on to say that when working aboard ships flagged to states that do not exercise effective jurisdiction and control over their ships that seafarers often have to work under unacceptable conditions, to the detriment of their well-being, health and safety and the safety of the ships on which they work.

⁴ The Organisation for Economic Co-operation and Development (OECD), <https://www.oecd.org>.

⁵ ILO, United Nations' Maritime Labour Convention, 2006, <https://www.ilo.org/global/standards/maritime-labour-convention/lang-en/index.htm>.

The International Transport Workers' Federation goes further, stating that flags of convenience provide a means of avoiding labor regulation in the country of ownership, and become a vehicle for paying low wages and forcing long hours of work and unsafe working conditions. Since FOC ships have no real nationality, they are beyond the reach of any single national seafarers' trade union. They also say that these ships of have low safety standards and no construction requirements, that they do not enforce safety standards, minimum social standards or trade union rights for seafarers, that they frequently fail to pay their crews, have poor safety records, and engage in practices such as abandoning crewmen in distant ports.

Variations in wages are significant, and a frequently cited rationale for the use of flags of convenience. 2009 statistics from the American Bureau of Labor Statistics give median earnings for able and ordinary seamen as US \$35810, varying from \$21640 (at the 10th percentile) to \$55360 (at the 90th percentile). This can be compared with 2006 statistics from the International Labour Organization, giving average yearly earnings for Filipino and Chinese able seamen around \$2000 to \$3000 per year (PHP 9900 per month and CNY 3071 per year). The wage differential for officers is similar. American chief engineers earned a median \$63630, varying from \$35030 to \$109310 while their Filipino counterparts averaged \$5500 per year (PHP 21342 per month).

2.4. *Environmental effects.*

While flag of convenience ships have been involved with some of the highest-profile oil spills in history, such as the Maltese-flagged MV Erika (The MV Erika sank in Bay of Biscay, about 60 nautical miles off the Britt'n? coast, on December 12, 1999. As a result, about 19800 tons of cargo oil spilled into the sea, affecting about 400 km of Franceh coast)⁶, the Bahamian-flagged MV Prestige, the Marshallese-flagged Deepwater Horizon (Deepwater Horizon was an ultra-deepwater owned by Transocean and operated by BP. On 20 April 2010, while drilling at the Macondo Prospect, a blowout caused an explosion on the rig that killed 11 crew men and ignited a fireball visible from 40 miles (64 km) away. The fire was inextinguishable and, two days later, on 22 April, the Horizon sank, leaving the well gushing at the seabed and causing the largest marine oil spill in history)⁷, and the Liberian-flagged MV Amaco Cadiz and MV Sea Empress) the most common environmental criticism they face regards illegal fishing. These critics of the flag of convenience system argue that many of the FOC flag states lack the resources or the will to properly monitor and control those vessels. The Environmental Justice Foundation (EJF)⁸ contends that illegal, unreported and unregulated fishing (IUU) vessels use flags of convenience to avoid fisheries regulations

⁶ Pham Van Tan, 'Assessment of implementation of clc in the Erika incident', Journal of Marine Science and Technology, vol.75 (April 2019), pp. 101-104.

⁷ Pham Van Tan, 'A study of civil liability for oil pollution damage: the Deepwater horizon oil rig explosion incident', Journal of Marine Science and Technology, vol.73 (August 2023), pp. 99-103.

⁸ Environmental Justice Foundation (EJF), <https://ejfoundation.org>.

and controls. Flags of convenience help reduce the operating costs associated with illegal fishing methods, and help illegal operators avoid prosecution and hide beneficial ownership. As a result, flags of convenience perpetuate IUU fishing which has extensive environmental, social and economic impacts, particularly in developing countries. The EJF is campaigning to end the granting of flags of convenience to fishing vessels as an effective measure to combat IUU fishing.

Conclusions.

Through the above analysis, we see that the flag of convenience regime has brought many economic benefits and freedom to the maritime industry. However, the negative impacts on the maritime industry in particular and the international community in general that FOC brings are not small. It is said to create an environment for criminal activities, support terrorism, provide poor working conditions for seafarers and have an adverse impact on the environment. Recognizing that, the international community has proposed solutions to reduce the negative impacts of FOC.

The principle that there be a “genuine link” between a ship’s owners and its flag state dates back to 1958, when Article 5(1) of the Geneva Convention on the High Seas also required that “the state must effectively exercise its jurisdiction and control in administrative, technical and social matters over ships flying its flag”. The principle was repeated in Article, 91 of the 1982 treaty called the United Nations Convention on the Law of the Sea and often referred to as UNCLOS⁹. In 1986, the United Nations Conference on Trade and Development attempted to solidify the genuine link concept in the United Nations Convention for Registration of Ships. The Convention for Registration of Ships would require that a flag state be linked to its ships either by having an economic stake in the ownership of its ships or by providing mariners to crew the ships. To come into force, the 1986 treaty requires 40 signatories whose combined tonnage exceeds 25% of the world total.¹⁰

We should not expect too much from a flag state in controlling the negative impacts caused by that ship, due to the economic benefits it brings to the flag state. Therefore, a number of European countries agreed in The Hague to audit labour conditions on board vessels vis-a-vis the rules of the International Labour Organization. To this end, in 1982 the “Paris Memorandum of Understanding on Port State Control” (Paris MOU)¹¹ was established, setting port state control standards for what is now twenty-six European countries and Canada. Several other regional Memoranda Of Understanding have been established based on the Paris model, including the “Memorandum of Understanding on Port State Control in the Asia Pacific Region”, typically referred to as the “Tokyo MOU”¹², and organizations for the Black Sea, the Caribbean, the Indian Ocean, the

Mediterranean, and Latin America. The Tokyo and Paris organizations generate, based on deficiencies and detentions, black, white, and grey-lists of flag states. The US Coast Guard, which handles port state control inspections in the US, maintains a similar target list for underperforming flag states. As of 2009, fourteen of the thirty-one flags of convenience listed by the ITF are targeted for special enforcement by the countries of the Paris and Tokyo MOUs or U. S. Coast Guard: Antigua and Barbuda, the Bahamas, Belize, Bolivia, Cambodia, the Cayman Islands, North Korea, Georgia, Honduras, Lebanon, Malta, Mongolia, Lebanon, Malta, Mongolia, Panama, and Saint Vincent and the Grenadines. In 2018, member states of the Paris MOU carried out 14322 ship inspections, resulting in 1220 ships were arrested. Member states of the Tokyo MOU carried out 13298 ship inspections, which have recorded 86820 defects, resulting in 1336 ships were arrested. It can be seen that, port state control is considered an effective solution in controlling the impacts caused by the flag of convenience regime. This has been demonstrated by the results of ship inspections by port state.

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