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Potentiality of Pakistan Flagged Merchant Fleet

-An Opportunity for Local Investment in Shipping Fleet Sector

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PAKISTAN

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Introduction and Background

Shipping sector plays an important role in Pakistan's sea borne trade and foreign revenue earnings. However, despite high potentiality of freight earnings from servicing sea-borne trade, the country only earns a meagre USD 6.9 million which is less than 1 percent of Pakistani total sea-freight trade. The rest approximately USD 2.30 billion outflows from country due to a major share in the sea freight by foreign (non-Pakistani flag) merchant fleet. Major reason behind huge outflow is insufficient national and domestic shipping services in terms of country flag and owned merchant fleets. The incentives to bring local investment for the merchant fleet considered to be unsuccessful due to lack of appropriate incentives along with lack of trust of local investors on governmental policies.

This research document is purposely developed to assist policy makers in understanding the prospects of the Country Flag Merchant Fleet as it can play an important role not only in terms of increased trade and domestic economic activities, generating employment but also has potential to support in reducing the sea freight foreign exchange outflow of the country. Further, it is also assumed that the Country Flag Merchant Fleet could also assist in reducing the cost of export in-turns making the exporters of the country more competitive. The document also highlights the issues faced by the industry / sector and future challenges, which need to be incorporated in policy making for the industry / sector.

World Fleet Status

During 2011-2018, the overall world fleet has increased by about 1.5 percent (CAGR)[1]. Of this, growth in Bulk carriers achieved a growth of 3.8 percent, other type of ships 2.8 percent and Container ships 0.5 percent. While the cumulative growth in Oil tankers and general cargo declined by 0.2 percent and 0.9 percent, respectively. Since, there is an overall increase in registered ships therefore there has been increase in demand of seafarers also.

Registered Ships / Vessels by Different Types									
Category	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**CAGR (8 year)**
Oil tankers	10,609	8,838	9,033	9,241	9,695	9,935	10,216	10,420	**(0.2%)**
Bulk carriers	8,228	9,001	9,568	10,162	10,509	10,747	10,892	11,125	**3.8%**
General cargo	21,090	20,309	20,282	19,664	19,566	19,698	19,716	19,613	**(0.9%)**
Container ships	4,966	5,096	5,107	5,101	5,111	5,227	5,158	5,164	**0.5%**
Other types of ships	38,390	41,465	42,494	43,786	45,589	46,467	47,280	47,847	**2.8%**
Total fleet	**83,283**	**84,709**	**86,484**	**87,954**	**90,470**	**92,074**	**93,262**	**94,169**	**1.5%**

Table 1- Registered Ships / Vessels by Different Types

Figure 1 shows the composition of world's total fleet. Miscellaneous types of ships comprise major of World's shipping fleet, around 51 percent, the category consists of small vessels excluding inland waterway vessels, fishing vessels, military vessels, yachts, and offshore fixed and mobile platforms and barges. Second big share consists of general cargo ships, 21 percent followed by bulk carriers, oil tankers and container ships at 12 percent, 11 percent and 5 percent respectively.

Share of World Fleet by Different Types (2018)

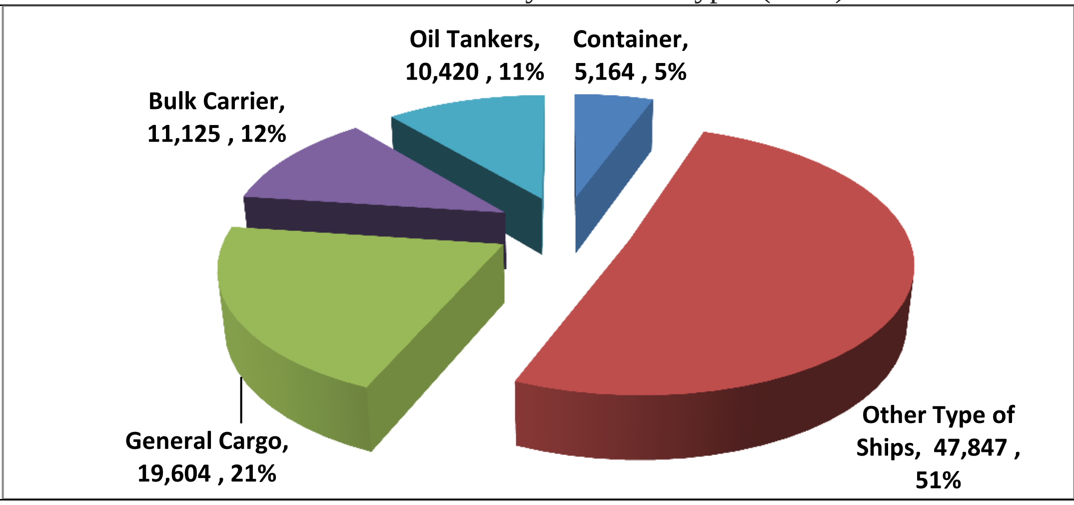

Figure 1- Share of World Fleet by Different Types (2018)

Given the purpose of this research, scope of argument is limited to merchant fleet only other types of ships are excluded.

[1]Cumulative Aggregate Growth Rate (CAGR)

Ownership and Flag of Registration

'Ownership' refers to ***'Beneficial Ownership Location'***, which indicates the economy in which the company that has the main commercial responsibility for the vessel is located. The economy of beneficial ownership may be different from the country in which the vessel is registered.

Registration or flagging of a vessel with the country means that the vessel maintenance, safety and on-board operations will be regulated by rules and laws of that country. Some countries promote registration of foreign operating vessels only to earn related registration charges, in turn beneficiary owners benefit from relatively lenient laws to abide by and substantial tax relaxation

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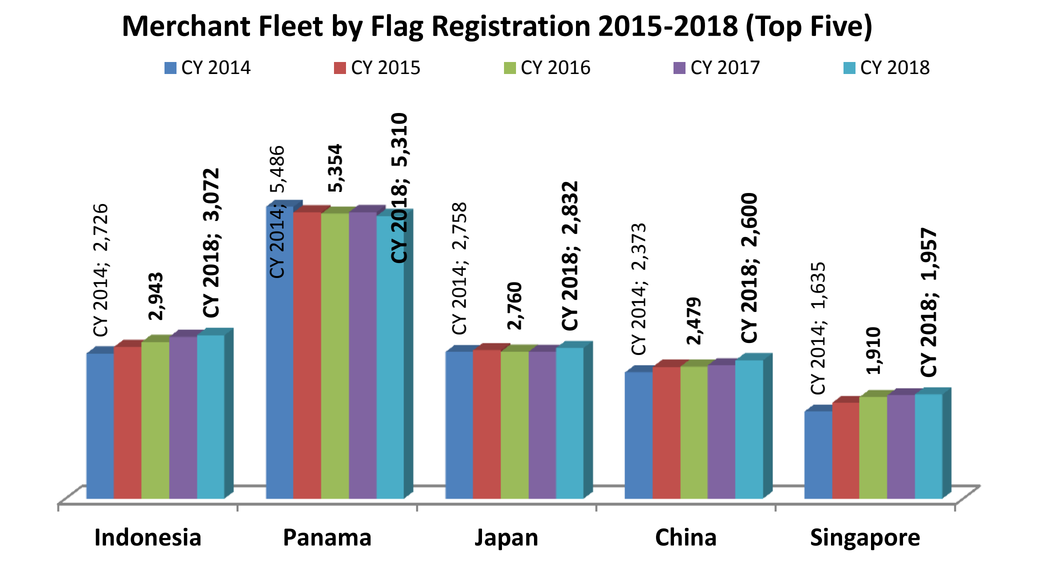
World Merchant Fleet by Flag Registration (2015-2018) – Top Five



**** This exclude other types of Ships***
***** includes General Cargo, Container, Oil Tankers and Bulk Carriers***
****** See Annexure for exhibits including Other Type of Ships***

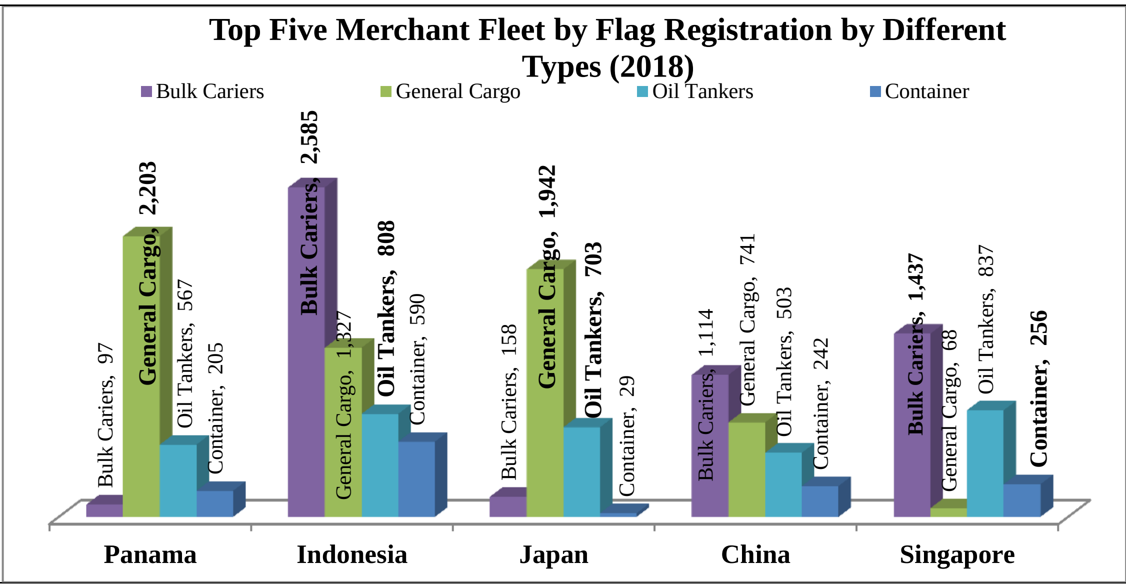
Figure 2- World Merchant Fleet by Flag Registration (2015-2018) – Top Five

For the year 2018 Panama leads the list of Merchant Fleet registration with total of ***5310*** flags registered under Panama's flag followed by Indonesia, Japan, China and Singapore with ***3072, 2832, 2600*** *and* ***1957*** ships registered under their flag, respectively.

Panama is a Central American country with very little trade and thus a very small shipping line of its own. However most of world's merchant ships are registered under Panama's flag, reason being Panama is an open registry. Its flag offers the advantages of easier registration (often online) and the ability to employ cheaper foreign labour. Furthermore the foreign owners pay no income taxes.[2] In case of China and Singapore high number of registration can be seemingly attributed to their higher Liner Shipping Connectivity Index (LSCI) which

[2] https://www.bbc.com/news/world-latin-america-28558480 (Accessed on March 26, 2019)

makes Singapore a favourable hub for cargo shipments. In Indonesia the nationally flagged ships include a large share of general cargo ships deployed in coastal traffic, which is reserved for nationally flagged ships.[3]



This exclude other types of Ships

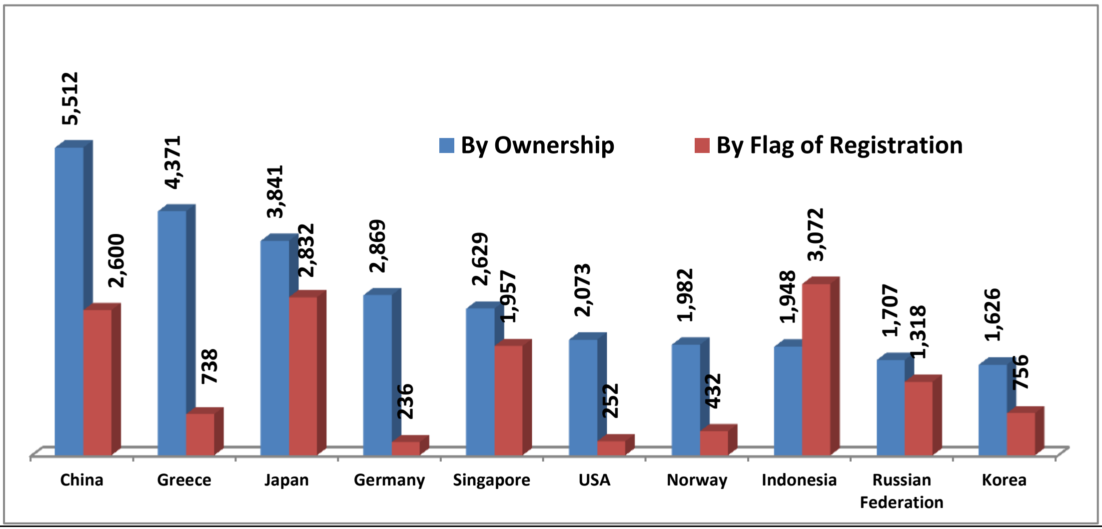
***** includes General Cargo, Container, Oil Tankers and Bulk Carriers***

Figure 3- Top Five Merchant Fleet by Flag Registration by Different Types (2018)

Classification of fleet by type of vessels show that Panama has most number of General Cargo fleet registered at ***2203*** whereas Indonesia leads in Bulk Carriers and container registration at ***2585*** and ***590*** respectively. Japan has 2nd most registration of general cargo vessels (***1942***), whereas Singapore leads in Oil Tanker registration with ***837*** vessels, followed by Indonesia and Japan at ***808*** and ***703*** vessels, respectively. At the containers end, Indonesia lead with ***590*** vessels amongst the top five merchant fleet flag registration followed by Singapore at ***256*** vessels, China ***242*** vessels and Panama at ***205*** vessels.

[3] Structure, ownership and registration of the world fleet, Review of Maritime Transport-2018, UNCTDA, Pg-29

World Merchant Fleet by Ownership Top Ten Countries (2018)

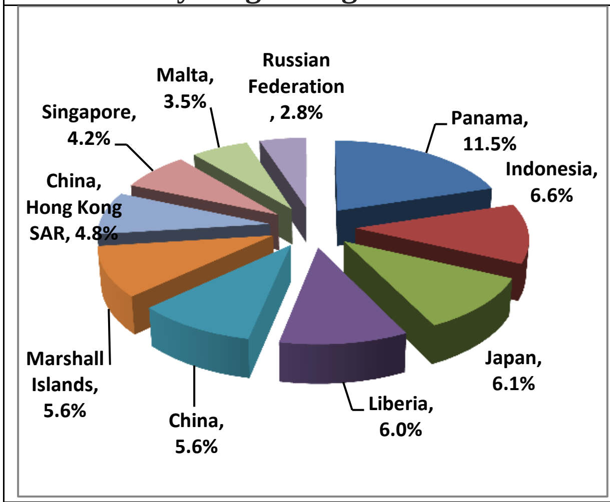


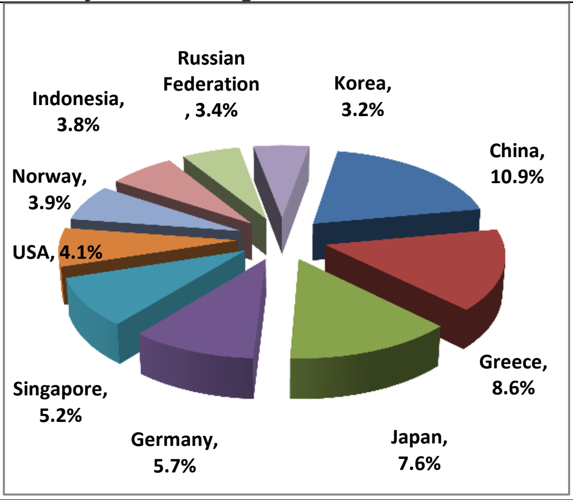
**** This exclude other types of Ships***
***** includes General Cargo, Container, Oil Tankers and Bulk Carriers***

Figure 4- World Merchant Fleet by Ownership Top Ten Countries (2018)

Figure 4 above provides comparison of number of ships owned by top ***10*** ship owning countries and the number of ships registered under their flag. The side-by-side plotting of numbers shows that, excluding Indonesia, remaining top ***9*** ship owning countries own more ships than the ships registered under their flag. This observation reiterates the common practice of convenient flagging. Among these countries Greece has widest difference of 3,633 between owned and flagged ships, followed by China at ***2912*** and Germany at ***2633***, in case of Indonesia the situation is reversed as it has ***1124*** more ships flagged in its registry than the ships it owns. Most major ship-owning economies are in Asia, Europe and North America. Each country specializes in different type of shipping like ship-owners from Greece specialize in dry bulk carriers and oil tankers, which have a large carrying capacity; ship-owners from the United States, by contrast, have greater shares in cruise ships and other vessels, primarily offshore, which are not used for trade in goods. Also its important to note here that majority of top ship owning countries are developed economies who has the capacity and resources to buy a ship, however they choose to flag their ship in developing economies or in open registries to avoid stricter flag rules and laws in their home countries.

World Merchant Fleet Top Ten Countries Share (2018)	
By **Flag of Registration**	**By Ownership of Merchant Fleet**





**** This exclude other types of Ships***
***** includes General Cargo, Container, Oil Tankers and Bulk Carriers***

Figure 5- World Merchant Fleet Top Ten Countries Share (2018)

In a surface analysis of ***Figure 5*** it is observed that only ***5*** out of top ***10*** ship-owning countries appear in top ***10*** list of flag registration. And these countries are Russia, Singapore, Japan, China and Indonesia. Major factor here to consider is that either these countries have long coastal areas or are island countries with restricted cabottage regulations. While comparing e two other sets of countries also emerges that appear in only one list, i.e Panama, Liberia, Marshal Islands and Malta are the countries that have high number of ship registration because of being "Open registries" and thus a choice of convenient flag to avoid taxation and other compliance protocols. Korea, Greece, Germany, USA and Norway are the top ***5*** countries collectively owning ***25 percent*** of world's fleet but only have ***2414*** merchant vessels under their flag.

Comparative Analysis of Selected Economies

In Table 2 an attempt is made to calculate ownership percentage of ships for neighbouring countries of Pakistan. The results show that Saudi Arabia, Pakistan, India and Bangladesh mostly own the ships flagged in their own countries. However reasons behind the behaviour are varying according to the economic situation like Saudi Arabia mostly has ships flagged as other types of ships which is the classification title also given to offshore vessels and gas carriers. As for Pakistan vessels flagged and owned by the country mostly belong to its national flagged carrier which provides services for bulk cargo and oil transportation. Also among its total fleet India mostly have General Cargo vessels which are utilized in coastal sea transport given the cabottage restrictions by laws.

Error! Not a valid bookmark self-reference. **Countries**	**No. of vessels Registered Under Flag**	**No. of vessels Owned**	**No. of vessels Flagged in Own Country**	**% of Total vessels owned**
Bangladesh	329	94	76*	81%
China	4610	5512	3456	63%
India	1719	1011	864	85%
Iran	720	226	168*	74%
Oman	51	48	7*	15%
Pakistan	53	15	13*	87%
Saudi Arabia	380	286	256*	90%
Turkey	1263	1522	834*	55%
United Arab Emirates	616	895	391*	44%
*the number is based on the assumption that vessels if not flagged in "Top-20 Registers" must be registered in beneficiary owner's country flag				
Data Source: https://unctadstat.unctad.org **Data Description:** Dead-weight (DWT)and number of vessels registered under economies and Dead-weight and number of vessels owned by economies in 2018.				

Table 2- Vessel Flag and beneficiary owner

It is assumed that ***9*** out of these ***13*** vessels registered and owned by Pakistan belong to PNSC, which covers only ***12.77 percent***[4] of Pakistan's sea trade. Other ***87.2 percent*** trade is carried out by non-Pakistani companies.

Performance trends of national sea-carrier show that with time PNSC's percentage market share has gone down. This could be attributed to the total dependence of PNSC on government allotted cargo contracts mainly for oil imports and general priority status. PNSC relates this downfall to the capacity constraints and administrative hurdles faced by it to buy new ships thus increase its capacity. At the same time it also argues that currently shipping industry is facing over capacity which is increasing administrative cost and thereby hitting profitability.

[4] As calculated from data published by PNSC in its annual report for FY18

Challenges for Shipping Industry in Pakistan

- It is important to note that Pakistan National Shipping Corporation (PNSC) is the **only** domestic merchant marine fleet that carries Pakistan flag. The share of PNSC in Pakistan's sea trade has improved. Its market share has increased to a peak of 26.4 percent in 2014, however, declined considerably in the last two years to around 12.79 percent in 2018. Majority of PNCS's contribution in Pakistan's sea borne trade is in crude oil sector, while dry bulk sector share is highly insignificant. Of the total share of 12.79 percent in Pakistan's sea borne trade, liquid handling (oil) accounts for 10.63 percent, while dry bulk trade handled by PNSC is only 2.15 percent. The oil cargo moved by PNSC is not based on competitive win but it is an allocated cargo provided by government. Interventions are required to make PNSC competitive enough to get cargo beyond its allocated share and priority by government.

- With developing PNSC is it also important to encourage private sector investment. Private sector participation in any industry is linked with the progress and development for that particular industry, and it also provides a positive outlook for the economy. During our consultation and research we came to know about some key factors (including lack of trust due to inconsistence in governmental policies) that are putting off private sector investment in the Pakistan's shipping industry.

- Prior to 2000, there used to exist national flag careers at private-domestic level. Those private shipping companies experienced nationalization in 70s and denationalization in late 80s. Afterwards intense competition in 80s and 90s and lack of government support, these companies could not survive. Resultantly private shipping companies mostly owned by Pakistani nationals have closed down. To attract local investors back in industry it in necessary to provide some rationalised governmental incentives and assurances.

- From ship registration to daily operations, there are many hindrances that do not supplement speed and time with the shipping industry. For instance ship registration process involves physical inspections from technical committee which takes months, which gets tricky to handle when there huge is financing and operating cost involve.

- Shipping is a sector which involves working with multiple entities situated in multiple countries on daily basis and this obviously requires financial transactions in Foreign Exchange (FX), current policies and regulations adopted by State Bank of Pakistan, is not conducive for this industry. To re-invigorate shipping sector and attract investors it is important to review restrictions on remittance flows especially for sectors which are also earning in foreign currencies.

- Shipping is a capital intensive business, it requires approximately ***USD 232 per DWT or you can say USD 25 million to by an Aframax oil tanker. Similarly it requires***

USD 242 or USD 18 million to get a dry bulk carrier.[5] In all such businesses require strong support of financial institutions. However current situation of Pakistan's banking and financial industry is not resilient enough. This makes it imperative that some initiative should be taken to build capacity of national financial institutions and room provided to get loans from international financiers.

- Another grievance of investors is duty and taxation on buying and selling of ships. Heavy duties increases the need for capital investment while high taxation (like of capital gains tax on selling ship) makes operations difficult and kills growth.

- To run the shipping business foremost requirement is availability of cargo to be shipped. This requires providing rationalised cargo preference list to safeguard business for encourage national flag carrier by providing them base cargo at market pricing.

[5] ***These calculations are approximation based on data provided by UNCTAD in Review of Maritime Transport-2018, data tables 2.1 and 2.9. Values provided here are not intended to give any form of purchasing advise and are just provided to highlight capital intensity of shipping business.***

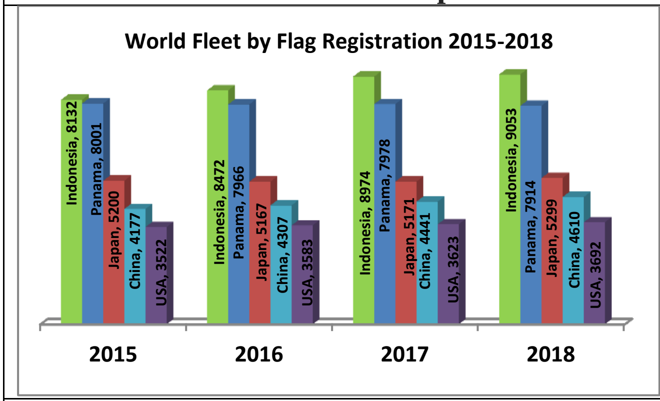
The Way Forward

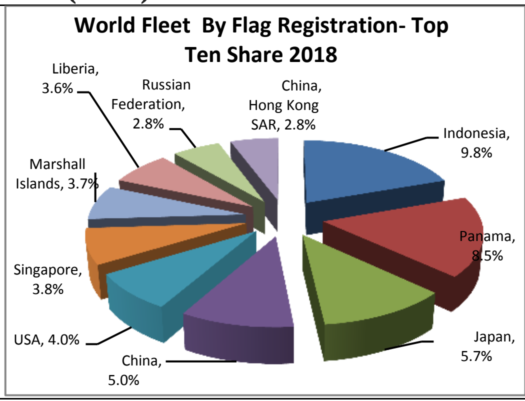
Pakistan annually pays out approximately ***USD 2.3 billion*** in sea-freight. Major reason behind this huge outflow is non-sufficient national and domestic shipping service. Many a times it has been tried to draft some policy to give incentive to local shipping. However those incentives fail to materialise first because of lack of relevance to the business and then lack of trust of businessmen on governmental policies.

In Pakistan Merchant Marine Policy-2001, cargo preference and tax relaxations are provided to Pakistan flagged vessels, however findings in this report suggest that the majority of the ships flagged under Pakistani flag are not owned by Pakistan, which lead to establish the impression that the incentives provided cannot be translated into long chain benefit to whole shipping industry and economy. This area needs further study to understand taxation potential and related benefits.

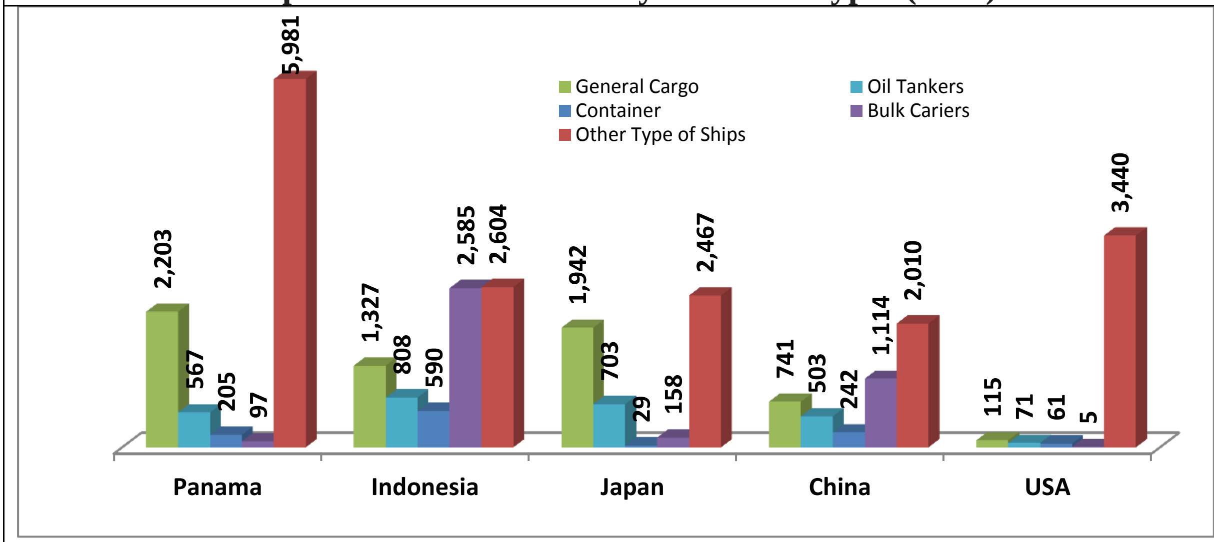
Appendix

World Fleet by Flag Registration (2015-2018) &
Top Ten Countries Share (2018)



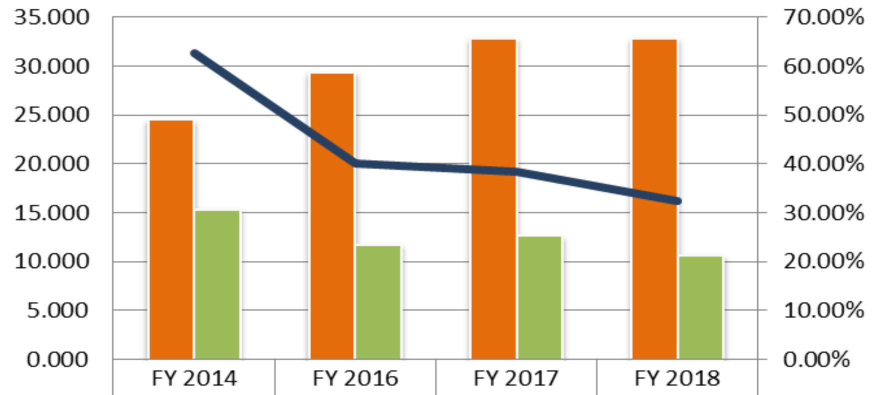


Top Five Merchant Fleet by Different Types (2018)



Registered Under Flag						
	Vessel Type					
ECONOMY	Total Fleet	Container	General Cargo	Bulk Carrier	Oil Tankers	Other Type of Ships
China	4610	242	741	1114	503	2010
India	1719	22	582	75	133	907
Turkey	1263	56	409	59	124	615
Iran	720	25	336	31	17	311
United Arab Emirates	616	2	103	..	22	489
Saudi Arabia	380	1	19	5	65	290
Bangladesh	329	4	77	33	122	93
Pakistan	53	..	..	5	7	41
Oman	51	..	9	..	..	42
Data Source: https://unctadstat.unctad.org						

Performance of PNSC in Wet Cargo



	FY 2014	FY 2016	FY 2017	FY 2018
Pakistan Seaborne Trade (in million tonnes)	24.508	29.419	32.863	32.863
PNSC Share (in million tonnes)	15.369	11.782	12.639	10.639
PNSC Share %	62.70%	40.05%	38.46%	32.37%