SHIPPING AS AN INTERNATIONAL BUSINESS

The maritime industry is a truly international business. A shipping company obtains its finance from a bank of the ship owner’s choice, to build a ship in yard that provides the best combination of price and quality. Usually the ship will be flagged with a flag that is advantageous in terms of the flexibility it allows in operations, chartering, taxation and crewing. When the ship is in service, the owner will choose the destinations where to trade so as to obtain the best financial returns. The owner is also free to change the name of his ship, to change its flag, or to sell it, at any time, in his efforts to navigate through the vagaries of the market.

At the right time, whether dictated by economic, technical or regulatory reasons, the ship owner may come to a decision to sell his ship for recycling at a destination of his choice. The price a ship is sold for recycling represents a significant residual value, which today stands between 17% and 23% of the replacement newbuilding price. The scrap price is therefore important in the ship owner’s long term calculations.

TODAY’S SHIP RECYCLING INDUSTRIES

Let us now look at today’s ship recycling industries. Five countries recycle 97% to 98% of all the tonnage recycled in the world. In four of these countries, namely Bangladesh, India, Pakistan and Turkey, all recycling is concentrated within a single area, while in the fifth recycling country, China, recycling is spread in numerous locations from the South to the North of the country. These five countries are at different stages of development, have different economies and a quite different gross domestic product (GDP). In 2010, according to the World Bank\(^1\), the GDP per capita in Bangladesh was $675, in Pakistan $1,019, and in India $1,475. On the other hand, in China it was $4,428, while in Turkey it was $10,094. Note as a comparison that the United Kingdom’s GDP per capita in 2010 was $36,144, while Japan’s was $42,831.

The five recycling countries share a common characteristic in having a large appetite for scrap steel. Bangladesh, Pakistan and to a large extent India use the steel from recycled ships in mills where steel is rerolled so that it can be used directly, for example in urban construction. It is understood that China and Turkey mostly melt the ship scrap. It is notable that Turkey, which is alleged to be the largest importer of scrap steel in the world, satisfies just 2% of its needs with scrap from its ship recycling industry. Equivalent figures for the contribution of steel from ship recycling

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\(^1\) [http://data.worldbank.org/indicator/NY.GDP.PCAP.CD](http://data.worldbank.org/indicator/NY.GDP.PCAP.CD)
to the steel production of the country, according to the World Bank\(^2\), is 50% for Bangladesh and 15% for Pakistan, while the figure for India is understood to be between 5% and 6%.

India’s recycling industry prefers to recycle smaller ships compared to Bangladesh. These two countries have generally offered similar prices for ships, except in the last two years, when the Bangladeshi recycling industry had to withdraw repeatedly and for long spells from buying ships following High Court litigation by a local environmental NGO. Pakistan, after being almost absent from the market from 2004 to 2008, returned to ship recycling and is offering prices that follow those offered by India. China, who also was almost absent from the market from 2005 to 2007, is now a very active buyer, generally paying prices which are around $50 to $70 per light ton less than those paid in South Asia, that is Bangladesh, India and Pakistan. Turkey tends to pay around $150 per light ton less than the prices paid in South Asia and specializes in recycling mainly Mediterranean trading ships and European government-owned ships. China and India each command around 30% of the world’s recycling capacity, while Bangladesh’s capacity is around 25%. Pakistan and Turkey each command 9% and 2%, respectively. These capacity figures are based on an analysis by IMO\(^3\) covering the last ten years.

The international perception of safety and environmental standards in the five recycling countries is that China and Turkey now offer safe and environmentally sound ship recycling, while India has progressively improved its standards, especially after the decision of its Supreme Court in 2007 which instigated important requirements for the industry. It is also widely considered that the ship recycling industries in Pakistan and Bangladesh are in need of making significant improvements in safety and in the responsible treatment and disposal of hazardous waste streams.

The fact that there is very little ship recycling activity in Europe is often explained in terms of the inability of Europe to compete with the low labour costs and low compliance costs of South Asia. However, the real reason, in my view, lies elsewhere: whereas the South Asian countries utilize scrap steel in their domestic economies, Europe is an exporter of scrap steel. Therefore, the idea of setting up a ship recycling industry in Europe to break ships – with more expensive European labour – in order to export the scrap to Bangladesh or India is simply not realistic.

SHIP OWNER CONTEMPLATING THE RECYCLING OF A SHIP

Let us return now to the ship owner whose ship is approaching the end of its operating life. For the sake of completeness I will first examine and then exclude from further consideration some special categories of ship owners and ships.

U.S.A. flagged ships

The Toxic Substances Control Act (TSCA) of 1976 effectively prohibits the export of USA flagged ships for recycling abroad. These ships have to be recycled in the

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\(^2\) Ship breaking and recycling industry in Bangladesh and Pakistan, World Bank, Report No 58275-SAS, December 2010

\(^3\) IMO document MEPC 62/INF.13, Calculation of recycling capacity for meeting the entry into force requirements of the Hong Kong Convention
United States, where often the owner has to pay for his ship to be recycled. USA flagged ships, however, form a rather special category, because United States law protects its cabotage trade with requirements that ships operating in this trade must fly the USA flag, must have been built in the country, and must be manned with USA nationality seafarers.

*Government-owned ships*

Another special category of ships is that of government-owned ships where political and legal requirements often apply which result in specific requirements and limitations to the recycling of such ships.

*Ships dispatched for dismantling from the European Union*

This, potentially wide, category includes ships flying any flag who happen to be dispatched by their ship owner or manager from a European Union port to a recycling yard located outside the OECD. The European Waste Shipment Regulation⁴ makes it illegal to export hazardous waste from European Union member States of the to any country outside the OECD, meaning that when this regulation is applied to end-of-life ships, the only viable destination for such ships is Turkey. Yet Turkey only commands a 2% share of the world’s recycling capacity. Understandably, the Waste Shipment Regulation is observed only by a very small minority of ships dispatched from the European Union for recycling and for this reason the European Commission is now preparing new legislation for the recycling of ships on the basis of the global standards required under IMO’s Hong Kong Convention.

*Small ships*

Small ships are another special category in that their recycling will usually be determined by their location at the time the decision is made to recycle, as their residual value may not justify a lengthy voyage to a distant recycling location.

*Damaged ships*

My final special category comprises ships that have suffered engine damage or other problems which may immobilize them or make it difficult to sail under their own power. The cost and risks of towing such a ship would become a key factor in the decision as to where to recycle.

This leaves us with the great majority of ocean going ships, which are free to be recycled wherever the owner decides. The ship owner would normally select to send his ship to the yard that gives him the best returns, bearing in mind the relative costs of repositioning the ship from the place where it discharged its last cargo, and also bearing in mind the different rates paid by recycling facilities in different locations.

**IS THE SHIP OWNER RESPONSIBLE FOR “GOOD” RECYCLING?**

Is the ship owner really free to recycle his ship wherever he decides? Some people believe that ship owners owe a duty to society to recycle ships in an ethical manner,
by selling to yards that will ensure safe and environmentally sound recycling, even if 
this results in the ship owners being paid a lower scrap price. Some people go further 
and campaign that the ethical obligation of ship owners is simply not to send ships for 
recycling to South Asia at all, because of lack of safety and of protection of the 
environment, and also because of the region’s reliance on the beaching method. 
Personally, I believe that this campaign is neither logical nor ethical.

Why is the campaign not logical? First, a shipping company is entitled to sell its asset 
to any recycler it decides. There is no international law that makes it illegal to do so 
and this activity is purely a market transaction. Second, if companies were to recycle 
their ships on the basis of this campaign, then they should also stop carrying iron ore 
cargoes from countries where miners are allegedly working in unsafe conditions, or 
coal to power plants which cause pollution. Let us not forget that we live in a real 
world where shipping companies must succeed in operating under conditions of stiff 
competition if they are to survive and remain profitable.

This is not to say that shipping companies, per definition, do not give a toss about 
recycling standards. There are, certainly, quite a few ship owners, who, although not 
obliged by law, have resolved to recycle their ships according to the highest practical 
standards. This, more often than not, means selling their end-of-life ships to one of 
the reputable yards in China, generally at a price that is around $50 to $70 per light 
ton less than the price paid by recycling yards in South Asia. So, the ‘green recycling’ 
of a ship of 10 to 15 thousand light tons can easily cost the owner between half to 
more than three quarters of a million dollars. This is a substantial amount of money to 
be ‘out of pocket’ for. But, like all milk is not cream, these companies are not normal, 
in the statistical sense of the word.

Moving now to the ethical dimension of the campaign against recycling in South Asia, 
as I said, in my view, the campaign is far from ethical. I do not see that it is ethical to 
deprive a poor region of an industry that brings much desperately needed 
employment, trade, and general economic activity. Furthermore, the blanket 
assumption of low standards in South Asia is biased, as I have personal experience 
of recycling yards in both India and Bangladesh, which are implementing gradual and 
meaningful improvements to safety, to environmental protection, and to social 
welfare. I, therefore, would suggest that these yards not only need but also deserve 
to be supported by the custom of quality ship owners, so that their businesses can 
prosper and thus provide much needed livelihoods to the benefit of local and regional 
communities. By giving them a chance to improve their standards, they can become 
examples to be imitated by the rest of the recycling industry in their country.

THE HONG KONG CONVENTION

A company that voluntarily accepts a sizeable cost for practising green ship 
recycling, or is prepared to bring its custom to yards that are genuinely trying to 
improve their standards, is a most powerful example to its peers, to its clients, and to 
society. Such companies can claim to be leaders, ahead of the rest, showing the 
way to a better future. But, showing the way forward is not the same as establishing 
common standards of a binding nature. This can only be achieved through an 
international legal agreement concluded between governments, and exactly for this 
reason the international community developed through the International Maritime 
Organization a mandatory, global regime for regulating the recycling of ships
worldwide. I refer of course to the “Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships, 2009”, also known as “the Hong Kong Convention”, which was adopted by an IMO Diplomatic Conference held in Hong Kong in May 2009. We are now at the stage during which governments are either working for the accession and ratification of the Convention, or are waiting to see what other governments will do. It is worth explaining that the steps for accession to an international convention in most government systems are quite complex. Typically, in a democracy, the following steps may be involved: formal translation by the Ministry of Justice; formulation of national regulations; approval by the Ministry of Justice of the proposed text of regulations; circulation to any Ministries who may have an interest in the subject and consideration of any comments made by them; approval by an appropriate parliamentary committee; signature by the Minister; signature by the Prime Minister; government decision; formal approval by the Parliament; and submission to IMO through the Ministry of Foreign Affairs. In ship recycling there is usually a number of stakeholder Ministries and this may prolong the consultation process (e.g. Ministries of Shipping or Transport; Environment; Labour; Industries – as is the case in Bangladesh; Steel – as is the case in India; and possibly Commerce). It is therefore not surprising that two and a half years after its adoption, the Convention has yet to receive the first ratification. I understand however that a number of key States – whether in terms of their ship recycling capacity or in terms of the ship tonnage registered under their flag – are busy working to ratify or accede to the Hong Kong Convention.

I will not spend time here to explain why the Hong Kong Convention is the only international convention that can take care of the intricacies of shipping while, at the same time, providing a serious and meaningful system of workable and enforceable regulations to promote the substitution of hazardous materials in the construction and maintenance of ships, and to address the environmental, occupational health and safety risks related to ship recycling. I take all this as a given, but if it becomes relevant to discuss it, we can do so later in the conference.

IS THE BURDEN SHARED EQUITABLY BETWEEN SHIP OWNER AND RECYCLER?

I wish instead to address the question of whether the Hong Kong Convention has failed to assign the appropriate financial responsibility to the beneficiaries of the ship’s working life and to the generators of the risks. The concern, and indeed criticism, expressed in certain quarters is that the Convention has failed to internalize the costs of recycling and, instead, has pushed all costs downstream to the developing world where recycling takes place. Those who have made these criticisms also proposed, during the IMO discussions leading to the adoption of the Hong Kong Convention, the establishment of an international fund, based on levies to ship owners, to facilitate the safe and environmentally sound recycling of ships. The proposal was however rejected by the IMO Member States. Instead, a provision was included in the Convention for Parties to undertake technical assistance, cooperation and technology transfer. Already, two Member States of IMO are establishing technical cooperation with two recycling States in South Asia, while the IMO Secretariat, in collaboration with the Secretariat of the Basel Convention and the International Labour Office, is already carrying out technical co-operation activities in the ship recycling sector. The establishment of an international fund, as proposed, would not only have been an extremely difficult undertaking, it would also have been of questionable purpose. It would have required an international
convention with universal implementation and a dedicated administration to collect and dispense the funds. Furthermore, it is debatable whether such funds should be spent to subsidize recycling yards already applying high standards so as to enable them to compete with yards characterized by low labour costs and by good utilization of recycled materials; or whether instead the funds should be spent to upgrade the already competitive yards in the developing countries; or whether perhaps they should be used for both purposes.

If end-of-life ships had no residual value at all, then an international ship recycling fund could certainly be useful in averting the dumping or abandonment of ships. However, as discussed earlier, ships going for recycling have substantial residual value. Today, a Panamax bulk carrier is sold for recycling for over five million dollars, while a Capesize is sold for around eleven million. A small part of this residual value is all that is required to ensure sound ship recycling.

So, returning to the question of whether the Hong Kong Convention has failed to internalize the costs of recycling, I wish to make the following observations. It is certainly true that the Hong Kong Convention imposes heavier demands on the recycling yards and a lighter load on the ship owner. Whereas the ship owner bears the costs of compiling the compulsory Inventory of Hazardous Materials and of complying with the required surveys, the recycler needs to train all his workforce and management; to prepare for any kind of accidental eventuality; to ensure the environmentally sound management of hazardous waste during removal, storage, transport and disposal; to maintain safety systems; to keep records; to provide personal protective equipment to all employees; and generally to establish and maintain more costly procedures for safer shipbreaking. Notwithstanding all this, I would maintain that the burden is, in fact, balanced equitably, because there is one further obligation for the ship owner. We must not forget that the Hong Kong Convention obliges the ship owner of a ship flying the flag of a Party to the Convention to recycle that ship in an authorized yard that is located in a Party State.

Let me explain the implications of this further obligation. The ship owner who does not change flag to a non-Party flag, so as to avoid the obligation of recycling in a Party to the Convention, will have to accept his fair market share of the costs of compliance incurred by the yard in the Party State. The option of reflagging to a non-Party State would only exist for as long as there are countries with recycling capacity that are not Party to the Hong Kong Convention. So, if Turkey ratifies the Convention, and if China, India, Bangladesh and Pakistan also accede to it, then there will be no alternative to all ship owners but to recycle their ships according to the requirements of the Hong Kong Convention and, in this way, a few years down the road from now, the Hong Kong Convention will be part of the fabric of shipping and people will wonder what all the fuss was about.

Note: The views expressed are those of the author and should not be taken as reflecting in any way the policies or views of IMO or of its Secretariat.