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COVID-19 TRANSPORT BRIEF

Lessons from Covid-19 State Support for Maritime Shipping

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State support packages are helping the shipping industry to deal with the Coronavirus crisis. Government support comes in many forms but usually without strings attached – and rarely aligned to broader policy objectives. A rethink is needed.

The Covid-19 crisis has a profound impact on the shipping industry. Passenger sea transport in particular has suffered heavy setbacks in volumes. Ferry services and cruise shipping were strongly affected by border closures and other restrictions on citizens. Cargo sea transport also faced reduced demand, but container shipping in particular managed to compensate by withdrawing ship capacity and increasing prices.

Many governments have put in place additional support measures for shipping, on top of the broadly aimed support to mitigate the overall economic fallout from the Coronavirus crisis, including instruments that could have significant impact on the shipping sector such as changes in the terms of export credits.1 At least 13 countries have implemented state support for the shipping sector in recent months, according to a preliminary inventory of support packages compiled by ITF (see table).

This inventory may understate the level of government support for shipping, as there is currently no systematic data collection on state aid for the maritime sector. Even the European Union's state aid database does not contain all known support measures for the shipping industry, although EU member countries are supposed to notify state aid.

State support to mitigate Covid-19 impacts on shipping is in large part directed towards ferry and cruise shipping companies. These are the targets of more than half of known aid packages, with nine out of the 17. Ferry companies receive state support in Estonia, Finland, Greece, Italy, Sweden and United Kingdom – countries where ferries provide important means of international or domestic connectivity.

Cruise companies benefit from aid in the United Kingdom, France, Hong Kong (China) and possibly in Germany in the near future.[2] France, South Korea and Chinese Taipei also provide support to their container shipping companies. Support packages in other countries target the entire shipping sector, not one particular segment.

Covid-19 support packages for the maritime shipping industry

Country	Beneficiaries	Main measures	Mio EUR
Singapore	Shipping companies, seafarers	Reduction of port dues	20
South Korea	HMM	Liquidity support	600
South Korea	Maritime companies	Liquidity support	1 000
United Kingdom	Cruise shipping companies	Liquidity support Bank of England Covid Corporate Financing Facility (CCFF)	350
United Kingdom	Ferry operators	Support for ferry routes UK-Northern Ireland, and UK - Continental Europe	63
Germany	No details available	Innovation, research, shore power, LNG bunkering, fleet renewal, cleaner ships	1 000
France	CMA CGM	Loan guarantee	1 050
France	MSC Cruise	Refinancing of loans by public development bank SFIL (formerly Société de financement local)	2 600
Finland	Maritime firms crucial for security of supply	Loan guarantees	600
Sweden	Eight ferry companies	Tax reduction for ten idled ferry ships	10
Estonia	Four ferry companies	Grant to compensate for lost revenues	20
Croatia	Maritime companies	Loan guarantees	80
Ireland	Three ferry companies	Support for costs of five ferry routes	15
Greece	Ferry companies	No details available	35
Italy	Ferry and cruise companies	Tax breaks, lost revenue compensation	85
Hong Kong, China	Ferry and cruise companies	On-off subsidies (ferries), waiving of rent and fees, refund of berth deposits (cruise)	n.a.
Chinese Taipei	Yang Ming, Evergreen	Credit facility and loan interest subsidies	850

Compilation: International Transport Forum from EU State Aid Database[3], government agencies[4], media reports[5]

The form of Covid-19 state aid for shipping companies differs. Some schemes compensate operators for lost revenues from having to idle vessels, e.g. because of border closures. This is the approach taken towards ferries in particular. Compensation can involve direct grants (as in Estonia) or tax exemptions (as in Sweden).

Schemes diverge substantially in their largesse. For example, the Estonian scheme allows compensation up to 80% of the revenue foregone of four ferry companies (granting EUR 20 million), whereas the Swedish scheme provides EUR 9.5 million for ten ferry companies to compensate for wage-related costs, estimated to be 10 to 20% of their forgone revenues.

Most support packages provide liquidity support in the form of loan guarantees and "free liquidity" from state banks. Most of the liquidity support is made available to very large shipping companies with high levels of debt acquired before Covid-19. Various countries have also temporarily reduced port fees (e.g. Singapore and Hong Kong).

Almost no strings attached

Aid schemes usually include safeguards to avoid that firms will be overcompensated. Beyond that, however, governments rarely impose conditions designed to achieve public policy objectives other than the immediate goal of mitigating economic losses for the shipping sector due to Covid-19.

A notable exception is Finland. The Finnish government imposes three conditions on aid recipients: first, they must carry products "deemed essential for the security of supply". Second, they must represent a sufficiently large transport capacity, defined as the ability to move at least 5000 tonnes per week. Third, they must offer regular transport services, defined as services operating several times per week for perishable goods and at least once a month for more durable goods.[6] Another exception is Germany that has reserved part of its maritime support package for cleaner ships and maritime innovation.

The missing link between Covid-19 subsidies and broader policy goals is part of a larger phenomenon. State aid for the maritime sector in general is subject to limited conditions only. Like aviation, the large majority of support measures for shipping include no conditions on economic, social or environmental objectives.[7] Most countries do not even report on the impacts of their maritime state aid scheme.[8]

In the European Union, 22 countries levy a tonnage tax from shipping companies – a sector-specific and generous tax regime that can replace the corporate income tax. Yet only Norway and Portugal have a tonnage tax scheme that includes incentives to improve the environmental performance of ships, and only the United Kingdom requires recipient shipping companies to train seafarers.

The lack of conditions for support received also applies to other shipping policies. The European Union exempts liner shipping companies from EU competition regulation, known as the Consortia Block Exemption Regulation. This stipulates that the whole transport system should benefit from the exemption, but in practice the European Commission has limited its scope to price reductions for customers, rather than any wider goals, such as connectivity, reliability and sufficiently regular services.[9]

State aid and taxation

The shipping industry benefits from tax exemptions on a very large scale. A substantial share of the world's shipping companies is incorporated in tax havens. Most ships sail under "flags of convenience" (open registries) that offer favourable tax treatment. Many countries have generous shipping-specific tax exemptions or regimes such as the tonnage tax.

The world's four largest cruise companies made a profit of USD 26 billion in the years 2015-19. Over the same period, they paid just USD 32 million of taxes. This represents an effective tax rate of little over 0.1%. Three of those companies, although headquartered in the US, are incorporated in Panama, Liberia and Bermuda so they do not qualify for US federal support under the CARES Act. The European Commission sent a similar signal when it recommended that member states should not grant financial support to companies with links to countries that are on the EU's list of non-cooperative tax jurisdictions.[10]

These political interventions have resulted in state aid for cruise companies in less visible ways. Liquidity support for shipping lines has come from central banks (for instance in the UK[11]) and national development banks (in France[12]), even though the recipients have extensive links to shipping registries in countries on the EU list.

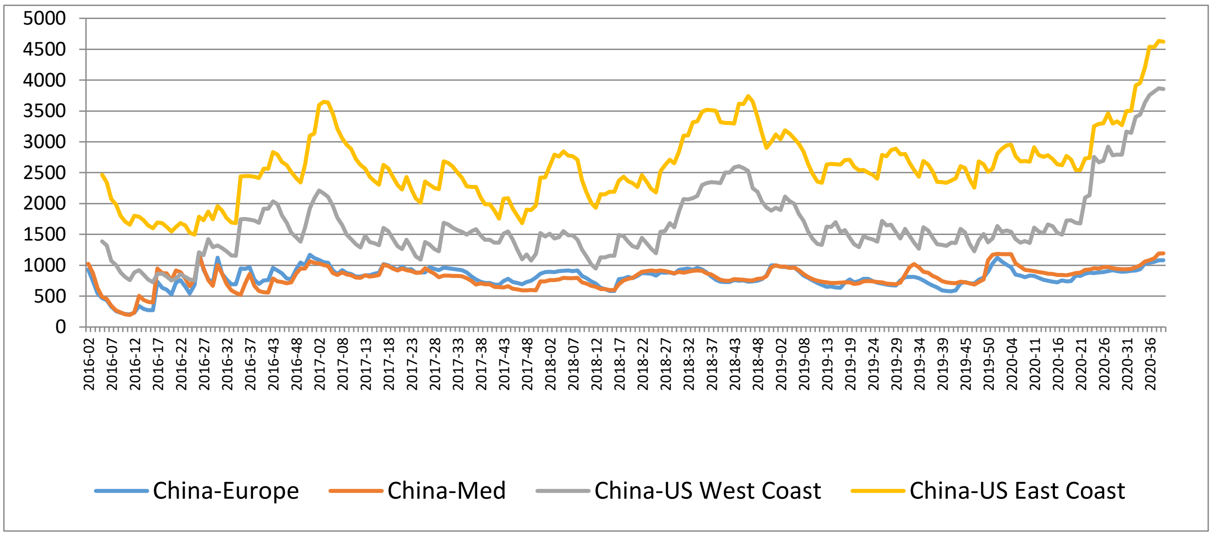
The ferry sector has different issues. Ferry companies rarely face global competition, often the main justification for state support, outlined for instance in the EU's Maritime State Aid Guidelines of 2004.

More generally, the EU has continued to expand regular maritime state aid schemes, in addition to approving the Covid-19 state aid for shipping. As such, it has perpetuated the shortcomings analysed in a recent ITF report on maritime subsidies[13], namely tax competition[14], market distortion[15] and expanding scope[16].

Shadow subsidies

The Covid-19 crisis has also seen the emergence of "shadow subsidies" in container shipping. Shadow subsidies are transfers from consumers to producers that result from constraints on competition contained in shipping regulation. Confronted with reduction in demand for containerised trade, the main container carriers jointly withdrew ship capacity by cancelling scheduled voyages, so called "blank sailings". Between February and June 2020, approximately 20 to 30% of the container ship capacity on the main trade lanes was idled.[17] The artificially created scarcity pushed up the price to ship a container. Freight rates rose particularly strongly on the Trans-Pacific trade lane, but many other routes also saw increases despite the drop in containerised trade volumes (see chart).

Containerised ocean freight rates developments per week in selected trade lanes



Note: Shanghai Containerised Freight Index: spot rate (USD) to ship a container from Shanghai to North Europe, Med, US West Coast and US East Coast. Source: International Transport Forum based on data from Shanghai Shipping Exchange

Because of these remarkable shifts in freight rates, container carriers made large profits in the first half of 2020. The profit margin of ten main container carriers in the second quarter of 2020 was 8.5%, the highest since the third quarter of 2010, according to Alphaliner.[18]

These profits could be viewed as a shadow subsidy paid for by consumers. By managing to push up the price above its level under competitive conditions, carriers have in effect reduced consumer welfare. This shadow subsidy comes on top of state support in some cases: at least four of the main container carriers have also benefited from the Covid-19 aid.

This development raises concerns for competition authorities. Chinese authorities have recently asked carriers for explanations and requested that they re-instate cancelled services on the Trans-Pacific trade lane.[19] In the United States, the Federal Maritime Commission has also announced to investigate the blank sailing strategy of carriers.[20] At the time of writing, the European Commission had not (yet) taken action.[21]

State involvement in shipping companies

The Covid-19 maritime state aid packages also raise questions about state involvement in shipping companies. Different approaches to this exist around the world. In most OECD countries, the tendency over the past few decades has been to reduce state involvement in companies via privatisation and sale of government shares. In various emerging economies, notably in Asia, governments remain actively involved in the business of maritime shipping and companies are often state-owned and the instrumental to state objectives.

In practice, several segments of the shipping industry are now hybrid sectors. Six of the ten major container-shipping firms have governments as shareholders. This is for example the case for the Germany-based Hapag Lloyd and France-based CMA CGM. In the case of CMA CGM, the state has a seat on the company board and a veto on certain strategic decisions. A number of governments even hold a majority stake in what are considered "national" container shipping companies - this is the case in China, Korea and Chinese Taipei. In all of these countries, interlinkages between state and container shipping are frequent, irrespective whether state involvement is larger or smaller.

The EU obliges member states to sell any equity in an enterprise after a maximum of six years, a rule reiterated in the European Commission's "Temporary Framework for State Aid Measures to Support the Economy in the Current Covid-19 Outbreak".[22] Yet such a restriction on state ownership must not always be in the public interest. After the German city state of Hamburg bought a large stake (up to 36%) in Hapag Lloyd in 2008 – cleared by the European Commission in 2009 - in order to avoid a take-over by Singapore's Neptune Orient Line; it was obliged to sell its shares in 2015 for half the price it paid earlier.[23]

Policy implications

State aid for the maritime sector during the Covid-19 pandemic mitigates the negative economic impacts of the crisis on the shipping sector. Yet it also raises questions regarding the stringency of government policies with respect to desired outcomes. The following insights could serve as starting points for a review of the policy framework for maritime shipping:

- **Intensify the monitoring of competition**. The level of consolidation and cooperation in segments of the shipping industry makes possible effective collusion to reduce competition. The recent joint efforts of container lines to eliminate capacity through a coordinated strategy of blank sailings raises many questions of concern to competition authorities and merits investigation. Liner shipping requires continuous monitoring and corrective action when inappropriate behaviour occurs. The freedom granted to liners by the EU's Consortia Block Exemption Regulation to manage capacity jointly and to exchange information is prone to abuse.
- **Widen the scope of shipping competition policy**. Maritime competition policy has often been narrowly focused on the price for customers. It should also take account of market power vis-à-vis suppliers and a wider set of indicators related to service quality, connectivity and environmental performance. A call for proposals on greening competition policy and state aid recently announced by the European Commission[24] should be used to start greening the EU Maritime State Aid Guidelines, the tonnage tax and the Consortia Block Exemption Regulation. An alternative to widening the scope of shipping competition policy would be to loosen the restrictions on state involvement in companies.
- **Create a global level playing field in maritime state aid**. Including shipping in Pillar 2 of the Global Anti-Base Erosion Proposal ("GloBE") of the G20/OECD would help to create a universally applicable set of rules and comparable conditions for the sector. The proposal foresees a minimum tax for multinational enterprises that would eliminate the incentives for tax avoidance and set the bottom for global tax competition. If the shipping industry should not be included in GloBE, international negotiations on maritime subsidies and tax exemptions ought to be initiated. At the regional level, more active initiatives for tax convergence could be launched. In the EU, the Maritime State Aid Guidelines with regard to the maximum permissible subsidies and tax exemptions could be clarified and more rigorously applied.
- **Tackle market distortions resulting from state aid for the maritime sector**. Competition authorities should avoid taking decisions that distort markets, as happened with the European Commission's approval of tonnage tax schemes that cover cargo handling in ports.[25]. This has resulted in undue advantages for vertically integrated shipping groups and should be corrected.
- **Focus maritime state aid on strategic supply chains.** State aid for shipping has proliferated over past decades. Often, expansion of aid has not been driven by objective assessments of potential benefits for the provider. Maritime sector support should be targeted more strategically to help achieve broader objectives than mitigating losses for recipients. The Finnish Covid-19 package provides an example by linking state aid to the policy objective of supply security.

Notes

[1] http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=TAD/ECG%282020%2910&docLanguage=En
[2] https://asia.nikkei.com/Business/Business-trends/Asia-cruise-giant-Genting-secures-227m-in-German-aid
[3] https://ec.europa.eu/competition/state_aid/cases1/202022/286316_2160382_30_2.pdf; https://ec.europa.eu/competition/state_aid/cases1/202028/286880_2170959_55_2.pdf; https://ec.europa.eu/competition/state_aid/cases1/202028/286999_2172527_56_2.pdf; https://ec.europa.eu/competition/state_aid/cases1/202027/286654_2169310_54_2.pdf
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[5] https://merrionstreet.ie/en/News-Room/Releases/Government_Support_Measures_for_Strategic_Maritime_Connections.html; https://theloadstar.com/ferry-operators-to-receive-35m-cash-injection-to-keep-cargo-moving/; https://www.mediapart.fr/journal/france/260620/affaire-kohler-l-ardoise-de-msc-s-eleve-26-milliards-d-euros-pour-l-etat; https://www.alphaliner.com.
[6] https://ec.europa.eu/competition/state_aid/cases1/202022/286316_2160382_30_2.pdf
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[8] https://www.itf-oecd.org/sites/default/files/docs/maritime-subsidies-value-for-money.pdf
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[12] https://www.mediapart.fr/journal/france/260620/affaire-kohler-l-ardoise-de-msc-s-eleve-26-milliards-d-euros-pour-l-etat
[13] https://www.itf-oecd.org/sites/default/files/docs/maritime-subsidies-value-for-money.pdf
[14] Estonia's tonnage tax scheme is the most attractive within the EU and aims to attract non-Estonian ship-owners from EU member states. As such, it seems to contradict the objective of the EU Maritime State Aid Guidelines to avoid a "subsidy race between member states". https://www.itf-oecd.org/sites/default/files/docs/passenger-mobility-goods-transport-estonia.pdf and https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52004XC0117(01)&from=EN
[15] In June 2020, the EU extended Italy's tonnage tax regime which defines cargo handling in ports as "ancillary activity" of maritime transport covered by the tonnage tax. As a result, terminal operators integrated in shipping companies (that can reduce their tax expenses) are treated more favourably than and non-integrated terminal operators. https://ec.europa.eu/competition/state_aid/cases1/202030/272414_2175193_193_2.pdf
[16] In April 2020, the EU approved Croatia's modified tonnage tax scheme that brings commercial yacht owners under the scope of the scheme. https://ec.europa.eu/competition/state_aid/cases1/202018/282852_2152628_145_2.pdf
[17] https://www.itf-oecd.org/sites/default/files/global-container-shipping-covid-19.pdf
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