

ECONOMIC SUSTAINABILITY

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Following on from the expert presentation by Martin Stopford, the theme of my remarks is economic sustainability. This has become something of a catch phrase and I will begin by explaining the context in which it is being used.

In June last year, alongside IMO, ICS represented the world's shipowners at the United Nations 'Rio+20' Summit on Sustainable Development in Rio de Janeiro.

ICS explained that without the low cost of transport provided by modern shipping, the movement of raw materials and energy in bulk to wherever they are needed would simply not be possible. Given our impressive environmental performance, ICS also made the case that the shipping industry is undoubtedly a driver of 'green growth'.

As a follow up to the UN Summit, the IMO Secretary-General is now committed to producing sustainable development goals for the international shipping industry. This is an objective which ICS fully supports.

As most of you may be aware, sustainable development, as defined by the UN, is made up of three components or 'pillars': environmental, social and economic which are all inextricably linked. As well as being, by far, the most environmentally efficient means of commercial transport, the shipping industry also offers high employment standards compared to many shore based industries. This is reflected, I believe, by the entry into force of the ILO MLC , which we will be talking about this afternoon.

However, we must also emphasize the importance of maintaining the economic sustainability of shipping, especially given its vital role in transporting around 90% of world trade, upon which the functioning of the world economy depends.

Sustainable development, and the spread of prosperity, in a world in which over a billion people still do not have access to electricity, is dependent on the continuing low cost of maritime transport, which should not be taken for granted.

It is sometimes hard to remember that, with the exception of Europe, the world economy as a whole continues to grow. Maritime trade, after a dip in 2009, is actually continuing to expand. This is especially the case in intra-Asian trades whose size and importance is sometimes overlooked by those outside the region.

The current crisis in shipping is in large part a symptom of the hubris that preceded the 2008 banking shock. However, as we all know, the underlying cause of the industry's problems today is that there are simply too many ships chasing too few cargoes. The immediate challenge for shipowners is to address this serious oversupply of shipping tonnage.

This is primarily a structural problem, and the product of industrial policy since the 1970s rather than market forces. Shipowners have no real way of controlling the provision of new or excessive shipbuilding capacity, about 90% of which is located in the Far East. Several attempts by the OECD to negotiate a global agreement to remove market distorting subsidies have so far come to nothing. The big three shipbuilding nations seemingly remain committed to expanding, or at least maintaining, their market share, regardless of the consequences for the supply and

demand balance in international shipping markets.

The influence which bodies such as ICS can bring to bear on such a fundamental problem as over supply is, of course, extremely limited. In the current cycle, market forces will no doubt find a solution, which will almost certainly involve large numbers of ships going to the recycling yards much earlier than their owners had planned. But there may still be several years to go before equilibrium and profitability are fully restored.

It is therefore important that shipowners take sensible and considered decisions about ordering new tonnage. Shipyards that have similar over capacity problems will be offering cut price ships. As the ICS Chairman, Masamichi Morooka, explained at the Nor-Shipping conference, what might be in the rational interests of an individual shipowner might not always be good for the collective health of the industry as a whole. This is one of the dilemmas that shipowners currently face.

ICS is the leading international trade association representing shipowners at the IMO. It is therefore our job to engage with governments about the principles and philosophies supporting shipping regulations, in addition to the practical details of how shipowners will eventually achieve their ultimate goal of zero accidents and zero pollution.

At present, at least for smaller companies, shipping finance is still in short supply. This is not just for new ships but also for the investments needed to continue operating **existing** ships. Despite the large amounts of capital involved, the majority of shipowners are small to medium-sized companies with proprietary/entrepreneurial

ownership. Most shipping companies rely on commercial financing from banks that have traditionally had shipping experts who understood our unique business and its volatile and highly cyclical nature. But most banks in the West are no longer providing finance, primarily as a consequence of their recent excesses and irresponsible management of credit in other sectors as well as an endemic short term view and approach to profitability in the financial world. Shortsighted is another word that could be applied.

To say the least this presents a challenge for shipowners trying to finance the retrofitting of expensive new ballast water treatment systems that will be required in the next few years, and the investment required for other green technologies to meet demands from regulators and charterers to reduce CO₂ emissions.

The problem with environmental regulations that require the retrofitting of ships is that they are often inefficient, inequitable and can lead to market distortion. If a shipowner orders a ship, in good faith, with an expected life span of 25 years or more, only to find that the goal posts have changed a few years later, the business of owning and operating ships, in fair competition with others, becomes a lottery. If as a result of new rules on retrofitting, perfectly sound ships have to be scrapped early and as a rule replaced with excessive newbuilds costing many millions of dollars each, this is not a rational use of resources, either economic or environmental. Whatever the marginal environmental advantages that the latest ships may have, the environmental impacts and CO₂ emissions involved in building and scrapping them is rarely taken into account.

While the IMO agreement on sulphur is fully supported by ICS – since the alternative

of piecemeal regional legislation would have been far worse – we think it is important for governments to understand that the cost of this change to the industry after 2020 is estimated to be over US \$50 billion dollars a year. Distillate fuels currently cost around 50% more than residual fuel, and the difference between the two fuels is expected to increase as the use of distillate in effect becomes mandatory for the majority of ships. Even if it were possible for ships to improve their fuel efficiency dramatically, this significant cost will need to be absorbed by shipping's customers, including those in developing countries. There is also an attendant risk of modal shift, especially from short sea trades to less environmentally friendly shore transport. This will clearly have a major impact on the sustainability of shipping as I defined just now.

As I have said, the IMO Secretary-General is rightly giving emphasis to the sustainable development of the shipping industry. Sustainable development must include the economic dimension too.

At our Annual Meeting in June, ICS members agreed that government regulators should give **equal priority** to each of the three pillars of sustainable development, **including the economic**. This is especially important in view of shipping's role in the continuing spread of global prosperity and the movement of about 90% of trade in goods, energy and raw materials. Unless the industry is commercially viable it will not be able to deliver the investments in environmental and social improvements that are sought by regulators on behalf of society at large.

The vital need to protect the environment and for ships to comply fully with all new environmental regulations is fully recognised by ICS. It is hoped nevertheless that

one of the outcomes of IMO's new focus on sustainable development is that all proposals for any **future** IMO environmental regulation will be shown to meet existing IMO criteria for **compelling need** and be subjected to a **full and proper cost benefit analysis**, in a similar manner to proposals relating to the improvement of maritime safety. Such cost benefit analyses should include comprehensive impact studies and assessments of whether effective technology is available in order to implement the proposed regulations, especially if they are to be applied to existing ships, as is the case with the new ballast water rules.

ICS believes that the conduct by IMO of full and proper cost benefit analysis of all new regulatory proposals will ensure the delivery of sustainable development, consistent with the goals agreed by the United Nations Summit in Rio, including the best means of ensuring optimal environmental protection.

While shipping's regulators have a responsibility to protect the environment and the interests of wider society, they also need to be practical and have an understanding of the impact that their actions can have on the industry's own long term sustainability, especially if the 'compelling need' for potentially very expensive proposals has not been properly demonstrated.

In view of the situation that has existed since the banking crisis of 2008 - which has made it difficult for many shipping companies to obtain access to finance - it is important that regulators avoid creating an industry in which only state owned or state supported companies might be willing to invest.

Thank you very much for your time today.