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CANADA'S MARITIME CABOTAGE POLICY

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MARINE AFFAIRS PROGRAM

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An examination of the continuing validity of the considerations that have served to formulate Canada's coasting trade policy, including a comparison with evolving maritime cabotage policy thinking in other developed maritime States.

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EXECUTIVE SUMMARY

Throughout its history Canada has had a mixed record of success in the field of maritime transport. While there have been brief periods when Canada has ranked among the leaders in maritime trade, for the most part Canada has found it difficult to compete in the international shipping market. More recently, exposure to the full force of globalization and the emergence of ‘open registry’ fleets have created particularly challenging conditions which, in the absence of any substantive Canadian policy initiatives to respond to these circumstances, have effectively led to the demise of the Canadian flag deep sea fleet.

Thus Canada’s efforts to nurture a marine transportation capacity have been focused almost exclusively on the domestic market, in activities usually addressed collectively as ‘maritime cabotage,’ or more commonly in Canada as ‘coasting trade.’ Unlike the international sector, it has been the traditional choice of many nations to provide some degree of economic protection for their respective cabotage trades, and Canada has been no exception. From before Confederation, Canada has had some form of protection in place to reserve this domestic activity, first to British Commonwealth and more recently to Canadian flag ships.

This protection has taken two principal forms: access control based on registration and payment of duty depending on country of build. These restrictions were of little import in the days where national jurisdiction extended only three miles, the Great Lakes were essentially isolated, Newfoundland was not part of Canada, there was little shipping activity in the Arctic, and offshore exploration and exploitation had not been contemplated.

This situation began to change quite significantly following the Second World War. Developments included the union of Newfoundland with Canada, the construction of the Seaway, the opening of the Arctic to increased shipping activity, and an expanded interest in hydrocarbon exploitation in the offshore. These trends, coupled with the contraction in importance of the Commonwealth, the emergence of the OECD as an important international economic policy forum, and the extension of sovereign rights to the outer edge of the continental shelf, have all served to focus attention on the expanded range and geographic scope of marine transportation and other related activities in waters under Canadian jurisdiction, and on what constitutes Canada’s best interests in the manner in which these activities should be managed.

This study examines how Canada's policy choices have evolved in deciding how maritime cabotage activities should be defined, and the regulatory regime that should apply. It endeavours to evaluate the rationale behind these policy choices and, in the light of recent policy initiatives taken by its OECD colleague States particularly in Europe, to draw conclusions as to whether these choices continue to be appropriate.

In setting the stage for this evaluation, the study first takes stock of the current economic health of Canadian domestic shipping and related activities. It notes the quite diverse nature of domestic marine transportation activities in the four principal sectors of activity, namely the East and West Coasts, the Arctic, and the Great Lakes/St Lawrence River system. It notes the dominance of dry bulk carriage, but also recognizes substantial liquid bulk and ferry activity. The study highlights the particularly difficult environment of Canada's domestic shipping markets. In particular, it notes the problems prevailing on the Great Lakes where the slow but steady contraction in demand over the last two decades, imposed upon an essentially captive fleet, has served to present severe problems for ship operators. These problems have been exacerbated by the recent introduction of Coast Guard charges and the continuing high cost of other service support charges (Seaway, pilotage, etc). The study concludes that the domestic marine transportation sector is facing significant challenges in many quarters.

In the light of these difficulties, the study sets out to examine the evolution of domestic marine transportation decision-making that has led to the current situation. It tracks the evolution of coasting trade policy since before Confederation, and also explores the manner in which policy decisions have been impacted by Canada's choice to apply broad transportation principles across all domestic modes, principles that have been directed at achieving modal policy harmony and equality of treatment.

Having set out the background and evolution of Canada's domestic marine transportation policy thinking, the study undertakes a more in-depth examination of the principal studies of Canada's maritime cabotage policy that have been undertaken since the 1950s. The most important of these are the Royal Commission on the Coasting Trade (The Spence Report, 1957), and the study undertaken by Howard Darling in 1970 entitled *The Coasting Trade of Canada and Related Marine Activity*. Also examined is the subsequent analytical work undertaken by Transport Canada and others, including the publication of two Discussion Papers, that led finally to the current legal and regulatory regime principally comprising the Customs and Excise Offshore Applications Act (1983) and the Coasting Trade Act (1992).

Having comprehensively examined the evolution of Canada's policy thinking in relation to domestic marine transportation and the resulting regulatory regime, the study explores

recent developments in maritime cabotage policy among other developed countries, most notably the Member States of the European Union.

The study highlights the significant differences in the policy approach to maritime cabotage that has been adopted by European countries. Since the late 1980s substantial efforts have been made to reduce protective barriers in Europe, to the point where now any EU flag ship that is eligible to engage in its own coasting trade is able to engage in coasting trade activities in any other EU State. Several States (notably the UK and Norway) have no restrictions on the use of ships of any flag in their cabotage trades. It should be noted, however, that the relaxed restrictions on the registration of vessels engaged in maritime cabotage do not preclude the imposition of requirements in relation to crew and the location of the ownership of the vessel in question.

Of equal importance is the fact that the large majority of European States also offer important fiscal aid, usually in the form of a ‘tonnage tax,’ which effectively reduces corporate taxation to levels approaching zero, as well as varying degrees of relief from income tax for seafarers. This State aid, formally endorsed as EU-wide policy, has the important effect of reducing or removing any differential in the cost of conducting operations between the domestic and the international sector, thus facilitating the comparatively unrestricted movement of ships from one sector to the other. Such circumstances are in sharp contrast to the substantial barrier between domestic and international sectors that exists in Canada.

The study also examines cabotage regimes in certain other States, notably Australia, where, although there is no tariff barrier, application of access controls not dissimilar to those prevailing in Canada has resulted in a very difficult competitive environment for Australian flag operators. These conditions have, in turn, precipitated calls for State aid to Australian ship operators similar to that which prevails in the European Union.

The study takes stock of the current situation in the US, and in particular that country’s continuing inflexibility in considering any relaxation of cabotage restrictions enshrined in the *Merchant Marine Act of 1920* (also known as the *Jones Act* after its sponsor, Senator Wesley Jones). Although the current North American debate on Short Sea Shipping is stimulating discussion on ways of improving the efficiency of waterborne movements, there is still little evidence of any willingness to bring cabotage trade under the terms of the Canada United States Trade Agreement (CUSTA) and North American Free Trade Agreement (NAFTA). This continuing, quite rigid protectionist stance complicates, but does not unduly constrain, Canada’s potential policy choices.

In the light of these widely contrasting approaches to cabotage activities, the study concludes by examining options for Canada’s future domestic shipping policy. In

particular it argues that Canada's current regulatory regime is not the right choice, and that there are more attractive policy approaches that merit serious consideration.

In making this argument, the study notes that the artificial barrier that is effectively constructed between domestic and international operations by the present tariff and access control regimes essentially precludes movement of ships between the two. The study further points out that, since such movement is not possible, an essential policy premise for the adoption of such a barrier has to be that Canada's domestic marine transportation industry is large enough and stable enough to function as an efficient and sustainable commercial regime, independent of its international marine transportation counterpart. This same argument extends to other related marine activities such as the offshore oil and gas industry. The study questions the validity of this premise and offers observations by leading experts in the field to illustrate the present tenuous state of domestic shipping in Canada.

Exacerbating this problem is the seasonal nature of much of Canada's domestic activity, which introduces important inefficiencies and additional cost resulting from the need for ships to be laid up for three or more months of the year. This consideration alone illustrates the shortcomings of a regulatory and tariff regime that inhibits mobility between sectors. The study concludes that, beyond providing artificial protection for hard-pressed and expensive domestic fleets, there is little evidence that the present regime is providing an optimum environment for domestic shipping operations.

Having concluded that the present regime has important shortcomings, the study turns its attention to examining alternative approaches. Its first conclusion is that there are fundamental flaws in the rationale for application of a 25% duty payment on imported ships. First, it is of no help to the shipbuilding industry, a fact borne out by the near total absence of shipbuilding orders. Second, it is generally accepted that application of such a tariff is significantly less cost-effective as a support tool than a subsidy. Finally, the use of duty payment as an assistance measure transfers the cost of that measure from the general taxpayer, where it belongs, to a discrete and comparatively small commercial sector, namely the users and operators of ships. In this respect the tariff is neither fair nor effective in achieving the objectives set for it. The fact that Canada is the only developed country that still applies such a tariff, and that such application has come under criticism from Canada's OECD colleagues, only strengthens the arguments for its discontinuance.

The study therefore argues that the tariff needs to be removed. However, recognizing that Canadian ship operators have adjusted to the current regime, it would be both inappropriate and unfair to effect an immediate full removal. Instead, a transitional phase, or tax credit equivalent, would need to be designed to provide for gradual adjustment to

the new regime. While the transition would need to be gradual, the decision to initiate that process needs to be taken as soon as possible.

As for access controls, the study recognizes that this is a more complex issue. While removal of the tariff would bring some relief to the capital cost of operating Canadian ships, there remain important cost differentials in relation to such aspects as corporate taxation and crewing costs that would continue to inhibit the ability of Canadian ships to compete with their international counterparts. Indeed, the situation that would then prevail would not be dissimilar to that of Australia, where, despite the absence of a tariff and a temporary entry regime that functions reasonably satisfactorily for shippers, Australian ship operators continue to face significant challenges.

In this respect, maintaining the status quo is not viewed as an attractive choice. The barrier, while reduced, still remains an important impediment, and thus maintains Canadian domestic marine transportation as an isolated market. Furthermore, with the removal of the tariff as a disincentive, the temporary entry process would come under increased pressure to accept foreign flag alternatives, a situation that has caused significant problems for Australia. Something, therefore, needs to be done to reduce the cost differential between Canadian and prevailing international shipping operations.

While not clearly articulated, it may be assumed that Canada's cabotage policy objectives are to ensure economic efficiency, adequacy, safety, environmental integrity and fair employment standards. These are laudable goals, but no different from those of other OECD States, many of which have adopted markedly different approaches in seeking to achieve them. In Europe, a significant relaxation in the cabotage protection has been complemented by attractive fiscal regimes and income tax rebates or exemptions. While several States maintain temporary entry regimes, their importance is reduced, as is the regularity of use. While the European regime is not without its problems, there is clearly a high degree of comfort with what has been achieved to date and the benefits that are emerging.

The OECD has made clear that it would like to see Canada and others follow the initiatives adopted by the EU. The study offers the view that Canada should be open to this encouragement. Of course, similar to the EU, any selective relaxation of access controls would need to be accompanied by an appropriate fiscal regime and other State aid similar to that provided to other States in the liberalized regime. As with the removal of the 25% tariff, considerable care would be required in gradually liberalizing access to ensure full reciprocity of terms and conditions.

The study points out that pursuit of such an approach would give rise to certain ancillary policy issues. Among these is the concept of modal "neutrality" (the construction of a

level playing field among domestic modes) that has been a cornerstone of Canadian transportation policy since the late 1960s. The study points out that the construction of this level domestic field gives rise to an uneven playing field in the international sector, and precipitates the need for the artificial barrier between domestic and international shipping operations, which in turn gives rise to serious difficulties for the marine mode. Modal neutrality is not viewed as a key principle by other OECD States, which instead have tended to regard the marine mode as in need of special considerations. The study suggests that the manner in which domestic “neutrality” is applied to the marine mode needs to be revisited. It also suggests that there are alternative ways of maintaining neutrality while adopting the policy stance that is being advocated.

Finally, the study addresses the issue of Canada’s policy relationship with the US, and concludes that opportunities for achieving any relaxation in cabotage protection, through such agreements as NAFTA, do not look particularly promising at present. In this respect it offers the view that Canada should not wait for any such relaxation, but should move ahead with exploring increased liberalization with like-minded States.

The study concludes by stressing the need to provide, as a matter of some urgency, policy assistance to Canada’s hard-pressed marine transportation industry, and in its final chapter sets out what the elements of that policy should be.

CHAPTER 1 – INTRODUCTION

Overview

Maritime cabotage, or coasting trade as it is referred to in Canada, may generally be defined as the movement of goods or passengers between two ports or places within the same State. While in Canada the definition has been expanded to include certain other related activities, the terms cabotage and coasting trade are used interchangeably in this study to refer principally to the domestic movements of cargo and passengers.

Restriction of access to cabotage trades is a protection measure that has traditionally been a policy choice of many maritime States, both developed and developing. Its aim is to reserve to national flag vessels those activities that involve domestic movements of goods and passengers. More recently this aim has been expanded in certain instances to include commercial activities such as non-renewable resource exploration and exploitation. In Canada, only ships that are Canadian registered and on which all applicable duties have been paid, have unrestricted access to engage in those activities that fall under the coasting trade ‘umbrella.’

Prior to the 1950s, coasting trade policy and legislation in Canada did not occupy a very lofty position in the hierarchy of national or even transportation related issues. Indeed for many years it hardly attracted any attention at all, and the relevant legislation consisted of a short set of provisions in the *Canada Shipping Act*. Coasting trade policy was effectively prescribed by the British Commonwealth Merchant Shipping Agreement (BCMSA), which called upon Member States to reserve the coasting trade to ‘British’ (meaning Commonwealth) ships. With the Great Lakes essentially isolated, a cabotage control regime really only had relevance for transportation activities on the East and West Coasts, activities that more often than not could be met by Canadian ship operators.

A number of developments after the mid-1950s served to make cabotage a much more important policy issue than in earlier times. These developments, itemized more fully in Chapter 3, included: the opening of the Seaway, a steadily increasing interest in the Arctic, rapid expansion of offshore hydrocarbon exploration and exploitation activities, shifts in the make up of the British Commonwealth, and the entry into force of the United Nations Convention on the Continental Shelf, and later the Law of the Sea Convention.

More recent developments include a significant increase in importance attached to free trade manifested in the emergence of several bilateral and multilateral trade agreements, most notably the European Economic Community (EEC), the European Free Trade Association (EFTA), the North American Free Trade Agreement (NAFTA) and the South American Trade Agreement (Mercosur). This continuing emphasis on free trade has, in particular, led to a substantial relaxation in maritime cabotage restrictions in the European Union, as well as review and adjustment of cabotage policies in a number of other countries.

There has been no parallel shift in North America, and despite the free trade thrusts of the Canada United States Trade Agreement (CUSTA) and NAFTA initiatives, the US has continued to insist upon retention of its highly restrictive maritime cabotage provisions, as contained in the *Merchant Marine Act of 1920* (the *Jones Act*). Notwithstanding this US inflexibility on cabotage, both during and since the CUSTA and NAFTA negotiations, there have been one or two glimmers of hope, including the recent expanded interest on the part of both Canada and the US in short sea shipping, and agreement to collaborate on examining the future potential of this specialized mode of transportation.

Canada has conducted several important reviews of maritime cabotage. The net effect of these reviews has been a substantial increase in the scope of the activities included in the definition of cabotage, and in the geographic areas to which it applies. More particularly, in the evolution of its policy thinking in this sector, Canada has chosen to:

- Limit cabotage access to Canadian (as opposed to Commonwealth) registered ships on which all applicable duty has been paid;
- Extend the area of application to the outer limits of the Canadian continental shelf, or to 200 nautical miles, whichever is the greater; and
- Expand the definition of ‘coasting trade’ to include a range of additional activities above and beyond transportation between two ports or places in Canada, including, for example, cruising activities, and activities related to the exploration, exploitation and transportation of mineral or non-living natural resources. (It should be noted that cabotage restrictions do not apply to a limited range of activities, including commercial fishing and certain oceans research activities).

The Objective of this Research

The aim of this research is to conduct a broad review and evaluation of the continuing validity of the considerations that have served to shape Canadian maritime cabotage policy. Thus the research aims to examine not only the evolution and current status of Canadian policy but also the maritime cabotage policies adopted in other member

countries of the Organisation for Economic Co-operation and Development (OECD). In particular, it looks at the initiatives taken since the late 1980s by Member States of the European Union to relax/remove the access restrictions that apply to the engagement of ships in maritime cabotage activities, and contrasts these with the still quite rigid and restrictive cabotage environment in North America. It also examines the current complex policy debate on cabotage in Australia, which has a number of parallels with Canada, and reviews the current situation in New Zealand.

The study aims to shed light on such issues as the nature of the considerations to which Canada's cabotage policy is intended to respond, and whether these considerations have changed at all since they were last evaluated in 1982 and measures to respond to them incorporated in legislation in 1992.

The study also has as an objective to address whether the current protectionist measures (principally access control and tariff protection) provide the most appropriate and effective policy response to these threats, and to examine the degree to which any negative impacts from these measures offset the positive elements.

In examining the issue, the study aims to draw on the cabotage policy approaches of other States, notably those that are members of OECD, in order to examine how they achieve essentially similar policy objectives. More specifically, the study aims to explore the considerations that argue for Canada to support the achievement of its cabotage objectives through the mechanism of tariff protection, recognizing that no other OECD colleague State has chosen to use this mechanism.

Ultimately, the aim of the exercise is to examine whether the current maritime cabotage controls constitute the most appropriate regime for achieving Canada's domestic shipping policy objectives. In fulfilling this objective, the study aims to focus in particular on a more fundamental issue. Recognizing that current cabotage policy constructs a regulatory division between domestic and international shipping operations, it effectively imposes a choice upon Canadian operators of ships. This choice is between either participation in the domestic market (in which case vessels must be Canadian registered and applicable duty paid) or in international trade (in which case vessels cannot afford to be Canadian registered and duty paid). At issue is whether this artificial market division is in Canada's best interests, and if not, whether there are options available to Canada to adopt a different approach.

This study may be seen as timely, as both NAFTA and CUSTA are now celebrating completion milestones, 10 years in the case of the former and a 15-year anniversary in the case of the latter. It is therefore appropriate for Canada to examine and update its policy hopes and aspirations in this important service sector.

Study Methodology

The study relies primarily on literature and electronic data and information searches, but has been supported by written exchanges (either letter or e-mail) and interviews with selected offices where clarification on important points has been required. Recognizing the time and expense involved in arranging translations from other languages, research efforts have been largely restricted to material available in English and French.

The subject matter has important implications for a wide cross-section of Canadian shipping and related interests. Recognizing that it is beyond the scope of this modest study to canvass and accommodate the diverse views of all these interests, the intent of this study is not to offer firm recommendations for change, but instead to distill a fresh set of policy premises and lines of thought that can hopefully provide a basis for further discussion and consideration.

The Organization of the Report

Chapter 2 provides a broad overview of the main characteristics of Canada's domestic shipping industry, including some insights into how these characteristics change across the four principal regions in which domestic shipping activities are found. It touches upon some of the main patterns of shipping operations, and the challenges that each region presents.

Chapter 3 provides a summary of the history and evolution of coasting trade policy in Canada. Its intent is to equip the reader with an appreciation of the nature and timing of domestic shipping policy decisions as they occurred, and their relationship to other more multimodal-oriented thinking in the evolution of Canada's transportation policy.

Chapter 4 takes a look at the more substantive studies and enquiries that have been undertaken over the course of the last half-century in order to propose an appropriate policy approach for Canada's domestic shipping industry. These are seen as important because they shed light on what was, and perhaps even more importantly what was not, considered in examining the optimum domestic shipping policy for Canada.

In order to examine the merits and shortcomings of Canada's current domestic shipping policy, particularly in relation to coasting trade, Chapter 5 examines recent policy trends in a number of established maritime States, with a particular emphasis on Europe, where some substantial adjustment to maritime cabotage policy have recently occurred. The aim of this chapter is to identify alternative approaches that could merit consideration by Canada.

Chapter 6 takes stock of Canada's current policy position, and in the light of the 'benchmark' comparisons with other approaches, offers views as to possible new directions in domestic shipping policy that Canada should consider. Finally, Chapter 7 summarizes the main messages emerging from the study, and sets out its conclusions.

CHAPTER 2 – SUMMARY DESCRIPTION OF CANADA’S DOMESTIC SHIPPING INDUSTRY

It is not practicable, within the comparatively modest scope of this study, to provide a comprehensive and detailed breakdown and analysis of the domestic marine transportation industry in Canada. In any event, several recent studies, notably those directed at the impact of the introduction of Coast Guard user fees, have undertaken such analyses, and the current joint government/industry study of the contribution of the industry to the Canadian economy will provide further insights. The aim here is to capture the essential considerations and challenges that characterize Canadian domestic shipping activities.

‘Domestic’ here is confined to those activities that come under, and are protected by, Canada’s Coasting Trade legislation. It therefore largely excludes both international and cross-border movements. It is important to note, however, that in certain specific areas such as the Great Lakes, ships used for cabotage movements may also be engaged in Canada/US import and export trade. Indeed it would appear that domestic coasting trade accounts for less than one-half of activities of members of the Canadian Shipowners Association (CSA), further clarifying the inter-relatedness of coasting and international shipping requirements (Tables 1 and 2). The annual reports of the CSA include statistics for both domestic and international operations and reports on them as one. It should be noted that certain of the largest companies have offshore subsidiaries as well as domestic ones. An extract from the 2003 annual report states:

CSA vessels carried over 73 million tonnes of cargo in 1999 to and from Canadian and U.S. ports – serving both countries’ natural resources and industrial economies. These vessels play an important role in Canada’s trade with the United States. Sixty-one percent of volume in 1999 was between Canadian and U.S. ports.

Iron ore is the largest volume commodity carried by CSA vessels – representing 28% of 1999 volume. Coal, limestone and grain together account for another 50% of the industry’s volume.¹

¹ Canadian Shipowners Association (2003), *Annual Report 2002-03*, p. 8.

The Canadian Domestic Fleet

In total, 138 vessels over 1,000 gross tons are currently registered in Canada for use in the coasting trade (see Table 4). There are only 139 vessels of this size on the register, meaning that, for all intents and purposes, the Canadian register includes only ships whose principal employment is in the cabotage trades. Clearly, Canadian operators in international shipping activities prefer to choose a foreign flag. The Canadian register constitutes 0.4% of the world gross registered tonnage as of December 31, 2002.²

Approximately half of the vessels on the Canadian register are dry bulk carriers, and they account for 86% of the gross tons operating in domestic trades. These carriers are primarily deployed on the Great Lakes. General cargo vessels and tankers constitute the next most important sectors of the domestic fleet, with ferries accounting for most of the rest of the over 1,000 GT size. In addition, 2,135 smaller vessels (including tugs, offshore supply and non-propelled vessels) fly the Canadian flag, but are generally too small to be included in globally collected statistics noted above.

Regional Breakdown

It is convenient to regard Canada's domestic shipping activity as divided into four broad sectors: the East Coast, the West Coast, the Arctic and the Great Lakes/St Lawrence River. Each sector has a number of unique features that define the nature of its operations and set it apart from the other three. Operations on the East and West Coasts and in the Arctic, while of significant importance, are comparatively straightforward to describe and will be addressed first. The Great Lakes/St Lawrence system is more complex and will receive a little more attention later.

The East Coast

With regard to East Coast domestic shipping activity, there are some important container movements, both domestic and feeder shipments. These include services between Montreal and Newfoundland, with a new service expected to start shortly from New Brunswick. There are also substantial domestic movements of refined petroleum products and coal.

There are important ferry services in the region, where virtually all except the constitutional routes are now largely privatized. Marine Atlantic not only operates the constitutional ferry services between Newfoundland and the mainland, but also the Newfoundland Coastal Service.

² UNCTAD *Review of Maritime Transport 2003* (2003), Appendix III, November 3.

Unlike other domestic shipping sectors, activities tend to be technically and economically more conventional. Hence one sees the highest levels of application for coasting trade licences from this region.

In addition to cargo and passenger movements there is substantial activity in offshore oil and gas exploration and development, resulting in a significant level of offshore support and resupply activity that comes under cabotage regulation. This industry also gives rise to a high percentage of coasting trade licence applications.

The West Coast

This region is unique both in terms of the nature of its domestic shipping operations and its isolation from other shipping regions of Canada. Shipping services are provided predominantly by quite specialized, tug/barge operations. The West Coast domestic fleet is highly diverse and comprises some 250 tugs and 750 barges, all Canadian registered, with a seagoing complement of 1,600.

Cargoes are dominated by forest products, but also include aggregates, cement, chemicals and petroleum products. There has been little offshore activity due to the moratorium on offshore drilling. There has recently been some contraction in level of activity as a result of the recent difficulties over lumber exports to the US.

Little or no use is made of foreign flag ships under the waiver system. In this respect the region seems to operate quite independently using terminals owned by shippers. Again, while deep sea shipping on the West Coast largely comprises comparatively large conventional ships, domestic bulk cargo operations are mainly conducted by smaller tug/barge operations. This significant technological dichotomy between domestic and international operations suggests that there is little potential synergy between these two regimes.

The West Coast is also home to BC Ferry Services Inc., which operates a very large fleet of passenger ferries. The coast is also a popular venue for large cruise ships, virtually all of which are foreign flag and generally operate without invoking Canada's coasting trade regime.

The Arctic

The principal activities impacting on marine transportation include community resupply in both the Eastern and Western Arctic, oil and gas exploration, exploitation of various mineral and oil deposits in the High Arctic, and grain movements out of Churchill. Of these, only the first two are primarily domestic movements under the *Coasting Trade Act*.

The Arctic is taking on new prominence with the forecast trends in global warming and the likelihood that it will trigger increased interest in shipping. It is reasonable to expect that an element of this interest would be increased domestic shipping opportunities. There are those in the science community who believe that limited trans-ocean navigation might be feasible for at least part of the year within the next 10 or 15 years

The seasonal nature of shipping in the Arctic presents particularly challenging problems for ship operators, since there is insufficient domestic business to keep a specialized (ice-capable) ship economically operating year round. However, once duty is paid, the ship is severely impeded from competing for business internationally, since the freight rates charged by the operator must then recover the added capital cost of the ship. Thus the only alternative, so as to be eligible to pay a reduced rate of duty, is to seek access under Canada's coasting trade provisions.

The Great Lakes/St Lawrence River

An understanding of shipping patterns in this region is rendered more complex by the significant level of international shipping activity, involving both cross lake movements and international voyages into and out of the Lakes. There is, of course, unrestricted foreign flag access to international movements in this sector; however an important percentage of this foreign flag tonnage is operated by well-established Canadian-owned and -based companies such as Fednav and Canfornav. Even though foreign flag ships cannot participate in cabotage trades, they can offer international alternatives (e.g., steel and grain) that effectively compete with domestic movements. Again, as we have seen, the Canadian Great Lakes cabotage fleets are also regularly utilized on Canada/US cross lake movements of cargoes such as coal, iron ore, cement and limestone.

With regard to cabotage movements, the region provides the principal route for the movement of domestic grain downbound from the Lakehead to the Lower St Lawrence ports, and the backhaul of iron ore to Canadian steel producers on the Lakes. These mutually supporting trades have long been a fundamental strength of Great Lakes shipping activities, but recent turbulence in both trades has served to weaken this foundation. Other important domestic bulk movements include limestone and salt, as well as petroleum products.

General cargo in the region accounts for little more than 2% of total cargo movements and there is presently no substantive container service operating above Montreal. This may be attributed to the unsuitability of the lock system configuration for receiving containerships, the need for quick turn-around times, and the problem that, with only a nine-month season, it is difficult to justify investment in expensive shore-based container handling infrastructure. While some form of geared feeder ship (i.e., a handysize vessel

or smaller with handling equipment enabling it to load or unload its containers with only minimal shore side assistance) could in theory operate for part of the year, finding employment for such a ship in the closed season is clearly difficult. This seasonality issue will be discussed in more detail later in this report.

Thus, the dominant domestic and trans-lake cargoes are almost exclusively bulk movements. These cargoes are moved mainly in specialized lakers (either straight deck bulk carriers or self-unloaders) that are designed to maximize throughput capacity of the locks. The present maximum size that can be accommodated in the lock system is about 32,000 tonnes DWT, with dimensions limited to about 222m x 23m x 8m. With continued growth in the average size of ships in international trade, the percentage of the world fleet that is sized to enter the Seaway is steadily declining. Thus, vessels operating on the Great Lakes are either lakers, designed and constructed for exclusive use in the system, or comparatively small (handysize) ocean-going vessels that are specifically acquired to support specialized international trade routes. In some respects, Great Lakes shipping is quite technologically advanced, illustrated by the innovative concept of the self-unloader. In other respects, it is technologically backward with a rapidly aging fleet in significant need of replacement.

As mentioned, the principal challenges facing domestic shipping operations on the Great Lakes include the seasonal nature of operations and the size limitations of the locks. Other challenges include the scale and diversity of support service costs, including port and canal services, navigational support and pilotage. The fleet is largely captive to the Lakes for both economic and technological reasons. This means that operators are not able to adjust the supply of ships to match demand by diverting them to some other activity, and are therefore very exposed commercially to reductions in cargo demand. This is particularly apparent in relation to gearless straight deck bulk carriers, whose numbers have contracted sharply in response to a reduction in demand for cargo movements on routes supported by shore-based cargo handling facilities. The numbers of tankers have also contracted. On the other hand, demand for self-unloaders has remained relatively stable, with even an increase in capacity.

The Canadian Shipowners Association, in its presentation to the Canada Transportation Act Review Panel,³ noted the following facts about Canada's domestic shipping industry:

- *Twenty years ago Canada's domestic industry comprised 20 companies operating 176 vessels and carrying 86 million tonnes. In 2000, the number of companies has been reduced to nine, three of which account for about 90% of industry capacity.*

³ CSA Submission to Canada Transportation Act Review Panel, November 17, 2000.

- *Over the 10-year period from 1988 to 1998, the bulker fleet capacity fell by over 35%. The remaining bulker fleet is underutilized throughout the shipping season.*
- *Over the last 15 years, eastern movement of Canadian grains has fallen by approximately 50%.*
- *The Canadian domestic fleet averages 27 years of age and requires renewal.*
- *The bulker fleet, carrying bulk grain and iron ore, averages 29 years of age.*
- *A new Canadian vessel has not been built for the Canadian trade in 15 years.*

These statements appear to be confirmed by available statistics (Table 3). It may be seen that, with the exception of self-unloaders, the number of ships operated by CSA members, and the GRT they represent, have continued to decline over the past 10 years. The number of self-unloaders has grown from 28 to 32, over the period of 1993 to 2002, but this includes their significant use in the cross lake trades.

Domestic Ship Operators

Seaway Marine Transport manages the largest and most versatile fleet of self-unloading vessels and the largest fleet of gearless bulk carriers operating on the Great Lakes, St Lawrence River and the waters of Eastern Canada. Seaway Marine Transport is a partnership of Algoma Central Corporation and Upper Lakes Group, Inc. The fleet of ships presently managed by this partnership includes 21 self-unloading vessels and 22 gearless bulk cargo vessels. Seaway Marine Transport represents a merger of two prior partnerships of Algoma Central Corporation and Upper Lakes Group Inc. called Seaway Self Unloaders and Seaway Bulk Carriers. These partnerships have been in existence since 1990 in the case of Seaway Bulk Carriers, and 1994 in the case of Seaway Self Unloaders. The merger of the two partnerships and the creation of Seaway Marine Transport was effective January 2, 2000.

Based on the size of the fleet, it appears that the top three companies were then and remain now Algoma Central Corporation (27 vessels in 2000, now 25), Canada Steamship Lines (11 vessels in 2000, now 15) and Upper Lakes Group Inc. (21 vessels in 2000, now 15). Company profiles of these three are provided in Appendices 1-3.

Also, in 2000, there were nine members in the Great Lakes/St Lawrence–focused Canadian Shipowners Association while now there are seven. The companies that are no longer listed include N.M. Paterson & Sons Ltd., P & H Shipping, and Transport Nanuk Inc. while Rigel Shipping Canada Inc. was added as a member in 2002. Rigel Shipping Canada Inc. is a Canadian domiciled and registered ship chartering and operating company, as a subsidiary of Rigel Schiffahrts GmbH of Bremen, Germany. It was

specifically established to provide high quality petroleum and chemical tanker shipping services to the Canadian petroleum and petrochemical industries and provides an excellent example of the transformation of a foreign owner to “Canadian” for participation in the coasting trade.

Table 1: Great Lakes–St Lawrence R. Cargo Tonnage as a Proportion of Trades, 2002

	<i>Import</i>	<i>Export</i>	<i>Domestic</i>
Coal	63.1%	3.9%	4.2%
Grain	7.9%	0.6%	13.6%
Iron Ore	17.0%	25.4%	28.0%
Limestone	5.3%	20.3%	15.0%
Salt	0.5%	23.4%	7.9%
Tanker Products	0.1%	2.3%	20.5%
Potash, gypsum & other cargoes	6.1%	24.0%	10.8%
Total	100.0%	100.0%	100.0%

Source: Canadian Shipowners Association (2003), *Annual Report 2002-03*.

Table 2: Summary by Type of Trade, 2002 (CSA Members)

<i>Type of Movement</i>	<i>Tonnes (millions)</i>	<i>% of CSA Total</i>
Import	25	37.7%
Export	11.7	17.7%
Domestic	29.5	44.6%
Total	66.2	100.0%

Source: Canadian Shipowners Association (2003), *Annual Report 2002-03*.

Table 3: CSA Fleet, 10-Year Profile

	<i>1993</i>	<i>2002</i>
Ships	112	72
Total G.R.T.	1,507,398	1,160,203
Bulkers	46	21
G.R.T.	760,999	369,789
Self-Unloaders	28	32
G.R.T.	568,338	652,413
Tankers	21	13
G.R.T.	116,706	79,826
Other	11	6
G.R.T.	61,355	58,175

Source: Canadian Shipowners Association (2003), *Annual Report 2002-03*.

Table 4: Canadian Merchant Fleet

Self-Propelled Ships of 1,000 Gross Tons and Over	<i>Number</i>	<i>Gross Tons</i>	<i>DWT</i>
Foreign Trade			
Ore/Bulk/Oil Carriers	<u>1</u>	<u>20,236</u>	<u>28,418</u>
Foreign Trade Total	1	20,236	28,418
Home Trade			
Atlantic Coast			
Ferries	13	134,788	18,078
Passenger Ships	0	0	0
Combined Passenger/General Cargo Ships	3	8,409	4,187
General Cargo Ships	13	127,770	126,036
Dry-Bulk Carriers	5	55,804	110,238
Tankers	<u>20</u>	<u>530,165</u>	<u>563,469</u>
Atlantic Coast Total	54	856,936	822,008
Pacific Coast			
Ferries	3	7,658	7,956
Passenger Ships	1	4,165	2,085
Combined Passenger/General Cargo Ships	0	0	0
General Cargo Ships	5	14,622	9,792
Dry-Bulk Carriers	2	17,639	22,770
Tankers	<u>0</u>	<u>0</u>	<u>0</u>
Pacific Coast Total	11	44,084	42,603
Home Trade Total	65	901,020	864,611
Inland Waters Trade			
Ferries	2	5,762	1,458
Passenger Ships	1	2,112	
Combined Passenger/General Cargo Ships	0	0	0
General Cargo Ships	9	63,335	65,967
Dry-Bulk Carriers	58	1,091,999	1,652,039
Tankers	<u>4</u>	<u>28,899</u>	<u>30,468</u>
Inland Waters Total	74	1,192,107	1,749,932
Home Trade and Inland Waters Trade Total	139	2,093,127	2,614,543
Others Not Included Above			
Cargo, Passenger, Research, and Other Ships	354	63,823	
Tugs and Offshore Supply Ships	325	117,398	
Ferries	34	19,783	
Government Owned & Operated Ships	186	335,369	
Non Self-Propelled Vessels	1,236	1,186,805	

Source: Canadian Merchant Marine Fleet (2004), www.cta-otc.gc.ca, accessed January 7, 2004.

Appendix 1: Selected Profile of One of Canada's Shipowners—Algoma

Algoma Central Corporation includes Algoma Central Marine, Algoma Tankers, Fraser Marine & Industrial, Algoma Central Properties Inc., and a share of Marbulk Canada Inc., Cleveland Tankers (1991) Inc., and Seaway Marine Transport. The Corporation has offices at Sault Ste. Marie and St. Catharines, Ontario.

Algoma Central operates vessels throughout the Great Lakes–St Lawrence Waterway, from the Gulf of St Lawrence through all five Great Lakes. The Corporation's fleet of 26 vessels includes 14 self-unloaders, seven bulkers and five Canadian flag petroleum tankers.

Algoma Central Corporation and Upper Lakes Group Inc. work in a partnership, Seaway Marine Transport, which manages the commercial activities of the partners' self-unloading and conventional bulker fleets. Algoma Tankers manages the commercial operations of the Algoma Tankers fleet. The Corporation has a 50% interest in Marbulk Canada Inc., which through a subsidiary based in Beverly, Massachusetts, operates an ocean-going fleet of seven self-unloaders. The Corporation also owns a 25% interest in Cleveland Tankers (1991) Inc., based in Cleveland, Ohio. Cleveland Tankers owns two US-flag tankers, which are on long-term charter to Algoma Tankers (USA) Inc.

Source: Reprinted from the Canadian Shipowners Association (2003), *Annual Report 2002-03*.

Appendix 2: Selected Profile of One of Canada's Shipowners—CSL

Canada Steamship Lines Inc., based in Montreal with offices in Winnipeg and Burlington, operates a fleet of self-unloaders and gearless bulk carriers that ply the waters on the Great Lakes–St Lawrence Waterway system, continuing to play a pivotal role in supplying raw materials to North American heartland industries such as steel, power generation, agriculture and construction.

In March 2002, CSL purchased N.M. Paterson's shipping assets comprising the vessels *Paterson (Pineglen)*, *Cartierdoc (Cedarglen)* and *Mantadoc (Teakglen)*. Moreover, in December 2002, CSL purchased from Fednav the *Fraser (Spruceglen)* and *Mackenzie (Birchglen)*. These acquisitions complement CSL's current fleet, thus providing all customers with greater flexibility in their delivery schedules and allowing CSL to increase its market share of the domestic business. CSL Inc.'s rebuilding program will see the delivery of the *Atlantic Huron* in April 2003, which will have completed a mid-life refit and widening, and it will join the previous rebuilds of the *CSL Tadoussac* and the *CSL Laurentien* in 2001, the *Rt. Hon. Paul J. Martin* in 2000 and the *CSL Niagara* in 1999. This program reinforces CSL's commitment to its customers while reinvesting in the future of the Great Lakes shipping industry.

CSL Inc. and its affiliated company, CSL Headquartered in Montreal, The CSL Group also has offices in Halifax, Boston, Singapore and Sydney, Australia. While continuing to serve its original customer base in the Great Lakes–St Lawrence Waterway system, the company has expanded its activities to include the East and West Coasts of North America, the Caribbean, South America, the Far East and now Australia. Today, The CSL Group controls a fleet of 42 vessels, 26 of which are owned within the Group, and the remainder with pool and joint venture partners.

Source: Reprinted from the Canadian Shipowners Association (2003), *Annual Report 2002-03*.

Appendix 3: Selected Profile of One of Canada's Shipowners—ULGI

Upper Lakes Group Inc. (ULGI) has been involved in the Canadian shipping industry since 1931 when it acquired its first vessel, the *SS Sarnian* to help service its elevator operations. ... In 2002 ULGI commissioned two 'new' vessels, the 11,000 dwt OPA '90 [Oil Pollution Act 1990] compliant asphalt-carrying articulated tug-barge combination *Everlast/ Norman McLeod* and the rebuilt and re-engineered Seaway-sized self-unloader *MV John D. Leitch*, two very different vessels, but with a common thread—innovative engineering with a customer focus.

A privately held company with headquarters in Toronto, ULGI maintains several offices across Canada. Upper Lakes has built its reputation on developing and maintaining long-term relationships with customers, as well as establishing affiliations with other companies. An important example is the ULGI partnership with Algoma Central Corporation in which both companies have pooled the marketing activities of their self-unloading and bulker fleet operations through Seaway Marine Transport. Another example is the joint venture between McAsphalt Industries Ltd. and ULGI to own and operate tug-barge units engaged in the transportation of asphalt and heavy residual fuels.

... ULGI has grown into a diversified marine company whose interests include a grain terminal and specialized bulk transfer facility in Trois-Rivières, Quebec; a grain terminal elevator in Thunder Bay, Ontario; two grain trading companies; and a marine and industrial fuelling operation. ULGI also owns 50% of Canadian Shipbuilding and Engineering Ltd. which, in addition to design, engineering and electrical expertise, offers full service drydock facilities at Port Weller Drydocks in St. Catharines, Ontario, and Pascol Engineering in Thunder Bay, Ontario.

Source: Reprinted from the Canadian Shipowners Association (2003), *Annual Report 2002-03*.

CHAPTER 3 – THE EVOLUTION OF CANADA’S COASTING TRADE POLICY

In order to set the stage for the examination of new directions for domestic shipping policy, it is considered useful to first look back at the evolution of Canada’s policy thinking in this sector, and in particular to review the broad rationale that has driven Canadian policy decision-making. This chapter will therefore track the main events in the evolution of Canada’s domestic shipping policy, while the next chapter will look more specifically at the principal studies and inquiries that have been undertaken.

The origins of Canada’s coasting trade policy may ultimately be traced back to the Treaty of Paris, 1763. This treaty, which ended the Seven Years War, not only marked a new phase in Britain’s relationship with its colonies, but also provided Britain with virtually undisputed control of the sea and maritime commerce. The treaty enabled Britain to pursue, without significant constraint, policies designed primarily to promote and protect British colonial trade, and despite the repeal of the Navigation Acts in 1849, all trade out of ports in Britain and its colonies was restricted to British ships up until 1854. While restrictions on coasting trade between ports in the United Kingdom were lifted in 1854, similar restrictions remained in place in most British colonies, including Canada.⁴

The *British North America Act*, passed in 1867, provided the Parliament of Canada with authority over navigation and shipping, but any Canadian legislation could not be inconsistent with UK law. In 1869 the Canadian Parliament enacted legislation continuing the restriction of coasting trade to British ships. This situation prevailed largely unchanged until 1931, when agreement was reached among the Governments of the Commonwealth to maintain uniform shipping legislation, and the *British Commonwealth Merchant Shipping Agreement* was signed. This agreement established uniform registration requirements and formally confirmed a common status for all ships of Commonwealth countries as ‘British’ ships. While the agreement provided each signatory State with authority to regulate its own coasting trade and to apply such customs tariff as it deemed appropriate, it also included an obligation, in Article 11, to treat all ‘British’ (Commonwealth) ships alike.

The *Canada Shipping Act* was enacted in 1934 and came into force in 1936. This new legislation meant that, for the first time, shipping law was fully under Canadian

⁴ Report of the Royal Commission on the Coasting Trade (The Spence Commission) (1957) p 7.

jurisdiction. Section XIII gave effect to the *1931 Merchant Shipping Agreement*, and continued the exemption provisions, first enacted in 1869 and subsequently adjusted in 1923, whereby non-British ships could under certain conditions be authorized by Order in Council to engage temporarily in the coasting trade. Part XIII also required a licence to be issued to any British ship that was built (or substantively repaired or altered) outside the Commonwealth before it could engage in the coasting trade. Such a licence could be issued by the Minister of National Revenue upon payment of a duty of 25% *ad valorem* on the fair market value of the vessel's hull, machinery, furniture and appurtenances.

It should be noted that while the aim of the tariff provisions was to provide protection to Canadian shipbuilders, their effectiveness was questionable since they were not applicable to UK-built ships, which at that time could be built at significantly lower cost than in Canada. In addition to the tariff protection, Canadian shipbuilders received some relief from customs and sales tax, and also assistance (principally in the form of a capital cost allowance) under the *Canadian Vessel Construction Assistance Act*.

Also of note was the fact that, at this time, there was little restriction on the nationality of persons employed on British ships, so long as they were properly certificated. Prior to the union of Newfoundland with Canada on April 1, 1949, coasting trade in Newfoundland was restricted to British ships, while trade between Newfoundland and Canada, being international, was open to ships of any flag. After the union, trade became restricted to British ships.

A number of considerations, but particularly the fast approaching opening of the Seaway in 1959, led to the establishment, on March 1, 1955, of a Royal Commission under the chairmanship of the Honourable Mr. Justice W.F. Spence. The Spence Commission was charged with examining the relationship of the coasting trade to shipping and shipbuilding, and to domestic and international trade, with a particular focus on the probable effects of the opening of the Seaway. The Commission was also charged with examining the need to adjust relevant policies, or to prescribe particular conditions. The report of the Commission was submitted on December 9, 1957. A summary of the Spence Report is provided in Chapter 4.

Some two years after the completion of the Spence enquiry, the MacPherson Royal Commission was established and tasked with examining the full range of Canadian transportation issues. While the stimulus for this Royal Commission stemmed from issues in relation to rail and truck competition, it offered principles that were expected to govern all modes. The report ultimately led to the *National Transportation Act 1967* (NTA). This Act called for the Canadian transport system to be economic, efficient and adequate, and set out certain key principles to guide the achievement of this goal. These included the promotion of free competition between modes, and the obligation on all modes to bear a

“fair proportion” of the costs of services provided to them. Despite significant changes in Canadian transportation generally and marine transportation in particular, the principles enunciated in the NTA continue, with only modest adjustment, to guide transportation policy in Canada today.

Despite the high quality and comprehensiveness of the Spence Report, a number of significant developments in the 1960s served to refocus attention on Canada’s domestic shipping policies. These included:

- Significant changes in the competitive positions of various Commonwealth States, including a reduction in cost competitiveness of UK ships, and in particular the emergence of a number of Commonwealth open registries (flags of convenience),
- The growing stature of the OECD in relation to the Commonwealth and the emergence of anomalies in the trade policies and mechanisms between the two,
- Commencement of operations of the St Lawrence Seaway and some consequential changes in shipping patterns that could not have been fully anticipated at the time of the Spence Commission,⁵
- The rapid emergence of containerization as the preferred method for the movement of non-bulk cargoes,
- Rapid expansion of offshore exploration/exploitation activities and a renewed focus and debate as to where Canada’s best interests lay in relation to this new and important industry,
- The entry into force of the *UN Convention on the Continental Shelf* involving a significant extension of sovereign rights,
- Expanding resource exploration and exploitation activity in the Arctic, for example nickel and copper in Northern Ungava, and deposits of lead and zinc at the northern tip of Baffin Island,
- Despite the recommendations of the Spence Commission, amendment (proclaimed January 1, 1966) of Part XIII, Section 671 of the *Canada Shipping Act*, to restrict Great Lakes cabotage to Canadian ships only.

These circumstances, together with the 1967 enactment of the *National Transportation Act*, which provided new opportunities for examination of policy, led to the initiation of a further inquiry into the Canadian coasting trade. The conduct of the inquiry was originally assigned in August 1969 to the Water Transport Committee of the newly established Canadian Transport Commission. However, in March 1970 a decision was taken to reassign the conduct of the inquiry to Mr. Howard Darling, who submitted his report in October 1970. A summary of the Darling Report is also provided in Chapter 4.

⁵ Darling (1970), p 5.

The essential message emerging from Darling's work was that all coasting trade activities should be reserved to Canadian ships, with the definition of 'coasting trade' extended to cover such activities as dredging, salvage, seismographic vessels, supply and support ships, and extending application to the Canadian continental shelf.⁶

Following the submission of this report, the Minister of Transport announced the government's intention to proceed with the development of new proposals with respect to the coasting trade, and to withdraw, at least partially, from the obligations of the *British Commonwealth Merchant Shipping Agreement*. A lengthy period now began in which efforts were directed at implementing the recommendations of the Darling Report. Despite these efforts, it would be another 20 years before this was actually achieved!

In the meantime, efforts were directed at streamlining the temporary entry process. In 1973 powers to waive the Coasting Trade restrictions were delegated to the Minister of National Revenue, through the Coasting Trade Exemption Regulations, once it had been confirmed by the Canadian Transport Commission that no suitable Canadian-registered, Canadian-built or duty-paid ship was available. Such regulations could, however, be viewed as at variance with Canada's obligations under the British Commonwealth Merchant Shipping Agreement, since the availability of a non-Canadian 'British' ship could not be considered in the waiver process.

In 1975, proposed new legislation (Bill C- 61) was introduced into Parliament. Its aim was to establish a Maritime Code to replace the *Canada Shipping Act* and to retain in the legislation the necessary provisions governing Canada's coasting trade. However, the coasting trade provisions included in the Bill emerged as controversial, and the level of concern expressed in the subsequent debate was sufficient for a decision to be taken to lift the relevant provisions out of the Code and address coasting trade under a separate Act.

Further work was undertaken to address perceived concerns and in July 1977 a Position Paper was released setting out proposed adjustments designed to respond to these concerns. However, these new proposals received very limited support and were subsequently withdrawn (see Chapter 4).

In 1979, a major roadblock was removed when all parties to the *British Commonwealth Merchant Shipping Agreement* agreed to withdraw, and the Agreement therefore became defunct. However, this withdrawal did not by itself alter much since it did not, of course, change the existing legislation and regulations. Subsequently, in 1982 a *Background Paper* was released by Transport Canada, in which the various issues and options were discussed. Despite this discussion, no recommendations were included in the paper. It

⁶ Darling (1970).

should be noted that this paper essentially constituted the last substantive analysis of Canada's coasting trade policy (see Chapter 4).

In January 1983, new policies were announced by government to enhance Canadian control over its offshore, and to promote industrial and employment opportunities from offshore developments. Also included was abolition of subsidies provided under the Shipbuilding Industrial Assistance Program, in exchange for protection through a uniform tariff rate. The principal aims were to encourage Canadian registration of the offshore fleet and the use of Canadian-built vessels.

Later that year, the new *Customs and Excise Offshore Application Act* came into effect, extending jurisdiction to the outer edge of the continental shelf or to 200 nautical miles, whichever was the greater. It also included "designated goods used in the exploration, development, production or transportation of the mineral or other non-living material on the shelf" thus extending the duty provisions and the payment for temporary entry permits to a wide range of additional activities on the continental shelf. Of course, since the *Canada Shipping Act* remained unchanged, "British" registered and constructed ships still had unrestricted access to these activities.

In contrast to this initiative to expand the protection regime applying to marine transportation, support for deregulation in other modes was gathering momentum. Starting in the late seventies, interest in deregulation in the US had steadily expanded, with the result that, by 1980, significant deregulation of the US air and rail industries had occurred. Interstate road commerce was also deregulated at the same time. While Canada followed suit with partial deregulation of the airline industry, it was not until July 1985 that the deregulation thrust was formally adopted with the publishing of a framework for transportation reform entitled *Freedom to Move* as a precursor to amendments to the *National Transportation Act*.⁷ It is interesting to note that despite the strong deregulatory thrust of the thinking driving this document, there was little in the way of analysis of deregulatory options in relation to coasting trade, and the recommendations confirmed the (largely protectionist) policy position that coasting trade should be reserved to Canadian ships, jurisdiction should be extended to 200 miles or the limits of the continental shelf, whichever is the greater, and that virtually all commercial marine activities, except fishing, should be included.

The outcome of the Freedom to Move initiative was a new *National Transportation Act* (NTA) in 1987. An interesting adjustment to the policy provisions (Section 3) of the new legislation was the inclusion of the goal to promote competition "both within and among" modes. The legislation also stresses competition and market forces as "the prime agents

⁷ Transport Canada (1985), *Freedom to Move*.

in providing viable and effective transportation services,” but does not differentiate between domestic and international competition. This introduces an important anomaly in the marine mode, since imposition of conditions to achieve a ‘level playing field’ in competition with other domestic modes precludes the provision of a level playing field in relation to international competition. None of the associated documentation addresses this anomaly, which will be discussed more fully later.

It should be noted here that, through the seventies and eighties, substantial attention had been focused on Canada’s deep-sea shipping policy. Flowing from the *Report of the Task Force on Deep Sea Shipping*,⁸ the Canadian government had taken steps to amend the *Income Tax Act* in an effort to encourage international shipping companies to locate their operations in Canada. In order to qualify, a company had to be incorporated outside Canada, be an operator of ships and such ships had to be used (exclusively) in international traffic. This latter requirement, together with the essentially tax-free environment that these ‘International Shipping Companies’ enjoyed, served to cement the clear division between international and domestic shipping regimes.

Finally in 1992, over 20 years after Darling had submitted his report, the *Coasting Trade Act* came into full force and effect. It essentially implemented the recommendations of Darling, as confirmed and endorsed by the *Freedom to Move* initiative, including removal of the concept of a ‘British’ ship, and thus reserving the coasting trade to Canadian flag, duty paid ships. It is noteworthy that while the purpose of the legislation is stated in its sub-title to be “An Act respecting the use of foreign ships and non-duty paid ships in the coasting trade,” no policy statement is included in the Act itself. Its ultimate policy objectives are therefore left unclear. Again, the Canadian Transportation Agency (CTA) has more recently observed that “the primary purpose is to protect the interests of the owners and operators of the Canadian merchant fleet;”⁹ however, this does not align with past declarations of objective to protect the shipbuilding industry and, in any event, no analysis is provided to explain why the selected mechanisms are considered to be the most appropriate to achieve that protection, indeed why protection rather than aid is considered the best choice. Again, this issue will be revisited in due course.

In early 1995, the policy focus shifted to infrastructure and services, when the House of Commons Standing Committee on Transport undertook a substantive review of Canada’s marine support systems and infrastructure, and submitted its report, *A National Marine Strategy*, in May of that year. Transport Canada also undertook extensive consultation with shippers, carriers, other levels of government, trade associations and others. In December 1995 the government announced a new *National Marine Policy* and declared

⁸ Transport Canada (1985), *Task Force on Deep-Sea Shipping*.

⁹ Canadian Transportation Agency (2002).

its intention to enact legislation in the form of the *Canada Marine Act*, which was subsequently tabled in June 1996.

Despite its all-embracing title, the focus of the *National Marine Policy* was limited to support infrastructure and services to shipping. More particularly it declared that Canada's marine system was overbuilt and overly dependent on government subsidization. It called for the system to be more responsive to the needs of its users. Its aim was declared to be to change (reduce) the Government of Canada's direct operating role in the marine sector.¹⁰ Neither the Policy nor the Act that followed directly addressed the optimum policy environment for users of the marine system, namely Canadian ship owners and operators.

In July 1996 the new *Canada Transportation Act* came into force replacing the 1987 NTA. This new Act was principally directed at the rail and air modes, and the restructuring of the regulatory agency. Apart from the removal of some regulation governing northern resupply, the legislation had minimal implications for the marine sector, beyond confirming the broad policy themes reflected in the original 1967 NTA. These included promotion of free competition between modes and an expectation that each mode should bear a fair proportion of the cost of services provided to them at public expense.

The *Canada Marine Act* received Royal Assent in June 1998. The Act included the 1995 *National Marine Policy* at Section 4, in which the objective of the Act was set out. Much of this objective was directed at goals related to infrastructure and services. However the aspects of particular importance to shipowners and operators included (a) that the policy promoted and safeguarded Canada's competitiveness and trade objectives, and (b) that marine infrastructure and services be managed in a commercial manner, that "encourages and takes into account input from users..."¹¹

The *Canada Transportation Act, 1996* called for a review of the operation of the Act to be completed after five years. More specifically, the legislation charged the review with examining whether it provided Canadians with an efficient, effective, flexible and affordable transportation system. A Panel was appointed on June 30, 2000, to conduct this review, and it subsequently released its report in June 2001.

While the marine mode received somewhat limited attention, most of it directed at infrastructure and service issues, the Report did make two recommendations that impacted upon coasting trade policy.

¹⁰ Transport Canada (1995).

¹¹ Canada Marine Act 1998, c.10 assented to 11 June 1998, Section 4.

The first was to reaffirm the desirability of pursuing a more liberalized approach to domestic shipping with the United States.

Recommendation 8.4

The Panel recommends that the government make clear to the government of the United States its preference for eliminating the restrictions on entry to domestic shipping in the Coasting Trade Act and offer to negotiate bilateral elimination of equivalent restrictions.¹²

The second was to stress once more the desirability of removing the import duty on foreign-built ships.

Recommendation 8.5

The Panel recommends that the 25% duty on vessels built or purchased outside Canada be eliminated.¹³

Recommendation 8.5 of the Panel was justified on the basis that it now “amounts to an impediment to efficiency for Canadian carriers, distorting competition between domestic shipping and other freight modes, and impeding acquisition of specialized vessels needed for certain trades (notably Arctic resupply and development)”¹⁴ The Panel went on to state its belief that “aid to shipbuilding companies—if this is to be government policy—should be provided directly to them.”¹⁵ It should also be noted that while the Review supported the concept of cost recovery *as a long-term goal*, based on the principle of equal treatment of modes, it also recognized the need for involvement of users in decision-making and recommended that “opportunities to commercialize marine services be sought.”¹⁶

In February 2003, Transport Canada published the product of its ‘blueprint’ initiative, the document *Straight Ahead*. This document had among its objectives to respond to the conclusions and recommendations of the report of Canada Transportation Act Review Panel. However, the document paid little attention to the marine mode, and where it was addressed the focus was principally on international shipping services, particularly the container trades, and on marine infrastructure, with only a passing reference to domestic shipping services and coasting trade. The document provided no response to the Review report recommendation that the 25% duty requirement be removed, nor did it respond to the Panel’s observation regarding the merits of aid to shipbuilding companies.

¹² Canada Transportation Act Review Panel (2001), (p 146).

¹³ Canada Transportation Act Review Panel (2001), (p 147).

¹⁴ Canada Transportation Act Review Panel (2001), (p 146-147).

¹⁵ Canada Transportation Act Review Panel (2001), (p 147).

¹⁶ Canada Transportation Act Review Panel (2001), (p 145).

Similar to the *Canada Transportation Act*, the *Canada Marine Act* (CMA) called for a review of the provisions and operation of the Act, to be completed during the fifth year after the Act came into force. Because the CTA Review Panel had recommended that the Minister review the CMA earlier than the five-year time frame, and given the concerns expressed by many in the Canadian marine transportation business, the Review Panel for the CMA was appointed earlier than required by law, but, despite this, final release of the report was delayed until the mandated timeframe.

In June 2003, Transport Canada released the report of the Panel appointed by the Minister to review the *Canada Marine Act*. Not surprisingly in view of the content of the Act, the main focus was on service support infrastructure, particularly ports. However, some observations on broader policy issues were included, such as the need to “promote and more fully integrate the marine transportation industry into the Canada Transportation Act” and “to develop a progressive environment that encourages both private and public sector investment.” It should be noted that the report also generally opposed the concept of cost recovery, and supported the elimination of the CCG Marine Services Fees. It also called for efforts “to raise the level of public awareness of the important role played by ... the marine transportation industry in our national economy.”¹⁷ Despite the excellent opportunity provided in the review terms of reference to make observations on other issues beyond amendments to the CMA, the Panel chose not to make any such observations on coasting trade policy. To date, no formal government response has been offered on the Panel report.

This chapter has endeavoured to document the main events in the somewhat complex and convoluted evolution of domestic shipping policy in Canada. So as to shed further light on the directions that future policy should take, Chapter 4 will now examine in more detail the analysis and policy rationale contained in the principal studies of domestic shipping as identified above.

¹⁷ Transport Canada, *Canada Marine Act Review*, p 51.

CHAPTER 4 – CANADIAN CABOTAGE POLICY: STUDY/REPORT SUMMARIES

In Chapter 3 we traced the main events that marked the evolution of domestic shipping policy in Canada. This chapter will review in more detail the principal studies that have been made of Canadian domestic shipping policy in order to understand more specifically the broad policy rationale that has guided Canada's choice of cabotage policy.

The Royal Commission on the Coasting Trade (The Spence Report – 1957)

Perhaps the first major study of domestic shipping that has relevance for policy today is the Report of the Royal Commission on Coasting Trade under the chairmanship of the Honourable Mr. Justice W.F. Spence.¹⁸ This was a very significant report, drawn from 173 briefs and the input of 200 witnesses that generated some 6,000 pages of transcript at 17 hearings across the country. The final report was over 350 pages long, and included a detailed analysis of the legal, technical and economic circumstances that were influencing the choice of coasting trade policy at that time.

Of course, circumstances were significantly different from those of today. These differences included the fact that the Great Lakes system was still a quite isolated inland shipping area, and there was no year-round operation of St Lawrence River ports. From a government intervention perspective there were a number of important subsidies provided for certain services, and often linked with the above, a quite extensive framework of regulatory controls (see below). Also of note, in the context of coasting trade policy and the provision of access to British ships, was the fact that the cost of doing business in Canada was at that time about two times that of the UK. This was to become an important consideration in the final conclusions of the Report.

On the other hand, there were a number of features that were very applicable to today's situation. These included a clear desire to ensure Canadian exports were not negatively impacted by unnecessary domestic costs, and, in this context, recognition that the 25% tariff protection provided to the shipbuilding industry had important negative consequences for shipowners and operators.

¹⁸ Report of the Royal Commission on Coasting Trade (1957).

The Report first examined the legal and regulatory regimes that applied to domestic shipping. These regimes included, of course, the control exercised through the regulation of coasting trade under Part XIII of the *Canada Shipping Act 1936*, which in turn was governed by *The British Commonwealth Merchant Shipping Agreement*. It also included:

- The licensing of certain bulk cargo movements, including maximum rates for grain on the Great Lakes under the *Inland Water Freight Rates Act* (enacted 1923), and goods in bulk on the Mackenzie River under the *Transport Act*.
- The licensing of certain general cargo and passenger movements on the Great Lakes and the Mackenzie River under the *Transport Act*.
- Provisions of the *Railway Act* that provided certain relief to coasting trade movements of vessels operated by railway companies as part of the rail system.
- Subsidies under the *Maritime Freight Rates Act* and the *Atlantic Region Freight Assistance Act*.
- Ferry subsidies, including those services provided to meet Canada's constitutional obligations under the terms of union with Newfoundland.

In addition, and in much the same way as it is today, domestic shipping was subjected to regulations dealing with manning and equipment under the safety provisions of the *Canada Shipping Act*, to customs provisions governing cargo, stores, etc., and to provisions governing the registration of a ship in Canada when it had been built outside Canada.

The Report also explored the relevant tariff and tax provisions as they applied to vessels engaged in the coasting trade, and also highlighted the anomaly generated by the fact that the definition of 'British' ship included all Commonwealth ships, thus enabling such ships to have unrestricted access to the coasting trade.

The Report then comprehensively examined the various activities that fell within the definition of coasting trade, and the related economic and commercial considerations. The Report also discussed the respective scale of activity for each of the three types of registration (Canadian, Commonwealth non-Canadian and foreign). Some 90% of coasting trade cargo was carried by Canadian flag ships, nearly 10% by Commonwealth (principally UK) flag and virtually nothing by foreign flag ships. The Report explored the specific regional characteristics of coasting trade, including the Great Lakes (N.B. pre-Seaway), Eastern Canada, the Pacific and the Intercoastal Trade.

The Report took a detailed look at the Canadian merchant fleet and, in particular, at that element of the fleet that was eligible to engage in the coasting trade. As of the end of 1956, vessels over 1,000 GRT in domestic trades were categorized as follows:

	<i>No. of ships</i>	<i>Total GRT (000)</i>
Great Lakes fleet	269	900
East Coast	42	133
Pacific Coast	26	82
Total	337	1,115

N.B. These figures did not include a large number of scows and barges totaling some 220,000 GRT, mainly on the West Coast.

It is interesting to compare the Great Lakes figures with the Canadian Shipowners Association fleet in 2002 comprising 72 ships, including some ships operating on the Lower St Lawrence, with a total GRT of about 1.2 million (Table 3, Chapter 2).

The Report then examined prospects for Canadian registered shipping in the coasting trade. It drew attention to the fact that a ship operating under the UK flag would incur significantly less cost (about one-third less) than one operating under the Canadian flag. Despite this, many operators continued to use Canadian tonnage, and use of UK tonnage was restricted principally to seasonal operations. This dominant use of Canadian tonnage was particularly evident on the West Coast where the engagement of Commonwealth vessels was negligible.

With regard to the Great Lakes, the Report examined the impact of the soon to be opened Seaway (a principal stimulus for the inquiry). It recognized the high level of uncertainty surrounding this event and the parallel concern that Canadian flag shipping could be eliminated by competition from lower cost Commonwealth ships in domestic trades, and, additionally, from foreign flag ships in transborder trades. The Report embarked upon an extensive and highly detailed analysis of the economic and other variables that were likely to exist between Canadian and UK flag ships. The principal area of high risk identified involved domestic bulk cargo movements, including grain repositioning movements for export. The Report foresaw a possible trend where Canadian operators would be chartering suitable UK flag tonnage for such movements.¹⁹ It also recognized that all flags would be eligible to enter the Great Lakes to pick up grain cargoes for export.

The Report examined the merits of restricting the coasting trade to vessels registered in Canada. The main argument for restriction of registry was to the effect that Canadian registered ships best served the public interest, but faced elimination by lower cost UK registered ships.²⁰ While those supporting such an argument conceded that an important element of the public interest was low-cost service, they contended that assurance of

¹⁹ Report of the Royal Commission on Coasting Trade (1957), p 107.

²⁰ Report of the Royal Commission on Coasting Trade (1957), p 109.

adequate and reliable service, in both peace and war was also important. Not surprisingly, those interests operating exclusively domestic shipping supported restriction, while those with an interest in international shipping opposed such restrictions. This latter group argued instead that the cost of assuring the availability of shipping in time of war should be borne by the nation as a whole and not by a particular sector of the country or group of users.²¹

To pursue this analysis, the Report then examined the economics of the proposed restriction. It recognized that a consequence of restriction would be a higher cost to the shipper than would result if no restriction was applied. There would also need to be a period of transition while Canadian operators acquired and registered suitable additional ships to make up for the shortfall created by the exclusion of British ships. The Report examined the situation once this balance was achieved. After extensive analysis the Report concluded that “restriction of the coasting trade to vessels registered in Canada would be detrimental to the public interest, whether the restriction applied generally or to only a particular part of Canada.”²²

In particular the Report concluded that with regard to the East Coast and the Gulf of St Lawrence, “the restriction could not fail to cause a substantial increase in transportation costs for a large volume of commodities, with similar effects in international services.”²³ In commenting on the impact on the Great Lakes and St Lawrence River, the Report observed that “it would probably cause most Canadian export grain to be shipped directly overseas from the Lakehead causing a substantial loss of coasting trade. This loss would impair the competitive position of Canadian operators in the transborder trade, and would not afford any substantial advantage in shipping service.”²⁴ With regard to the West Coast, the Report concluded that “the restriction would afford little or no practical benefit to Canadian operators generally or to the public, and hence would lack justification.”²⁵

The Report completed this particular analysis by examining the merits of lifting the current coasting trade restrictions so as to allow ships of all flags (not just Commonwealth) access to Canada’s domestic transportation. It concluded that this would not be desirable since the competition provided by Commonwealth, and in particular UK, ships was sufficient, and foreign flag participation would impair its access to allied shipping services in the event of hostilities.

The remainder of the Report was devoted to considering the shipbuilding and repairing industry in Canada. After providing a summary of the evolution of shipbuilding in

²¹ Report of the Royal Commission on Coasting Trade (1957), p 110.

²² Report of the Royal Commission on Coasting Trade (1957), p 139.

²³ Report of the Royal Commission on Coasting Trade (1957), p 139.

²⁴ Report of the Royal Commission on Coasting Trade (1957), p 139.

²⁵ Report of the Royal Commission on Coasting Trade (1957), p 139.

Canada, the Report examined government policy respecting shipbuilding. It pointed out that the imposition of a 25% tariff afforded no protection against UK shipbuilding competition, since any ship built in the UK was able to enter duty-free. Thus the only effect of the duty was to protect UK shipbuilding against its foreign competition! The Report spent some time discussing the various support measures provided to the shipbuilding industry, including the Replacement Plan introduced in 1948 and the *Canadian Vessel Construction Assistance Act*. The Report also included some of the associated policy thinking by such organizations as the Canadian Maritime Commission. The Report concluded this debate by observing that

*Activity in the shipbuilding industry will not long remain at its present level, unless there is a repetition of the circumstances which brought construction orders to Canadian yards. In the absence of further governmental assistance, the longer term prospect is that the industry will build few ships, and that it will depend largely on repair and other activities.*²⁶

The ongoing difficulties experienced by the shipbuilding industry over the past several decades would appear to confirm the accuracy of this prediction.

The Report responded to the Canadian Shipbuilding and Ship Repair Association proposal to reserve the coasting trade to Canadian-registered and -built ships (effectively a Canadian *Jones Act*). The Commission pointed out that while the proponents of restriction to Canadian-built ships emphasized that the policy would benefit the shipbuilding industry without involving an outlay of public funds, it was just this circumstance that concerned the Commission since it meant that the cost had to be borne by Canadian shippers and ship operators. Instead the Commission pointed out that subsidization as an alternative to restriction would have the advantage of spreading the cost of assistance among taxpayers at large.²⁷ The Commission estimated that the cost to government of supporting the industry by subsidy would be a fraction of the cost of restriction. More particularly, the Commission calculated that if the government subsidized about one-third of the costs of a shipbuilding order worth approximately \$9 million, it would cost the government about \$3 million. The Commission compared this with the cost of restriction, which it estimated to be of the order of \$15 million, or about five times as much!

With regard to tariffs the Report pointed out that the prevailing level of 25% was insufficient to achieve its intended goal, and that a rate in excess of 50% would be required to balance costs with non-Canadian competition. Unless it was set at that level, it was concluded that many operators would continue to charter foreign-built vessels of UK

²⁶ Report of the Royal Commission on Coasting Trade (1957), p 151.

²⁷ Report of the Royal Commission on Coasting Trade (1957), p 175.

registry, particularly for seasonal operations. In other words the tariff would increase the cost of employing foreign-built UK vessels (and hence transportation costs) but would not induce any UK owner to have a vessel built in Canada, since a Canadian-built vessel would be uneconomic in alternative employment outside the coasting trade. The Commission therefore recommended rejection of the proposal to restrict coasting trade to vessels built and registered in Canada. If the shipbuilding industry needed help, it should be achieved through direct subsidization.²⁸

Ultimately, after a huge analytical undertaking, the Spence Commission recommended no change in the coasting trade regime of the day. This was based primarily on the conclusion that the main source of alternatives to Canadian ships was the UK, and that unrestricted access to UK shipping was desirable for a number of reasons. It is noteworthy that, while circumstances have changed to a point where this position is clearly no longer valid, the reasoning offered in arguing for or against varying degrees of restriction is as valid today as it was then. In this respect the Report merits careful study as an exercise that took a very deep look at the issues surrounding the formulation of an appropriate domestic shipping policy.

The Coasting Trade of Canada and Related Marine Activity (The Darling Report – 1970)

The Spence Commission Report has no subsequent counterpart that matches it for depth and comprehensiveness. However, as set out in Chapter 2, a number of developments occurred in the 1960s that raised important questions about the continuing suitability of the policy regime recommended by Spence. Thus, only 12 years later, Mr. Howard Darling was asked to undertake a review of Canada's policy position on the coasting trade. Darling's study, while significantly less comprehensive than the Spence Commission Report, has effectively been adopted as the foundation for domestic shipping policy ever since.

At the outset of his study, Darling made clear a broad difference in philosophy from that reflected in the Spence Commission Report. Darling observed that this earlier Report had taken the position that any action that would restrict competition or raise costs of shipping in Canada would be on balance harmful to the economy.²⁹ Darling based his approach on the assumption that what was at issue was not purely the economic problem of minimizing costs by whatever means, but primarily matters of economic policy. He noted that the Spence Report reflected the stance that the coasting trade was only in part a

²⁸ Report of the Royal Commission on Coasting Trade (1957), p 178.

²⁹ Darling (1970), p 2. This claim was not actually quite correct since Spence had talked in terms of harmful to the 'public interest.'

member of the Canadian economy, and in part related to international trade, and that it should therefore be expected (and presumably equipped) to meet the full force of foreign competition. Darling argued instead that policy for coasting trade should be considered in the same way as for any other Canadian industry.³⁰ This difference of perspective is a key policy issue that will be discussed more fully later in this study.

Interestingly, Darling observed that there had been continual demands for a review of Canadian shipping policy.³¹ Thus his initiative, together with others, was intended to make an important contribution to the formulation of that policy, which needed to embrace both domestic and international activities. In making this observation, he also made clear that development of a comprehensive Canadian shipping policy was a necessary prelude to the development of a Canadian shipbuilding policy, not the other way round!

A principal focus of Darling's study was a re-examination of the impact of the British Commonwealth Merchant Shipping Agreement. In this respect, and unlike the Spence Commission Report, the scope of study was constrained to an examination of the nature and degree of the protection to be afforded to Canada's maritime cabotage activities, and did not address whether there were alternatives to restricted access and imposition of duty that would better achieve Canada's shipping policy objectives. Put another way, the starting premise was that the need for protection was taken as a given, and that debate was therefore limited to how that protection should be provided. This is important because at no time since has this question of protection (through access and duty controls) versus alternative support mechanisms been revisited, despite the fact that, as we shall see in Chapter 5, many developed maritime nations have endeavoured either to remove or to significantly reduce protection measures in favour of alternative support mechanisms.

In this respect the foundation of Darling's recommendations was to retain protection as the essential mechanism, while proposing "fundamental changes both in the rules of the game and the size of the field."³² These changes were directed at ensuring that the economic benefits flowing to Canadians from shipping activity in waters under Canadian jurisdiction would be maximized.

With regard to the 'rules of the game,' Darling argued that the same degree of protection provided to Canadian cargo and passenger ships should extend to other 'related marine activities.' Thus activities such as dredging and salvage, as well as a variety of activities (e.g., seismographic, offshore supply and support) associated with offshore oil and gas exploration and exploitation, should be included in the protection envelope (but

³⁰ Darling (1970), p 3.

³¹ Darling (1970), p 7.

³² Darling (1970), p 206.

excluding platforms or rigs unless self-propelled). With regard to the ‘size of the field,’ he concluded that application of the protection envelope should extend to the edge of the continental shelf.

While Darling supported the need for a waiver system, he observed that the issuance of permits should be directed as much as possible and practicable toward replacing foreign vessels with Canadian equivalents. In this respect he saw the waiver fee principally acting as a deterrent³³ and argued that it should be increased to 1/60 of the fair market value per month. Notwithstanding this position, Darling recognized that the seasonal nature of much of Canada’s domestic marine activity presented problems to ship operators.

Canadian ships, because of their higher construction and operating costs, find it difficult to compete in international trades, and the possibility of being idle during part of the year makes it a high risk for a Canadian shipowner to provide a ship on certain contracts and raise the price by requiring a year’s overhead to be covered during a few months’ work. This is perhaps the most serious obstacle to Canadian flag shipping on the East Coast and in the Arctic, and some ingenuity will be required to get Canadian ships firmly established in such seasonal trades. There is a limit to which law and regulation alone can be used to exclude foreign ships without either drying up the traffic or driving it into the international trade.³⁴

He goes on to speculate on possible solutions to this dilemma:

One such means might be to permit Canadian ships to take a foreign registry for either short or extended periods with the right to return to Canadian registry to participate in the coasting trade or other marine activity. This might require us to find our own “Liberia” in the form of a Commonwealth country with which special arrangements could be made.

Such an approach could, Darling believed, result in a pool of Canadian-built and -owned ships (manned with Canadian officers, if practicable) on the high seas, which could then be drawn upon for work in Canadian domestic trades as required. However, he did not address how such vessels, if built in Canada and with operations taxed in Canada, might be able to compete effectively in international shipping markets.

It should also be noted that Darling addressed the question of competition between domestic shipping and rail. He pointed out that while railway policy had never been far from the top in terms of government priorities and public interest, the same could not be said of coastal shipping policy. He particularly drew attention to the manner in which

³³ Darling (1970), p 226.

³⁴ Darling (1970), p 222.

Newfoundland had joined Confederation in 1949,³⁵ and to the fact that the political exigencies of maintaining the Newfoundland Railway and of extending the Canadian railway freight rate structure to points in Newfoundland had the effect of channelling the enormous amount of traffic generated by Confederation through the ferry route bottleneck. He argued that this approach effectively precluded the development of a modernized, privately operated, coastal shipping industry. He cited other examples to further illustrate the negative impact of railway policy- and rate-making on Canadian domestic shipping.

Overall, the Darling Report on the Coasting Trade may be viewed as a comprehensive and well-reasoned examination of the circumstances prevailing in the late sixties. He was, however, constrained by his terms of reference to examine the scope and application of the coasting trade legislation of the day, and the shortcomings and anomalies it contained. While he was tasked to examine both broadening the application of the legislation to a wider area and to other marine related activities, he did not interpret his tasking to include examination of support mechanisms beyond the protective regime already reflected in Part XIII (later Part XV) of the *Canada Shipping Act*. At no time since then has this situation changed, and this study will later argue that it is probably time that it did so!

The Coasting Trade Act – A position paper dealing with the policy implications of a proposed Bill on the Coasting Trade of Canada (1977)

Darling's 1970 inquiry was the last substantive exercise to be conducted by an external appointee on domestic shipping policy in Canada. However, subsequent to the submission of his report, a considerable amount of internal study was undertaken, including the release of a couple of position papers. The first of these, developed by TC Policy staff and released by the Minister in 1977, was entitled *The Coasting Trade Act – A position paper dealing with the policy implications of a proposed Bill on the Coasting Trade of Canada*.

This report was the culmination of several years of complicated and, it must be said, largely unproductive discussion following the completion of the Darling Report. After quite extensive consultations on Darling's recommendations, efforts were directed towards a revision of the coasting trade provisions of the *Canada Shipping Act*. This paper was prepared in support of that effort.

The paper made clear that the underlying policy was to continue to protect the position of Canadian shipping to some degree but to recognize that, where Canadian shipping was not adequate for the purpose, ships of all nations should be granted access to the trade on

³⁵ Darling (1970), p 198.

payment of a suitable fee.³⁶ The position paper set out in an explanatory section certain proposals for adjustments to the prevailing regime. It argued that there was a need to clarify and facilitate access to foreign flag ships when suitable Canadian flag ships were not available. The paper proposed that this be achieved by the inclusion of:

- a statement of objective;
- a section on statutory exceptions that would allow for use of foreign flag ships;
- proposals for the issuance of permits to ‘grandfathered’ Commonwealth ships;
- suggested adjustments to the licensing procedure for foreign flag ships.

The paper also included draft legislation and supporting regulations that in turn included a number of schedules for use in calculating the fee.

It became apparent from discussions that took place following release of this position paper that support for this adjusted approach was limited. There was a feeling that the approach was overly complex and the benefits over what was already in place were at best unclear. As a result, the proposals embodied in this position paper were shelved, and the policy-makers returned to the drawing board.

Transport Canada Background Paper – A New Coasting Trade Policy (1982)

As Canada continued to grapple with the way ahead on domestic shipping policy, the policy environment simplified somewhat in 1979 when, as mentioned earlier, a collective decision was taken by the signatories of the British Commonwealth Merchant Shipping Agreement to abandon it. In this respect there was no further international obligation imposed on Canada that constrained it from adopting the coasting trade policy and legislation of its choice. Of course, as pointed out earlier, the termination of the Agreement did not in itself adjust the existing regulatory and duty regime. However, it is probably fair to say that, coupled with a recognition that it was by then in excess of ten years since Darling submitted his report, this development provided the necessary impetus for yet another attempt to distill an appropriate policy regime and mechanisms for achieving it. In February 1981 a team of officials was assembled to move the file ahead, and the product of their efforts was a new paper entitled *New Coasting Trade Policy – A Background Paper*, dated September 1982.

Interestingly, this paper observed³⁷ that the track record of the existing legislative and regulatory regime had generally functioned satisfactorily to the point where no major commercial hardship was apparent, and the waiver system authorizing access to foreign flag ships operated in a manner judged, in general, to be smooth and impartial.

³⁶ Transport Canada (1977), p 3.

³⁷ Transport Canada (1982), p 6.

The arguments for change were therefore directed more at a number of perceived anomalies that existed in the present system, for example:

- the definition of coasting trade, in particular use of the word “includes” as opposed to “means,” thus leaving doubt as to what other activities were included in the definition;
- the practice of limiting considerations of availability to Canadian ships only, even though the legislation made no differentiation between Canadian and other ‘British’ ships;
- the fact that a number of ‘British’ ships were in fact from Commonwealth States offering open (flag of convenience) registry; thus undermining the intent of the legislation;
- the fact that Canadian flag ships that had not paid duty were treated identically to foreign flag vessels, despite their clear national identity and credentials in all respects except duty.

More substantively, the paper recognized that the increased activity on the Canadian continental shelf had introduced some issues regarding “employment, the use of vessels and the degree of Canadian participation.”³⁸ The *Background Paper* concluded that these issues needed to be examined in the context of a new policy addressing other marine related activities.

The paper reviewed the statistics relating to the actual use of non-Canadian shipping in coastal commerce. It noted a declining use of such ships (from 5.7% of total coasting trade tonnage in 1977 to 2.0% in 1981), and attributed this to the announced intent of the government to reserve coasting trade to Canadian ships. It also reviewed the respective positions of the Provinces, and the conflicting concerns of various sectors of industry, including shippers, ship operators, shipping unions, and shipbuilding interests.

The bulk of the *Background Paper* was devoted to analysis of the issues, the consideration and resolution of which were regarded as important. These issues included:

- Reservation of the coasting trade to Canadian vessels
- The use of non-Canadian shipping as a downward pressure on Canadian shipping and other surface mode rates
- The administration of the waiver system
- The status of the intercoastal route
- The status of passenger cruising vessels
- Customs duty on vessels temporarily imported under waiver
- The role of the Canadian Transport Commission

³⁸ Transport Canada (1982), p 7.

- The looseness of the coasting trade exemption regulations
- The scope of the legislation
- Marine activities on the continental shelf
- Other federal government initiatives.

The paper also addressed problems concerning past misconceptions of the coasting laws, and federal government policy proposals. It emphasized that “in no instance was there a rejection of the overall principle of reserving coasting trade to Canadian ships.”³⁹

Finally, the paper presented three alternative approaches, each offering choices regarding the status and scope of any new legislation. These options comprised:

- unqualified reservation to Canadian ships, immediately ruled impractical;
- the status quo, immediately declared unsatisfactory due to the existing anomalies, the uncertain status of marine related activities and the expansion of Canadian oversight to the Canadian continental shelf; and
- qualified reservation to Canadian ships, the clear choice recognizing that the others had been rejected.

The paper outlined proposals for this third alternative, addressing:

- the area of application, to include ‘Canada Lands’ as defined;
- the scope of activities, to include extension to ‘related commercial marine activities’;
- customs duty aspects, including termination of duty free access privileges for Commonwealth flag ships, but retention of the same level of payment for temporary entry; and
- exemption from the temporary entry fee for vessels on the intercoastal route, ships temporarily engaged in offshore exploration and exploitation, and Canadian flag non-duty-paid vessels for a specified maximum period in any one year.⁴⁰

The paper pointed out that the main changes reflected in the proposals were:

- The separation of the control of shipping (Transport Canada) from customs duty (National Revenue) and tariff policy (Department of Finance),
- The application of customs duty to all non-Canadian built ships engaging in the coasting trade,

³⁹ Transport Canada (1982), p 27.

⁴⁰ Transport Canada (1982), p 28.

- The denial of entry to foreign flag ships for a range of additional marine activities beyond transportation of goods and passengers when suitable Canadian vessels are available, and
- The simplification of the process.

In advocating these proposals the paper recognized that some adverse reaction to the new Canadian policy could be expected in the OECD Maritime Transport Committee where a study of liberalization of offshore supply shipping was taking place at the time.⁴¹

Finally, with regard to employment objectives, the paper noted that

the placing of offshore activity within the regime of the coasting laws will considerably enhance the powers of the Canadian Employment and Immigration Commission regarding preferences which must be given to Canadians in this field of employment. (p. 31)

It is probably fair to say that this policy document essentially captured the broad protectionist thrusts of the Darling Report completed over 10 years earlier, and constituted substantive input and guidance to the content of the *Coasting Trade Act* which was to follow some 10 years later.

Further Policy Examination

While, as mentioned in Chapter 3, the 1982 position paper was effectively the last formal policy pronouncement on the coasting trade, it was to be yet another 10 years before legislation governing the coasting trade, the *Coasting Trade Act*, was finally enacted. It is noteworthy that Darling's inquiry was triggered by what was then viewed as a crisis caused by a Commonwealth flag vessel carrying a cargo of grain from Thunder Bay to Halifax.⁴² That it took over 20 years before the corrective measures were formally adopted begs the question as to how serious the crisis really was!

With the coming into force of the *Coasting Trade Act*, it is probably fair to say that domestic shipping policy analysis effectively ceased, at least in any formal study sense. To the degree that there was policy activity in the marine transportation field it was directed principally at services and infrastructure in the form of the National Marine Policy.

Since that date the principal policy focus on marine transportation has been essentially in a multi-modal context, first with the Canada Transportation Act Review, released in June

⁴¹ Transport Canada (1982), p 31.

⁴² Darling. (1970), p 71.

2001, and the subsequent publication in February 2003 of the government's policy document *Straight Ahead*.

Recent Related Studies – Short Sea Shipping

Before concluding this chapter a few words should perhaps be devoted to the recent new focus on the concept of 'short sea shipping,' which, while having its origins in Europe, has subsequently attracted significant attention in North America. Among a number of initiatives to examine the potential of this mode of transport, Transport Canada has recently begun to examine short sea shipping opportunities in Canada. It has relevance to this study because, while the activity may involve either international or domestic movements (as its focus is regional as opposed to intercontinental), the short sea shipping concept has begun to shed new light on the interrelationship between domestic and international shipping policies.

Marinova Consulting and Brooks (2003), in their study of short sea shipping in Atlantic Canada, concluded, with reference to both Canada and the US, that

While both countries continue to protect domestic traffic for vessels flying the domestic flag (Canada) or owned by nationals (American), the ability of an operator to mount a one port per country shuttle service is a manner competitive with over-the-land options is unlikely. Currently SPM operates a Halifax-Boston-Portland feeder but cannot carry US traffic between the two US ports, incurring less-than-optimal asset utilization.⁴³ Furthermore, it was noted that improvements to the coasting trade environment, and in particular efforts to induce modal switching from trucking on congested roads to the less congested and more environmentally-friendly marine option, might assist Canada in meeting its Kyoto obligations.

Social costs imposed by road congestion and air pollution are not borne in general by the transport provider but by the taxpayer and consumer. Furthermore, as the population grows so will consumption of goods and hence there will be an increase in cargo transported. In Canada, road congestion and pollution are not at the same levels as in Europe and so the pressure on government to provide support to mitigate these social costs through providing support for moving freight off the road and on to more fuel-efficient modes like marine is not yet as vocal as it is in Europe.⁴⁴

Marinova Consulting and Brooks (2003) went on to note:

⁴³ Marinova Consulting Ltd and Mary R. Brooks (2003), p 52.

⁴⁴ Marinova Consulting Ltd and Mary R. Brooks (2003), p 54.

The issue of cabotage is a complex one, both in Canada and the U.S. Clearly, it will be more difficult and expensive to establish new short sea shipping services between Atlantic Canada and the U.S. than it would be to start new inter-regional services, simply because a foreign-built, and foreign crewed (if need be) ship can be chartered or purchased, at relatively minimal cost (depending upon age, technology etc).

Oceanex has been quoted in the foreign press as really having only one major concern going forward: that of the 25% duty that must be paid on foreign-built tonnage... However, the duty becomes a significant added cost, which is reflected in the company's return on investment as well as the cost to the end user.

However, as one shipowner told us, it would not be fair to lift the duty all at once as it would place many shipowners, who have duty-paid vessels, at a competitive disadvantage. A phased approach may be more appropriate in this case.

There is also the issue of a level playing field between Canada and the U.S.; currently, the regulations are sufficiently different that the crewing and country of build provisions need to be more closely examined.⁴⁵

The following illustrations, provided by a carrier, serve to highlight the dilemma facing short sea shipping in an environment where Canada/US regimes that are neither integrated nor in harmony with each other:

1. American origin cargo shipped over Saint John (NB) cannot tranship at a US port. Such an activity can take place in St. Thomas, since the Virgin Islands are not covered by the *Jones Act*. The impact on the New England cargo owner is a longer transit time for his cargo and a higher price for the transportation service.
2. San Juan–destined cargo originating in Canada that is loaded on a rail system that transits Maine is considered to have entered the US and must exit on a US flag vessel. The US and Canada do not appear to subscribe to the Transport International Routier (TIR) system, which allows in-bond travel across international borders.

These are simple illustrations of the problem facing potential developers of short sea shipping regionally, and serve to illustrate how protectionist domestic shipping policies, particularly when such policies are not mutually compatible, give rise to important transport anomalies.

⁴⁵ Marinova Consulting Ltd and Mary R. Brooks (2003), pp 57-58.

Conclusions re Canadian Maritime Cabotage Policy Studies

Through the 1970s and 1980s there was a widely held perspective among shipping policy-makers that the most attractive strategic approach with respect to Canada's policy on coasting trade was to announce the intention to change the regime, but never actually to finalize that change! Certainly the track record would suggest that this was the strategy that was followed during that period.

With the closure of Canadian maritime cabotage to all but Canadian ships, albeit with a waiver provision, and with the maintenance of a duty payment on (most) imported ships, and a duty-based fee for temporary entry, Canada has essentially reconfirmed the same protectionist philosophy that had existed ever since Canada inherited its coasting trade regime from Britain through the 1931 Treaty of Westminster. Indeed, the policy reflected in the *Coasting Trade Act*, incorporating increases in both scope and geographic application, only served to strengthen the degree of protection. As noted earlier, this policy direction is significantly at odds with the trends that have occurred in Britain (the original source of Canadian policy in this sector) and indeed in the whole of the European Union. This policy direction also is at odds with an environment where international and domestic shipping are able to support each other through adverse business cycles. These trends will be examined in the next chapter.

CHAPTER 5 –RECENT MARITIME CABOTAGE POLICY DEVELOPMENTS AMONG DEVELOPED COUNTRIES

This chapter first examines recent developments in maritime cabotage in Europe, both in general and then specifically, before examining developments in Australia and New Zealand. As the US is Canada's closest and largest trading partner, the chapter then briefly discusses Canada's international trade obligations with the US with respect to cabotage legislation. It closes by examining the academic literature on coasting trade, in order to see what else might be learned from other countries.

Recent Maritime Cabotage Developments in the European Union

The current state of maritime cabotage policy in Europe has its origins in the discussions leading up to the promulgation of Council Regulation 4055/86, which comprised a package of maritime regulations addressing the freedom to provide services in international maritime transport, both between Member States and third countries, and between two Member States. While cabotage, i.e., the movement of goods or passengers between ports or places within a single Member State, was an important part of the early negotiations in this package, it was ultimately lifted out of the discussions because of the significant political sensitivity that emerged. This sensitivity may be attributed to the fact that while a number of northern European States, notably the UK and Denmark, and to a large extent the Netherlands, Germany and Belgium, had open cabotage policies, most of the major southern European countries, notably Greece, Italy, France, Spain and Portugal, which were concerned about their inter-island services, were much less comfortable with any relaxation of their closed cabotage regimes. This subsequently led to a specific, concerted focus and effort on cabotage policy, which some six years later resulted in Council Regulation 3577/92.

The principal provision in this regulation, set out as Article 1, was as follows:

As from January 1, 1993, freedom to provide maritime transport services within a Member State (maritime cabotage) shall apply to Community shipowners who have their ships registered in, and flying the flag of, a Member State, provided that these ships comply with all conditions for carrying out cabotage in that Member State.

Other elements contained in this regulation included statements of policy intent, including the goal of ‘liberalization of maritime cabotage,’ ‘abolition of restrictions on the provision of maritime transport’ as well as freedom for all members to provide marine transport services. It also included various definitions of sub-categories of maritime cabotage that merited specialized treatment (e.g., island cabotage) and how the cabotage regime was to be reconciled with the provision of essential services involving acceptance of service obligations, and provision of financial support (public service contracts). The regulation also assigned authorities in relation to the manning of ships. Finally, it provided for a gradual phasing in for sensitive areas (for example, Greek island cabotage), and for safeguard measures were some significant commercial disruption to arise.

Following the entry into force of Council Regulation 3577/92 on January 1, 1993, a process of monitoring was initiated. This resulted in a series of Commission Reports advising on progress. The first such report addressed the period 1993-94, and consisted of three parts: a description of the implementation steps taken by Member States, an analysis of the effects of admission to the market of ships that did not meet the conditions of admittance to cabotage in the flag State, and an overview of the cabotage fleets of the EFTA countries. (At that time both Sweden and Finland were part of the EFTA group.)

A second Commission Report was subsequently made for the period 1995-96. It consisted of four parts: an analysis of the economic development in the cabotage industry compared with the period 1993-94, a study of the involvement of Danish DIS and Portuguese MAR registered ships in cabotage activities and the question of extending Regulation 3577/92 to all European Economic Area (EEA) countries (i.e., EU plus EFTA), a comparison of crew costs, and an analysis of the economic impact of liberalizing island cabotage.

A third Commission Report was issued on February 24, 2000, covering the two-year period 1997-98. This report again dealt with the legal and market developments in the EU and EFTA States, this time as a result of the decision taken on October 4, 1997, to extend the maritime cabotage regime to the whole of the EEA. Essentially this provided for access to cabotage trades as follows:

- All EEA first registers
- Second registers as follows:
 - Spanish Special Register (REC)
 - Portuguese Madeira Register (MAR)
 - Danish International Ship Register (DIS) – Cargo only

Vessels of the German International Ship Register (ISR) and those on the Finnish list of cargo vessels were only authorized access where regular services were being offered throughout the year. Otherwise, vessels registered with the Norwegian International Ship

Register (NIS), the Italian second register and passenger vessels in the DIS were not authorized access to EU cabotage, since they were not authorized to engage in their own national cabotage activities.

The report recognized that all northern Member States had already fully liberalized cabotage services. However, southern Member States, which had traditionally reserved domestic cabotage trades to the national flag, were still engaged in the gradual opening of their cabotage markets. The report looked ahead to January 1, 1999, when island cabotage would be liberalized. This was expected to be quite sensitive, particularly in relation to the important ro-ro ferry segment where there existed a number of public service contracts, which, while at the time let to domestic companies, were expected to attract interest from companies in other Member States.

With regard to the issue of crew costs, clearly an important consideration, the report provided statistical comparisons for 1998 across the EEA membership. The Portuguese MAR flag was concluded to be the cheapest, followed by the Danish DIS register, and the Dutch first register. The French, Swedish and Belgian registers were found to be the most expensive. The report examined the possible impact of recently adopted State aid regimes, involving fiscal relief in various forms, on the overall cost picture, concluding that the impact was minimal.

A fourth report, the most recent, was published on April 24, 2002, and covered the period 1999-2000. The report comprised three broad chapters which addressed legislative developments among the Member States, manning costs, including specification of the rules on manning imposed by certain States on ships engaged in island cabotage activities, and market trends.

With regard to legislative developments, the report advised that, as of January 1, 1999, the liberalization of cabotage services in Europe was virtually complete. Only the Greek market remained partially protected, and this protection was expected to be lifted by November 2, 2002. The report addressed the rules on manning and advised that the majority of Member States had not chosen to pronounce on this issue. Only five Member States had decided to promulgate rules to be applied to island cabotage and vessels smaller than 650 GRT. With regard to public service obligations, virtually all Member States having services to, from and between islands had chosen to impose public service obligations on those services, through a tender process.

With regard to market developments, the report observed that the liberalization of services since January 1, 1999, had not resulted in any significant increase in traffic or penetration of national markets by vessels flying foreign flags. It was also noted that the quality of services had increased. The report provided quite extensive statistics up to and

including 1999 on the volume of cargo carried in cabotage trades including breakdowns by country and by type of cargo. The principal leaders in terms of cargo tonnage carried were the United Kingdom, Italy, Norway and Spain. With regard to passenger transport the report noted that, as with cargo, passenger traffic appeared stable overall. To the degree that there were trends, there was a small increase in demand in southern States (attributed to improved service), and a contraction in northern States (attributed to such events as the opening of the bridge linking Copenhagen to the mainland). The main transporters of passengers were Norway, the UK, Italy and Greece.

With the pending May 2004 expansion of the EU to include 10 more Member States, no doubt new transition issues will arise and need to be addressed. The exact nature of these issues, and how it is proposed that they be addressed, has yet to be made known.

Cabotage Policies of Individual European States

Having provided a general overview of the collective cabotage policy regime in Europe, the emerging situation with regard to individual Member States on various dimensions of maritime cabotage will now be summarized. It should perhaps be stressed at this stage that what follows is intended to illustrate not only the nature and degree of liberalization that individual EU States have adopted, but also the flexibility inherent in the liberalization process that enables individual States to tailor their respective national cabotage regimes to meet their particular needs. There are, however, insufficient data readily available to support an evaluation of the relative effectiveness of the different choices made by respective States.

Basic principle of cabotage

EEC Regulation No 3577/92, later extended to EFTA thus applying it throughout the European Economic Area (EEA), called for access to national cabotage for all Member States as a minimum requirement. However, the question as to whether or not cabotage trades should be further opened to foreign (non-EEA) ships has been left to the discretion of each State. In practice, seven European States—Belgium, Denmark (except DIS passenger ships), Ireland, Netherlands, United Kingdom, Iceland, Norway—have chosen not to place any restrictions on foreign flag access.⁴⁶ Of these, four (Belgium, Ireland, Netherlands and Iceland) have very low levels of both cargo and passenger cabotage activity, and while Denmark is somewhat more significant, its cabotage trade has been contracting in size. Only the UK and Norway have significant cabotage tonnage, both in cargo and passengers.

⁴⁶ EC Fourth Report on the implementation of Council Regulation 3577/92, April 24, 2002.

Of the States that have restrictions on foreign (non-EEA) vessels, these constraints take a variety of forms. In **Finland**, as previously mentioned, national flag vessels in the List of Cargo Vessels in International Trade (second registry equivalent) have access, subject to certain restrictions. Otherwise, non-EEA vessels are generally prohibited from entering domestic coastal trades, except under a permit issued when no suitable Finnish flag vessel is available. **France** also prohibits use of foreign flag vessels except under a waiver system.

Germany also prohibits foreign flag engagement in domestic maritime cabotage, except under a waiver. These waivers may be granted if no EEA vessels are available, or where they are available under ‘very unfavourable’ conditions. Waivers can also be granted on the basis of reciprocity. **Greece** also restricts the entry of foreign flag vessels, except under a waiver system, which can be granted on the basis of reciprocity.

Italy restricts cabotage to EEA flag shipping and lays down ‘host State’ rules for EEA ships crews in the applicable trades. The Ministry of Transport/Navigation may grant waivers on a case by case basis. **Portugal** also applies restrictions, and sets ‘host State’ rules for island cabotage. Waivers may be granted in the event of non-availability of EU vessels. **Spain** gives unrestricted access to REC register vessels, but engagement of foreign flag vessels is prohibited except under a waiver issued when EEA vessels are not available. Finally, **Sweden** restricts cabotage trades to EEA vessels, but provides for a waiver system when EEA flag vessels are not available.

Crew nationality requirements

Most EEA States require that the ship’s master be of the nationality of that State, with some extending the requirement to certain other officers; for example **France, Italy, Spain** and **Portugal** require the first officer to be a national as well. In certain instances there is a waiver system, but not in all circumstances. For example, there is no flexibility in this requirement regarding the ship’s master in **Sweden** or **Greece**. With regard to **the UK**, the master of certain vessels that are designated “strategic ship types” must be of British, Commonwealth, EEA or NATO nationality.

With regard to crewing, the normal requirement for first registers is for the crew to be citizens of EEA States. However, certain States (e.g., **Denmark**) authorize engagement of third country nationals in their first register so long as they are engaged under terms equivalent to seafarers of that State. Certain States that also have second registers may authorize nationals to be engaged under local wage conditions (e.g., **Denmark**). Alternatively they may require that a certain percentage of the crew be EEA citizens (e.g., **Finland, Portugal, Sweden** – 50%, **France** – 35%). In certain instances, second register vessels may employ foreigners only if they are operating in international trades

for more than six months (e.g., **Germany**). Others may only employ foreigners if nationals are not available.

Vessel ownership requirements

Most States require that the ship be owned by an EEA citizen or by a company having its registered office in an EEA State. They may also require that the management of the ship be located in the ‘host State’ (e.g., **Denmark**). Some States may require national ownership or a certain percentage of ownership (e.g., **Finland** – 60%, **Netherlands** – 66%), or foreign ownership provided that at least 60% of the ownership is domiciled in the EEA. Second registers may allow foreign ownership, but with a branch office or legal representation in, for example, the Canaries (REC) or Madeira (MAR).

Fiscal regimes

It should be noted first that the fiscal regime that is applicable to a ship engaged in European maritime cabotage is set by the State in which the ship is registered. It is not necessary for the purposes of this study to provide a detailed breakdown of the specific fiscal elements that apply to maritime cabotage in each European State. Suffice it to say that the principal fiscal elements provided include: corporate tax relief of various forms (but increasingly in the form of a low rate tonnage tax), and a significant degree of tax relief for crews on income and social security benefits, normally related to the amount of time that a ship spends in international trading (with ‘international’ including trading between EEA States).

To illustrate further, in **the UK**, ship operators may choose a ‘tonnage tax’ fiscal regime, and UK seafarers are exempt from income tax if they are engaged on a ship in international trades (and therefore not resident in the UK) for more than 183 days per year. In **Norway**, a tonnage tax regime has been in place since the late 1990s, and all crew members serving on Norwegian vessels, whether or not on the domestic or international register, are entitled to a 30% deduction on their gross income. **Spain** allows a 90% reduction in corporate tax, and exempts 50% of a seafarer’s income from tax.

In summary, virtually every EEA State provides some important degree of corporate tax relief (either in its traditional form or in the form of some sort of tonnage tax). This tax regime is applicable to the operation of ships, whether participating in their own cabotage trades, in the cabotage trades of a fellow State, in ‘international’ movements between EEA States including its own, or in international movements between the EEA and third flag countries. Similarly, most States offer some degree of relief in relation to a seafarer’s income tax, usually dependent on the percentage time spent in domestic and international trades respectively. This, coupled with the imposition of a requirement for a minimum

percentage of EEA nationals in foreign flag vessels, where such vessels have been authorized to engage in a State's cabotage trade, and/or a requirement that foreign crews be engaged under the same terms as national seafarers, largely removes any cost differential relating to manning.

This situation is now markedly different from that prevailing in Canada, and clearly provides for circumstances that facilitate flexible transfer between domestic and international operations.

Maritime Cabotage in Australia and New Zealand

Both Australia and New Zealand have faced issues related to shipping, and in particular maritime cabotage, which have a number of parallels with the policy challenges faced by Canada. It is therefore instructive to examine the situation with regard to policy and legislation in these two countries.

Australia's coasting trade is governed by *The Navigation Act 1912*. The Act provides, in Section 7, sub-paragraph (1), a definition of coasting trade, and sets out the requirements for engaging in that trade. Under the Act:

A ship shall be deemed to be engaged in the coasting trade, within the meaning of this Act, if it takes on board passengers or cargo at any port in a State or a Territory, to be carried to, and landed or delivered at, any other port in the same State or Territory or in any other State or other such Territory.

The definition provides for a number of circumstances where such carriage is not deemed to be coasting trade, including for example international cargo on through bills of lading, or passengers on through tickets to/from overseas. The Act also provides for certain trades to be exempt, including trades between the mainland and certain island territories, and also passenger cruise liners operating in coastal passenger trades (other than between Victoria and Tasmania).

Ships may engage in the coasting trade by being issued with either a licence or a permit.⁴⁷ It is important to note that nothing in the Act differentiates an Australian flag ship from any other ship.

A ship qualifies for the issuance of a licence if the seafarers on board are paid in accordance with prevailing Australian rates and conditions, and the ship is not in receipt,

⁴⁷ Australian Government Transport Regulation Ministerial Guidelines for Granting Licences and Permits to Engage in Australia's Domestic Shipping Trade, June 24, 1998.

nor has it been in receipt, of a subsidy from a foreign government. It should be noted that there is no discretion in this matter if the conditions are met, and thus no barriers to reputable foreign shipowners. Nor are there any duty payments. There are, however, some general immigration restrictions on foreign crews that are activated after 30 days. Vessels must, of course, also meet international standards and qualifications as required under those IMO and ILO Conventions to which Australia is a signatory.

Unlicensed ships may engage in the coasting trade on being granted either a Single Voyage Permit (SVP) or a Continuous Voyage Permit (CVP). SVPs, as their name implies, are for single voyages. CVPs are issued for periods up to six months. In both cases, the cargo to be carried and the ports between which the movements are made are specified, and vessels only have to meet normal Port State Control requirements. While there is a charge for permits, the amount is nominal.

The principal condition that must be met is that there is no suitable licensed (Australian or foreign) ship available, or the service offered by a licensed ship is inadequate. It must also be considered to be in the public interest. Availability, suitability and adequacy are defined. Public interest is assessed on ‘the merits of the case,’ and, in the case of bulk carriers and tankers, includes the provision of satisfactory inspection reports.

In an independent review of Australian shipping completed in September 2003, under the auspices of the Australian Shipowners Association and entitled *A Blueprint for Australian Shipping*, the observation is made that “the coastal shipping industry in Australia is in a confused and confusing situation.”⁴⁸ It contends that the interaction of a number of different pieces of legislation causes a competitive disadvantage to Australian operators, and that the situation has been exacerbated by ad hoc steps taken to liberalize the coastal shipping market for non-Australian operators without taking into account the competitive disadvantage imposed on Australian operators. The authors stated that they had heard overwhelming evidence that, over the past few years, the criteria had been administered in such a way that the coastal trade could now be regarded as virtually deregulated.⁴⁹

Issues identified by the document as being in need of resolution included:

- The difference between Australian crew costs and those of quality foreign crews,
- The impact of higher on-costs (benefits) involved in employing Australians, such as seafarers compensation and leave arrangements,
- The lack of manning flexibility,

⁴⁸ Independent Review of Australian Shipping (2003), p 2.

⁴⁹ Independent Review of Australian Shipping (2003), p 13.

- The lack of a competitive tax system for Australian seafarers working in international trades, and
- Confusion and inconsistency in the administration of Australian shipping regulations.⁵⁰

The report concluded that if Australia was to retain a viable shipping industry it had to undergo significant change. It states:

*If all sectors are unanimous on a single issue, it is the need for Government to enunciate a clear, certain and consistent policy towards the industry, and for regulatory activities to be carried out in a consistent way.*⁵¹

The statement most frequently made by Australian operators was “we can compete if the playing field is level, but we cannot compete if the field is tilted in favour of foreign operators who have different tax rules and different crew costs.”⁵² The Review then pressed for the introduction of a tonnage tax system, similar to that adopted by a number of countries, observing that, where such an initiative had been applied, it had led to a revitalized shipping industry.⁵³

While there is, at present, no indication of the Australian Government’s perspective on this Review, it would seem clear that the Australian situation, far from offering any sort of panacea for Canada, reflects many of the same problems, with the same prediction as to outcome, namely a continuing serious decline in the industry. The reasons given as to the cause of this circumstance, and the high level of discomfort in the industry are also quite similar; Australia has effectively chosen not to participate in international trades, and has instead endeavoured to construct an artificial barrier between international and domestic activities. That country is now increasingly encountering policy anomalies with the barrier. While Canada has provided certain opportunities to engage in international shipping activities under its International Shipping Corporation concept, this has only served to enforce the partition between domestic and international activities. Clearly the Australian Shipowners Association believes that there are fundamental policy and administrative flaws in any policy that sets as its goal the construction of a partition between these two regimes. As a means of rectifying these flaws, the Association has argued that the solution lies in fiscal relief so that the barrier can be reduced or removed. This study will argue later that such a solution merits attention in Canada.

Turning to **New Zealand**, the provisions governing maritime cabotage are laid out in Section 198 of the *Maritime Transport Act 1994*. Coastal shipping control is not

⁵⁰ Independent Review of Australian Shipping (2003), p 17.

⁵¹ Independent Review of Australian Shipping (2003), p 20.

⁵² Independent Review of Australian Shipping (2003), p 21.

⁵³ Independent Review of Australian Shipping (2003), p 34.

economically highly significant and its administration is comparatively straightforward. It may be viewed as protected in that no ship is permitted to carry coastal cargo unless it is either a New Zealand flag ship, or a foreign ship that has either loaded or unloaded international cargo or passengers at a port in New Zealand, or will do so before departing from such a port. There is no Ministerial discretion with this provision; however, the Minister may authorize the carriage of coastal cargo by ‘any other ship’ under such conditions as the Minister considers appropriate.

In a document entitled *Transport for New Zealand – Overview* it is reported⁵⁴ that about 15% of New Zealand’s domestic trade is carried by marine transportation services, of which about 11% is moved by domestic shipping, comprising about 15 merchant vessels, and 4% by international shipping. There are no New Zealand ships in international trades, and the comparatively small scale of New Zealand’s coasting trade makes it unlikely that it can offer much in the way of solutions for Canada.

Canada/US Trade Policies and Obligations

Protection of coasting trade is contrary to the overall liberalized trade intentions of the two primary trade agreements that Canada has negotiated with the United States, the *Canada US Trade Agreement* and the *North American Free Trade Agreement*. It had therefore been Canada’s hope, in entering into negotiations, that a more liberalized regime for cabotage might be achieved through these agreements. This was not to be, however, principally because the US was not prepared to relax the highly protectionist cabotage regime it had in place.

As mentioned earlier, US cabotage is protected for US flag vessels under Chapters 24 and 27 of the US *Merchant Marine Act of 1920* (the *Jones Act*).⁵⁵ The Act states that cargo may not be transported between two US ports unless it is transported by vessels built in the US and owned by citizens of the US. The Act also covers a variety of other maritime issues, including harbour dredging, compensation to seamen and government loan guarantees to shipbuilders.

The US Maritime Administration defends its protectionist stance with the argument that “cabotage restrictions are more common than many believe”⁵⁶ and offers its assessment of worldwide cabotage practices (presented for selected countries in Appendix 1 to this Chapter) as evidence of this. It might be observed, in response to this claim, that while many countries do impose cabotage restrictions, the scope of US restrictions is almost certainly unparalleled.

⁵⁴ NZ Ministry of Transport (2002), p 12.

⁵⁵ 46 U.S.C. 883, 19 CFR 4.80 and 4.80(b).

⁵⁶ US MARAD (2001).

Canada-US Trade Agreement

During the negotiations of the *Canada US Trade Agreement*, the US was quite protective of its domestic shipping situation, and while trade in services was discussed, in the end no progress could be made in altering the provisions of the US cabotage legislation. Trade in international shipping services continued to be aligned with OECD principles for free and open access to international shipping services, but traffic between two national ports continued to be reserved for domestic flagged ships. This meant that shipping services were, in both countries, reserved for vessels flying the flag of the respective country, a really quite bizarre situation in this day and age when one examines shipping activity on the Great Lakes.

North American Free Trade Agreement

At the time of negotiation of the *North American Free Trade Agreement*, on the international side, there were no direct Canadian/Mexican marine services and only inducement sailings were possible. Coasting trade in both countries was reserved for national flag carriers.

During the negotiations, shipping services were once more discussed. Both Mexico and Canada hoped to open up access to trade in marine services to vessels flagged in the three countries. Early in 1992, Canada tabled its proposals for the inclusion of maritime services in NAFTA.⁵⁷ According to the industry, Canada sought a new cabotage environment as well as liberalization of the investment regime for shipping and minimum restrictions on the sale and reflagging of vessels among NAFTA parties.⁵⁸ Once again, the US position was firm and the *Jones Act* was protected by negotiated exclusion. As a result, Mexico and Canada struck an agreement on international shipping that excluded the US and preserved cabotage as a matter of national interest. Annex III, which was signed by the two countries, opened international shipping services to the flag of the other country. Annex I Schedule of Mexico reserved maritime cabotage, towing, stevedoring and investment over 49% in port facilities to Mexican nationals. In short, cabotage trade continued as a fundamental anomaly, directly at odds with the broad thrust and intent of the Agreement.

The situation remains unchanged today. The existence of the *Jones Act* has been met by reciprocal protectionism on the parts of Canada and Mexico, ensuring that Canadian coasting trade continues to be reserved for Canadian vessels or foreign flag ships operating under waiver. While there is no concrete basis for assuming that the policy perspective in the US will change any time soon, it is to be noted that the internal debate

⁵⁷ Canada Ports Corporation (1992), pp 24-25.

⁵⁸ Brooks (1994).

on the pros and cons of the *Jones Act* provisions has been gathering momentum, and becoming increasingly contentious. Where it will lead remains to be seen.

Academic Studies on Coasting Trade

There is surprisingly little written in the academic literature on maritime cabotage. A study undertaken by Francois *et al.* (1996) concluded, based on the research undertaken by the US International Trade Commission, that the *Jones Act* imposed costs on US consumers and taxpayers.⁵⁹ Other academic studies tend to be of an historical nature (e.g., Sheridan, 1995⁶⁰).

There has been more written on short sea shipping, but not much more. Paixão and Marlow (2002), for example, provided a thorough understanding of the economics of this concept.⁶¹ They noted that short sea shipping worked in Europe because between 60 and 70% of industrial production capacity lay near its sea coast and it was recognized as having the added advantages of being highly energy efficient, while producing lower levels of air pollution, and having lower fatality rates than road.

Saldanha and Gray (2002) explored the likelihood of modal switching to support short sea shipping in the UK but concluded that in spite of a number of measures to promote modal switching it had met with opposition from the trucking industry.⁶² Peeters *et al.* (1995) viewed short sea shipping as an area where governments might help fund innovation.⁶³ In all, these authors indicated that building a business case for maritime cabotage was difficult; competition was intense, and competitiveness was a critical factor in usage. As can be seen, more can be learned from the government studies already discussed than from the academic literature.

In summary, it may be concluded that cabotage policy is under intense scrutiny in virtually all established maritime States. Even, as noted above, there are signs of discontent with the status quo in the US but it would probably be unwise to forecast much change any time soon. Member States of the European Union have taken important steps to liberalize cabotage between them, without apparently encountering major trade difficulties or commercial disruption. This situation offers compelling arguments for Canada to examine the merits of following suit. These arguments will be examined in the next chapter.

⁵⁹ Francois *et al.* (1996).

⁶⁰ Sheridan (1995).

⁶¹ Paixão and Marlow (2002).

⁶² Saldanha and Gray (2002).

⁶³ Peeters *et al.* (1995).

Appendix 1: MARAD Data on Coasting Trade Provisions Elsewhere (2001)

<i>Country</i>	<i>Reflagging Restrictions</i>	<i>Domestic Construction Provisions</i>	<i>Ownership Restrictions</i>	<i>Crewing Requirements</i>	<i>Cabotage</i>
United States	yes	Yes	yes	yes	Yes
Australia	no	No	no	yes	Yes
Belgium	no	No	no	yes	No
Brazil	yes	Yes	yes	yes	Yes
Canada	4	No	3	yes	Yes
Chile	yes	no	yes	yes	Yes
China	yes	no	yes	yes	Yes
Denmark	4	no	yes	yes	2
Finland	1	no	yes	yes	Yes
France	1	no	3	yes	Yes
Germany	4	no	no	3	Yes
Greece	1	no	yes	yes	Yes
Italy	4	no	no	3	Yes
Japan	4	no	yes	yes	Yes
Malta	4	no	no	3	Yes
Mexico	1	no	yes	yes	Yes
Netherlands	1	no	yes	3	2
New Zealand	no	no	yes	yes	Yes
Norway	1	no	yes	no	2
Panama	no	no	no	no	2
South Korea	yes	no	yes	no	Yes
Spain	1	yes	1	yes	Yes
Sweden	no	no	yes	3	Yes
United Kingdom	no	no	no	yes	2

Notes

1. No information provided.
2. Countries that do not exclude foreign vessels but do have certain restrictions
3. No formal requirement, but some minor restrictions.
4. Reflagging allowable, but controlled.

Source: Selected elements from US MARAD (2001), p 4.

CHAPTER 6 – CANADA’S OPTIONS WITH RESPECT TO DOMESTIC SHIPPING POLICY

The Current Situation

It may be seen from the earlier chapters that Canada’s fundamental policy position with respect to cabotage has changed surprisingly little since Confederation, even though international trade policies and perspectives have evolved significantly. Thus, despite the fact that Canada has generally supported a substantial shift towards the concept of free trade in goods and selected services, it has chosen to maintain a markedly protectionist stance in relation to coasting trade (as well as other services such as telecommunications and banking). While, for maritime cabotage, this has not until quite recently been out of line with the policy choice of many maritime States, the degree of this protection, employing both access control and tariff mechanisms, is now much greater than that prevailing in Europe and, among developed maritime States, appears to be only exceeded by the cabotage regime of the United States.

It is of note that despite the resolute manner in which Canada has stuck to its protectionist policy stance in this sector, there is surprisingly little in the way of any formal statements setting out the supporting shipping policy rationale, or any track record of examination of possible alternatives. To the degree that there is guidance as to policy aims, such guidance emerges more from the consequences of other policies applied in such areas as shipbuilding, land transportation or employment.

While Canada’s fundamental protectionist philosophy has changed little, what has changed is the functional and geographic scope of application of Canada’s cabotage restrictions, a trend that has served to expand the strategic scope and importance of the policy. Whereas in the first half of the twentieth century, the *de facto* impact of Canada’s coasting trade policy was essentially limited to transportation of goods and passengers on Canada’s East and West Coasts, developments such as Newfoundland’s entry into Confederation, the opening of the Seaway, the emergence of offshore resource exploration and exploitation activities, and increased activities in the Arctic, have led to significant expansion in the definition, and hence the impact and importance, of Canada’s coasting trade restrictions.

Canada protects its maritime cabotage activities principally through two legal instruments: the *Coasting Trade Act* and the *Customs Tariff*. Under the *Coasting Trade Act*, the only ships that have unrestricted access to maritime cabotage movements are those registered in Canada and either built in Canada, or if not, where the applicable import duty has been paid. The *Customs Tariff* sets this import duty at 25% of the fair market value of the vessel for most types of ship. It should also be noted that, if a foreign-built vessel is to be registered in Canada, it is frequently obliged to incur substantial additional expenditures to meet the registration requirements as laid down in the *Canada Shipping Act* and supporting regulations.

As we have seen, the level of policy analysis activity in this sector has been quite modest. Indeed it is probably fair to regard the evolution of cabotage policy over the last half century as comprising only four significant events: the Spence Commission Inquiry, the Darling Report, the internal policy debate leading to pronouncements in the early 1980s, and finally the passage of the *Coasting Trade Act* in 1992. Since this last event, there appears to have been a view that Canada's policy challenges in this sector have now been resolved and that no further attention needs to be paid to it. Thus, for consideration is whether this policy stance is the right choice for Canada. This chapter will argue that it is not. More particularly it will make the case that both national and global shipping trade and business environments have changed and it is time to re-evaluate the incumbent policy.

The Problem: It isn't Working!

A basic premise of past policies, principally those directed at providing guiding principles for the country's national transportation system, has been that domestic marine transportation will function in the most economically efficient manner if it is treated in the same way as other domestic modes of transportation. Thus, as reflected in *Straight Ahead*, the fundamental principles that continue to guide Canada's transportation policy include "coordinated and harmonized actions across all modes of transport in support of intermodality and to achieve modal neutrality."⁶⁴ While this principle may seem highly appropriate at first glance, it precipitates a fundamental problem for the marine mode, since intermodal neutrality between domestic modes precipitates intramodal imbalance between domestic shipping and its international counterpart. Thus the principle of domestic modal neutrality, which has been broadly reflected in the policy statements of the *1967 National Transportation Act* and its successors, essentially precipitates the need for Canada to construct an artificial barrier between its domestic and international marine policy and operations. It is interesting to note that, while the *Canada Transportation Act*

⁶⁴ Transport Canada (2003), *Straight Ahead*.

Review Panel recognized this clear distinction by identifying the two separate sectors,⁶⁵ it chose not to comment on whether this was a good or bad thing!

Thus an essential element of the policy premise is that Canada's domestic marine transportation industry is large enough and stable enough to function as an efficient and sustainable commercial regime, independent of its international marine transportation counterpart. There is, however, no evidence that this concept has been critically examined, and the authors believe that there is reason to doubt the validity of the premise. Indeed there is a clear message that emerges from a variety of sources that speaks to the current precarious economic circumstances faced by the domestic shipping industry, including the offshore oil and gas sector.

Transport Canada has itself acknowledged these difficulties in a recent statement: "over the last 25 years (1976-2001) the Canadian merchant fleet has faced many economic and financial difficulties."⁶⁶ The industry has also been quite vocal in expressing its concern. For example, the Canadian Shipowners Association (CSA), in its November 2000 submission to the Canadian Transportation Act Review Panel, observed:

*Canada's domestic marine industry faces severe challenges. Unless a marine policy environment which supports industry growth, reinvestment and innovation is developed and implemented, the industry will cease to be a competitive option for shippers.*⁶⁷

Meanwhile Mr. Jack Leitch, in an address to the Company of Master Mariners, stated:

*Today we must question the viability of Canadian fleets. How can we reduce costs and increase revenue to a degree that justifies renewal of the Canadian Fleet?*⁶⁸

The international media has also addressed Canada's marine transportation industry particularly in relation to the Great Lakes. In its February 22, 2001, issue, *Fairplay International Shipping Weekly* observed under the heading "Shadows Lengthen in Canada" that

*A shadow of recession hangs over Canada's maritime industry at a time when it is struggling to compete with its rivals in rail and road. Against a backdrop of North American economic contraction, maritime sectors bemoan the absence of a level playing field which is hurting business.*⁶⁹

⁶⁵ Canada Transportation Act Review Panel (2001), p 133.

⁶⁶ Transport Canada (2002), *Transportation in Canada 2001*, p 103.

⁶⁷ Canadian Shipowners Association (2000), *A Framework for a Competitive Marine Transportation Industry in Canada*, p 6.

⁶⁸ Leitch (2000).

⁶⁹ *Fairplay International Shipping Weekly* (2001), Shadows Lengthen in Canada, Feb 22.

A year later, in January 2002, *Fairplay International*, in an article entitled “From Decline to Free Fall” observed:

A potent mix of circumstances has battered Canadian ship owners and operators, especially in the Great Lakes and St. Lawrence waterway, where the maritime industry is focused. Here a steady decline in trading conditions during 2000 accelerated alarmingly in 2001.

Driving international demand on the Great Lakes and Seaway are inbound steel imports and outbound grain exports. US anti-dumping measures saw steel imports plummet by 50%, while Canada’s largest trading partner and neighbour, the US, slid into recession. Low lake water levels, weakening grain exports and a drop in international charter rates for dry bulk vessels have exacerbated the problems.⁷⁰

It is clear that several trends and developments in the demand for marine transportation have caused significant difficulties for domestic shipping operations, particularly on the Great Lakes. These include, for example, demand-related developments such as shifts in grain export movements to the West Coast, and subsidized diversion of grain through Churchill. There have also been shifts in demand for iron ore and coal due to turbulence in steel sourcing and production. While the emergence of these commercial challenges cannot be attributed to the choice of cabotage policy, it may be argued that current cabotage policy presents some important impediments to ship operators as they endeavour to adjust to such market difficulties.

More particularly, the argument might be made that if circumstances were such that, in a time of downturn in demand, excess capacity could be redirected to the international market and operators were realistically able to compete for business in that sector, it would provide an attractive means by which the supply of domestic shipping could adjust to fluctuations in domestic market demand. However, since Canada’s coasting trade regime effectively constructs a barrier between domestic and international markets, there is no such mechanism available to Canadian ship operators to seek alternative employment.

There is a technological dimension to this dilemma, where the long, narrow hull of the standard (i.e., non-salty) laker, designed to maximize throughput in the Seaway locks, is such that the ship cannot be certificated to operate east of Anticosti Island. This technological constraint makes sense in circumstances where the market can provide full employment for the ship west of Anticosti, and where, in any event, international employment is significantly impeded by the cabotage regime. Were this regime to be different, however, and international employment was made a more realistic and

⁷⁰ *Fairplay International Shipping Weekly* (2002), From Decline to Free Fall.

attractive commercial option, it could well be that, to allow a more flexible response to a downturn in domestic demand, it would be more attractive than at present for a shipowner to make a different technological choice. As we have seen in the concept of the ‘salty laker,’ such a choice results in a ship that is not designed to make full use of the Seaway locks, but can be diverted to international use. Thus the concept of the ‘salty-laker,’ as a means of managing the seasonal nature of operation on the Great Lakes, would be rendered significantly more viable and competitive by the reduction or removal of any of the barriers to competitive participation in international trade that are effectively created by the current cabotage regime.

In this connection, it is interesting to note that Fednav has recently purchased vessels for (non-cabotage) operation in the Great Lakes, where the overall length has been reduced from the maximum capable of being accommodated in the Seaway. To quote the president, Laurence Pathy:

We found through experience that the 222 meter gearless vessels were costly and inefficient during the non-lakes season, when they had to trade across the Atlantic in wintertime. The additional lakes deadweight did not compensate for the losses sustained during those months. We also concluded that putting cranes on our newer bulk carriers gave us more flexibility and more options than the gearless vessels of the 1960’s, 1970’s and 1980’s. And of course we were able to reduce fuel consumption on these new vessels by improved hull forms and more fuel efficient engines.⁷¹

These vessels are on the international side of the artificial cabotage barrier, and are therefore only able to operate into and out of the Lakes on international voyages. However, it illustrates that, were there to be a different cabotage regime where the markets were not artificially separated, domestic ship operators would very likely make different technological choices for the design of their ships, choices that would enhance their flexibility in times of market turbulence.

While the above difficulties are particularly acute in the Great Lakes, they are not exclusive to that region. On the East Coast, in addition to a cargo transportation market with only limited opportunities for sustainable domestic movements, the hoped for expansion in offshore activity has not materialized nearly to the extent originally envisaged by Darling. This has presented difficulties for Canadian support ship and equipment operators in maintaining sustainable domestic activity in this sector, while at the same time being handicapped in competing internationally by the relatively high cost of the Canadian-registered (applicable duty paid) ships.

⁷¹ Pathy (2003).

A further challenge in maintaining competitiveness relates to the Canadian registration requirements themselves. A successful East Coast offshore support ship operator has estimated that as part of the investment required to register imported vessels in Canada for service in the Canadian offshore, meeting Transport Canada construction and equipment standards on an imported vessel can add as much as 25% to the base cost of the vessel. These standards are not applicable to those operating in the offshore industry in other jurisdictions, which begs the question as to why, when there are global vessel standards established by IMO and supported by the highest quality classification systems, Canadian regulations require standards to be met that involve expenditures sufficient to have a significant impact on the cost of extraction of the resource, and render such vessels even more non-competitive in the international market.

Clearly, if economic development through offshore oil and gas exploration and exploitation is to be stimulated, it is critical that coasting trade restrictions and related regulatory requirements not render the activity uncompetitive. Offshore exploration initiatives are in direct competition with other exploration possibilities elsewhere in the world, and must compete for the attention and subsequent investment of energy multinationals in the global sourcing game. The resource is very expensive to extract, and every dollar added to the cost of operating offshore shipping services flows to the per barrel price of the resource, and therefore the competitiveness of the project. Excess regulation and tariffs on equipment brought in to support the development of the resource act as important disincentives to investment.

The seasonal nature of potential transportation markets on the East Coast has similarly handicapped the commercially sustainable use of ships at competitive rates. There have been other negative influences on the East Coast as well. While not directly related to cabotage policy, there is undoubtedly some validity to Darling's argument that the evolution of efficient marine transportation services between Newfoundland and the mainland has been impeded by the distortional impact of rail-focused subsidies paid on the Sydney/Port aux Basques route.

Similar seasonal circumstances exist in the Arctic. For example, Transport Nanuk is on the record as having been strongly critical of the federal government in not responding positively to its request for exemption from the 25% import duty, and thus impeding the development of streamlined, modernized shipping services to Nunavut.⁷² Canada's efforts at establishing and expanding domestic transportation of mineral and hydrocarbon based resources have also been impeded by the seasonal nature of operations coupled with the inability to find domestic employment for Arctic-class ships on a year round

⁷² *Fairplay International Shipping Weekly* (2002), Import Duty Pressure in the Arctic.

basis, this despite the large investment made by the federal government in Arctic transportation research through operation of the *M.V. Arctic*.

As noted earlier, Darling recognized this potentially serious shortcoming in cabotage policy, but offered no concrete solutions, beyond the idea of frequent flag transfers to some other Commonwealth nation offering flag of convenience opportunities. He termed it a sort of Canadian Liberia but in modern parlance it would probably more readily equate to a Canadian second register.

Shipping operations on the West Coast are ‘opaque’ to say the least. However, it is probably fair to say that the absence of seasonal limitations, plus the lack of any significant competition from other modes, has meant that the constraints and anomalies generated by Canada’s coasting trade policies are less pronounced. Again the absence of Canadian flag cruise ships coupled with exemption from payment of temporary entry fees, has removed any potential commercial disruption in this important West Coast activity. In the same way, where intercoastal movements are contemplated, the virtual absence of Canadian ships suitable for this trade, plus exemption from payment of any temporary entry fee, largely removes any significant commercial impediments or delays in acquiring foreign flag shipping for the few such movements.

In summary, the present cabotage regime has effectively constructed a barrier between domestic and international operations, to the point where ships positioned and qualified to operate in one regime are unable to participate in the other. This concept is workable so long as the domestic regime is large enough and stable enough to sustain a healthy commercial regime. However, this does not appear to be the case. The contraction and turbulence in demand for cargo movements, the very modest growth in offshore oil and gas activity, and the challenge of seasonal operation in many parts of Canada’s waters, raise questions as to whether such an independent domestic regime is viable. Beyond providing artificial protection for hard-pressed and expensive domestic fleets, there is virtually no evidence that the present regulatory regime is providing an optimum environment for domestic shipping operations. The cost of such a market failure is passed on to the cargo owner, who must, as a result, pay increased prices for services. As noted by Marinova and Brooks (2003), it costs more to ship from Halifax to St John’s than it does from Halifax to Thailand!⁷³

Something needs to be done.

⁷³ Marinova Consulting. and Mary R. Brooks (2003) p 57.

Examination of Possible New Directions

The present mechanisms for affecting Canada's cabotage regime are duty payment and access control. Each of these will be examined in turn.

The tariff on vessel imports

Not to put too fine a point on it, the policy rationale driving the justification of the 25% duty payment is fundamentally flawed.

First, from an industrial assistance policy perspective, it places responsibility for the cost of supporting the shipbuilding industry firmly on the backs of a discrete and comparatively small commercial sector, namely the users and operators of ships. Not only is this patently unfair to the marine transportation industry but, if the analysis included in the Spence Commission Report is accepted, it is also a much more expensive way of providing such support, when compared with the provision of a subsidy. In short, as first stressed by the Spence Commission and subsequently reconfirmed by the CTAR Panel, if it is deemed to be in the public interest to provide help to the shipbuilding industry, the cost of such help should be borne by the general public.

Second, there is virtually no evidence that it has done anything to help the hard-pressed shipbuilding industry. The imposition of a tariff (as opposed to a subsidy) immediately removes any possible interest in the placement of orders by foreign operators since the high price of Canadian ships in relation to international alternatives is unchanged, and a Canadian-built ship remains internationally uncompetitive, except in a few special niches at the small end of the scale.⁷⁴ Orders for Canadian government ships, since they are normally placed with Canadian yards despite cost differentials, are not usually directly impacted by any tariff considerations. Thus the only potential source of orders that is supported by the tariff regime is Canadian cabotage ship-operators. Because of the difficult commercial conditions that have prevailed over the last two decades, the tariff acts as a disincentive to investment in new business development.

In any event, when operators are in a position to place an order, the 25% rate is insufficient to make Canadian shipyards the first choice, and it is therefore more attractive to build offshore and pay the duty. Since, under NAFTA, the 25% tariff does not apply to US-built ships, with the recent increase in the value of the Canadian dollar Canadian operators may well find it cheaper to build in the US. This same tariff consideration applies to Mexico, Chile, Costa Rica, Israel and the Caribbean, thus introducing a policy

⁷⁴ There is evidence that Canadian yards are competitive for conversion and repair business. In addition there are some small vessels (under 1,000 GT) that are currently being constructed for foreign owners in Canadian yards.

anomaly not unlike that which prevailed under the *British Commonwealth Merchant Shipping Agreement*. Exclusion of a number of coastal activities, for example the cruise trade, from temporary entry payments, while making good commercial sense from a shipping policy perspective, further undermines the tariff provisions as an effective support mechanism to Canadian shipbuilding.

Not only has the tariff been of no value to the shipbuilding industry, it has given rise to some serious issues for ship operators. These include, for example, the additional financing burden imposed on ship operators by the existing tariff situation. It appears that banks are unwilling to view the 25% tariff as part of the purchase price of the vessel, and so there is no bank financing available to support acquisition of a foreign flag vessel. Thus the 25% tariff on an imported vessel must come from the retained earnings or the acquisition year's cash flow, with a chilling impact on investment in vessels.

There are other commercial distortions in the ship operating industry. No other transportation mode is required to pay anything like the level of import duty for capital assets applied to ships. In this connection, it should be noted that this consideration has not been recognized in any assessment of modal equity, even though it clearly impairs the competitive position of marine transportation in relation to other modes. At the same time the high cost of acquisition of ships, either through domestic construction or payment of duty, damages the competitive position of Canadian domestic shipping in relation to alternative international trade movements in important areas such as grain and steel. Removal of the tariff would encourage existing Canadian shipowners to renew their fleets and would improve competitiveness of East Coast energy production. There is currently no incentive to attract new players or newer vessels to maritime cabotage trades, where they will be in competition with aging vessels that have fully discounted capital costs!

In view of all the above, this study argues, as did the recent Canadian Transportation Act Review Panel, that the tariff must go. Equally clear, however, is the fact that it cannot just be removed, since industry has long since adjusted to its existence, and any removal of the tariff would cause significant commercial pain and difficulty for those who have already made the asset investment, since any ships subsequently imported without payment of duty would have a significant competitive advantage over ships either built in Canada with no assistance provided, or foreign-built and duty paid. In this respect, it is very clear that a complex phase-in period, or tax credit equivalent, would need to be designed to effect the transition. Without such a phase-in, the industry could well be worse off. This does not, however, preclude the need for the decision to be taken now, even if the implementation of the decision may be spread across a number of years.

Again, it should be stressed that this study is not advocating removal of any support for Canadian shipbuilding. It is clearly not in a position to make that assessment. What it is

saying is that there are more appropriate mechanisms for providing assistance to shipbuilding and they must be utilized, perhaps in line with assistance measures provided to that industry in other established developed shipbuilding nations. Those States that currently provide aid to the industry are hardly in a position to complain if Canada mirrors their practices. While such measures have been declared by Canada to be ‘unfair’ as justification for maintaining a tariff barrier, no analysis as to what constitutes unfairness is provided with such declarations, nor any explanation as to why a tariff policy is any less unfair. It is reasonable to argue instead that greater harmony with those who provide such assistance will reduce current market distortions.

The access control issue

The question of access control is significantly less clear cut than the tariff issue. It is both legitimate and widely accepted that a State has a right, indeed an obligation, to ensure appropriate commercial, fiscal and employment conditions in its domestic trades. At issue is what constitutes ‘appropriate’ and how to achieve such conditions.

While removal of the 25% duty payment (and, if necessary, provision of support to Canadian shipbuilding in some other way) would effectively remove any significant disparities in the capital cost of a ship for Canadian cabotage operation and its equivalent in international shipping, there are still significant cost factors, principally in relation to corporate taxation and cost of crewing, that would continue to present important impediments to the participation of Canadian flag ships in international trade, thus maintaining a barrier between domestic and international shipping activities.

Indeed it could be argued that the Canadian situation would then be akin to that prevailing in Australia. In that respect, the adoption by Canada of the Australian licensing (as opposed to permitting) system could be viewed as attractive. Under this concept a foreign ship that wished to engage in coasting trade might do so as long as the seafarers on board were remunerated at prevailing rates and conditions, and the vessel was not in receipt of any form of subsidy. While this mechanism appears to function reasonably well, circumstances could be expected to arise in Canada, as they do in Australia, where the licensing mechanism could not provide for all cabotage needs, and thus a waiver system would also continue to be required.

It is clear from the recent study by the Independent Review of Australian Shipping, discussed in Chapter 5, that this mechanism is problematic and would not appear to offer an attractive alternative for Canada. In short, if Canada cannot see its way to examining alternative approaches that allow for a relaxation in access controls, and therefore an increased facility for ships to move into and out of the Canadian coasting trade, it could legitimately be argued that it would be best to stick with the present waiver process, at

least for transportation of cargo and passengers. It is apparent, however, that the waiver process works much less well in relation to the complex technology and long lead times in decision making that characterize the needs of the offshore oil and gas industry. This dimension of the temporary entry process merits substantial further examination.

In any event, this study would argue that retention of the status quo would be a poor second choice, and that there are better approaches to managing Canada's cabotage activities. This issue will now be addressed.

Alternative Approaches

In a recently published study undertaken by the OECD it is stated:

Cabotage is recognized as being important to many countries. However the effectiveness of cabotage in preserving employment and national fleets has been questioned, and cabotage regulations have been relaxed within the European Union without obvious downside costs. Therefore in view of the benefits that followed domestic liberalization in other economic sectors, it is suggested that those countries that restrict cabotage should consider removing those provisions. Even if it is not politically feasible to achieve full liberalization immediately, serious consideration should be given to setting a time frame for such liberalization, with access initially given to OECD member countries. Full liberalization may then follow at a later stage.⁷⁵

In examining Canada's options in this sector, it is first logical to establish what it is that the Canada wishes to achieve. While clear statements of objective are elusive, it is reasonable to conclude that Canada's broad aim is to ensure a transportation system that meets its expectations with regard to economic efficiency, adequacy, safety, environmental integrity and fair employment standards. These objectives are no different from any other OECD State. Nevertheless, certain States, notably those of the European Union, have chosen a markedly different approach in seeking to achieve them.

Access controls in Europe have been significantly liberalized as described in Chapter 5, to the point where ships of any EU flag may now participate in the cabotage trades of any other Member State. However, this does not mean that the 'host' State has no influence or control over such ships. On the contrary, each country is able to impose crew nationality requirements, vessel ownership requirements, and fiscal constraints. In addition, those members that retain some restriction on access for 'third flag' ships usually maintain a waiver system, not unlike the Canadian system, based on the criteria of non-availability or unsuitability of national flag (or in certain cases EEA flag) ships.

⁷⁵ OECD Directorate for Science, Technology and Industry (2001), p 11.

This relaxed cabotage regime is complemented by significantly increased flexibility for ships to move easily between cabotage and international trade. This flexibility is achieved by attractive fiscal regimes, frequently involving optional recourse to a tonnage tax, and significant relief from crew costs through such mechanisms as income tax exemptions or rebates and social security exemptions.

While this is a fast evolving commercial environment in Europe, and the regime is by no means without its problems, there is clearly a high level of comfort with what has been implemented to date and the benefits that are emerging. Furthermore, by suggesting that access be initially liberalized between OECD member countries, the OECD clearly embraces an invitation for Canada to join the liberalized European regime.

What might then be done?

Surely, in principle, Canada should find it attractive to liberalize its coasting trade regime, at least in relation to those of its OECD colleagues that also wish to pursue liberalization. Such a policy would provide expanded choice to shippers and expanded opportunities for Canadian flag ship operators, so long as the playing field is levelled with the ship operators of other participating OECD States. Of course, levelling the playing field would require providing domestic ship operators with an appropriate fiscal regime equivalent to that provided to other States in the liberalized regime. In this connection, if it is good for Europe, why should it not be good for Canada?

In order for Canada to participate in such a regime, it would be necessary to provide a national regime that would likely include: some form of tonnage tax or equivalent fiscal regime; reduced income tax for seafarers, at least when engaged on international movements (even if it is in cabotage activities of some other OECD State); and some enhanced degree of facilitation in registration requirements, so that (without sacrifice to safety) the cost of registering a ship in Canada would not be sufficient to render it uncompetitive. In return for this specialized treatment, domestic shipping would be exposed to a higher degree of international competition by the lifting of access restriction to those OECD States (e.g., EU, EFTA) offering reciprocal access. Canada would, of course, reserve the right to apply any limited, non-discretionary rules regarding positioning of corporate headquarters, manning requirements and so on as is currently the practice in Europe.

Similar to the considerations that argue for a phased approach to any removal of the 25% tariff, so considerable care would need to be taken in gradually liberalizing access controls to ensure full reciprocity of terms and conditions. This would be particularly important in such specialist areas as offshore support services, where a careful examination of support measures provided to the industry in, for example, Norway,

would need to precede any relaxation of access controls. With provision of the support measures outlined above this should not present insurmountable problems.

Some consequential policy issues

Adoption of a new policy regime for domestic shipping along the lines of the above would clearly give rise to certain ancillary policy issues:

Modal neutrality. Canadian transportation policy since the late 1960s has continued to call, in one guise or another, for equal treatment among modes. As observed earlier, this essentially means levelling the playing fields among domestic transport modes. This study argues that, while such a policy principle is philosophically tidy, in practice the means by which modal neutrality is assessed and implemented has been highly problematic, particularly in relation to marine transportation. It also introduces a fundamental anomaly for the marine mode in that constructing a level playing field in the domestic transportation sector gives rise to an uneven playing field in the international sector. This unevenness has been dealt with by constructing a protectionist barrier between the domestic and international sector. As set out earlier in this chapter, not only does this barrier preclude participation of Canadian flag ships in international trade, but it also presents fundamental difficulties for the domestic sector, difficulties that have handicapped the domestic fleet for the last two decades. In short, the policy objective of domestic modal neutrality, and its parallel need for an artificial barrier between domestic and international operations, gives rise to serious difficulties for the marine mode and thus needs to be revisited.

Intermodal competition. While marine transportation is much more often complementary to, as opposed to in competition with, other modes of transport, rectification of the above problem carries the risk for certain specific cargoes and routes by introducing changes in the balance of intermodal competition. However, if there is a concern that somehow, through specialized treatment, the marine mode is placed in a more advantageous position, it should first be recognized that such a situation has a number of positive attributes. Not only is it positive from an environmental perspective, but it also contributes positively towards the goals of the current short sea shipping initiative. Ultimately, in the unlikely event that any specialized treatment is concluded to give rise to a degree of imbalance that is still deemed to be excessive, there are certainly alternative mechanisms available to manage competitive equity between modes while maintaining the policy stance advocated here, namely the removal, or at least significant reduction, of the artificial division between domestic and international shipping sectors.

NAFTA considerations

There are those that might argue that Canada should not enter into agreements for liberalized trade conditions with Europe, until or unless such conditions are put in place in North America. While this argument is in theory attractive, it risks becoming a recipe for policy gridlock. Canada has sought, through various trade in services negotiations over the last 15 years or so, to achieve some relaxation in the maritime cabotage regime in NAFTA and through the World Trade Organization. However, such efforts have to date been unproductive, and there are many who are of the opinion that there is virtually no prospect of any change in the foreseeable future. While there are others who would argue that US desire to progress towards an external, secure North American perimeter, and the new policy momentum generated by the Short Sea Shipping initiative, may introduce some flexibility south of the border, these are still quite tenuous policy thrusts, and it is important that Canada's cabotage policy not be held hostage indefinitely to intransigence in US domestic shipping policy. Again Canada would have to decide, in pursuing relaxation of US regulations, whether a continued regime of protection, albeit in a larger market, would be more attractive than seeking more liberalized approaches in other markets.

Canada needs to provide, as a matter of some urgency, policy assistance to a hard-pressed industry. There is a real opportunity to provide some new stimulus and inertia to a largely depressed industry, and unless there is a strong expectation of an early change in the prevailing policy climate in the US, Canada should not wait long before pursuing opportunities elsewhere.

CHAPTER 7 – STUDY SUMMARY AND CONCLUSIONS

The intent of this final chapter is to summarize briefly the main messages that this study sets out to convey. In so doing it should be stressed once more that the limited scope of this quite modest exercise has not permitted any substantive opportunity to test in depth the ideas reflected here with various interests and stakeholders in the domestic shipping and related industries. In this respect, these messages are offered more as policy proposals for consideration, which the authors believe should now be exposed to a broader and more public discussion and debate.

In summary, the record shows that, in relation to maritime cabotage, Canada has pursued a virtually unbroken policy of protection. The nearest that Canada ever came to adopting a more liberalized regime was probably at the time of the Spence Commission. However this brief endeavour to pursue a more relaxed cabotage regime was quickly reversed by Howard Darling, and by the modal symmetry expectations of the *1967 National Transportation Act*. Since the early 1970s, Canada has only chosen to expand, in terms of both activity and geographic scope, the definition of coasting trade and, hence, the associated protective regime.

A basic premise for maintenance of this regime, as offered by Darling, was that there was every reason to believe that, given the developments of the 1960s, there were significant opportunities for domestic shipping to achieve considerable commercial success and economic self-sufficiency in a wide variety of activities that extended out to the edge of the continental shelf. Unfortunately, for a number of reasons this maritime ‘utopia’ did not materialize. These reasons include globalization of manufacturing and distribution, and the resulting shifts in international markets that led to changes in domestic cargo patterns, as well as seasonal impediments that inhibit, or prevent altogether, year round operation.

Cabotage measures have had as their primary goal the provision of a protected environment in which Canadian shipping could prosper, without being exposed to the full force of international competition. Unfortunately, in the absence of sufficient domestic activity to sustain a viable industry, the protective barrier has proved to be as much an impediment to Canadian shipping seeking performance efficiencies as it has been a barrier constraining international access to domestic markets. The result has been to

create, particularly over the last two decades, a very challenging environment for Canadian ship operators, and higher costs for the users of the services they offer.

The authors conclude that it does not need to be this way. Rather there are opportunities to furnish the industry with an appropriate policy regime and commercial environment that can stimulate renewal and expansion. The way ahead involves adoption of the following elements:

1. Removal of the 25% duty on the importation of foreign-built ships.

As discussed earlier, the policy considerations that have sought to sustain this duty are fundamentally flawed; indeed the authors are hard-pressed to identify any redeeming feature. Recommendations for its removal have been made at regular intervals over the past 50 years, for example by the Spence Commission, and most recently by the Canada Transportation Act Review Panel. If, for whatever reason, there is a reluctance to initiate action to remove this tariff then the reasons for that reluctance need to be clearly set out so that the policy rationale for maintaining it can be fully understood. If it is determined that continued provision of support for the shipbuilding industry is desirable, there are other better instruments available to achieve this end.

2. While the decision to remove the 25% duty needs to be taken now, circumstances are such that there needs to be a program of transition to allow industry to adjust to the different regime.

The present regime created by the 25% import duty may be likened to an addiction problem; it is bad for you, but you've become dependent. Clearly there are many ship operators who have made capital investments or paid the duty and who would now be disadvantaged by exposure to new tonnage brought in following quick and total, 'cold turkey' removal of the tariff. Some form of transition program needs to be constructed to ensure that shipping interests that have adjusted their operations to accommodate the artificial environment created by the tariff, are not disadvantaged by the tariff removal process. One possible approach might be a graduated tax credit applicable, upon application, to past investments but not available on a go-forward basis.

3. Pursue adoption of a more liberalized access regime with like-minded States such as the European Union.

There is clear encouragement in OECD literature for States to seek a more liberalised access regime, and an invitation to join with other States in providing opportunities for more trade freedom in maritime cabotage. Of course an alternative is to seek a wider regime within NAFTA, and there are glimmers of light suggesting that this circumstance could actually occur sometime in the future, particularly under the Short Sea Shipping agenda. However, not only is this possibility still seen as quite remote but it would only

result in an expansion of the protected domestic regime and do nothing to reduce the problems related to the international/domestic barrier. Canada would do well to look at the experience of the EFTA States, which have joined the EU in a more liberalized cabotage regime, and study how such liberalization might be implemented in Canada without damaging the interests of those who have made substantive investments in the present regime.

4. Provide the domestic shipping industry with fiscal and other aid (e.g. tonnage tax opportunities and relief for seafarer income tax, when, for example, engaged in international trade, including foreign cabotage), in line with equivalent measures adopted in much of the European Union, as a prerequisite for proceeding with more liberalized access.

Canadian shipping can only compete if it is provided with the same basic commercial environment as its competitors. Those who might see such aid as somehow setting an unacceptable precedent can take comfort from the fact that this technique is becoming increasingly the norm among developed maritime States, and has been viewed by them as being highly successful in revitalising their respective shipping industries, and providing a stimulus to short sea shipping. Why would Canada not wish to do likewise?

It should be noted that this would not replace the current structure for foreign flag vessels operating under the International Shipping Corporation scheme, but complement that with a regime for those trading domestically that allows them to pursue opportunities outside Canada in times when the home market is thin.

5. Similar to the proposal for a gradual transition with regard to the removal of the tariff, it will be essential to ensure that, in any decision that is taken to adjust the cabotage access and industry aid provisions as set out in 3 and 4 above, adoption of a more liberalized regime proceed with extreme care to ensure that the competition faced by Canadian shipping is both fair and healthy.

Clearly there is a need to ensure broad reciprocity of treatment, so as to provide a level playing field for Canadian interests throughout the transition process. In addition, Canada would need to examine the ancillary constraints such as crew nationality, and vessel ownership requirements that it would wish to impose on its cabotage trades to ensure that certain national objectives are not undermined. With respect to crewing, Canada would clearly need to choose a policy that ensured that there was no forecast net loss of jobs in the new expanded cabotage regime to which Canada would now have access. This should not present insurmountable difficulties.

Many of the steps envisaged will likely need to be phased in over a number of years. This process can only start if decisions are taken now to initiate them. The authors believe that the process of discussion and debate, leading to adoption of some or all of the above suggested courses of action, needs to commence without delay.

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