



Institutional performance and ship registration



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ABSTRACT

The paper introduces a new concept in ship registration, the net flag-out ratio (in contrast to the standard flag-out ratio) and examines the potential contribution of metrics of corruption and institutional measures as decisive factors in explaining flag choice. Context-related factors are also controlled and included in the study. The study uses a cross-sectional, multiple regression econometric approach. Focusing on a sample of the 33 largest ship owning countries, we find that institutional factors do not explain the traditional flag-out measure but determine the net flag-out ratio. Our findings indicate a potential effect of institutional performance/environment on ship registration.

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1. Introduction

Ship registration has retained for at least six decades now its central role as a vital element of modern maritime business strategy and policy. Initially a requirement under international law and the focus of a strong debate in international inter-governmental shipping quarters, ship registration has through the years been transformed into a complex business decision rather than a mere legal prerequisite. Ship registration is not only a ship's prerogative and duty; its impact extends to a much wider system of constituents in the shipping industry, including national governments, port authorities, trade unions, international policy and law making bodies, competing shipping companies. Contemporary changes and developments in international shipping but also oversights in previous investigations highlight the need for further research into the issue of ship registration along a number of parameters, exogenous and endogenous to the industry, which this paper seeks to address.

The significance of ship registration has been reflected in both the theory and practice of the shipping sector. A growing mixture of diverse ship registration alternatives for ship owners has arisen; multiple national and supranational policies have been developed around ship registration aspects, and; flagging behavior has constituted the focal area of investigation for academic research along a number of parameters. The main flag distinction has of course traditionally been between national flags and open registries. Although other types of registries, such as second or international registers, have gained prominence at certain times, the major issue has been the proliferation of the open registers regime as a competitive alternative of ships' registration in national flags. With shipping being the truly global business that it is, ship owners have always sought an international level playing field for their activities. Therefore, the decision to 'flag-out' – i.e. to change a vessel's registry from a national flag to a foreign flag, namely a flag of convenience (FoC) – would have to be affected by not strictly the status and requirements of the national flag but by its comparative status in relation to existing flag alternatives. Open registries have been designed and established to provide mainly a cost reduction and commercially simple service to ship operators and have been successful in doing that, given that since 1989 the ratio of foreign registered vessels in total vessels

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has generally been on the increase reaching the 71.5% in 2012 (UNCTAD, 2012). Safety concerns have arisen, though, in the process.

Yet, this sort of dualism in the international maritime transport sector, splitting the industry into two segments distinguished by operating characteristics peculiar to the two different scenarios and by lower break-even points, may have been surpassed by recent developments. Literature denotes an observed convergence between the two main types of registry along a number of parameters (Mitroussi and Marlow, 2010). Such convergence is seen to stem both from the inclination of national flags to incorporate open registries' features, as well as from the open registries' efforts to upgrade their game in the maritime safety standards arena. However, ship registers are not separate from the nation from which they originate and they should not be examined irrespective of them or of their administrative and institutional performance.

There have been numerous attempts to try to explain flagging behavior and especially flagging-out behavior. Shipping literature has focused too heavily – and therefore perhaps too restrictively – on shipping-related aspects of ship registration. Further research on the impact of controlling parameters exogenous to the industry is needed. Previous research has also not taken into account, concurrently with other factors, latest changes in the ship registration regime. These include the apparent convergence along certain parameters between previously distinct types of registry, but also, an increased volume of flagging-out from traditional national flags not to open registries but to other traditional flags.

This paper revisits the issue of flagging-out in the light of factors both internal and external to the shipping industry. Its contribution is twofold. First, it proposes a new measure of flag-out behavior, defined as net flag-out ratio, which, in contrast to the standard flag-out definition, accounts not only for the nationally owned ships which flag-out to other flags but also for foreign-owned ships flagging-in the national flag. By definition, the net flag-out ratio is a wider concept than the traditional one and, as we argue later in the paper, more suitable to study flag-out behavior within an environment of an increased volume of flag-out within traditional flag countries. Second, it uses, for the first time, quantitative measures relating to the areas of corruption/transparency and institutional performance/friendliness-to-business to capture the potentially impact of these factors to ship registration, while controlling for context-related factors. The remainder of the paper is structured as follows: Section 2 gives an overview of ship registration and flagging-out, as reflected in extant literature. Section 3 reviews the new emerging trends in flagging behavior and presents the net flag-out ratio proposed by the paper. Section 4 presents the empirical findings relating to the standard and net flag-out ratios obtained by applying correlation analysis and cross-sectional, multiple regression econometric approach to capture the effect of a country's institutional performance and/or environment on ship registration and flagging-out. Finally, Section 5 summarizes and draws the paper's research conclusions.

2. Flagging-out traditional overview

Ship registration found a prominent position in shipping literature with the advent of open registries or FOCs especially after the 1950s. This new breed of ship registry challenged the legal requirement for a 'genuine link' between the flag and the vessel and had a number of repercussions at multiple levels – company, industry, national and international level. It attracted the attention of academics in the same way that it attracted the attention of business people. Today, however, many of the definitions of FoC provided in the early literature may seem rather surpassed by the current state of affairs. For example, Boczek (1962) defined a FoC as: the flag of any country allowing the registration of foreign-owned and foreign controlled vessels under conditions which, for whatever reasons, are convenient and opportune for the persons who are registering the vessels. Metaxas and Doganis (1976) identified as a FoC: the national flags of those states with whom ship owners register their vessels in order to avoid the fiscal obligations and the conditions and the terms of employment of factors of production, that would have been applicable if their ships were registered in their own countries. Today's reality sees foreign-owned vessels being registered not just in open registers but also in traditional national flags, whereas the relaxation of fiscal regimes and employment related requirements, like manning, have acquired a more or less universal character (Haider, 2013; Marlow and Mitroussi, 2008).

Other definitions of FoC's may appear to be more in tune with today's changing environment. Bergstrand (1983, p.4) definition may be one of them: "A FoC is a flag of a state whose government sees registration not as a procedure necessary in order to impose sovereignty and hence control over its shipping but as a service which can be sold to foreign ship owners wishing to escape the fiscal or other consequences of registration under their own flags". The definition distinguishes FoCs on the basis of varying incentives and attitudes between exercising true sovereignty and offering a commercial service and does not necessarily preclude traditional flags from accepting foreign-owned vessels on their registries.

Flagging-out, which essentially denotes the shrinkage of the registered fleets of the traditional maritime countries, has in fact always been associated with the surge and proliferation of open registries. The fleeing fleets of traditional maritime nations were almost wholly attracted by open registers, hence their staggering expansion, especially in the 1980s and 1990s. The share of world deadweight tonnage registered in the major open registries was about 4% in 1950, it then had a sharp increase in the 1970s, going from 21.6% of the world total fleet to 31.1% during that decade, and in 1988 the open registries' fleet surpassed for the first time the traditional maritime countries' fleet (UNCTAD, 2008). Today that share is not diminishing. The fleets of the 10 most important open registries – Panama, Liberia, Bahamas, the Marshall Islands, Malta, Cyprus, the Isle of Man, Antigua and Barbuda, Bermuda, and Saint Vincent and the Grenadines – have continued expanding their market share, amounting to 56.6% of the total world fleet (UNCTAD, 2012).

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