www.maritimeindia.org

India's Endeavour to Reboot Shipping Industry: Rationale and Implications

Author: Rajesh Soami*
Date: 12 March 2019

Abstract

India`s shipping industry has failed to keep pace with the rapidly increasing needs of maritime trade of the country. Consequently, the government sees more reason in engaging with foreign shipping companies and listening to their demands. This is in line with the future development plans of ports in the country.

In last couple of years, the government has progressively relaxed cabotage regulations. The local shipping industry has opposed these moves as they may make shipping on Indian flagged bottoms economically uncompetitive. Besides, there are also strong security implications of these decisions. The government though is convinced about the economic necessity of the steps. The shipping industry therefore needs to recalibrate its approach to the issue. The government also needs to carefully deliberate the long-term damage, primarily to the nation`s merchant fleet that its decisions may lead to.

Introduction

Indian economy has been growing at a rapid pace since the country initiated economic reforms in 1991. The country's GDP has doubled in the last decade[1] alone and multiplied almost ten times since '91. Earlier this year, the World Bank in its global economic prospect report said that, India is expected to grow at the fastest pace among all major economies[2] in coming years. Buoyed by healthy current figures and future predictions, Prime Minister Modi has talked of targeting double digit growth for the country[3]. Growing economy has meant growing trade. Figures for the country show exemplary growth in trade in the previous decades. In financial year 2017-2018 alone, Indian trade grew 16.32% from 660.2 to 769.9 billion dollars[4]. Bulk of this trade is carried through the maritime route. According to government data, 90% of the country's trade by volume, and 70% by value, is carried on ships[5]. This has led to increased activity of merchant ships in ports in and around the country. Unfortunately for Delhi, flag bearing merchant fleet of the country has failed to keep pace with growing trade[6]. Consequentially, it is the foreign shipping companies which have reaped benefits of India's growth story.

At the same time, foreign ports around India, Colombo, Dubai and Singapore have also benefitted from Indian trade. Larger ships are loaded and offloaded at these ports. Containers are shipped to or from smaller ports in India. New Delhi is now trying to bring back this traffic directly into India by investing in development of large ports in the country. But the ports alone are unlikely to change the transportation habits of the larger shipping companies. Indian government has therefore decided to give incentives to these companies by relaxing old laws and changing its shipping policies.

The smaller merchant shipping industry in India is protesting against these policy decisions pertaining to the sector. These new policies, promulgated in the last couple of months, seek to remove advantages that the local industry receives in favour of free competition between Indian and foreign flagged vessels. Indian ship owners have threatened to flag out[7] if these new policies are implemented. In case the government fails to satisfy the Indian companies and the threat is indeed carried out, it would mean the end of the country's merchant fleet. This could have grave implications for the country, both in strategic and economic terms.

At the heart of the dispute lies the nature of business operated by the shipping sector. As transport vessels, ships pay bulk of taxes in the countries of which they carry the flag. In return, they receive favourable treatment in the territory of the native country to support their business. This favourable treatment could be in many forms. Laws and regulations to support domestic shipping have been the norm in the sector for ages.

Change in laws

Till recently, cabotage laws used to be the most common means of supporting the home-based shipping industry. What exactly are cabotage laws? Cabotage may have come from the french word 'caboter' meaning `to coast` or the spanish word `cabo` which means `cape`. Either ways, cabotage has everything to do with shipping in the coastal regions of a country. The first cabotage laws were introduced by the Portuguese in the early 16th

century to protect their coast from foreign ships. Other countries followed soon after. Cabotage laws place various restrictions on ships of other countries to travel in the territorial waters of a country. Initially designed to protect the coast, cabotage laws became a powerful tool to support indigenous shipping industry as ship-building and naval warfare grew in relevance in succeeding centuries.

These laws could range from very restrictive to extremely open. The Japanese and the Americans have some of the most stringent laws. Article 3 of the Ships Act in Japan prohibits foreign ships from traversing Japanese territorial waters for trade between country's ports. Similarly, Section 27 of the Merchant Marine Act in the US, commonly known as the Jones Act, dictates that ships traversing American territorial waters, from one port to another, must be country-flagged and also majorly crewed by their nationals. Till recently, India had similar provisions in law. Section 407 of Merchant Shipping Act allowed for only Indian ships or Indian owned ships to be granted license to indulge in coastal trading in the country[8]. On the other hand, lesser or non-sea-faring states have either relaxed cabotage laws or no such restrictions in place.

There is an ongoing debate[9] in many countries about the protectionist nature of cabotage laws and if they must be done away with. Some countries have chosen to relax their cabotage laws in favour of freer trade. Loosening the cabotage regulations provides incentives to merchant ships to use the country's ports. Increased traffic into and from ports leads to larger collection of port charges by the country. This often offsets the economic disadvantages which countries may accrue when moving away from discriminatory laws supporting their shipping industry. The Philippines[10], China[11], and Canada[12] have relaxed their cabotage laws to varying degrees. The same enthusiasm though is missing from other traditional seafaring nations like Japan and the US which have stuck to centuries old laws.

India has now decided to follow the Philippines and China in loosening the cabotage regulations. For long, international shipping giants had lobbied the government for such a step. Initially, the government relaxed rules for transshipment of containers[13] from one port to another. This allowed the transportation companies to move empty container from one port to another using the territorial waters of India. That was in 2016. Now in 2018, New Delhi has decided to do away with requirement of licenses[14] to carry agriculture, horticulture, fisheries and animal husbandry products. Government has also removed restrictions[15] on carrying fertilisers. This means that the domestic shipping industry will have to compete with foreign shippers even in Indian territorial waters to carry Indian products. Needless to say, this has not gone down well with Indian shipping companies.

The government is also in the process of reviewing another pillar that supports Indian shippers. According to media reports, the government has informed the shipping industry of its intention to scrap the 'right of first refusal' provision available to national carriers[16]. Under this provision, Indian shipping companies have the choice of matching the lowest bid of any foreign company and thereby picking up tenders of Indian state-owned companies who require transportation services.

Shipping Industry's Arguments

The Indian shipping industry has vigorously protested against these new regulations. They claim that the new regulations, if enforced, will wipe out the Indian merchant fleet by making them economically uncompetitive.

Shipping companies, with Indian flagged ships, argue that they pay their taxes in full to the government. Besides, they also contribute by hiring Indian nationals to man their ships, which is mandatory by country's law. Moreover, the shipbuilding industry catering to the requirements of these companies also contributes to the manufacturing industry in India and indirectly to the economy. None of this applies to foreign shippers. It is only fair then, that Indian companies get concessions from the government for their activities. Afterall, cabotage laws are the general norm in the industry, they argue. Most of the developed or developing countries have one or the other form of cabotage laws supporting their own shipping companies. Why then should India become the vanguard of cabotage law relaxations, damaging the economic viability of its own shipping industry?

These arguments are not without basis. Many international shipping companies register their ships at either tax havens or where the taxes are sufficiently low to be negligible. For example, Panama, Marshall Islands and Bahamas have extremely large number of registered ships although the volume of trade of these countries is extremely low. Similarly, many other countries also have lower taxes when compared to India. Countries like Greece proactively encourage their shipping companies. They also tax foreign ships in almost equal measure to ensure fair competition. Indian shipping companies argue that in the prevailing situation they would be unable to compete successfully without help from the government.

Anil Devli, the President of Indian National Shipowners Association (INSA), recently, in a passionate argument[17], said that if the apathy towards Indian merchant fleet continues, the country could end up with East India Company on its horizons again. East India Company of Great Britain had initially colonized India before the British government directly took over governance in the middle of the 19th century.

Government's View

The government of India has very little consideration for such dramatizations as Devli's. For nearly half a century, the government, fed by Marxist historians and economists, equated capitalism with imperialism. Consequently, they pursued socialist policies and protected indigenous companies from international competition. In this, they were lobbied for by the industries themselves, not unlike the shipping industry today. This served India poorly. The now infamous license-raj, turned Indian companies inefficient and burdened the taxpayers. Only after the International Monetary Fund (IMF) forced the country to open up its economy in 1991, did India eventually see some meaningful economic growth. Free trade, globalisation and liberalisation are seen as drivers of growth now and not threats. Protectionism is considered regressive and there are few takers for it.

Specifically, in the shipping industry, government sees less and less logic in continuing with rigid cabotage laws. As previously stated, Indian economy and therefore its trade has shown remarkable growth in the last two decades. The merchant fleet though has failed to catch up. The sector has continued to report stunted growth despite the country allowing hundred percent foreign direct investment (FDI) in the shipbuilding industry. As a result, there are simply not enough Indian-flagged ships in the Ocean to cater to increasing demand. Even with rigid cabotage laws, Indian-flagged bottoms never manage to carry more than 40% of the trade in any of the products. Bulk of the transport continues to be carried by foreign ships.

Secondly, strict cabotage laws, among other factors, have led to the growth of transshipment ports around India. In fact, Colombo has emerged as a major hub for large ships to offload their India bound cargoes. Smaller ships could then ferry these cargoes to various Indian ports. Almost 50% of the transshipment containers being loaded or off-loaded in the Colombo port are either destined for India or originate from here[18]. This causes losses to New Delhi in two ways. Indian ports do not receive sufficient traffic to become financially profitable as foreign flagged ships prefer Sri Lanka to India. As a result, Indian ports end up losing millions of dollars of port charges. Also, trading through foreign ports increases turnaround time as well as cost for Indian products, making them expensive in the international market in the long run.

To bring this trade back to India, shipping ministry's flagship project, Sagarmala, envisages the construction and upgradation of ports along both of the Indian seaboards. Presently, India is heavily dependent on its road and rail infrastructure for its transportation needs even within India. More than 90% of transport is carried over these means, despite maritime trade offering the benefit of relatively lower transportation, operation and logistics costs[19]. New Delhi now seeks to end its criminal underutilization of the country's long coastline.

The plan is to move transportation from land to sea. The international Container Transshipment Terminal (ICTT) at Vallarpadam, functional since 2004, has been showing healthy signs of growth in the last couple of years[20]. At the same time, India is also moving ahead with developing other ports in the country including Vizhinjam close to Vallarpadam itself. Another six mega ports have already been cleared by ministry of shipping for development in the future[21]. The ports being built or upgraded under the Sagarmala programme will need traffic. Relaxing of Cabotage laws is therefore in line with the future plans of the government in the sector.

Security and Strategic Aspects

After the attack on Mumbai in 2008 by jihadi terrorists, India woke up to the perils of not properly manning its coastline. Since then, the government has been working to upgrade its security along the entire coast of the country[22]. Phase one of this plan has been completed with the establishment of a chain of 46 coastal surveillance radars and electro-optic sensors. Phase 2 proposes installation of another 38 additional radars and four mobile surveillance stations as well as two vessel traffic management systems (VTMS)[23]. Even with the best of technologies though, it could prove difficult to defend a long coastline from subversion.

As stated before, cabotage laws were initially put in place to secure the coastline from foreign ships. The argument supporting these laws continues to be relevant. Allowing foreign ships, with foreign crews on them, to move close to the Indian coast is a security challenge for the agencies manning the coastline. India remains a major target of international terrorists. To defend against such threats, more than a hundred coastal police posts have been set up since the 2008 attack. The patrolling capacity of the agencies has also been increased, both through increased manpower as well as through acquisition of boats and planes/choppers. Nevertheless, subversion and infiltration from foreign ships close to the coast will now be a new threat.

Secondly, the concerns of the Indian shipping industry are also real. The lack of economic viability of Indian bottoms will kill the industry. Eventually, all of Indian trade will have to be carried by foreign flagged vessels. This could be detrimental in more ways than one. During sanctions on Iran, New Delhi has already seen international insurance companies refusing[24] to support the shipment of oil from the country. Without a national merchant shipping capability of its own, the country could end up in hot waters when its interests collide with those of other powerful adversaries in future. Considering that oil is the lifeline of Indian economy, the country could be endangering its much vaunted `strategic autonomy` by crippling its merchant shipping industry.

Also, merchant fleet forms the auxiliary support system for the Navy during any conflict. India's ability to arm and supply troops and weapon systems will be severely hindered without a large number of functional merchant ships which could be called upon in times of need. India aims to have a blue water navy, capable of power projection in the Indian Ocean and also perhaps in the South China Sea. Without a successful shipping industry, this could remain a pipe dream.

But government is willing to accept such risks in view of the larger dangers associated with geopolitics. China along with its pseudo-alliance with Pakistan already encircles India on its land borders. With its increasing financial muscle, it could also pose a naval challenge in the Indian Ocean in future. This would complete the encirclement of India. China has been investing heavily in ports all over the Indian Ocean which could help it in this endeavour.

Beijing has taken over the strategically located Hanbantota port on a ninety nine-year lease[25] after Sri Lanka expressed its inability to pay back loans received from Beijing by the previous government. India till now, has been unable to convince its neighbours, all of whom are in need of foreign investment, to stay away from opaque Chinese funding. Now the financial problems faced by Sri Lanka[26] have become a warning for other countries willing to jump onto the Chinese rollercoaster. India could use its better geographic advantage to buttress this point.

By making its own ports more lucrative for foreign shippers, India could pull away substantial traffic from Sri Lankan ports. India is the largest economy in the Indian Ocean region and most of the trade flows from the country. It could use this as leverage in a strategic sense, the same way Beijing is attempting to use its newfound economic muscle to lure countries into its orbit. Undercutting Chinese financial investments in Sri Lanka while promoting its own ports is a win-win situation for New Delhi.

Conclusion

Relaxation of cabotage laws has taken place in a number of countries including the Philippines, China and Malaysia. The argument that freer trade will increase the volumes, thereby countering the damage to the merchant fleets of these countries has many supporters. India does not want to be late on this new economic trend as it was on the liberalisation and globalisation processes. China opened up its economy a decade before India and earned itself a massive lead in economic prowess. Free trade is the order of the day. Protectionism is passé.

Government of India seems to have made up its mind. Despite furious protests[27] from the shipping industry, government has refused to review its decisions[28]. Both the geopolitical equation with China as well as the economic rationale seems to have convinced the government about relaxation of cabotage laws. According to all indications, the government might be considering loosening the rules further to increase shipping via Indian ports. The success of Sagarmala programme depends on this.

It is therefore unlikely that the demand of the shipping industry to reinstate the cabotage laws in toto will be successful. That is not to say that their concerns are unfounded. The relaxation of cabotage laws are bound to hurt the tax paying merchant fleet of India. But perhaps, the shipping industry needs to recalibrate its approach to the whole issue.

Rather than seeking the rollback of the recent decisions, the industry will do well to demand a fair playing ground. Healthy economic competition is what globalisation and liberalisation is all about. If government-imposed restrictions and taxes are unfairly disadvantaging the Indian shipping industry, removal of these is what will even the grounds again. Later, if the Indian merchant fleet proves itself to be efficient, it can demand financial support from government and other institutions to increase the quantity and size of its ships.

As to how far such an approach will succeed is difficult to guess. Governments all over the world are resistant to decreasing their income by reducing or removing taxes, unless there is a strong rationale for it. Strategic and economic arguments may succeed in convincing the government to bite the bullet. Clearly, similar considerations have forced the government to relax the cabotage laws in the first place.

****

**Rajesh Soami is an Associate Fellow at National Maritime Foundation, New Delhi. The views expressed in the article are his own and do not reflect the position of the NMF. He can be reached at rajesh96_isg@jnu.ac.in*

Notes and References

[1] "India Replaces France As World'S 6Th Biggest Economy". *Https://Www.Livemint.Com/*, 2018. https://www.livemint.com/Politics/xHmKR9JBEzahuw38wtA5SL/India-replaces-France-as-worlds-6th-biggest-economy.html. (accessed August 20, 2018)

[2] World Bank. *Global Economic Prospects, June 2018*. World bank, 2018. http://www.worldbank.org/en/publication/global-economic-prospects. (accessed August 26, 2018)

[3] Times of India. "PM Seeks Double-Digit GDP Growth, Raising India's Share In World Trade", 2018. https://timesofindia.indiatimes.com/business/india-business/pm-seeks-double-digit-gdp-growth-raising-indias-share-in-world-trade/articleshow/64694389.cms. (accessed August 14, 2018)

[4] Government of India, Ministry of Commerce and Industry. http://commerce-app.gov.in/eidb/default.asp

[5] Government of India, Ministry of Shipping. *Ministry Of Shipping 2017- Year Of Consolidation*, 2018. http://pib.nic.in/PressReleaseIframePage.aspx?PRID=1513281. (accessed August 14, 2018

[6] ibid

[7] Manoj, P. "Indian Ship Owners Threaten To Flag Out If Cabotage Is Eased And Rofr Removed". *The Hindu*, March 30, 2018.

[8] Section 407, Merchant Shipping Act, 1958

[9] Isidore, Chris, and Madison Park. "Puerto Rico Crisis: What The Jones Act Controversy Is All About". *Cnnmoney*, 2018. https://money.cnn.com/2017/09/27/news/economy/jones-act-puerto-rico/index.html. (accessed August 14, 2018)

[10] "Philippines Repeal Cabotage Law". *The Maritime Executive*, 2018. https://www.maritime-executive.com/article/philippines-repeal-cabotage-law#gs.EoHOwT0. (accessed August 22, 2018)

[11] Chen, Celia. "China'S Easing Of Cabotage Rules Deals Serious Blow To Hong Kong Ports Industry, Say Experts". *South China Morning Post*, 2016. https://www.scmp.com/business/global-economy/article/2049041/chinas-easing-cabotage-rules-deals-serious-blow-hong-kong. (accessed August 21, 2018)

[12] "Could Free Trade End Canada's Cabotage Laws?". *The Maritime Executive*, 2018. https://www.maritime-executive.com/article/could-free-trade-end-canadas-cabotage-laws#gs.U8mKdSA. (accessed August 14, 2018)

[13] Government of India, Ministry of Shipping. *Cabotage Restrictions Relaxed For Container Transshipment Ports*, 2018. http://pib.nic.in/newsite/PrintRelease.aspx?relid=138099. (accessed August 15, 2018)

[14] Government of India, Ministry of Shipping. *Relaxation Under Section 407 Of The Merchant Shipping Act, 1958, For Coastal Movement Of Agriculture, Horticulture, Fisheries And Animal Husbandry Commodities.*, 2018. http://www.dgshipping.gov.in/writereaddata/ShippingNotices/201805230234105484282GeneralOrderNo02of2018_sd.pdf. (accessed August 20, 2018)

[15] Government of India, Ministry of Shipping. *Relaxation Under Section 407 Of The Merchant Shipping Act. L958, For Coastal Movement Of Fertilizers*, 2018. http://www.dgshipping.gov.in/writereaddata/ShippingNotices/201807030530443256146GeneralOrder3of2018_Ministry.pdf. (accessed August 21, 2018)

[16] Thomas, Tanya. "Shipping Firms Look To Register Abroad If Govt Scraps Benefits", 2018. https://www.livemint.com/Companies/nGqd27UUSgpJV3mBxPuecP/Shipping-firms-look-to-register-abroad-if-govt-scraps-benefi.html. (accessed August 21, 2018)

[17] Vivekanand International Foundation. *Session 2 - Conference On Assessing India'S Connectivity With Its Neighborhood*. Video, 2018. https://www.youtube.com/watch?v=Ar5tTkZ7EoI. (accessed August 21, 2018)

[18] "Better Infrastructure Leads To Dip In India Foreign Transshipment". *Joc.Com*, 2018. https://www.joc.com/port-news/asian-ports/better-infrastructure-pushes-india-foreign-transshipment-lower_20180131.html. (accessed August 21, 2018)

[19] Bhaskar, RN. "How A Robust Water Transportation Can Help India Drastically Cut Its Freight Costs". *Firstpost.Com*, 2016. https://www.firstpost.com/business/how-a-robust-water-transportation-can-help-india-drastically-cut-its-freight-costs-3116440.html. (accessed August 21, 2018)

[20] Martin, K. A. "Vallarpadam Traffic At Record High". *The Hindu*, May 03, 2016.

[21] Acharyya, Kangkan. "India To Get Six New Mega Ports Under Ministry Of Shipping's Sagarmala Project". *Firstpost.Com*, 2016. https://www.firstpost.com/india/india-to-get-six-new-mega-ports-under-ministry-of-shippings-sagarmala-project-3082626.html. (accessed August 21, 2018)

[22] Das, Shaswati. "Govt Moves To Strengthen Security Along Coastline". *Livemint.Com*, 2017. https://www.livemint.com/Politics/ZiD6LX38qRHt1TZIe5ZQZJ/Bid-to-strengthen-security-infrastructure-across-coastal-sta.html. (accessed August 21, 2018)

[23] Peri, Dinakar. "More Radars To Beef Up Coastal Surveillance". *The Hindu*, February 21, 2017.

[24] Dutta, Sanjay. "Iran Oil Puts Refineries On Slippery Ground With Insurance Companies." *The Times Of India*, July 26, 2018.

[25] The Hindu. "Sri Lanka Formally Hands Over Hambantota Port On 99-Year Lease To China", December 9, 2017.

[26] Shepard, Wade. "Sri Lanka's Debt Crisis Is So Bad The Government Doesn't Even Know How Much Money It Owes". *Forbes.Com*, 2016. https://www.forbes.com/sites/wadeshepard/2016/09/30/sri-lankas-debt-crisis-is-so-bad-the-government-doesnt-even-know-how-much-money-it-owes/#5721614d4608. (accessed August 21, 2018)

[27] Bhaskar, R. N. "Troubled Waters? Who Owns The Right Of Way On India'S Coasts?". *Moneycontrol.Com*, 2018. https://www.moneycontrol.com/news/business/troubled-waters-who-owns-the-right-of-way-on-indias-coasts-2739121.html. (accessed August 14, 2018)

[28] Manoj, P. "Shipping Ministry Says It Won'T Review Rules On New Cabotage Law". *Https://Www.Livemint.Com/*, 2018. https://www.livemint.com/Politics/7AgP8KjiWK8XgZzLJGdkIO/Shipping-ministry-says-it-wont-review-rules-on-new-cabotage.html. (accessed August 18, 2018)