National Security and Canada’s Shipping Policy: We Can Do Better

Dick Hodgson

The Canadian Naval Review is focused principally upon “strategic concepts, policies, operations, history and procurement of the Canadian Navy, plus national security in general and marine/oceans affairs.” The title of this article might therefore be viewed by some readers to be at best peripheral to this central CNR thrust. Certainly it is legitimate to question whether and if so where marine transportation policy fits into any consideration of Canada’s security. The purpose of this article is to respond to this question. More particularly it is to argue that Canadian shipping policy is, and should be recognized as, a fundamental element of Canada’s maritime security, and that Canada should be paying significantly more attention to this important dimension of national maritime policy if it is to ensure that the full range of available opportunities to protect its maritime interests is being exercised.

The premise offered here is that, while the provision of naval security is unquestionably of vital importance, it is only one dimension of a broader range of ‘tools’ available to Canada to protect its ocean interests and that there are other dimensions that merit serious examination. More specifically, changes have been occurring in world shipping and maritime commerce, driven by globalization trends including: rapid advances in technology; significant increases in transportation security concerns such as terrorism, smuggling and piracy; and new threats to the environment, particularly global warming. Each of these considerations triggers important policy issues and security threats that cannot simply be addressed by naval resources alone. Thus the objective of this article is to shed some light on the nature and extent of these considerations, and to argue that there is a need for a broader, more appropriate, Canadian shipping policy.

Some Background

In order to appreciate where we need to go in relation to shipping policy, it is necessary to have a broad awareness of the brief but turbulent history of Canada’s merchant marine and the various decisions that have affected it. While Canada’s participation in deep-sea shipping can be traced back to the early 1800s, the first apparent effort
to stimulate the formal existence of a Canadian fleet did not occur until the early 1920s when, following the First World War, the Canadian Government Merchant Marine Limited was established, with a mandate to operate some 60 ships on a worldwide basis. This early initiative folded in 1936, only to re-appear towards the end of the Second World War, in the form of the Park Steamship Company Limited, which, at the time of its formation, was mandated to operate some 150 Canadian-built, owned and registered ships – the fourth largest merchant fleet in the world. Such was the renewed optimism among Canadian ship operators that they could compete in international trade that the government of the day arranged for Park Steamship to divest itself of most of its ships to private operators, and for it to be replaced with a new government entity, the Canadian Maritime Commission, tasked with overseeing the economic health and prosperity of the fleet.

It became rapidly clear that this optimism was misplaced, and considerable difficulties were encountered by Canadian deep-sea ship operators in competing for international trade. This may be attributed to the rapid evolution of technology, growing gaps in wage levels between developed and developing countries, and the evolution of new approaches to ship registry that resulted in the emergence of low cost, open registry (pejoratively termed ‘flag of convenience’) shipping, most notably under the Liberian flag. These trends resulted in the Canadian fleet coming under significant pressure, and despite a Canadian Maritime Commission report recommending the provision of support to establish a nucleus of Canadian flag ships (as well as a Canadian shipbuilding capacity), the bulk of the remaining ships were transferred to British registry, and by 1969 the Canadian deep-sea fleet had effectively ceased to exist.

Not surprisingly, this situation raised some serious policy issues and concerns. Over the next two decades, the federal government undertook a number of studies of Canada’s international marine transportation policy to establish whether Canada’s best interests were being served by the near total absence of a deep-sea fleet. Efforts were focused particularly on examining whether, and if so in what manner and to what degree, Canada should make it its goal to re-activate involvement in deep-sea shipping. While a principal objective was to examine the merit of encouraging some form of Canadian flag deep-sea fleet, attention was also focused on the benefits of less ambitious alternatives such as the operation of a largely Canadian-owned but foreign-registered fleet.

The main recommendation of what was essentially the last major examination of this matter, the 1985 Report by the Task Force on Deep-Sea Shipping, was that the federal government not take steps towards the establishment of a core deep-sea fleet under the Canadian flag. There were, however, two further recommendations: (1) that Canada encourage and strengthen its expertise and interests in international shipping; and (2) that the government create a fiscal environment conducive to the establishment and maintenance of international ship management activities in Canada. The task force report stated: “[t]he presence of a strong basis of shipping expertise within Canada is essential in order that Canada may respond more effectively and forcefully to the complex and changing international shipping environment and protect its exports and imports.”

It is important to appreciate that a dominant consideration guiding these various studies was the economic performance of marine transportation and whether adoption of some alternative to the status quo would yield economic
benefits. Left largely unaddressed were other dimensions of Canada’s marine interests including safety and security benefits and protection of the environment. Again while the need for ‘shipping expertise’ was recognized, it was viewed more in the context of business and corporate management skills, as opposed to ship operating and technological expertise. With the focus almost exclusively on commercial and business expertise, it is not surprising that the modest product of these studies was a complex and, one might say in retrospect ineffective, adjustment to the Income Tax Act intended to facilitate the establishment of international shipping corporations (ISCs). Under the adjustment, so long as certain conditions were met, ISCs could be exempted from the payment of Canadian taxes. These conditions required that the company be incorporated outside of Canada, and that it operate ships exclusively in international trade. If a corporation met such conditions, then it could locate its ‘mind and management’ in Canada without paying corporate taxes. It is fair to say that, while modest interest was shown in this concept in the early going, such interest appears to have waned rapidly and there is now little evidence of any extensive activity under this complex and confusing fiscal option, probably due to the availability of more attractive models elsewhere internationally. Certainly there has been no turn around in the continuing contraction in the numbers of Canadians with sea-going knowledge and experience. This trend is serious because the concerns that drive the rationale for an increased Canadian involvement in the operation of international shipping have become more pressing, with expanded economic, safety and environmental security risks. As well, ever-growing shortages of sea-going expertise are evident in virtually every dimension of shipping and ancillary services in both the public and private sectors.

**What Have Other Maritime States Done About This?**

In contrast to Canada’s lack of action, numerous developed maritime countries, led primarily by the European Union (EU) and its members, have taken substantive steps to respond to the same concerns. These steps have now reached a point where it is probably fair to say that Canada is effectively steering a unique and independent course in international shipping policy. In so doing, it is running a substantial and increasing risk of arriving at a point where its policy objectives are significantly at odds with the thinking of its developed country colleagues, and particularly their perspective that important state security objectives are achieved by the nurturing of a national flag deep-sea fleet.

It is interesting to note that Canada’s policy studies, and its chosen course of rectification action took place in the 1980s and early 1990s, before the European examination of these issues had really got underway. Had this situation been reversed, it is not unreasonable to conclude that Canada would have had available to it a considerably broader appreciation of available options, as well as enhanced leverage to follow in the wake of the course of action selected by European countries.

What was it that occurred elsewhere that should have merited Canada’s consideration? Principally it was the recognition by the EU and most of the leading member states (and certain interests in the United States), that the ever-expanding dominance of foreign flag (usually ‘open registry’) vessels in international trade, was leading to a significant erosion of national knowledge and expertise in marine transportation in their respective countries. In addition, the contraction in national presence on the world’s oceans was also viewed as giving rise to increasing threats to national safety, security and environmental interests. It was concluded by a number of European countries in the late 1990s that this was sufficiently serious to justify substantive action to rectify the problem. This action has taken a number of forms, including a more radical and ambitious type of fiscal relief than that adopted by Canada. More particularly it has included the introduction of an optional and quite nominal ‘tonnage tax,’ based on the tonnage of each (qualifying) vessel irrespective of profit or loss. Initiatives have also included making the national flag registration process simpler, more appealing and user-friendly, while not sacrificing safety standards. It has also included the imposition of certain personnel training obligations, as well as income tax relief for national seafarers serving on national flag ‘qualifying ships,’ by treating wages earned in international trades.
as foreign earnings. In short, this rectification action is based on the recognition that the world of international shipping is unique and demands a unique national policy approach.

By adopting these features and thus making national registration, as well as crewing by nationals, attractive, it has been possible to make such vessels increasingly competitive with low-cost open registry vessels. It has therefore become much more attractive commercially to place ships under a national flag and to crew them with national seafarers. For example, in the UK, one year after the introduction of the new tax option, nearly 50 companies had opted for the new regime representing some 600 ships and 450 billets for new officer trainees. The contraction in the number of national flag ships had been transformed into an annual growth of about 5%. Not surprisingly, the UK government was extremely pleased with the success of the initiatives, and a new sense of confidence has become evident in the British shipping industry.

In the Canadian examination of international shipping policy, national security (with a focus more on military mobility than terrorism at that time) was frequently addressed in the various analyses undertaken. However, little policy consideration was given to the potential safety and environmental threats presented by the ever-expanding use of open or high-risk registry vessels. This may perhaps be attributed to the fact that North America did not become fully focused upon the risks of environmental, particularly pollution, disasters until the *Exxon Valdez* incident off Alaska in 1989. On the other hand, Europe had become much more concerned with environmental hazards as a result of the *Torrey Canyon* (1967), *Amoco Cadiz* (1979) and *Braer* (1993) oil spill incidents.

More recently Europe has become even more preoccupied with reducing its exposure to the risks inherent in the operation of poor quality ships around its shores. The sinking of *Erica* (1999) and *Prestige* (2001) and the extensive damage that their cargoes caused to the coastlines of France and Spain have served to provide additional strong impetus to policy initiatives that have lessened the impact of poor quality shipping. With the heightened concern over terrorism, illegal immigration, piracy and drugs, the EU has viewed increased involvement in the national registration and management of ships by member states as serving to reduce potential risks arising across the full range of maritime security considerations.

Such concerns had already provided the impetus for Europe to pursue enhancements to such regulatory tools as port state control (including the Paris Memorandum and the French-led ‘Equasis’ ship-quality tracking initiative) as well as for other initiatives such as the International Safety Management (ISM) Code and the Standards of Training, Certification and Watchkeeping (STCW) Convention with its associated ‘white list’ of approved states. Of course, Canada has also strongly supported these initiatives, but Europe chose to go further and made safety, security and environmental protection important goals in its initiatives designed to make EC-registered ships competitive with open registry (flag of convenience) shipping. In contrast, Canada has shown little interest in seeking cost parity with open registry shipping as a means of enhancing national security or protecting the environment.

Another aspect that perhaps received less attention than it should have through this period of Canadian policy review related to the importance to be attached to seafaring experience and competencies, and the means by which...
this shipping expertise might be made available to fill key marine shore-based positions in both the public and private sectors. The Canadian policy studies recognized the value of establishing and maintaining shore-based institutions in such private sector fields as ship acquisition and financing, ship management, ship chartering and brokerage, shipping agencies, ship chandlery, freight forwarding, marine insurance, etc. However, not highlighted to nearly the same degree was the need for public sector expertise in shipping policy, marine safety, ship inspection, coast guard fleet operations, accident investigation, pilotage, and so on. Despite the stress placed on these considerations, Canada appears to have paid little attention to the requirement for persons employed in those institutions to have had substantive sea-going experience. As a result, such experience is now very limited and continues to contract. This situation is in contrast to the situation in many European maritime states, where expanded opportunities to gain sea training and experience have received priority attention.

The Special Case of the Canadian Arctic

The Canadian Arctic and its security issues can be used to illustrate the essential thrust of this article. There have recently been studies focused on the risks associated with future shipping activities in the Arctic. Clearly for consideration in any such examination is the degree to which these risks might be mitigated by enhancing the nature and degree of Canadian content in the activities taking place. Various programs in the north already exert a modest degree of influence and control over Canada’s Arctic marine interests. These include the application and enforcement of regulatory authority through, for example, the Arctic Waters Pollution Prevention Act, the provision of (albeit sparse) port and terminal services, modest ice-breaking support, quite rudimentary navigational guidance and ice pilotage, limited search and rescue services and inadequate oil spill response capabilities. It also includes the still largely undefined ‘constabulary’ functions envisaged for the Canadian Navy’s Arctic Offshore Patrol Vessels.

All these programs and activities involve oversight of, or support to, Arctic shipping activity with the quality of such programs and activities made more assured by the fact that it is Canada that is providing these services. However, left virtually unaddressed to date is whether the threats to Arctic security arising from the operation of foreign flag, particularly flag of convenience, shipping in the Canadian Arctic might be further mitigated by adopting measures that stimulate ownership and operation of Canadian flag shipping (above and beyond the protected cabotage activity associated with community resupply⁴). Not only would this contribute to enhanced security in all its forms, but it would stimulate expanded Canadian Arctic marine leadership and expertise.

This is not a new idea. Ever since there has been some expectation of enhanced development activity in the Arctic, the value has been recognized of developing and implementing regional shipping policy initiatives tailored to the special challenges and opportunities offered by the Arctic.⁵ The advantages of such an approach include assurance of availability for Canadian use of specialized classes of shipping, and the nurturing of Canadian expertise in the design, operation and navigation of ice-capable vessels. Also among the benefits of involvement in commercial shipping operations would be the strengthening of Arctic sovereignty and security, as well as opportunities for
enhanced technological research, likely leading to reductions in the need for ice-breaking support due to enhanced ice-breaking self-sufficiency. Clearly this innovation and leadership would enhance Canada’s stature as an expert in northern marine management – a stature sadly lacking at the moment. Unfortunately, despite recognition of the benefits of this policy shift, no substantive steps have been taken to implement it.

In the meantime, and in the absence of adjustment to Canada’s deep-sea shipping policy or, indeed, its cabotage policy, all proposals currently under consideration for the transportation of resources out of the Arctic involve transportation to foreign destinations by foreign flag (likely flag of convenience) vessels. This almost complete dominance of commercial shipping in the Canadian Arctic by foreign flag vessels (apart from modest cabotage activities associated with community resupply) clearly heightens the threats to Canada’s Arctic security in all its forms.

So What Should be Done?
As mentioned earlier, there are sufficient international examples and experience to argue that things do not need to be this way. ‘Ring-fenced’ tax incentives (the ‘tonnage tax’ concept), coupled with tax and other relief for national crews engaged in international trade, have narrowed the gap between the costs associated with flagging under traditional developed maritime administrations compared with ‘open registry’ options, to a point where numerous developed states are successfully operating shipping under their national flags.

One of the conclusions in a study undertaken in 2008 by Oxford Economics, an institute connected to Oxford University, was that, as a result of the introduction of a tonnage tax system in 2002, the British shipping industry was three to five times larger than it would have been without this tax reform. Such an option is open to Canada should it choose to go that route, and could be viewed as particularly appropriate for the Arctic, where, with quite modest investments, there would likely be opportunities for Canadian flag shipping to operate competitively with open registry options. And where shipping operations are limited to certain seasons of the year, such vessels would be well positioned to take up alternative opportunities in other international trades.

It would therefore seem reasonable that, from several perspectives including enhancement of Arctic security and sustainability, Canada should wish to be a leader in Arctic marine transportation operations. However, it will not achieve that wish under its current shipping policy framework. There is a real opportunity to alter this situation by a fundamental re-examination and adoption of a more advantageous Arctic shipping policy approach – the sort of approach that is stimulating European shipping, both conventionally and in specialized Arctic applications.

In conclusion, it is worth reiterating that the primary objective here has been to offer insights into the shipping policies that are being pursued by many, if not most, of Canada’s developed maritime partners, and to provide a broad illustration of what Canada’s deep-sea shipping policy regime might look like, were it to adopt similar measures. There have been persuasive observations made on several occasions over recent years by representatives of government, industry and academe that the marine transportation sector has not been receiving its fair share of policy attention. This needs to change. The objective here has been to highlight the fact that, consciously or not, Canada has chosen to pursue a virtually unique policy direction that has no parallel in the policies and practices adopted by its international partners. In so doing, this article stresses the urgent need for a much broader examination of Canadian shipping policy. We can and must do better. ☎

Notes
3. Ibid., p. 54.
4. The scope of this article does not permit inclusion of the complex and in many ways unsatisfactory situation with regard to Canada’s cabotage (coastal trade) policy, particularly as it affects the Arctic.
5. The development, construction and operation of MV Arctic is a good example.

Dick Hodgson has spent his career in the marine field, first as an officer in the Royal Navy and subsequently for many years as a federal senior executive and academic.