



Productivity Commission
Vulnerable Supply Chains

Contact: Teresa Lloyd

30 April 2021

Table of Contents

1	About MIAL	3
2	Introduction	3
3	Transport modes / vectors are a risk factor.....	4
3.1	Availability of shipping assets	4
3.2	The relationship between ships and nations	4
3.3	Recent experience	7
3.4	Risk management.....	9
4	COVID Experience	10
4.1	Dealing with COVID on board	10
4.2	Crew changes	11
5	Expansion of imports related to food production	12
6	Shipping overlooked	12

1 About MIAL

Maritime Industry Australia Ltd (MIAL) is the voice and advocate for the Australian maritime industry. MIAL is at the centre of industry transformation; coordinating and unifying the industry and providing a cohesive voice for change.

MIAL represents Australian companies which own or operate a diverse range of maritime assets from international and domestic trading ships; floating production storage and offloading units; cruise ships; offshore oil and gas support vessels; domestic towage and salvage tugs; scientific research vessels; dredges; workboats; construction and utility vessels and ferries. MIAL also represents the industries that support these maritime operators – finance, training, equipment, services, insurance and more. MIAL provides a full suite of maritime knowledge and expertise from local settings to global frameworks. This gives us a unique perspective.

We work with all levels of government, local and international stakeholders ensuring that the Australian maritime industry is heard. We provide leadership, advice and assistance to our members spanning topics that include workforce, environment, safety, operations, fiscal and industry structural policy.

MIAL’s vision is for a strong, thriving and sustainable maritime enterprise in the region.

MIAL’s overarching position concerning maritime policy in Australia is that we ought to have a sustainable, viable maritime industry. This activity can occur anywhere – coastal, offshore and international. This maritime activity should encompass anything – freight, tourism, passenger movement, port and harbour services, offshore oil and gas, construction, scientific/research, essential services, and government services.

2 Introduction

The interim report prepared by the Productivity Commission released on 26 March report considers many issues concerning the vulnerability of supply chains however falls short of comprehensively identifying and considering sea transport vulnerabilities as part of the supply chain.

This submission addresses several specific issues contained within the report and canvasses the omission of the vector of the ships themselves as a key supply chain vulnerability.

In summary:

- Australia is exposed in terms of ensuring that adequate ships would be available to the nation should the global market fail.
- Even when markets are functioning, total reliance on foreign interests can leave Australia without adequate levels of service.
- Australia narrowly avoided catastrophic failure of maritime supply chains during the pandemic because the global shipping industry (governments and businesses) were unable to manage their obligations due to border closures and the disruption of international shipping norms. The pandemic is not over, these risks still exist.

3 Transport modes / vectors are a risk factor

This report does not consider the transport modes (i.e. ships) themselves as posing a risk to supply chains. The discussion of centralisation and over-reliance on the 'nodes' - being sources of products – is central and there is a brief reference to ports as being potentially limiting factors, and transport corridors (e.g. Strait of Hormuz) but there is no consideration at all that the transport assets themselves might represent a vulnerability.

MIAL believes this is huge gap in the consideration of the report. It is entirely possible that ships themselves might be unavailable in the market in a time of crisis and it is this potential that exposes Australia to considerable vulnerability – we simply could not bring those products to the nation because we do not have the assets on the water to do it.

While part of Defence's role is to protect trade, the reach of our armed forces is limited. Ultimate control of commercial ships is determined by the nation in which they are registered or where the owner is domiciled. Only these nations can requisition vessels or direct them into high risk areas. Australia has very, very few such vessels left that could be tasked to serve Australian trades, if it came to it. We are utterly exposed and reliant of foreign ships under foreign government or corporation control to service our trading needs.

Australia has allowed our national merchant shipping capability to reach the point where there is no vessel that we could direct to deliver liquid fuel or chemicals (for say water treatment) and very, very few suitable for the carriage of other essential products such as fertiliser or medical supplies. We are at the point where the skilled mariners this nation has relied upon to ensure safe passage of vessels to and from the country has been so eroded that it will take decades to rebuild.

Relying on the market to take care of supply of essential goods ignores historic events where ships have been required on Government terms – that is requisitioned. Further, a reliance on open registries to not requisition (thereby leaving the vessels in the market) fails to understand the relationships between ownership and registration.

3.1 Availability of shipping assets

There are several key constructs in international shipping that need to be considered when determining the possibility that assets might be unavailable / withdrawn from the market.

Requisitioning of vessels is the clearest form of a nation requiring assets for use in the national interest. During the Falklands war (1982), the UK requisitioned 54 civilian ships from 33 owners for government use including tankers for potable water and fuels, freighters carrying food and munitions and luxury liners converted to carry troops. This was known as Ships Taken Up From Trade (STUFT).

Requisitioning is typically applicable only to the ships flying the flag of the nation, however it is possible to apply to other flags – as contemplated in the next section.

3.2 The relationship between ships and nations

Primary flags are usually readily identifiable and are the traditional registry type - that is, they are administered by an individual country as a national registry and there is a genuine link between the owner and the nation.

However, many primary registries have offshore registries – where ships are registered and fly the flag of dependent territories.

The Red Ensign Group is a good (and unusually transparent) example of this. The Red Ensign Group is a group of British Shipping Registers¹.

It is made up from the United Kingdom, the Crown Dependencies (Isle of Man, Guernsey and Jersey) and the UK Overseas Territories (Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Falkland Islands, Gibraltar, Montserrat, St Helena and the Turks & Caicos Islands) which operate shipping registers from their jurisdiction.

Any vessel registered in the UK, a Crown Dependency or UK Overseas Territory, is a "British ship" and is entitled to fly the Red Ensign flag.

These registers are divided into two categories:

Category 1 - register ships of unlimited tonnage and type. Category 1 Registers are Bermuda, British Virgin Islands (BVI), Cayman Islands, Gibraltar, Isle of Man and United Kingdom.

Category 2 - register commercial ships and pleasure vessels of up to 150 gross tons (GT). This limit can be extended to 400GT with an agreement in place with the UK. Category 2 Registers are Anguilla, Falkland Islands, Guernsey, Jersey, Montserrat, St Helena and Tucks & Caicos Islands.

The Isle of Man Ship Registry is a Category 1 British Red Ensign Group member able to register vessels of unlimited type and size. It is the flag of choice for many large shipping corporations operating all vessel types to very exacting standards. It currently has over 16m gross tons on its register of which over 50% are tankers.

Another example is the Netherlands/Curacao.

Some primary registries also have International Registers (sometimes called second registers) e.g. France and Norway. Australia has an international register.

Then there are Open Registries – where ship owners of other nationalities can flag their ships and where there needs to be no genuine link to the nation.

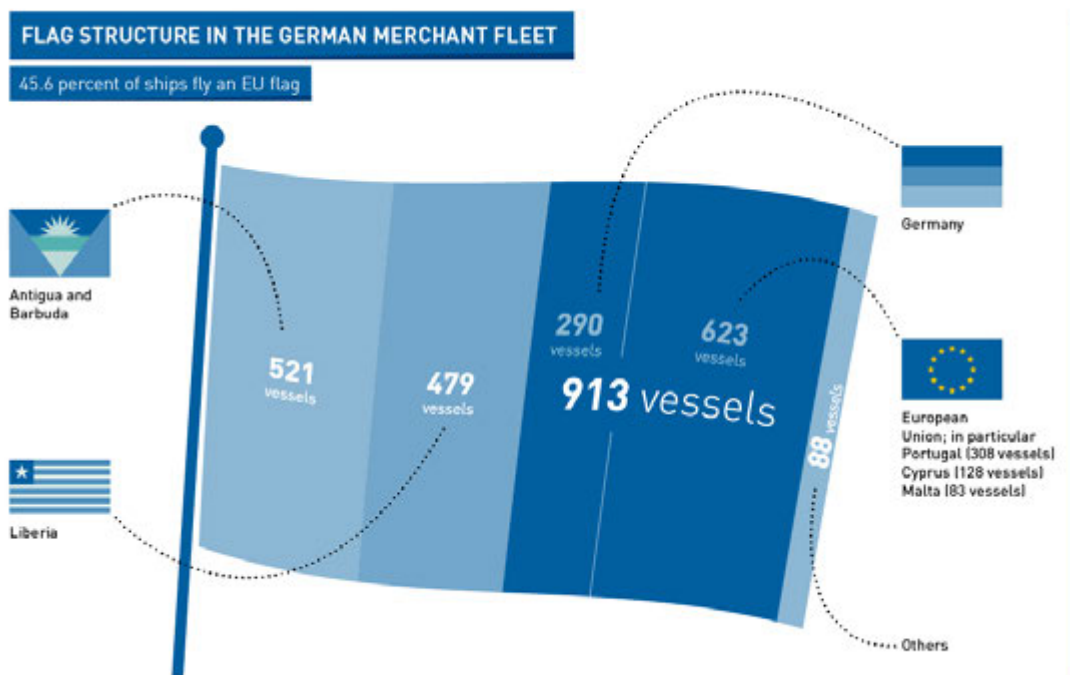
While the nations with the largest flagged fleet are open registries they should be viewed with caution when counting on the fleets therein to be available to the market at all times.

Some of these flags are almost entirely dependent on a single other nation for registrations, such as Antigua and Barbuda which has 80% client base in Germany².

¹ <https://www.redensigngroup.org/about-us/about-the-red-ensign-group/>

² <https://www.guidetoshipregistries.com/shipregistries-country/antigua-barbuda>

When considering access to open register ships (in a time of crisis) the most important consideration however is the location of ownership or control of the ship. Which if using an open register, will not be in the nation of the flag. Common parlance to describe the distinction is flagged fleet vs controlled fleet. For any nation, the controlled fleet is far in excess of the flagged fleet, however what is clear is that the identity of the ship is that of the nation from which they are controlled. The following diagram depicts this in the case of Germany³.



From this it is clear that German owners would task their ships operating under all of these flags to serve the German interest. Ownership, the connection between those companies and their countries is key to determining where their interests lie.

In addition, the ship registries/nations relationships and linkages with other nations (be they previous occupiers, etc) is important to understand. They are in many instances where the connection is undeniably strong, what is less clear is whether they are potentially binding or would be exercised in the interest of their 'partner' nation, e.g. USA and Liberia and the Marshall Islands.

The Liberian Registry, established in 1948 by former U.S. Secretary of State Edward Stettinius.

The Liberian Registry is administered by LISCR, LLC, the Liberian International Ship & Corporate Registry, a U.S. owned and operated company that provides the day-to-day management for the Republic of Liberia's ship and corporate registry.

Since its inception, the Liberian Registry has been operated from the United States. This further strengthens the U.S.-Liberia alliance and provides the Registry the

³https://www.reederverband.de/fileadmin/vdr/images/Daten_und_Fakten/infopool2021/Downloads/Englisch/PNG/10-Flag-structure-in-the-German-merchant-fleet-2020.png

ability to participate in the international arena with key industry institutions such as the U.S. Coast Guard.⁴

Acceptable Flag for EU Tonnage Tax Schemes – *The Liberian Flag is an acceptable choice for many of the new Tonnage Tax Schemes currently being offered in the EU, including the UK, German and Dutch tax systems.⁵*

In the case of the UK, the tonnage tax regime requires:

Ships that are strategically and commercially managed in the UK⁶

Guidance published by HM Revenue & Customs ("HMRC") emphasises that Tonnage tax is, 'a State aid approved by the EU Commission'. The guidance states that the qualifying 'test is ... aimed at ensuring that there is, through the strategic and commercial management of ships in a territory, a substantial contribution to economic activity and employment within the EU' (Tonnage Tax Manual, TTM03800).

The HMRC guidance indicates that they will 'adopt a common-sense interpretation' of this test, taking into account activities including:

1) Strategic

- a) Location of headquarters, including senior management staff
- b) Decision-making of the company board of directors
- c) Decision-making of operational board
- d) UK stock exchange listing

When noting the connection to vessels accessing taxation regimes in other nations it is again imperative to consider what the means in terms of the linkages back to the companies in receipt of that favourable taxation treatment – they are obliged to have considerable presence in those countries and be linked economically to that nation – which would drive behaviour in pursuit of that national interest.

Of course there are the aligned nations – such as the EU, which could limit the ships available to non-EU states; and China which could control the Hong Kong flagged fleet (4th largest in the world). Undoubtedly there is the prospect that some nations could pressure other nations to provide direct their ships towards a particular interest (or indeed away from a particular interest).

All of this is to say that the existence of large open registers is not a reliable source of vessels to 'count on' simply due to the fact that they would not be requisitioned by the flag nation and therefore would remain available for the market to use as needed.

3.3 Recent experience

The exposure Australia has to the shipping link of the supply chain being 100% reliant on international industries has been demonstrated in recent months in the domestic container

⁴ <https://www.guidetoshipregistries.com/shipregistries-country/liberia>

⁵ <https://www.liscr.com/unique-advantages>

⁶ <https://www.clydeco.com/en/insights/2017/05/uk-tonnage-tax>

shipping sector. The current state of the market is a good example of international conditions impacting service in more marginal locations.

In recent times, the cost of ships has tripled to ~\$30,000/day and charterers are being asked by owners to commit for 2-3 years. And they are doing it.

Demand has skyrocketed to higher than pre-COVID levels which no one saw coming. The blockage in the Suez canal combined with this unprecedented demand has caused a shortage in containers in Asia and as a result many of the services that would typically sail around the Australian coast with capacity are instead heading directly back to Asia with empty containers. This isn't expected to continue in the long term but the lack of shipping capacity has created demand on rail, which is also now and capacity, and road.

This has put pressure on the supply chains reliant on shipping capacity and if the issue were to occur again in the future in a more acute / severe way, Australia could find itself with supply chain issues that were of national significance.

Australia has no internationally trading container ships and domestically the capacity to carry containers is limited to the ships dedicated to the Bass Strait trade and other smaller services around the QLD northern coast. Australia therefore has no ability to ensure that adequate container shipping capability is secured for the nation.

The same can be said for many other ship types – because we do not have any of them under national flag or national control.

The report notes: *Pg 92: "By storing crude oil in the United States, Australia meets some of its international treaty obligations, but its role in supporting Australia's physical or strategic oil reserve is less clear. In addition to possible geopolitical risks, time delays in shipping and refining the oil once in Australia are also a risk."*

There is not only the risk of a delay, there is the risk of not being able to obtain a ship to carry the oil, or to sail through a war zone.

Australia must build redundancy, integrity and assurance in the reliability of Australia's maritime supply chain. To achieve that goal, and build our sovereign industrial capability, we must create the policy conditions, as other maritime nations have, for a vibrant and sustainable Australian maritime industry.

There is a very strong rationale for Government to enact positive policies that would encourage maritime businesses to have significant Australian presence and to ensure the diverse range of assets required are available – particularly during times of crisis.

An island nation cannot afford to continue to overlook and undermine an industry that provides so much support and capability in times of need. It is time to recognise the breadth of the capability that we have and the willingness of these businesses to assist. Australia's strategic maritime capability must be considered across a diverse range of assets and expertise, to ensure Australia's broader interests are also protected.

Until Australia has a regime that supports a level of local content in our shipping task, we will not see certainty and stability in the sector and industry will continue to be wary of investment. With the complete demise of the industry, Australia further relinquishes control over critical supply chain links along with the associated essential strategic maritime skills. Suggested areas where supply chains are vulnerable and Australian interests in ships would mitigate the risks include:

- Tankers – liquid and gas (national fuel security; chemicals for use such as water treatment)
- Cruise ships (personnel transport/hospital)
- Ro/ro and landing barges (LHD supplement; essential national supply chains – Tasmania and Northern Australia and National crisis and emergency response)
- Break bulk (military support)
- Container (essential national supply chain – pharmaceuticals, and foreign aid)
- Dry bulk (phosphate for fertiliser)
- Bunker barges and tugs (in port support craft)

3.4 Risk management

The report discusses in several places the elements that relate to risk and the management thereof.

Pg 88 "Government intervention could be justified where private firms might under-invest in supply chain risk management or might otherwise be unable to effectively respond to disruptions, whether due to government or other impediments. It might also be justified where the amount of residual risk that results from the market exceeds the amount of risk that the community might be willing to accept, that is, where firms' risk appetite exceeds that of the community (Pg 88)".

Pg 69: Risks are best managed by those who have direct incentives to mitigate against them. Government has responsibility, like any firm, to manage risks in supply chains for which they purchase and deliver goods and services directly.

There may be conditions where government intervention in private sector risk management is justified, such as where the private and public net benefits of risk management diverge. In these cases government could implement a range of options - from providing better information to taking more direct ownership of risk management (such as maintaining government stockpiles, mandating or subsidising private stockpiles, or maintaining domestic production capacity). But higher levels of government intervention impose higher costs on the community, and also decrease firms' incentives to invest in risk mitigation. Even where an in-principle case for government intervention exists, any case for intervention needs to demonstrate that the benefits of intervention outweigh the costs.

Pg 73: "In the context of this study, we care about effective risk management from a community perspective - that is, balancing trade-offs given the impact of a disruption to the community and society's degree of risk aversion. This means choosing the balance of risk management strategies that maximises community wellbeing over time."

Pg 74 : "Finally, cognitive and behavioural biases can affect how people and firms perceive risks. Cognitive biases mean that firms can underprepare for low probability events, and overprepare for events that have occurred recently. During a long period of relative stability, the probability assigned to disruptions declines. This can lead to firms under-investing in risk management strategies. Cognitive biases also mean that firms can over-estimate the probability of a disruption for a period following the occurrence of an event, leading to firms

over-investing in strategies designed to deal with that specific type of disruption (to the detriment of investing in strategies to deal with other types of disruptions). Such biases mean that firms may not always make full use of available information, or may evaluate the information inadequately."

MIAL support the proposition that there is a case for Government intervention on the basis of national security. The risk must first be understood before the appetite of Government or business can be determined. To fully understand and assess the risks related to ship registration, as it relates to national interest, is the role of Government. Commercial businesses do not look at ship registration through that lens – the Government needs to do this.

4 COVID Experience

The interim report speaks to how we dealt well with COVID from a supply chain point of view.

Pg 76 Despite concerns, the pharmaceutical supply chain functioned well and 'demonstrated significant resilience', according to Medicines Australia (Davey 2021)

MIAL is of the view that Australia has narrowly escaped catastrophic international shipping failures during the pandemic. Australia's maritime supply chain has been under significant strain due to the difficulties in moving people across national and state borders and other restrictive actions of State Governments, most notably, Western Australia.

MIAL outlined much of the background and detail of the experience in our [Submission to the Joint Standing Committee Inquiry into impacts of COVID on Foreign Affairs, Defence and Trade \(JSCFADT\)](#). We recap two points below:

4.1 Dealing with COVID on board

The prospect of an international seafarer, hailing from a nation where COVID is rife, arriving on a ship in Australia and testing positive to COVID-19 should be something that the nation expects and is well prepared to manage. Unfortunately, this is not always the case. In mid April 2021 the *Auqagenie* arrived in Western Australia with two COVID +ve cases on board and was denied entry to port and forced to sail without loading the cargo she came to collect. This does not serve our national interest and does not secure supply chains.

The stance of the WA State Government with respect to ships with positive COVID cases has for many months, meant that any ship undertaking a crew change prior to travel to Australia are labelled as toxic in the market. This affects both the willingness of the shipowner to undertake the crew change and the pool of ships available to hire for Australian cargoes. Along with the backlog of vessels caught in the China trade dispute, there have been impacts on the supply of suitable vessels servicing our nation, and as with any supply and demand situation has affected the rates payable to secure shipping services.

Australia, and the businesses affected, are perhaps fortunate that the commodity prices are at levels whereby these price rise can currently be accommodated. We may not always be so lucky and the actions of Governments in creating market distortions through their actions ought to be strongly advised against.

4.2 Crew changes

Crew on international ships come from all over the world and join ships in all parts of the world. Their ability to move efficiently between their home and their ships is critical to the smooth functioning of the shipping industry. In earlier times of the pandemic, the global issues of border closures and minimal aviation linkages made moving seafaring crews incredibly difficult at best, and impossible at worst. Even now, some nations refuse to allow crew changes to occur in their countries. Australia makes it very difficult by virtue of mandatory quarantine and incoming passenger caps on flights.

There was a point when international ships could have stopped all over the world, including in Australia – thereby blocking Australian ports, for any of the following reasons:

- 1) Crew walk off the job and demand to be repatriated home (as they were lawfully able to do as they were well beyond their contracts); and/or
- 2) Shipowners refuse to sail their ships with crew that do not have compliant contracts; and/or
- 3) Australia began to vigorously uphold their international obligations to seafarers rights and welfare and insists they be relieved before the ship can sail.

Despite UN conventions providing protections to vessels crews, the situation deteriorated to the point where the global shipping industry was unable to manage their obligations to their crews. These obligations exist on both industry and governments - shipowners/operators; and the governments who facilitate their operation (nations where they are flagged and nations where those ships operate). International norms within the shipping industry failed during the pandemic.

The only thing that averted Australia from feeling this failure was our willingness, as a nation, to accept that the seafarers serving on these ships were completely denied their rights and worked well beyond their contracts, with no idea when they might be able to return home. To this day, international seafarers are not allowed shore leave in Australia. Our own national seafarers have endured up to 5 periods of quarantine just to go to and from work across the country.

The lack of humanity of this situation is indefensible and we absolutely reject the assertion that our supply chains demonstrated resilience throughout this period. The sacrifice and circumstance endured by seafarers cannot be condoned and must not be allowed to happen again.

Because the world has failed to properly understand and rectify the situation for global seafarers, Australia was entirely exposed and at the mercy of other nations to keep their ships moving and their seafarers working, in breach of international laws, to service our needs.

We must learn from our experience so far, and the only way to do that is to understand how perilous the situation was - and could be again, this pandemic is far from over.

PC interim report pg 44 states "The COVID-19 pandemic, for example, has restricted the movement of people across domestic and international borders. Supply chain disruptions may occur where these people have specialist skills that Australia or its particular states may lack. Supply chain vulnerability to imported services and the movement of skilled labour should also be assessed using the best available information."

MIAL supports this observation and reiterates our call for maritime workers to be considered essential workers to be able to move more freely across borders. Again, the specific actions needed to deliver this is provided in the MIAL JSCFADT submission – these are repeated again here:

Key solutions that industry needs delivered by Government(s):

1. Marine crews, specialists (marine technicians and quality assurance inspectors, such as SIRE inspectors and ISM auditors) must be considered essential maritime workers.
2. Access across borders needs to be guaranteed (i.e. no hard border closures) for essential maritime workers. This includes going to work and returning to their residence.
3. Access to international flights needs to be secured for essential maritime workers – whether this is having them:
 - 3.1. allowed in excess of the incoming passenger cap; or
 - 3.2. exempt from incoming passenger cap; or
 - 3.3. required to be taken as priority passengers by the airlines.
4. Sufficient quarantine hotels need to be guaranteed for essential maritime workers (where quarantine is required), or provision of dedicated crew hotels or the ability for companies to provide appropriate isolation facilities.
5. Access to visas needs to be much more straight forward given the number of moving parts that are in play at the moment
 - For maritime crews
 - 5.1. Extension of transit visas is by far the most straight forward option
 - 5.2. Automatic extension (3 months) of an MCV should be applied.
 - For specialists
 - 5.3. Priority processing of their visa applications.
6. Protocols for handling of COVID positive cases on board – scenario plan for locations with and without shore facilities (hospitals, quarantine hotels);
7. Ensure COVID tests are available for essential maritime workers at all times; and
8. Removal of mandatory quarantine periods and allow seafarers to join their vessels as soon as possible (in line with IMO crew change protocol).

5 Expansion of imports related to food production

The main imports by value identified by the report were: motor vehicles and parts; electrical, optical and other specialised equipment; fuel; pharmaceuticals; and chemicals.

Most of the products MIAL concern ourselves with in the context of securing capability for Australia are identified in this report. What is not covered is phosphates/fertiliser - as the report does not consider food or food production. This seems to be gap in the report given Australia's reliance on Mongolia and Morocco for phosphates and coverage of this product should be considered.

6 Shipping overlooked

Pg 33 contains a diagram providing examples of components of supply chains. There is a box containing the examples of "Infrastructure and logistics (domestic and international)". This box lists "Road, rail and air transport, communications, wholesale, retail". Shipping / Sea is not mentioned and would be usefully included.

Pg 96 Box 5.7 Examples of government responding to the COVID-19 pandemic. There is no reference to maritime or shipping despite this being about supply chains.