

COUNCIL
WORKING PARTY ON SHIPBUILDING

ISSUES AFFECTING THE SHIPBUILDING MARKET

This document is submitted for information to Delegates at the Workshop with non-member economies to be held on 18-19 December 2006.

Contact: Structural Policy Division, Mr. Danny Scorpecci, tel: +33 1 45 24 94 33;
fax: +33 1 44 30 62 57; e- mail: danny.scorpecci@oecd.org or
Mr. Wolfgang Hübner, tel: +33 1 45 24 91 32; e-mail: wolfgang.hubner@oecd.org

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Summary

The Council Working Party on Shipbuilding Workshop with non-member economies, being held on 18-19 December 2006, will take a stock-take of the global shipbuilding industry from both government and industry perspectives.

This document is intended to be a resource document to facilitate discussions at that Workshop, and briefly examines a range of issues that are likely to impact on the shipbuilding industry in the short to medium term.

Action

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ISSUES AFFECTING THE SHIPBUILDING MARKET

BACKGROUND

1. Since the Council Working Party on Shipbuilding (WP6) last met in early 2002, the attention of policy makers in both government and industry have been focused on the negotiations on a new Shipbuilding Agreement to bring normal competitive conditions to the global shipbuilding market.
2. These negotiations were “paused” for an unspecified period in September 2005, and since then the WP6 has been reconstituted to once again provide a multilateral “window” to improve the transparency of the shipbuilding sector. The WP6 first met in its new format in July 2006.
3. At that meeting there was recognition that there had been many changes in the shipbuilding environment since 2002; not the least being the buoyant state of the market, with order books full well into this decade, and with much of the demand generated by economic growth in Asia generally, and China in particular.
4. However, a number of other developments in Governments, the market, technology and regulatory regimes will also have an impact on the global shipbuilding industry in the short to medium term.
5. This document is aimed at identifying some of the key issues that are affecting the shipbuilding market in 2006, and which are likely to play a dominant role for the rest of this decade. It is not intended to be an exhaustive catalogue of issues or a definitive statement of policy intent by governments or the private sector companies mentioned, but is part of the general material intended to generate discussion at the Workshop with non-OECD economies to be held on 18-19 December 2006.

THE BIG PICTURE

6. For the purpose of this analysis the issues identified for further consideration have been grouped under these broad headings:

ISSUE	DETAILS
Economic	Global economic development, expectations of future economic growth, changes in global economic patterns.
Government Policies	Government policies directly aimed at the shipbuilding industry.
Structural	Structural changes in the shipbuilding industry that will impact on the market.

Market Developments	Changes in the market that may significantly impact on the shipbuilding industry.
Regulatory	Changes in safety/environmental regulatory regimes (principally at the IMO, but also unilateral or regional), that will impact on shipbuilding.
Technology	Changes in ship design.
Support Measures	Actions by governments in support of their shipbuilding industries that could affect the normal operation of competitive conditions in the industry.
New Players	The impact of 2 new emerging players in the shipbuilding market.

DETAILED EXAMINATION OF ISSUES

ECONOMIC

➤ *Continuing strong global economic growth, but with concerns for its sustainability*

7. All of the major financial and economic institutions (IMF, World Bank, OECD) are forecasting relatively strong economic growth for the world economy. As recently as September 2006 the IMF had raised its expectations of economic growth for the rest of 2006 and 2007 to around 5% pa. Other institutions were broadly in line with this assessment.

8. Such an outcome would maintain trade at around current levels, and would continue the current high demand for both bulk (commodities/raw materials) and container (finished products) shipping. Energy demand is expected to remain high. In turn, these developments would encourage a continuation of the strong demand for new vessels.

9. However, all of the institutions have voiced some concerns about uncertainties that could affect that expected economic growth. The key issues identified were the growing pace of inflation globally, fuelled by the absorption of spare capacity, the high (and volatile) price of oil, and high commodity prices due to strong demand. Any oil/commodity shocks, or softening of demand from consuming economies (e.g. EU, USA, Japan) could quickly lead to the slowing, or even the contraction, of growth.

➤ *Role of China and India in global growth*

10. China and India are the current engines of global economic growth. Current wisdom amongst the major economic/financial institutions is that while these economies continue to grow then the current rate of global economic growth can be sustained. However, a slowdown (especially in China) could result in a significant backwash effect on the global economy and on trade, and (as a consequence) on both shipping and shipbuilding. The health of both of these economies is a key issue, and efforts by the Chinese government to cool down its overheating economy may be a taste of things to come.

➤ *Impact on shipping/shipbuilding of changes to levels and direction of trade*

11. A significant proportion of current shipbuilding demand is premised on the expectation of sustained or growing trade, and a consequent high demand for shipping. Therefore, any weakening of either the demand on commodities, or the demand for finished products, will initially have a direct impact on demand for shipping services, and subsequently on the demand for new vessels. In addition, any diversification of commodity sourcing (such as the recent Chinese decision to source more of its oil from Latin America rather than the Middle East) may also impact on the demand for shipping services.

GOVERNMENT POLICIES

➤ *Adoption by some governments of policies to increase domestic shipbuilding activity*

12. A number of governments have adopted policies aimed at increasing domestic shipbuilding activity. For example, China has the stated policy objective of becoming the world's largest producer by around 2020, while Vietnam has set the objective of becoming the fourth largest producer by 2015. Other governments have identified their shipbuilding industries as strategic, and/or critical to the growth of their economies. As well as emphasising the importance of shipbuilding as an economic activity, the importance of these kinds of government policies is that they may extend beyond the simple recognition of their importance and the setting of objectives, but could also extend to other support being extended to those industries by their respective governments, an issue that is taken up more specifically in a later section.

➤ *Possible new environmental/safety policies affecting ship dismantling*

13. There are increasing pressures on governments to introduce regulations to ensure that vessels are cleaned of environmentally hazardous or dangerous materials (such as asbestos) before they are sent for scrapping/recycling. As an example, such regulations are under active consideration within the EU, and these could increase cost of scrapping, which in turn could encourage some shipowners to keep vessels in operation and delaying their replacement.

➤ *Effect of removal in 2003 of Japan's capacity restrictions (scrap and build policy)*

14. For a number of years Japan operated a system of "scrap and build" of facilities. In short, new facilities could be built only after an equivalent amount of old capacity had been scrapped. The policy was intended to prevent overcapacity in the industry, but this was only effective while Japan was the dominant producer. The growth of both Korea and China has meant that the policy may actually have handicapped Japanese producers, while globally the Japanese policy had little effect on the growth in shipbuilding capacity.

15. The removal of that restriction in 2003 could have been expected to encourage Japanese production, and this may have been evidenced by the record volume of newbuildings in Japan in 2005. An effect of the removal of the capacity restrictions may be that Japan will compete more effectively with its major competitors.

STRUCTURAL

➤ Increase in capacity by established builders to capitalise on current high demand

16. Established shipbuilders in the major shipbuilding centres of Korea, Japan and Europe, as well as enhancing their own capacity through continuing productivity gains, have also broadened their horizons by investing in foreign shipyards in China, Vietnam, the Philippines and central Europe.

17. Also, there have been reports of ship repair activities moving to cheaper, specialised off-shore locations in order to release yards, to undertake building rather than ship repair.

➤ Growing capacity due to new entrants into shipbuilding industry

18. Substantial investments in capacity are being made by emerging shipbuilding economies. This has taken the form of substantial green-field investments in new facilities (sometimes with the financial participation of established shipbuilders), examples of this have been seen in China, Vietnam, Philippines and India. These investments are generally encouraged by government policies and occasionally enjoy some form of government assistance.

➤ Changes to constructions patterns

19. A trend noted in China, but which may also exist in other emerging economies, is that a reaction of the shipping industry to the ever growing size of container ships has been to increase the number of smaller feeder vessels, thus bringing smaller yards in China currently not servicing international markets into the mainstream. This would free other major yards to focus on larger vessels, but it would also have the effect of bringing effective new shipbuilding capacity into the market.

20. Another increasingly growing trend has been the construction of hull blocks in lower cost foreign yards before transfer to the home yards for finishing. A number of major yards in Europe, Japan and Korea have invested in foreign yards in order to facilitate this process.

➤ Possible tie-up between shipbuilding and steel companies to exploit integration

21. The increasing price of steel has increased the cost of producing ships, to the extent that many yards, even with full order books, are finding it difficult to generate profits from orders based on contracts entered into before the steel prices rose. As well as the rising cost of steel, some shipyards have found it difficult to secure steady supplies. A recent announcement of a possible investment by the Korean steelmaker POSCO into the Korean Daewoo shipyards may be a pointer to a closer integration in some economies between these heavy industry sectors. For the shipyards such a tie-up would ensure constant supplies of steel at economic prices; for the steel producers the shipyards would provide a steady base demand for their products.

MARKET DEVELOPMENTS

➤ Continuing high demand for new vessels of all types

22. Strong demand for new ships has left most shipyards with full order books for the next two to three years. The demand for container vessels has been sustained by the popularity of the larger TEU versions, and one report claimed that as of June 2006 the container order book stood at almost 51% of the total container fleet. Both liquid and dry bulk vessels were in high demand due to the continuing demand for commodities. LPG/LNG vessels have enjoyed a very strong growth due to the growing preference shift for gas energy over oil.

23. However, despite the current strong order there are signs (even reflected in comments by shipyards) of a softening in that demand, and a possible shipping capacity glut is anticipated in 2009.

➤ *Changing market patterns*

24. The most recent order book data (June 2006) indicates that Korea continues to dominate the market (approx 36%), while China is making very strong gains (approx 17%). Japan (approx 24%) has shown a sharp decline in its market share as reflected by the order book. If this situation persists then this could indicate a substantial and rapid shift in the market share pattern of recent years.

➤ *Changing economics of the industry*

25. The very high demand for ships has not necessarily translated into profitability for all shipyards. Some find themselves in a poor financial position despite full order book because of contract prices set before increases in the cost of energy and raw material inputs. Competition from new entrants and existing builders trying to meet the challenge has also limited the exploitation of the strong demand. Other factors, such as the increasing cost of shipyard risk insurance, and the expected softening of the market, have also been mentioned as adding to future uncertainties for shipbuilders.

REGULATORY

➤ *Current regulatory issues*

26. There are currently a number of regulatory issues, principally (but not exclusively) at the IMO, that could impact on both newbuild demand and the cost of producing new ships. The main issues are:

- Single hull tanker phase out by 2010, which has yet to play itself out on the shipbuilding market, especially if shipowners become concerned that there may be insufficient shipyard capacity to meet their orders if they delay too long.
- Coatings for ballast tanks (due to come into force on 1 July 2008), which will require considerable adjustment by shipyards, including the building of new blasting and painting facilities.
- Goal based standards for shipbuilding still under consideration at the IMO.
- IMO anti-fuel pollution rules which reportedly may add up to \$3m to cost of construction of new vessels.
- Common Structural Rules recently developed under the auspices of the International Association of Classification Societies (IACS).

TECHNOLOGY

➤ *Advent of large container ships*

27. In recent years the industry has seen the development of very large container vessels. Whereas not long ago a vessel of 6 500 TEU capacity was considered large, this has rapidly escalated, with vessels already in operation now exceeding 10 000 TEU, and the expectation is that vessels with a capacity of 15 000 TEU are not far away. The impact of these larger container ships can be felt in ports, which need to provide the infrastructure to handle them, and in shipbuilding where upgraded technology and facilities are necessary in order to construct them. Are there other technological leaps of this kind on the horizon?

SUPPORT MEASURES

➤ Various types of government support given to shipyards

28. At any given time there are a variety of supports given by government to shipyards. Certain types of subsidies are regulated by the WTO's Agreement on Subsidies and Countervailing Measures (ASCM), but in the absence of an overarching multilateral agreement (negotiations on the OECD's Shipbuilding Agreement having been paused) most are not regulated or disciplined.

29. No effort has been made to catalogue the many different support measures that exist (although this is on the WP6 Programme of Work for 2007/08) but in order to encourage some discussion some examples of support measures recently commented on in the media are presented below.

- Government efforts to attract foreign investment in shipbuilding yards.
 - : *e.g.* Hanjin investment in a major new greenfield site in the Philippines.
- Government guarantees for shipyards
 - : Several European governments (*e.g.* French, German, Netherlands) have provided government guarantees of loans to yards in accordance with EU regulations.
 - : Vietnam, use of government bonds by Vinashin.
- Government and other public sector involvement in the ownership of shipyards.
 - : Poland, sale of Gdynia yards, and government acquisition of Gdansk yards.
 - : Italy, 99.7% of Finacantieri shares bought by state owned holding company.
- Government assistance related to bankruptcy.
 - : Spanish holding company to provide employee protection for 10 years following sale of Izar yards.
 - : Korea, sale of Daewoo following bankruptcy by state owned Korea Development Bank.
- Use of Government subsidies.
 - : India, extension of subsidy assistance for yard development beyond 2007.
 - : Malaysia, assistance to reduce outflow of funds on purchase of new vessels from foreign yards.
- Use of government preference.
 - : Possible extension by US of Jones Act to cover ship repair/conversion of vessels to be used on Jones Act trades.
 - : Brazil, use of domestic yards for the building of the Petrobras fleet.

NEW PLAYERS**➤ *Increasing role of China***

30. China is a rapidly growing force in world shipbuilding, and has the stated objective of becoming the world's largest producer of new ships. In 2005 it produced almost 15% of global production, while as at June 2006 it held almost 17% of the world order book. The following is a brief list of the major recent events that will continue to underpin this rapid growth:

- Announcement of the major new shipyard, Janghan Changxin, which with a projected annual capacity 4.5m dwt, would make it the largest in the country.
- A proposal for the 1.1m dwt pa capacity Zhousan Jinhaiwan yard.
- The China Shipbuilding Industry Corporation (CSIC) has announced a planned capacity expansion to triple turnover by 2015.
- There are increasing numbers of smaller vessels for the international trade being constructed by minor Chinese yards (which together account for around 1/3 of total Chinese production).

➤ *Vietnam, a rapidly growing force*

31. Vietnam has identified its shipbuilding industry as a key cornerstone of future economic development, and has the stated ambition of becoming the world's fourth largest producer in the short to medium term. Recent developments in Vietnam include:

- Restructuring of Vinashin to become the "Vietnam Shipbuilding Industry Group".
- The creation of a new major shipbuilding consortium to be known as "Vinalines" which will build two shipyards as part of a USD 2 billion investment strategy by the group.
- STX Shipbuilding Co of Korea considering the possibility of building a new yard on a 3.5 million square metre site, making it one of the largest in SE Asia.

➤ *India, Philippines and Brazil all planning major new facilities*

32. Brazil, India and the Philippines have all announced major facilities, a number with investment from foreign shipyards. Apart from benefiting from lower costs, such investments are particularly attractive when existing shipyard sites are physically constrained from further development.