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EUROPEAN SHIPBUILDING INDUSTRY STATEMENT

1. A healthy European maritime technology industry, a strategic sector for Europe and its economy and long-term ambitions

Europe's maritime technology industry, which includes European shipbuilding, has an aggregated production value of €115 billion and generates directly and indirectly more than one million jobs in Europe, often located in remote regional areas. The main shipyards contribute to the continuous development of an extensive network of subcontractors, equipment manufacturers and suppliers, by providing long-term work and allowing the development of innovative technologies that may also be applied in other industrial sectors. Investments in shipbuilding create an added value of around 4.5 times the initial amount throughout the entire supply chain and in the regional economy. European shipbuilding and its supply chain is therefore a key strategic sector for the well-being and future growth of Europe since it represents, in the vast majority of cases, the main source of income for many European families and, therefore, needs a strong support from all the European Union institutions.

1.1 *The key strategic, competitive threat to the European maritime industry comes from the Asian large shipbuilders*

Although in this moment the European shipbuilding industry is performing relatively well, boosted by a booming cruise sector, it faces important risks due to a ramping competition from Asia. Like the shipping industry, commercial shipbuilding operates indeed in a truly global market. Hence in this industry, the key competitive threat is not within Europe, but between European shipyards and the Asian large Corporations.

Through large investments in their shipbuilding systems – largely inspired by geo-political and geo-strategic considerations[1] as opposed to economic considerations – Asian corporations have been able to build shipbuilding giants, which can today compete in all the large size vessels market segments, including now cruise ships, offering very low prices. Because of their geo-political and geo-strategic dimension for their country, such corporations have been able to rely on national State-led strategies linking shipbuilding and shipping as well as the civilian and defense sides. Hence, the growth and the consolidation of Asian shipyards has been largely led - and continues to be led - by their government through huge State subsidies. In contrast, Europe's shipbuilding industry, even if in certain circumstances the State is a direct shareholder, is fully driven by private/market considerations. There is thus a fundamental difference between Europe's and Asia's shipbuilding business models.

Hyundai and Daewoo in South Korea and CSSC and CSIC in China, for example, are about to execute state-led mergers[2] that will create shipbuilding giants active in all the segments of the shipbuilding industry (including in high tech, high -value segments). These state-driven operations would also allow those shipyards to have stronger contracting powers upon European suppliers who already face today an increasing number of trade and market access barriers in such countries (and more trade barriers are expected to come). It is also worth considering that in 2018, Hyundai and Daewoo had an aggregate turnover of more than €18 billion, and CSSC and CSIC of over €60 billion, of which about

[1] Shipbuilding is considered in Asia as a strategic sector *inter alia* due to its key role in controlling access to oceans and seas, trade, marine resources, energy sources, food supplies and in supplying modern navies with advanced vessels, a key element for effective military operations. Today, China is targeting Europe's global leadership in complex shipbuilding and in advanced maritime equipment manufacturing (see "Made in China 2025") as well as Europe's global leadership in shipping (see "Belt and Road Initiative"). In line with this policy framework, the Chinese government issued a series of sectoral plans to support the development of the shipbuilding industry.

[2] Lloyds' List "The rise of State power in Shipbuilding", 25.07.19

€15 billion in civilian ship newbuilding and more than €5 billion in naval new buildings. These figures are not comparable at all to the turnover of the largest EU shipbuilders. This huge consolidation trend in Asia will forge a new shape for this industrial sector. Seoul and Beijing repeatedly bailed out or subsidized money-losing shipyards and, by promoting a consolidation among their national giants, they would be ready to face the future big trends in energy markets and the new regulations.

This increasing competition from Asia is the result not only of the frequent dumping practices (i.e. offer prices below cost of production, sustained by state subsidies), but also of the effects of a consistent long-term strategy carried out in Asia, based on large investments in their shipyard production systems. In the last decades, these dumping practices have distorted normal competition to the detriment of EU shipbuilding. At the same time, many EU shipowners, ordering in Asia, have been the beneficiaries of these practices to the detriment of EU shipbuilding.

Until largely the second half of last century, Europe was a market leader in all the merchant and defense shipbuilding segments. Afterwards, the Asian giants progressively pushed the European players out of the bulkers segment, the tanker segment, the containership segment, and most of the offshore segments, thanks to the constant and consistent application of the above-mentioned state-led strategies, with no strategic response from Europe. In fact, in the last decade Asia Pacific Players led the market with more than 80% of ordered volumes, leaving Europe a marginal role.

It is also a widely acknowledged fact that shipbuilding has been suffering from a unique lack of effective trade defense tools. Existing WTO and EU trade defense remedies are regretfully inadequate for shipbuilding due to the specificities of the "ship" product and its purchase transaction (ships are not "imported" in the common customs sense known for other products, i.e. permanent entry into commerce into the buyer's country). These and other characteristics of the sector render the application of traditional trade defense measures imposed at the border, like countervailing or antidumping duties, extremely difficult in the case of unfairly traded ships. Hence, contrary to most other manufacturing industries, shipbuilding is exposed to global, fierce competition without de facto this type of protection against unfair trading practices.

Apart from the naval segment, the European shipbuilding industry is today only able to compete globally in the ferry and cruise segments and in some other high tech, specialized niche segments[3]. However, the ferry shipbuilding segment has already almost entirely shifted to China (as a result of the afore-mentioned state-led strategies that already helped Seoul and Beijing to conquer successfully merchant ship types and partly offshore building) and today there is no newbuild ferry delivery from a European shipyard foreseen after 2022 based on recent orderbook data[4]. Nonetheless, Europe is still market leader in the Cruise segment, due to a years-long policy of investments in design, technology and processes, without a significant public support, a policy that has created a large number of skilled technicians who have no equal in the rest of the world.

Yet this leadership is today being directly challenged in a scenario that sees China, in its "Made in China 2025", declare a clear strategy to build cruise ships, having already created a suitable cruise production capability, and to become leader in high-tech ships and equipment manufacturing. This new cruise production capability in China proves that barriers to entry do almost not exist for those large shipyards that have developed full industrial capabilities, controlling large design, engineering and project management functions.

In this regard, historical evidence proves that Asian yards successfully broke into technologically complex, high-value ship segments where EU yards were once world leaders or that they had even created, as also illustrated in various European Commission reports issued under EU Council Regulation 1540/98 and in recent studies[5].

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[3] These include for instance some complex, high tech non-cargo-carrying vessels, like mega-yachts, fishing vessels, dredging etc.

[4] Orderbook as of 30 June 2019 (Data source: IHS Fairplay)

[5] For instance, **offshore vessels** (including drilling/production/lifting units) rank amongst the most technologically complex ship types existing. According to an EU-sponsored study carried out in 2017 "***Europe lost 30% market shares in the period 2006 to 2011 and levelled out at 15% market share by 2015. China and South Korea inherited all those lost market shares and stand at the end of that period with a market share of 35% and 20% respectively. With regard to the orderbook (in 2015) China achieved the largest share with >40%*** (Source: "New Trends in Globalization in Shipbuilding and Marine Supplies: Consequences for European Industrial and Trade Policy", carried out by BALance Technology Consulting on behalf of the European Commission (published in October 2017).

Therefore, the European leadership in cruise construction is now in danger, as it happened consistently in the past with all the above-mentioned other market segments, as is its global position in the high-tech equipment manufacturing. According to the study carried out in 2017 by BALance for the European Commission "*It is anticipated that the European shipbuilding market for special high-tech and high value ships, predominantly cruise ships, will come under more and more pressure over time. In the absence of an imminent improvement of the market situation for the major commodity ship-types, the market sectors for special high-tech and high value ships will face more competition. China is preparing to enter this market sector as a political objective and is keen to build-up critical capacities to serve a wider range of marine supply needs*"[6]. The current challenges have been also recognized in a paper from the European Political Strategy Centre (issued on 28 October 2019)[7]. At stake is therefore the progressive decrease of the overall competitive capability of the whole European shipbuilding system, including its extensive supply chain and the naval side, putting at serious risk the future of European workers and their families.

The only possible answer is to help the European shipbuilding industry supporting its innovation, growth and consolidation, finding new policies, which take into account the changed scenario in which it operates, avoiding letting it face the fierce and often unfair competition from non-EU countries alone. Greater consolidation leads indeed to more productivity efficiencies and stronger competitiveness which enable such shipyards to sustain lower prices (and not higher prices) vis-à-vis the global (Asian) competition. The lack of strong or consolidated shipbuilders, not only would decrease the European competitiveness, but it would jeopardize the future of the European network of suppliers.

1.2 *A European technological leadership to be preserved*

Shipbuilding is one of the few sectors in which Europe has a worldwide technological leadership. A ship is a complex system that needs expertise, provided in most cases by a qualified network of subcontractors, mainly composed of small and medium enterprises, which represent the core of the excellence achieved by EU shipbuilding but, at the same time, cannot further flourish without the presence and the support of strong and global European shipbuilders.

The complex and innovative maritime products built or manufactured in Europe have made shipping, ports and logistics smarter, safer and more environmental-friendly and will remain key in transforming the maritime sector into a climate neutral mode of transport and thus in making the EU a climate neutral society by 2050.

The European Commission has acknowledged such importance and has launched a series of programs, including Horizon Europe, to finance research and innovation activities, with a special focus on protecting the environment. The European Commission and Member States have recently approved a co-programmed partnership on zero-emission waterborne transport as proof of the recognition that the sector plays a fundamental role in making shipping a green and climate-friendly mode of transport.

Indeed, the shipbuilding industry will be a pillar of these strategic projects. To implement its zero-emission ambition, the shipbuilding sector in Europe will need to make significant investments in research, development and innovation in the coming five to 10 years.

In order to maintain its technological leadership and to further invest and develop new technology, including eco-sustainable ones (e.g. fuel cell, lithium batteries), the European maritime industry must pursue efficiency and promote consolidation.

2. The cruise market is driven by shipowners

It is important to note that the cruise market is a market driven by shipowners, and not by shipbuilders. Very concentrated non-EU cruise operators dominate a high profitable market now attracting new entrants. 85% of cruise demand is in the hands of 4 non-EU players mainly for non-EU clients (45% of which coming from the US, with the relative weight of Chinese cruise passengers

[6] BALance Technology Consulting, "New Trends in Globalization in Shipbuilding and Marine Supplies: Consequences for European Industrial and Trade Policy", October 2017 (available here)

[7] European Political Strategy Centre, "Clean Transport at Sea – Setting a course for European leadership ", 29 October 2019 (available here)

growing at double digit) in non-EU destinations. These cruise players strengthened their leadership through consolidation during the last decade and with constant expansion of their ships.

The business model of such operators presents incredible marginality (as opposed to shipbuilders whose market is characterized by low marginality). Differently from shipbuilders, cruise shipowners, the vast majority of whom being non-EU corporations, have consistently shown in the last years extremely profitable balance sheets. They have an unequalled EBITDA[8] and ROIC[9] and can access favorable financing schemes through export credit, while shipbuilders need to finance on the market their huge working capital. From this point of view, Asian shipbuilders have an additional advantage since they can access non-market financing schemes and, in case of China, they are backed by the State which is controlling the whole industry from operators to suppliers.

Furthermore, shipowners can easily keep under control any possible attempt to increase ship prices by one player, leveraging the need shipbuilders have to ensure the continuity of shipyards' workload, mainly to recover their significant fixed costs. These costs of inactivity create a huge pressure to sell all available slots and therefore production capacity is not a competitive tool in the hands of shipbuilders. Since shipbuilders cannot waste their professional skills, they have a very strong economic incentive to ensure the continuity of their workload, even at low or negative profitability as after the 2001 or 2008-2009.

Nonetheless, even in the case of an unlikely increase of the ship price, it would not cause any relevant consequent increase in the ticket price. In fact, ships depreciates in 30-35 years, and the ship depreciation charge is a voice which, differently from other costs such as labor or fuel, has a relatively low impact on the product "profit and loss account" for the owner (10% of total cost of ticket price). In addition, it is worth mentioning that a significant portion of the revenues generated by the ship (approx. 30%) refers to on-board services.

Another important aspect to consider is the high bargaining power in the hand of shipowners, through contractual arrangements that have become a market practice (i.e. almost the entire price of the ship is paid at delivery or there are huge penalties for late delivery) and through the selection of the equipment makers' list. In this way they can obtain multiyear frame agreements with key technology suppliers for performance improvement, servicing and spare parts, at the same time reducing the possibility for shipbuilders to improve competition in their suppliers' base. Finally, as opposed to shipyards, shipowners can benefit from a wide range of dedicated support measures estimated by the ITF[10] in approx. 3 billion EUR per year. These include inter alia tonnage taxes, fiscal measures to reduce wage costs of seafarers and tax exemptions for fuels. In addition, shipowners – including cruise operators –uniquely benefit from various long-standing VAT exemption/Zero-rate arrangements applying to international and intra-EU maritime passenger transport tickets and other supplies.

All the above proves beyond any doubt that the shipbuilding industry is the weak side in the cruise overall business, and this creates yet another reason to defend it before it is overwhelmed by Asian competition.

3. The maritime segment is crucial for the development of a European defense industry

Navy ships, coastguard and other public vessels built in Europe and (complex) naval systems, equipment and technologies manufactured in Europe enable the navies and coastguards of Member States to guarantee the EU's defense and security, to protect coastal and maritime regions and to control access to trade lanes, marine resources or Blue Economy activities. These products also contribute to the EU's Common Security and Defense Policy (CSDP), allow the EU to participate in peace-keeping operations, conflict prevention or in combatting ship piracy, and are important assets in fisheries inspections, salvage operations, anti-pollution actions or research activities. Furthermore, innovative naval products are relevant for developing innovative commercial products and vice versa

[8] EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization)
[9] ROIC (Return On Invested Capital)
[10] International Transport Forum (OECD), 2019 "*Maritime Subsidies – do they provide added value for money*".

(so-called "dual-use technologies"). Since many naval products are state-owned, they are often subject to strict public procurement rules. Last but not least, Europe's naval shipyards are global leaders in naval shipbuilding and in the export of naval ships. Europe should acknowledge the strategic dimension of the maritime technology sector and reflect it in all EU policies, programs and tools.

Even though Europe has a global technological leadership, the European naval defense market is fragmented, with very low volumes and high non-recurring development costs resulting in inefficiencies. In contrast, the USA are more effective in having three types of frigates compared to Europe having more than 30 different models. This generates high investment costs, inefficiency and makes it difficult for Member States to have compatible ships. Furthermore, a European defense industry is crucial to reach the dimensions necessary to compete successfully on world markets whilst guaranteeing the defense and security of EU citizens. One only needs to think of Australia's €50 billion programs (frigates and submarines), of the USA's €25 billion FFG (X) frigates or of Canada's €32 billion CSC fighter ships. Finally, the European naval shipbuilding sector is also beginning to suffer the same threats from Asia experienced in civilian shipbuilding. In this regard, it is worth noting that China is starting to offer subsidized defense supplies merged into large agreements with developing countries as a way to boost its defense industry, which resulted in European companies beginning to lose market shares in such countries.

A stronger European shipbuilding industry would become hence the central piece of the development of the European defense industry.

4. Conclusion

In conclusion, given the above described competitive threat, SEA Europe calls on the European Commission to launch as soon as possible a roundtable table with the Industry to define effective European answers to meet the increasing threat from Asian-state led competitors and enable the strategic European shipbuilding sector to grow and prosper – to the benefit of Europe's economy and society – as opposed to decline and ultimately disappear. An essential part of this roundtable exercise should be a support for solutions that allow Europe to safeguard its current leadership in complex shipbuilding, including cruise building, through a variety of instruments, of which consolidation is an example.

Private-led consolidation enables companies, including shipyards, to improve efficiency, including in the production process, and allows shipyards to sustain lower prices to the benefit of consumers (including the shipowner). This type of consolidation is driven by market considerations, and should be distinguished from state-led consolidations, like in South Korea and China, which are purely driven by geo-political and geo-strategic considerations instead of market forces.

Nevertheless, this may not be enough if, at the same time, the growth and the consolidation of Asian shipyards continues to be largely led by their government through huge State subsidies and consequent dumping activities. A holistic, ambitious and forward-looking sectoral industry policy strategy is therefore vitally needed for the European maritime technology industry, as highlighted in the **SEA Europe Leadership 2030 White Paper.**[11]

Background Note: *SEA Europe represents close to 100% of the European shipbuilding industry in 16 nations, encompassing the production, maintenance, repair and conversion of all types of ships and floating structures, commercial as well as naval, including the full supply chain with the various producers of maritime systems, equipment material, and services*

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[11] SEA Europe White Paper "MARITIME TECHNOLOGY IN EUROPE: A STRATEGIC SOLUTION PROVIDER FOR MAJOR SOCIETAL CHALLENGES" (executive summary available here)