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**State of the industry
and crisis measures**

**Communication from the Commission to the Council
on a scheme to promote
the scrapping and building of ocean-going ships**

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Communication from the Commission to the Council
on a scheme to promote the
scrapping and Building of ocean-going ships

Introduction

1.1 In its Communication to the Council of 9 December 1977 on the reorganization of the Community shipbuilding industry,¹ the Commission stressed the need for urgent action to be taken to support the reorganization of the sector.

In its Resolution of 19 September 1978,² the Council recognized the need to make qualitative and quantitative adjustments to the sector. It therefore requested the authorities of the Member States and the Community to support the restructuring efforts undertaken by the industry and to alleviate, in particular, the social consequences of the crisis. In addition, it requested the Commission to investigate measures which could help to increase orders for new ships at Community shipyards.

This Communication concentrates on the latter aspects of the Resolution. Although the proposals contained in this document would have positive social implications for the sector, this Communication does not concern itself with specific social measures.

The Commission intends to propose, in good time, supplementary social measures for the sector. These will be developed in close collaboration with all interested circles. The Commission will take pains to ensure that these measures are consistent with those others aimed at facilitating the restructuring of the sector.

1.2 The crisis afflicting the shipbuilding industry appears to be even more serious than indicated in the abovementioned Communication from the Commission to the Council, the new energy crisis having darkened the prospect still further.

This applies in particular to the Community industry: it is to be feared that the extremely low level of new orders which the Community shipbuilding industry has won since 1975, and which is tending to drop still further, will in the years ahead bring down production to a level even lower than that predicted for the beginning of the 1980s. Such a steep decline in activity will gravely hamper the efforts the Community industry has been making to achieve gradual, orderly adjust-

ment. This turn for the worse makes such restructuring even more imperative – and much harder.

The reorganization of the sector is a difficult, long-term process which cannot be successfully carried through unless there is a minimum level of orders.

Given that the problem of the whole shipbuilding industry in all the Member States is affected, the Commission feels that it has a duty to take the initiative in proposing a scheme to restimulate demand in this sector over the coming years in which the crisis will be most severe.

The Commission considers that any scheme should satisfy two criteria:

- reorganization of the sector is indispensable in order to maintain a healthy and competitive industry whose scale of activity is consistent with the Community's basic interests; a scheme designed to raise the level of demand should facilitate, as a temporary measure, the reorganization while preventing the collapse of the sector;

- in view of the seriousness of the crisis the action should have a real impact, in as short a time as possible, on the level of demand.

In the light of what has been said above, and after examination of various possibilities, it appears that a scheme providing financial assistance to encourage the placing of additional orders, combined with the scrapping of ships which would not otherwise be broken up yet, is the most suitable (a scrap-and-build scheme).

It resembles the scheme in progress for the steel industry in that they are both crisis schemes designed to make the reorganization more tolerable from the political, regional and social viewpoints. For the steel crisis plan, however, the Community was able, under the ECSC Treaty, to use instruments which by their nature have a much greater impact on the market than those available for the implementation of the scrap-and-build scheme. Although the Commission is unable to make use of instruments of comparable efficacy, it nevertheless

¹ Supplement 7/77 — Bull. EC.

² OJ C 229 of 27. 9. 1978; Bull. EC 7/8-1978, point 2.1.20.

considers that the scheme must be tried. There is a real need for action, even with more modest objectives.

In any case, scrap-and-build will have not only a salutary effect on the Community shipbuilding industry, but also a modest but real impact on the absorption of the fleet overcapacities. It should be noted that as far as shipyards are concerned, the impact will be felt largely on the construction side since scrapping is not very profitable in the Community. This impact could be optimized if non-member countries were also to take steps to reduce their overcapacities, especially by adopting the same scrap-and-build scheme. How can those countries be encouraged and negotiations opened with them if the Community does not first decide on its own course of action?

This is a specific, anticyclical measure with considerable social impact; it is not, however, a direct restructuring project, although it will exercise a beneficial effect by improving the conditions, which otherwise may well become intolerable, in which such restructuring can take place.

1.3 This Communication provides the necessary details to enable the Council to discuss the principle and features of a scrap-and-build scheme.

The Commission hopes that from this discussion will emerge a policy on the choice of solutions for implementing such a scheme.

In the light of this first discussion, the Commission will then submit a formal proposal.

Grounds for considering a Community scheme

2.1 Aid schemes implemented by the Member States to help their shipyards or their shipowners have only in a limited number of cases led to sufficient structural adaptation of the yards. On the other hand, they have made it possible to progressively cut down production in the sector without causing too great social stresses. The trend in the level of orders won by the Community industry shows, however, that these measures are not generally sufficient to cope with the crisis.

In addition, as the first half-yearly report on the state of the Community shipbuilding industry indicates,¹ the state of the shipping market will in the years ahead probably remain characterized by overcapacity and instability.

Admittedly, the total overcapacity of the fleets, which was still estimated at 100 million dwt² at the end of 1978, has fallen, in part more or less permanently (one reason being the practice of reduced speed); nevertheless, the basic worldwide excess tonnage remains.

In addition, the energy crisis and its probable consequences – in particular increased inflation and reduced growth rates – will affect the development of world trade and therefore of shipping; hence the crisis on the shipping market is likely to worsen and to last for several years longer.

The present improvement in freight rates and second-hand market prices is probably a temporary and sectoral development; moreover, a considerable proportion of the present improvement in freight rates merely represents a compensation for the increase in bunker fuel prices.

Hence it is unlikely that there will be a fundamental overall recovery of the shipping market during the next few years. Consequently, the overall volume of orders for new ships will remain very low, even tending to drop further, and it is probable, for example, that orders, more especially for large

¹ Published as the first part of this Supplement.

² See the annexed data sheet.

crude oil tankers, will basically be limited to replacements.

2.2 This gloomy prospect for the shipbuilding industry is especially confirmed for the Community because of the unfavourable state of Community shipping. The Member States' merchant fleets are at the moment having to deal with a host of problems and the Community's share of the world fleet is continuing to drop, having fallen from 33.6 % in 1960 to approximately 18 % in 1979, i.e. well below the part in world seaborne transport generated by the Community. During the nine-month period from 1 July 1978 to 1 April 1979, the Community fleet has even undergone a considerable reduction in absolute value of 2.4 million grt, i.e. more than 3 % of its trading fleet of 72.4 million grt.

This trend is liable to result in the Community shipowners' share of world demand declining still further. Orders from Community shipowners already account for more than 75 % of the total volume of orders placed with the Community industry.

2.3 As pointed out in the first half-yearly report on the situation of the shipbuilding industry in the Community, the consequences of the shipbuilding crisis are steadily becoming more acutely felt at both production and employment levels. The industry is faced with a constantly diminishing number of orders on its books due to the fact that the level of new orders remains considerably below the production level, despite the significant drop in production that has occurred since 1976.

New orders placed in the Community amounted to 2 million cgrt in 1978, while production in that year reached 3.53 million cgrt. The orders on the books, which traditionally represent at least two years of work, stood at 4.78 million cgrt at the end of March 1979, equivalent to a workload plan of less than one year's production at the 1978 rate, since over 40 % of the work had already been completed by that date.

The level of orders booked by the Community industry shows a downward trend, in line with the contracting pattern of the Community fleet. The fear exists in certain circles that orders could be-

come stabilized at a level appreciably below 2 million cgrt per year for several years, which would tend to bring production down to a level of the order of 2 million cgrt or less per year during that period, corresponding to less than 50 % of the production level in 1975 and 1976. There is thus a risk that several of the best shipyards will not find further work and may be unable to continue operating if they cannot receive additional opportunities.

2.4 Remaining inactive under these circumstances will result in a situation where the indispensable rationalization of the industry, which has already fallen seriously behind, is replaced by a straightforward reduction of capacity, without the necessary structural changes, to an extent incompatible with the essential interests of the Community. In this context, one must also bear in mind the serious consequences that such a development could have for the related industries upstream.

On the other hand, the situation would also deteriorate if the Member States reacted individually by applying emergency measures that would distort competition and complicate the problems of our shipowners.

Type of action to be considered

3.1 The drop in production and the continuation of the crisis for longer than was anticipated in 1977 is increasing the severity of the employment problem. In order to be effective, any action adopted must produce immediate results.

Apart from the decrease in orders for the expansion of existing fleets, we find that replacement orders are being deferred. The proposed scheme is particularly aimed at speeding up such ordering. A flood of orders placed when the market recovers would be almost as harmful as the current scarcity of orders.

Any action to reactivate demand must avoid increasing the excess capacity of the fleets or affecting the competitive position of the Community shipowners.

Several approaches have been examined in consultation with the bodies concerned. It has become evident that the measure which best meets the requirements set out above would be a scheme that affects both the demand and the excess merchant fleet capacity. A scheme which solely encouraged the shipowners to place new orders would aggravate the problems of the shipping market; one which solely favoured the scrapping of old ships would not only have a very limited scope (since it would affect only ships flying the flags of the Member States), but would in no way guarantee the placing of additional orders with the Community industry.

An action which combined the reactivation of demand with encouragement to scrap old vessels could have the desired effects, provided that it were sufficiently extensive.¹

3.2.1 The essence of the scrap-and-build scheme proposed by the Commission is that financial support will be granted for an order to build ocean-going ships, placed with a Community shipyard by a shipowner established on Community territory,¹ provided that as part of the same operation the said owner also sends ships to be scrapped representing

twice the tonnage to be built, calculated in compensated gross register tons.

3.2.2 Since the level of demand is currently of the order of 2 million cgrt per year, with a risk of a further downwards trend, the Commission considers that an objective intended to increase orders by around 1 million cgrt per year for a period of three years ought to enable production to be maintained at a level of between 2.5 and 3 million cgrt per year.²

This would involve scrapping at the rate of 2 million cgrt per year over the same period, for, in order to have a certain impact on the absorption of fleet overcapacities, the tonnage to be scrapped would have to be appreciably greater than the additional tonnage to be built (especially bearing in mind the greater productivity of certain types of new ship), although it should not exceed a level that would discourage the shipowners.

In consequence, the Commission recommends a target of 1 million cgrt to be built and 2 million cgrt to be scrapped per year, over a period of three years. This question is examined in more detail at points 3.3 and 3.4 since it is advisable to establish whether the target is financially bearable and technically feasible.

3.2.3 In order to benefit from the arrangements provided, the ships to be scrapped will have to meet certain very specific eligibility criteria, particularly with a view to excluding as far as possible ships that would at all events be scrapped during the period scheduled for the scheme. Shipowners would have to undergo inspection procedures to ensure that such criteria are complied with and that the operations are genuine.

Should only those ships be taken into account which have flown the flag of one of the Member States for a certain period before being scrapped, or should ships that do not meet this requirement be included?

¹ It should be considered whether, and how, certain major conversions of vessels could in this context be rated as newbuilding.

² It should be noted that the EEC Shipbuilders' Liaison Committee considers that, even supposing that the new orders placed with Community shipyards, under the present conditions, were at the same level as in 1978 (2 million cgrt), Community production might be somewhat below this level over a period of three years.

The fleets under the flags of the Member States are in general of quite recent construction, so that not enough tonnage for scrapping is available in these fleets to enable the target of 2 million cgrt per year to be attained. The Commission thus considers that the shipowner should be allowed to put forward for scrapping, in the context of a scrap-and-build operation, ocean-going ships at least one of which has been registered in one of the Member States for not less than twelve months prior to the scrapping contract.

3.2.4 A similar problem arises in respect of the ships built in the context of a scrap-and-build operation; that is to say, provision must be made for their obligatory registration in one of the Member States for a certain period. The Commission feels that it would be out of the question for such a ship, on the day following its delivery, to be transferred to the register of a non-member country to compete subsequently against the Community fleets. In consequence, the Commission suggests that transfer of the registration to a non-Community country within a period of six years after delivery should, as a rule, impose on the shipowner the obligation to repay at least part of the subsidy he received.

3.3.1 The Commission suggests that the financial support should consist of (a) a variable part to offset the difference between the second-hand price and the scrapping price of a ship and (b) a fixed component to encourage the shipowner to invest. According to present estimates, the variable part, calculated at a flat rate on the basis of the type, size and age of the vessel, should range from 10 to 75 EUA per lightweight tonne,¹ representing an estimated average of 32.5 EUA per cgrt of scrapped tonnage, and the fixed part for encouraging construction should be 80 EUA per cgrt. With a quantitative objective of 1 million cgrt to be built and 2 million cgrt to be scrapped per year over a period of three years, the average annual cost of the scheme would be 145 million EUA, giving a total cost of the scheme for three years of 435 million EUA. The annual payments would, however, not necessarily average 145 million EUA, as the payments could be spread over a longer period exceeding three years. It should be noted that the sum of 145 million EUA represents 15-20 % of the government aid currently granted for

shipbuilding and shipping throughout the Community.

3.3.2 And here the question arises whether aid for the scrap-and-build scheme should be additional to national aid measures already being applied. The Commission would mention in this regard that the current measures taken by the Member States have generally not sufficed to prevent the decline of new orders to their present level and will be even less suitable for coping with a situation that is persisting and will probably grow worse. Furthermore, the aids to shipyards are primarily designed as measures to offset the differences in production costs between non-Community and Community shipbuilders, not to promote the placing of additional orders. The Commission is thus of the opinion that the scheme can only succeed if it is added to the national intervention measures.

3.4.1 The Commission expects that this system will be able to:

- assist in providing the shipbuilding industry with a basic workload;
- obviate adding to the excess capacity of the fleet, by tying new construction to scrapping;
- help to reduce excess tonnage at world level;
- help the shipowners to modernize their fleet and hence remain competitive;
- assist in combating marine pollution and in furthering the safety of ships.

The Commission also hopes that this scheme – primarily intended to generate additional demand from Community shipowners – will lead to a reduction in aids aimed at encouraging orders from owners in non-member countries who are in fierce competition with Community fleets.

3.4.2 It should be pointed out that the execution of the planned programme will have a positive impact on employment in the sector. In the Community direct employment in merchant shipbuilding yards dropped from 206 354 in 1974 to

¹ See the annexed data sheet.

155 840 in 1978, a loss of around 25 %. In 1979 an additional decrease is expected of between 10 000 and 17 000 jobs, and according to present market indications 50 000 more jobs could be lost over the next few years. Overall, the workforce in Community shipyards is therefore in danger of being reduced by over 50 % compared to 1975, particularly in those regions where there are already high levels of unemployment.

If the scheme's target were attained it would help to maintain employment for about 35 000 persons working in the shipyards, but also for a comparable number of people in related and upstream industries.

3.4.3 The scrap-and-build scheme is one of the measures to be taken in the context of more general action in the shipbuilding and shipping industries, for which guidelines were laid down in the Communication to the Council of 9 December 1977.¹ Designed as a temporary measure, its aim is not to have a direct influence on restructuring but rather to allow such reorganization to take place smoothly. The scheme, because it constitutes a contingency measure, differs from those existing financial instruments, intended to have a structural impact, such as the funds for industrial restructuring and reconversion (Article 375 of the budget), although it does, in a specific way and for a specific area, complement such financial measures. Proposals for a regulation on the use of these appropriations, now being discussed in the Council, would allow financial contributions not only for reorganization of Community shipyards but also for the redevelopment of regions affected by such reorganization.

At the Community level, the aim of the scrap-and-build scheme is, therefore, to assist in the reorganization of the sector; but measures will only be effective if combined with national aid measures. And, according to the Fourth Directive, national measures of aid are authorized only in so far as the shipyards are engaged in activities designed to restore competitiveness.

3.4.4 As with any aid scheme, it is impossible to guarantee unconditionally that the objective of the scrap-and-build scheme will be achieved. The success of the schemes will depend on both the devel-

opment of the market and the attitude of the shipowners. The system can operate only on a depressed shipping market, where freight rates are not profitable and the gap between second-hand market prices and scrapping prices is small and remains within limited margins. If the health of the market were restored, and consequently the gap between second-hand prices and scrapping prices widened beyond the set limits, the scheme would automatically shut off: the market forces alone would be sufficient to attain the objective pursued. In any event, the scheme requires flexible management, which means that it must be possible to suspend application of the scheme if it becomes clear that the effects are no longer compatible with the objectives pursued. This would notably be the case if very few additional orders were placed.

The remaining uncertainties cannot be put forward as justification for doing nothing: a Community approach to the current situation is a minimum requirement.

¹ Supplement 7/77 — Bull. EC.

Procedure for implementing the scheme

Community or national financing

4.1 The main issue to be decided, as far as the implementing procedures are concerned, is whether the scheme requires Community financing and management or whether a harmonized national approach to these aspects is more advisable.

A harmonized national approach gives each Member State the opportunity of using the proposed method, but does not ensure that all the Member States will do so.

If, however, a scrap-and-build scheme of the size advocated by the Commission is recognized as being necessary in order to safeguard a substantial part of the Community industry, it seems preferable to ensure participation by all Member States and consequently to finance the scheme at Community level.

Even if all the Member States agree to participate in the project on the basis of a nationally-financed approach aimed at achieving a common objective, such an approach presupposes its sharing among the Member States. This sharing at a national level runs the risk of failing to achieve the overall objective for the Community and hence the uncertainties of the project generally could increase.

The Commission considers that since a quantitative objective is essential all the Member States should participate in the project at Community level. Although not ruling out the concerted action formula, it feels that a Community-financed project would be preferable.

If, however, the Council feels that part of the financing should be defrayed from the national budgets, consideration could be given to a system whereby the variable part of the financial support is financed by the Community and the fixed part by the Member State in which the yard is located.¹

Execution of the scheme

4.2.1 If it is decided that the scheme should be wholly financed by the Community, the decisions on all expenditure required should be made by the Commission. In this event the Commission will be assisted by a Consultative Committee made up of the representatives of the Member States.

The Member States would participate in this system in the preparatory phase, especially by examining and selecting the applications for the benefit of the scheme and examining them in accordance with the rules established at Community level, but also in surveying the correct execution of each scrap-and-build operation financed under the scheme.

This system of management will not upset the traditional distribution of orders within the Community, because the Community scheme merely provides support that complements national aid granted outside this scheme, and it is the latter which forms the most decisive factor in the distribution of orders.

4.2.2 If, however, it is decided that the scheme should be wholly financed by the Member States, the Commission would have to assess the financing in the light of the provisions of the Fourth Directive on aid to the sector and of Article 92 *et seq.* of the Treaty, and decide in which way the Member States should carry out this scheme in order to obtain a harmonized national approach.

Assuming a system of wholly national financing, a choice should be made between several possibilities as follows:

— The execution and financing of the scheme are undertaken by the Member State in which the shipowner who orders the scrap-and-build operation is established. This system has the advantage of not resulting in distortions of competition and a walling-off of markets, provided that the owner is allowed a Community-wide choice of yards.

In that case, the Commission could, for example, prepare the framework within which such aid could be administered. But it would scarcely be acceptable for the Member State of the shipowner to be

¹ Point 3.3.1.

responsible for implementation and financing when it is the Member State of the shipyard to which the owner has given the order which will profit from the operation.

— The implementation and financing of the scheme are the responsibility of the Member State where the shipyard which has won the order is situated.

In that case, financial support would be granted to a shipowner situated in the Community who, as part of a scrap-and-build operation, places an order with a shipyard established in the territory of the Member State which is financing the operation. The aid could then be funded either at national level by new funds, or by existing funds for aid to shipbuilding, or by a combination of such funds.

It should be noted that this system could, in the absence of any control, easily give rise to distortions of competition. This is particularly true if the system is implemented only by certain Member States. The Member States which cannot for one reason or another take part in the scheme, or which do so at a later stage, are likely to see orders diverted to the other Member States. As in the case of direct aid to shipyards, the Commission must make sure that this new system complies with the general criteria of the Fourth Directive, particularly as regards selectivity and the ceiling for total amounts of aid.

Naturally, care must also be taken to ensure that the project remains wholly within its set horizons of a scrap-and-build scheme and is not transformed into a system of supplementary aid to shipbuilding.

— A third possibility would be for the Member State of the shipowner to take on the subsidy costs that relate to compensation for the difference between the second-hand price and the scrap price (variable part), while the Member State of the shipyard would take on the subsidy costs that relate to encouraging investment by the shipowner (fixed part).¹

This system raises problems similar to those in each of the options described above. Another drawback is that it entails applying to two decision-making centres for grants of financial aid, and this is not likely to be attractive to shipowners. The attract-

iveness of the system would disappear completely if one of the Member States involved in a scrap-and-build operation were not a participant in the scheme.

It is inherent in all forms of these nationally-financed schemes that the Member States would be responsible for the entire management, including reception of applications, examination and taking the final decisions respecting the abovementioned rules.

4.2.3 If it is decided that the scheme should involve both national and Community finance with the variable part of the financial support financed by the Community and the fixed part by the Member State in which the yard is located, it will be necessary to establish Community rules for the scheme and its implementation by the Commission and the Member States, similar to those described at 4.2.1 and 4.2.2 respectively.

In the framework of these rules it should be provided:

- that the Commission decides on all expenditure of Community finance as described at 4.2.1;
- that for the part nationally-financed the Commission would have to make an assessment as described at 4.2.2.

In the realization of this mixed system of financing, the Member States will participate especially in examining and selecting the applications in accordance with the rules to be established at Community level and also in surveying the correct execution of each scrap-and-build operation financed under the scheme. Owing to the inseparable nature of the scrap-and-build elements of the scheme, the final national decision granting aid for the fixed part can only be taken if a Commission decision has been made in favour of the variable part of the same operation.

4.2.4 The legal form of the Community instruments to be adopted in order to bring into force the methods described above should be decided upon in the light of the solution chosen. However, it can

¹ Point 3.3.1.

be assumed that in systems involving total or partial Community finance their legal basis will be Article 235 of the EEC Treaty.

4.3 It is clear from the foregoing that the problems related to the choice of the method of financing are serious, but not insurmountable. They are sufficiently complex to justify the Commission's desire that the Council examine the alternatives put forward in this Communication before a formal proposal is made.

Conclusions

5.1 The Commission therefore requests the Council:

1. to adopt the principle of a 'scrap-and-build' scheme to ensure a minimum level of activity for Community yards and help to reduce surplus shipping capacity while improving the competitiveness of the Community fleet;
2. to adopt the objective of one million cgrt to be built and two million cgrt to be scrapped per year, for a three-year period;
3. to take a decision on the various practical suggestions put forward by the Commission;
4. to recognize the usefulness of initiating contacts (for example, in OECD) with non-member countries interested in the scheme.

The Commission points out that the scrap-and-build scheme recommended here is in line with the projects recommended by the Commission to tackle the whole issue of shipyards, including the social aspects and regional redevelopment programmes. In this context, it has also already proposed that both the internal reorganization of the shipyards and the creation of alternative employment in the regions in which they are situated should be stimulated by the use of suitable Community financial aids. To this end, the Commission has advocated that funds from Article 375 of the budget be made available to the shipbuilding industry.

Annex

Data sheet

Definition of units used in the Communication:

Gross register ton (grt)

The register tonnage of a ship is the volume below the main deck plus that of the tween decks and superstructures, excluding all open spaces; it is expressed in tons. The value of the ton is 100 cubic feet, or 2.83 m³.

Compensated gross register ton (cgrt)

Since the normal gross register tonnage of a ship does not reflect the amount of shipbuilding work done (which also represents the degree of sophistication of the ship), the OECD has laid down coefficients for each type and size of merchant vessel ($\text{grt} \times \text{coefficient} = \text{cgrt}$).

Deadweight tonne (dwt)

The deadweight tonnage, calculated in tonnes, is equal to the weight of the cargo, fuel, stores, crew and passengers, if any, when the vessel is floating at its normal loadline.

Lightweight tonne

The lightweight tonnage of a ship is equal to the weight of the fitted-out hull and the propulsion machinery in working order.

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To prop up demand in the shipbuilding industry, one of the hardest hit by the crisis, the Commission advocates a scheme to promote the scrapping and building of ocean-going ships, the main purpose of which is to limit the effects of any worsening of the situation.

It was prompted to recommend the scheme by the conclusions in its first report on the state of the shipbuilding industry in the Community.

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