

**Chapter 6**  
**U.S. Maritime Policies**

*Photo credit: Sea-Land Industries*

# Contents

	Page
Overview . . . . .	141
Development of Maritime Policy . . . . .	141
General History . . . . .	141
Policies for the Future . . . . .	143
Comparison With Other Transportation Policy . . . . .	146
U.S. Coast Guard Safety Regulations . . . . .	151
Subsidy Policy . . . . .	152
Maritime Regulatory Policy . . . . .	157
U.S. Shipping Taxation Policies . . . . .	160
Cabotage Policies . . . . .	163
Summary . . . . .	168

## TABLES

<i>Table No.</i>	<i>Page</i>
39. Comparison of U.S. and U.S.S.R. Merchant Fleets . . . . .	146
40. Maritime Subsidy Outlays—1936-80 . . . . .	154
41. U.S. Shipyard Orders, 1970-81, Financed Under Title XI Program . . . . .	155
42. "BuyAmerica" Comparisons . . . . .	167

## OVERVIEW

An array of Federal policies and programs has been established in the past with the goal of aiding, assisting, or promoting the U.S. maritime industry. It is widely held that most of these policies are ineffective under current conditions and that major changes are needed. Some significant changes, most notably in funding cuts of subsidy programs and relaxing of some "buy America" provisions, have been instituted by the present administration over the past 2 years. Also, a regulatory measure to provide increased antitrust immunity and greater flexibility for U.S. liner operators to compete with foreign shipping is working its way through Congress. \*

However, many argue that the United States has no overall, coordinated, consistent, and effective maritime policy that is based on today's challenges and problems of future survival for the U.S. maritime industry, nor is it directed toward assuring that future national needs are met. Clearly, existing maritime policies are a patchwork. The Federal role in maintaining an industrial base, assuring competition, and coordinating national and interna-

tional initiatives, is poorly defined. The administration has spent 2 years in an attempt to articulate a new maritime promotional program. The result has been announcements of a variety of program elements with a promise of more to come. <sup>1</sup> Several of these elements were incorporated in a draft bill to amend the Merchant Marine Act of 1936 and were submitted to the Senate on April 8, 1983.<sup>2</sup> The legislative package is being considered in H.R. 3156 in the House and in S. 1038 in the Senate.

This chapter will describe briefly the development of the more significant maritime policies that exist or are part of major current debates. It will also discuss some important future considerations covered in previous chapters and will compare existing maritime policies with other transportation policies. Separate sections will discuss subsidy policy, maritime regulatory policy, taxation policies, and cabotage policies.

<sup>1</sup>See "Initial Elements of Maritime Policy Announced by DOT," May 1982; and "Lewis Announces Additional Elements in Administration Maritime Policy, August 1982.

<sup>2</sup>Letter from Secretary of Transportation to President of the Senate, Apr. 8, 1983.

\*The Shipping Act of 1983 passed the Senate as of Apr. 4, 1983.

## DEVELOPMENT OF MARITIME POLICY

### *General History*

It is possible to trace maritime policy development from the beginning of the Nation. For example, in his second annual address to Congress on December 8, 1790, President George Washington said:

I recommend it to your serious reflection how far and in what mode, it maybe expedient to guard against embarrassments from these contingencies, by such encouragements to our own Navigation as

will render our commerce and agriculture less dependent on foreign bottoms. . . .

One of the first acts of the First Congress of the United States dealt with the promotion of industry, trade, and shipping. Between 1789 and 1828, over 50 additional statutes and commercial treaties were approved to protect and promote *American* shipping. Since that time, Federal assistance in support of the Nation's maritime industry has been a constant of Government policy, including the Tariff Act of 1789, the Cabotage Law of 1817, the

Reciprocity Act of 1828, Government mail contracts in 1845, the Subsidy Act of 1891, the Military Transportation Act of 1904, the Shipping Act of 1916, the Merchant Marine Act of 1920, the Merchant Marine Act of 1928, the Intercostal Shipping Act of 1933, Public Resolution 15 in 1934, the Merchant Marine Act of 1936, Public Laws 480 and 664 in 1954, the Merchant Marine Act of 1970, and the Trade Act of 1974.<sup>3</sup>

Since the 1930's, U.S. maritime policy and the development of U.S. maritime industries have been influenced heavily by the philosophies of Admiral Alfred T. Mahan, which were published in 1918 in his book, *The Influence of Sea Power Upon History, 1660-1783*. In essence, Mahan held that national power was dependent on sea power and that sea power consisted of merchant ships, naval vessels, and the necessary supporting bases and industries.

Prior to the passage of the Merchant Marine Act of 1936, the U.S. merchant marine was at a low ebb. Inconsistent Government policies had discouraged capital investment, and a subsidy system tied to mail contracts proved to be ineffective. The Merchant Marine Act of 1936 was modeled after the Mahan philosophy and provided for Government subsidies to U.S. maritime industries.

Following 1936, the role of the maritime industries was perceived as vital and heroic during World War II and the Korean and Vietnamese conflicts. The performance of the maritime industries in World War II enabled America to sustain a two-front war across both the Atlantic and Pacific Oceans. Due primarily to the running start afforded by the Merchant Marine Act of 1936, the country produced 5,500 merchant ships for the war effort. Both the shipbuilding and operating industries cooperated in the construction and operation of the wartime merchant fleet. The merchant marine was the only civilian industry directly exposed to the combat of war. The extent of the involvement is evidenced by the fact that by 1943 there were a total of 130 ship-operating organizations, called general agents, serving the U.S. Government. \* The U.S.

<sup>3</sup>Irwin M. Heine, "The United States Merchant Marine: A National Asset" (Washington, D. C.: National Maritime Council, July 1976).

<sup>4</sup>McDowell & Gibbs, *Ocean Transportation* (New York: McGraw-Hill, 1954), p. 452.

Army utilized 330 ports of debarkation for over 7 million troops and 268 million tons of cargo.<sup>5</sup> With only 14 percent of the world's merchant tonnage at the start of World War II, the U.S. fleet grew to 60 percent of the world tonnage after the war. The experience of World War II is relevant because it has a profound and continuing influence on the policy and performance of our maritime industries.

In all statements of policy or purpose of past major maritime legislation, the *national defense* is mentioned first. This is not surprising when the timing of the acts is considered. The Shipping Act of 1916 followed the outbreak of World War I in Europe in the summer of 1914. At the time, the United States was dependent on foreign-flag vessels for 90 percent of its foreign trade. As foreign vessels disappeared from the sea lanes, U.S. cargoes were left rotting on the piers. In August 1914, Congress acted to allow the registration of foreign-built ships. By 1916 the experience was fresh in the minds of both the public and the legislators. The motives underlying the legislation of 1916 were stated in historical texts as "fear of trusts and monopolies; realization of inadequacy of the U.S. fleet for commerce, particularly in times of emergency. . . ."G

The Merchant Marine Act of 1920 was enacted basically to dispose of Government-owned ships constructed for World War 1, most of which were delivered after the war was over. Here again, this policy was conceived and enacted in a war environment.

The Act of 1936 was passed at a time when Europe was on the brink of war, and the United States saw the need to prepare. The Act of 1936 resulted after 15 months of debate and the compromise of many disparate points of view. Although the pending war was the primary motivation behind passage of the act, it included promotional features which encouraged investment in both the operating and building industries.

In retrospect, the Act of 1936 was most appropriate for the times. The policy it espoused served the Nation well in the ensuing 10 years. It was undoubtedly the headstart afforded by the Act of 1936 that allowed the United States to respond so rapidly

<sup>5</sup>Ibid., p. 445.

<sup>6</sup>Ibid., p. 412.

to the merchant ship demands of World War II. The Act of 1936 was a useful policy for its time, but many believe that its time is past.

### ***Policies for the Future***

In the future, the most effective U.S. maritime policies will be those that can respond to changing conditions of the industry and competition, changing conditions of trade and technology, and changing conditions in the international arena.

Virtually all maritime nations provide direct or indirect aid to their merchant fleets and shipbuilding industries. Assistance may include operating subsidies, construction subsidies, trade-in allowances, official low-interest loans, interest subsidies, official loan guarantees, accelerated depreciation, tax-free reserve funds, duty-free imports of required materials, cargo preference, and cabotage. In addition, social, economic, and political assistance may be provided. Examples include schools for training merchant seamen, hospital and medical care for seamen, social security family payments, and laws requiring that materials and component parts for ships be acquired from domestic sources.

A recent report prepared by the Maritime Administration (MarAd)<sup>7</sup> describes maritime policies of 48 nations. It contains examples of many approaches to industry assistance, reflecting the concern of other nations for the support of their merchant marine. It should be recognized that the international competitive nature of shipping and shipbuilding makes it imperative to consider relative influences of many other governments on the viability of the U.S. maritime industry.

#### **Industrial Changes**

Some recent analyses have concluded that major changes have taken place in industrial America. Plants and factories that closed because of reduced consumer demand are being replaced by modern, more automated facilities or, in many cases, the work has been exported to low-cost foreign countries. Several recent studies claim that the United States is in a transition period from an industrial society to an information-based society and that the

<sup>7</sup>U. S. Maritime Administration, "Maritime Subsidies, February 1983.

production of industrial hardware is irretrievably moving out of the country toward those countries with low wage rates.

The same studies project that the U.S. economy is moving away from self-sufficiency and that all the industrialized countries, including Japan and Germany, are deindustrializing. There appears to be some evidence of this in the maritime field with Korea emerging as the second largest shipbuilder in the world and with significant amounts of its business diverted from Japan.

The predictions about U.S. deindustrialization could significantly affect the maritime industries. An example is the well-known disadvantage of high-cost labor in both our ship-operating and shipbuilding industries. Despite a myriad of studies with proposed solutions, the problem remains as chronic today as when it was first perceived. Therefore, some believe that the tide of inevitable change in our maritime industries will be met from the bottom up by entrepreneurs and scientists with creative new solutions.

It appears that if U.S. ship operators are to compete in the future, it will require new breakthroughs in vessel design and system operation that increase efficiency and system capabilities. Shipyards, as well, will become competitive only through innovative approaches, products, or marketing. Future policies—if they are to benefit the Nation—must allow and encourage a high degree of innovation.

#### **National Defense**

The future of the maritime industry is important to the national defense. The Department of Defense (DOD), with assistance from MarAd, is in the process of defining specific national defense needs for ships and shipbuilding. Two separate studies were initiated early in 1983. One addresses the possible wartime demands for and existing capabilities of the U.S. shipyard mobilization base, and the other examines similar demands and capabilities of the U.S. sealift (merchant shipping) base. Neither was released as of September 1983, but initial findings of the shipyard study were discussed in a paper in May 1983.<sup>8</sup> Policy proposals in that paper

<sup>8</sup>R. V. Buck, "Maritime Policy Formulation: Preservation and Enhancement of the Maritime Industrial Base," presented to the Senior Officers' Forum, Naval Amphibious School, May 1983.

varied from support for broadly based cargo preference to preserving the Jones Act to suggestions for more study.

The second study—examining sealift needs and capabilities— is based on a projected scenario specifying military requirements to deploy and support forces under wartime conditions. The requirements do not include support to U.S. mainland industry or civilian activities. The study assumes that ships of several fleets—Military Sealift Command (MSC) fleet, U.S.-flag active commercial fleet, U.S. defense reserve fleet, fleets of U.S. allies, and the U.S. Effective Control fleet—all would be available under appropriate time constraints. The general conclusion of the sealift study, as discussed informally, is that the collection of all shipping assets that probably would be available to the United States in a national emergency are “marginally inadequate.”

Following the release of both of these reports, DOD intends to conduct a separate analysis of specific national objectives to support a certain level and type of a shipbuilding and sealift base to meet the defense needs described. The method of support of those objectives are key elements in any future U.S. maritime policy. The release of both reports is scheduled for late 1983. They should serve to clarify defense needs and identify approaches to meet those needs.

Although there is continuing discussion of the need for an active shipbuilding base and a strong merchant marine to serve the national defense, the concepts most often discussed are those of World War II and before. In a future war, there may be very different needs. Major conflicts today might result in the use of nuclear weapons; limited conflicts would require an existing force. This latter capability, insofar as it involves merchant vessels, probably can be met through continuous purchases of new and existing vessels for both operations and reserve. Whatever scenarios are postulated, policies must include a realistic appraisal of shipping and shipyard capabilities, a commitment of resources to maintain acceptable levels, and careful and continuous evaluation and support of the necessary reserves.

<sup>10</sup>Meeting with staff of the Secretary of Defense, Office of Program Analysis and Evaluation, July 27, 1983.

Although the Merchant Marine Act of 1936 cited a “Declaration of Policy, the exact meaning never has been defined in terms of specific national goals for maintaining a merchant fleet adequate to serve in a national emergency. Many believe that relatively few ships under U.S. registry today have the genuine capability to meet military needs. Containerships rarely are equipped with cranes to handle their cargo. There are few heavy-lift, breakbulk, or roll-on/roll-off (RO/RO) ships under U.S. registry, though these types are very useful for carrying military cargo. Industry spokesmen have suggested that defense features should be incorporated and continually maintained on the U.S.-flag fleet and that DOD should bear the cost of these features.

One of the most expensive national defense features (for large merchant ships) is the requirement that they be able to maintain cruise speed with a U.S. Navy task force deployed in time of war. In light of current design trends, it appears that the ability to maintain such cruise speed at adequate range will not always be present in ships constructed to be competitive on the open commercial market.

Such considerations of defense requirements needs to be more completely defined to devise national and international policies to satisfy those needs.

#### The U.S.S.R. Comparison

The Soviets have a large, modern, and diversified oceangoing merchant fleet consisting of 1,727 ships totaling about 19 million deadweight tons (dwt) (as of April 1983). While the number of ships is over three times the U.S.-flag fleet, the total tonnage is nearly the same. The Soviets, however, appear to have been much more successful than the United States in developing and maintaining a strong merchant fleet that has substantial military support capabilities. In addition, the Soviets recently have expanded their capabilities of serving commercial worldwide trade and, by offering low rates, have made substantial advances as cross-traders.

After the Cuban missile crisis in 1962, the U.S.S.R. carried out a series of fleet expansion and

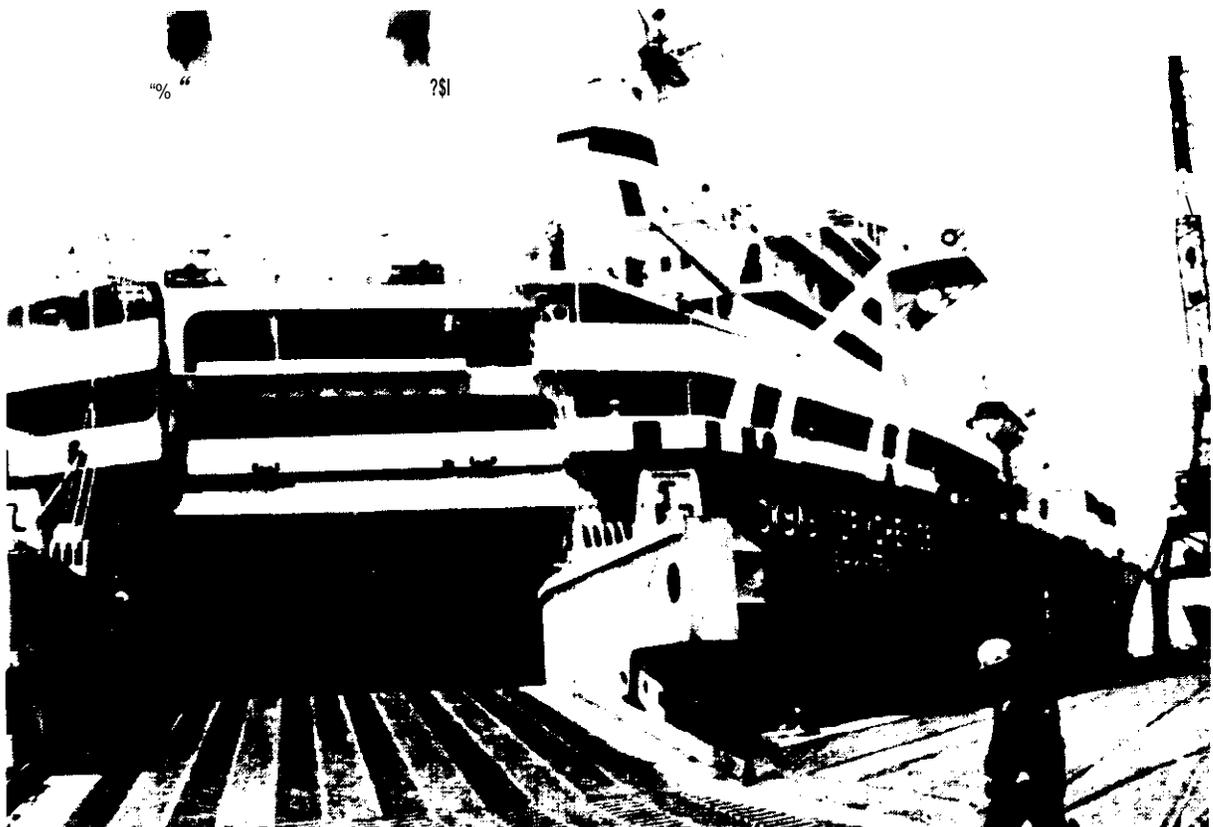
<sup>10</sup>See “Recent Figures and Movements of Soviet Merchant Marine, a research department report by Mitsui OSK Lines, Ltd., November 1982.

modernization plans. As a result, the Soviet merchant fleet showed a fivefold increase to 1981. The growth in size of the fleet has slowed in recent years, but there appears to be a trend toward modernizing and diversifying—especially with additions of new flexible types of ships—RO/ROs, barge carriers, heavy-lift ships, and containerships—all of which have significant military adaptability as well.

The Soviets have been quick to recognize the military significance of these new commercial-type ships. Their fleet contains 50 RO/ROs totaling 510,000 dwt (the third largest RO/RO fleet in the world) plus a number of smaller vehicle/train ferries. The RO/ROs have stern ramps and decks strengthened to carry tanks. The newest designs, some of which are now under construction, have service speeds of 20 knots and ranges of up to 20,000 nautical miles. This compares to the U.S. fleet of 25 RO/ROs, totaling 380,000 dwt.

The Soviets possess five heavy-lift ships and five barge carriers of two types, both constructed in Finland. The lighter-aboard-ship (LASH) type carry 26 barges. The smaller type can carry either barges or patrol craft, and have heavy-lift capability. They are equipped with 350-ton-capacity gantry cranes. Also, construction of a new nuclear-powered LASH is almost completed. The Soviet containership fleet consists of about 125 vessels. Nearly all of their containerships have the ability to off-load without port assistance.

The Soviet's new Five-Year Plan (1981-85) includes construction of many modern specialized ships replacing the older, smaller, general cargo ships. The trend is toward a smaller number of larger, more specialized ships with only modest growth in total fleet tonnage. To be completed by 1985 are about 250 vessels, including 50 containerships, 64 RO/RO ships, heavy-lift and barge car-



*Photo credit: U.S. Navy*

The Russian fleet of RO/RO ships is one of the largest in the world

riers (including nuclear-powered icebreaking designs), and over 1 million dwt of tankers.

Table 39 shows a comparison of the U.S. and U.S.S.R. merchant fleets as of April 1983. Of course, the Soviet merchant fleet is operated by the State under a system different from that of a free economy. This means that commercial operators from the United States and the rest of the free world cannot compete on an equal footing. Most of the Soviet merchant fleet is maintained within the U. S.S. R Navy's budget, and crewmen of merchant and naval ships are regularly exchanged to train seamen in line with naval strategic objectives.

The Soviet fleet does not operate on a commercial basis but exists to fulfill specific national goals of: contributing to military strategies, expanding influence over developing nations, strengthening maritime transport capacity for its own trades, and earning foreign currency through cross-trades. Many of these are similar to U.S. goals, but the U.S. Government is far less involved in any commercial activities. Therefore, the competitive position of U.S. operators may be influenced substantially by future Soviet actions, especially as they advance more and more into commercial shipping.

**Table 39.—Comparison of U.S. and U.S.S.R. Merchant Fleets** (vessels 1,000 gross registered tons and upward)

Type ship	U.S. active (numbeddwt)	U.S.S.R. (numbeddwt)
Cargo . . . . .	271/4,948,000	1,355/11,647,000
Tanker . . . . .	272/16,167,000	308/7,884,000
Passenger . . . . .	11/62,000	64/142,000
<i>When built:</i>		
Cargo:		
1982 and prior . . . . .	86	255
1983 through 1972 . . . . .	115	706
1973 through 1983 . . . . .	70	394
Tanker:		
1962 and prior . . . . .	140	58
1983 through 1972 . . . . .	45	159
1973 through 1983 . . . . .	87	91
Passenger:		
1982 and prior . . . . .	7	29
1983 through 1972 . . . . .	4	15
1973 through 1983 . . . . .	0	20
<i>Speed by type: 14 knots or more:</i>		
Cargo . . . . .	261	884
Tanker . . . . .	259	197
Passenger . . . . .	11	60

NOTE: The U.S. fleet includes only the privately owned, active oceangoing fleet (no reserve fleet). The Russian fleet includes only active oceangoing ships.

SOURCE: U.S. Navy, April 1983

U.S. maritime policy must be developed with a clear understanding of Soviet capabilities and participation in world maritime trade.

### ***Comparison With Other Transportation Policy***

Ocean transportation is a unique transportation industry, particularly in the foreign trades. Although some parallels can be found between foreign and domestic transportation, as well as international air and ocean transportation, in most cases the circumstances differ greatly, and meaningful comparisons are possible only in the academic environment.

To understand the differences, similarities, and bases for transportation regulation, it is first necessary to examine the history. The regulation of transportation in the United States can be traced directly to the late 1800's when American railroads were pushing into the last of the western frontiers. Between 1865 and 1870, there was an unprecedented burst of construction, centering on the Midwestern and western grain States. Competing lines were run adjacent to each other, and railroads were actively recruiting homesteaders to settle the surrounding land in hopes of creating business to pay for their investments. However, by the mid-1870's, the expectations of the new homesteaders had not been realized, and the railroads rapidly fell into disfavor. As one text noted, railroads "were no longer the pioneers of dawning civilization or the harbingers of increased prosperity; they were the tools of extortion in the hands of capitalists. 11

Antagonism toward the railroads and big business eventually culminated in the Act to Regulate Commerce (1887). This act—now the Interstate Commerce Act (ICA)—has served as the foundation of U.S. transportation regulation from 1887 until the present. The areas of rate regulation included in the Act of 1887 focused on such railroad abuses as unreasonable rate levels, service discrimination, rebates, and combines that destroyed competition. The act created the Interstate Commerce Commission (ICC). Part I of the 1877 Act applied to railroads; part II, added in 1935, applied to

<sup>11</sup> Fair and Williams, *The Economics of Transportation* (New York: Harper, 1959), p. 429.

motor carriers; part III, related to water carriers, was added in 1940; and part IV, treating freight forwarders, was enacted in 1942. Air carriers were the only domestic mode of interstate commerce to remain outside the act.

A rise in freight rates at the turn of the century, plus continued abuses by powerful business interests, spawned a new round of regulatory bills. In 1903, the Elkins Act sought to improve the enforcement against rebating. The Hepburn Act of 1906 also focused on rebating and allowed the ICC to set maximum rates. Also, it prohibited carriers from carrying articles they produced. The Panama Canal Act of 1912 forbade railroads to own, lease, operate, control, or have any interest in water carriers operating by way of the canal.

It was against this background of active domestic regulation of transportation that the Nation began to focus on waterway transport. At the turn of the century, there were two aspects of ocean transportation that differed substantially from today. First, there was an active intercostal and coastal liner trade that was in competition with the railroads, and second, the United States, prior to World War I, was an extremely insular country, with little interest in foreign trade.

The Shipping Act of 1916, the primary regulatory law affecting ocean transport, was prompted by two specific conditions—the shipping shortage caused by the initiation of hostilities in Europe in 1914 and the country's general economic philosophy toward free and open competition. One part of the Shipping Act of 1916 applies to domestic transportation, the other to foreign transportation.

For domestic trades, the act applied similar principles of regulation to domestic water carriers as were applied to railroads competing for the same traffic. In the domestic sphere, the 1916 Act followed the lead of the ICA by setting maximum rates and prohibiting rebates. This authority over coastal and intercostal water carriers was shifted to the ICC by the Transportation Act of 1940 (part 111 of the ICC Act).

For international water transportation, the Shipping Act of 1916 applied some uniquely American regulatory principles to an international marketplace. However, the so-called Alexander Committee prepared an Investigation of Shipping

Conditions under H. Res. 587 that preceded passage of the Shipping Act of 1916 and concluded that conferences and cooperative industry agreements should be allowed. The following statement was offered in the Alexander report:

To terminate existing agreements would necessarily bring about one of two results: the lines would either engage in rate wars which would mean the elimination of the weak and the survival of the strong, or to avoid a costly struggle, they would consolidate through common ownership. Neither result can be prevented by legislation, and either would mean a monopoly fully as effective, and it is believed more so, than can exist by virtue of an agreement. Moreover, steamship agreements and conferences are not confined to the lines engaging in the foreign trade of the United States. They are as universally used in the foreign trade of other countries as in our own.

Based on the Alexander report, U.S. ocean carriers were allowed antitrust exemption in the 1916 Act under the provisions of section 15. The U.S. Shipping Board, predecessor to the Federal Maritime Commission (FMC), was given the power to grant antitrust immunity to shipping conferences and to approve, cancel, and modify proposed agreements.

The 1916 Act required all carriers by water in foreign commerce to file rates on all commodities except those carried in bulk. The remainder of the act gave considerable attention to the prohibition of rebating and discrimination.

Any comparison of regulatory and promotional policies among various transport industries must be based on the recognition that both are in transition. The domestic air, rail, and motor industries have been deregulated, including prohibitions concerning common ownership of various modes. Both the domestic offshore and foreign merchant fleets are the subject of pending legislation and administrative review.

The term 'deregulation, however, has different meanings and connotations when applied to different industries. For example, domestic air, rail, and trucking deregulation recently has been enacted as *quid pro quo* for the reduction of antitrust immunity while, in foreign ocean shipping, the legislative concept currently under consideration proposes lesser regulatory controls plus greater antitrust immunity.

Domestic waterway transportation has been regulated historically by the same principles as domestic rail and motor carrier transportation. There are some differences and anomalies:

- Where rail and motor carriers have been regulated by one agency, domestic water carriers have been controlled by two agencies—the ICC for Great Lakes, inland, and coastal; and the FMC for noncontiguous areas. For all practical purposes, there has been very limited ICC-regulated service because of the demise of the coastal and intercostal liner carriage and the lack of Great Lakes package services. Inland waterway service generally has consisted of bulk carriage, which is exempt. In recent years, increasing levels of Alaska trailer and container traffic have moved under ICC tariff as substitute water-for-motor carriage. Recent court decisions also have permitted ICC regulation of rail/water and motor/water intermodal carriage in the offshore trades (e. g., Puerto Rico),
- Regulation of domestic water carriers, where it has been exercised, has been primarily in maximum rate regulation, financial responsibility of passenger carriers, and in collective agreements. However, there are no conferences in the domestic trades. Historically, other domestic modes have been subjected to a higher degree of rate regulation, plus entry and abandonment regulation.
- Domestic water carriers are required by the Jones Act to employ U.S.-built vessels, manned by U.S. citizen crews, and owned by U.S. citizens. This restriction does not apply to the same extent to domestic rail, motor, and air carriage.
- In terms of promotion, domestic water carriers have had the benefit of Government aid in harbor improvement and aids to navigation. Subsidized vessels, however, are not allowed to serve the domestic trade except on waiver. Motor and rail carriers also have received significant Government aid in the form of highway construction and maintenance and in original land grants to railroads.
- The comparison of domestic water carriers with domestic air carriers is less relevant because the latter is engaged primarily in passenger transportation, while domestic water

carriers engage almost exclusively in cargo bulk transportation. Historically, domestic air carriers have been more closely regulated than domestic water carriers, although the regulation of air carriers has been greatly reduced.

Regulation and promotion of the shipbuilding industry can be compared with the aerospace and transportation equipment industries. Generally, there are few differences in terms of regulation, albeit different agencies are involved in approving the safety of the products they produce. In the promotional area, both the aerospace and shipbuilding industries benefit from military spending. The shipbuilding industry is unique in that it has been subsidized in the past through a construction differential subsidy (CDS) awarded to operators to cover differences in cost between U.S. yards and competitive foreign yards. The U.S. shipbuilding industry also is afforded a captive market by the Jones Act and benefits from other “buy America” policies not prevalent in the other transportation equipment industries.

In the international sphere, U.S. ocean carriers are subject to the provisions of the Shipping Act of 1916 and regulated by FMC. In comparison with domestic surface carriers, the U.S. international-ocean-carrier industry operates in an international market with unlimited entry, numerous state-owned or state-subsidized carriers, and a long history of accepted traditions and business customs.

The U.S. international air carriers are similar to U.S. international ocean carriers in that they operate in an international market, but they are dissimilar in that their major concentration is in passenger services as opposed to cargo services. In addition, international air carriers operate within a regime of bilateral agreements setting the rules for air commerce, while in shipping there are few intergovernmentally agreed on rules of competition.

In comparing domestic-surface-carrier regulation with U.S. international-ocean-carrier regulation, the differences have been primarily in the regulation of the entry of carriers and in rate regulation, with the domestic regulations being the more stringent. FMC has no authority to set or approve rates of ocean carriers in foreign trade but does require the filing of tariffs. Relative to the international-air-carrier and domestic-surface-transportation in-

dustries, the U.S. international-ocean-carrier industry has been comparatively unregulated.

#### U.S. Transportation Regulatory Concepts v. an International Market

The principal point in comparing domestic and international regulation is that the regulatory remedy for a domestic industry where all players can be regulated equally is completely different from the international arena where most of the players do not recognize American rules and usually cannot be forced to comply. The area of antitrust prohibitions and rebates has been the most troublesome. Even though the legislative history of the Act of 1916 shows that the framers of the act recognized the unique nature of international shipping and gave authority to the regulatory agency (i.e., FMC) to grant antitrust exemptions, the Justice Department frequently has fought the granting of such exemptions. Foreign carriers serving the U.S. trades are more likely to receive immunity to collaborate and rationalize their services than U.S. carriers. Attempts to do so by U.S. carriers have been met with stringent and frequent Justice Department protests and Government-initiated and financed litigation, as in the case of the attempted U.S.

Lines/R. J. Reynolds merger. Deferred rebating, a common practice in ocean shipping worldwide, is prohibited in the U.S. trades and stringently enforced.

Prior to 1977, a number of U.S. and foreign companies allegedly engaged in illegal rebating activities within the established liner conferences of the time. FMC investigated these activities and, between 1977 and 1980, settled claims against 27 liner operators (21 foreign and 6 U. S.) and against almost 100 shippers. The amount of the individual claims ranged from about \$5,000 to \$4 million and totaled \$15.6 million. The claims settled with the 6 U.S. liner operators totaled \$7.4 million and with the 21 foreign liner operators totaled \$5.1 million. Many believe that this example illustrates the disparity of treatment of U.S. v. foreign operators under U.S. law. Certainly, in this case, foreign operators dominated the trade (by factors of two to three times) and were suspected of a major share of illegal rebating. Yet claims settled were much less. The contention is that U.S. laws cannot be evenly enforced in such an international business, and U.S. operators have a resulting economic disadvantage.

<sup>12</sup>Data on claims settled as of Dec. 31, 1980, obtained from the Federal Maritime Commission, General Counsel's Office.

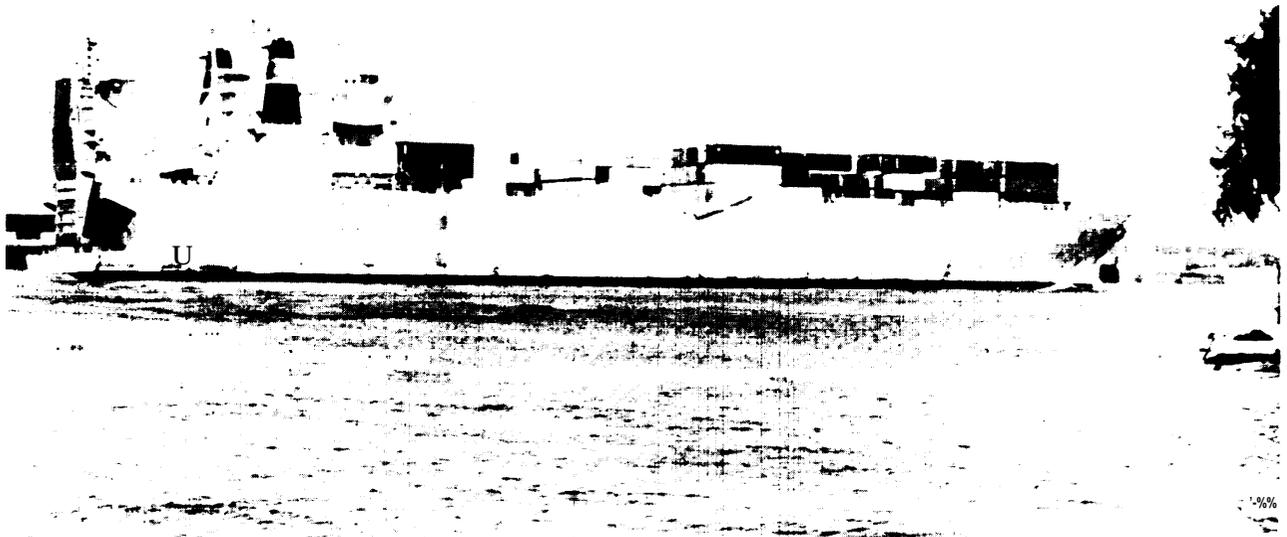


Photo credit: Pori of New Orleans

A Greek-flag liner ship entering the Port of New Orleans

The other anomaly involving the application of U.S. regulatory concepts is the existence and use of the Canadian and Mexican gateways. For instance, ocean carriers serving Montreal need not file tariffs with FMC for U.S. origin or destination cargoes and can form intercarrier agreements as necessary to serve the U.S. trade without disclosing relationships or receiving FMC approval. Foreign-flag carriers serving the United States through the Canadian gateway have maximum flexibility and have been able to charge differential rates, including marginal (noncompensatory) rates, to shippers in order to fill their ships. This same flexibility is not available to U.S.-flag carriers competing out of U.S. ports. In the United States, rates can be dropped immediately on filing, but rates cannot be increased without a 30-day filing notice.

#### Comparison of International Ocean and Air Regulation and Promotion

In comparing U. S.-flag international-ocean-carrier regulation and promotion with international-aviation carriage, there are essentially four areas that can be examined:

- . rates and fares;
- . mergers and acquisitions;
- . entry requirements; and
- promotion.

**Rates and Fares.**—Both the Civil Aeronautics Board (CAB) and FMC require rate filing for scheduled service, and both recognize conference-type ratemaking, although CAB is backing away from routine acceptance of International Air Transport Association (IATA) airline agreements. By law, both agencies may grant antitrust immunity to ratemaking groups and in practice have granted this immunity after a hearing and full disclosure. CAB has authority to suspend or reject rates that are unreasonable, although the President may override the CAB decision. CAB seldom suspends rates in international service. Also, there are provisions in most bilateral air agreements that allow the designated authority to reject rates. FMC can find that rates are too high or too low and thus impede the foreign commerce of the United States, and it can order the carrier to discontinue charging that rate. However, it has rarely exercised this power over rates in foreign trade. Under the Con-

trolled Carrier Act (CCA), FMC can suspend rates that it finds unreasonably low, and in fact has done so in several instances involving the Far-Eastern Shipping Co., a Soviet-owned cross-trading ship-operating company. Both agencies (CAB and FMC) regulate against rebates, and law dictates that both air and ocean carriers must adhere to published tariffs. According to case law, ocean-carrier rates must cover fully distributed costs.

**Mergers.**—CAB is required to approve airline mergers of U.S. airlines, but may be overruled by the President where international routes are concerned. FMC may not approve U.S. ocean-carrier mergers that are subject to antitrust laws.

**Entry.**—There is a basic difference in entry regulation in that U.S. ports are open to all ships of all nations (with the exception of some security considerations at some ports) that adhere to our laws. Air carriers, on the other hand, are subject to bilateral agreements limiting the number of flights and carriers that can enter a country's air space and that are granted landing rights.

**Promotion.**—Promotion includes subsidy and other measures to assist U. S. carriers. Although CAB is authorized to provide direct subsidy to U.S. air carriers, as a matter of practice it does not, other than premiums on mail rates. The authorized air-carrier subsidy may be paid regardless of where the aircraft were built. On the other hand, most U. S.-flag ocean carriers are paid an operating differential subsidy (ODS) directly by the Maritime Subsidy Board (as specified in the Merchant Marine Act of 1936) only on ships built in the United States. The subsidy is technically a contract in which the carrier agrees to serve an assigned (i. e., 'essential' trade route and observe other specific operating constraints. However, MarAd is moving to phase out ODS by not granting new contracts and encouraging early termination of existing contracts.

As mentioned previously CDS has been paid to U.S. ocean-carrier operators to cover cost differentials for vessels built in U.S. shipyards. At the current time, no new construction subsidy awards are being made. There is no construction subsidy counterpart in the aviation industry.

Bilateral agreements reserving cargo also are considered forms of promotion. Aviation bilateral

agreements usually limit competition to carriers of the two countries and selected third-flag carriers but do not allocate market share. Equivalent competitive opportunities are afforded. In the maritime sphere, bilateral agreements tend to specify cargo shares to be carried by each trading partner. Bilateral agreements are the rule in international air transport and are the exception in U.S. ocean trade.

U.S. Government-impelled cargo-reservation policies for U.S.-flag ships could also be compared to Federal aviation policy, which requires all Government personnel to use U.S. airlines whenever possible on international travel.

### ***U.S. Coast Guard Safety Regulations***

The U.S. Coast Guard (USCG) plays an important role in promoting safety in marine transportation and has specific regulatory responsibilities in commercial vessel safety. Some of these safety requirements have been criticized by the maritime industry as putting undue burdens and excessive costs on U.S.-flag operators that foreign-flag operators do not have to comply with. Industry examples of these requirements are different for new vessels built in U.S. shipyards than conversion of foreign-flag vessels to U.S.-flag.

The most frequent complaint by the industry regarding new vessels is the increase in costs of both materials and labor associated with the application for USCG approval. USCG has not required that many materials be different from that desired by an owner or required by a classification society or Industrial Standard. However, the material control costs have increased because USCG requirements duplicated functions (i. e., certification and factory inspections) provided by classification societies or Industrial Standards. The net effect is that 'off-the-shelf' components have cost more merely because suppliers must provide evidence of USCG approval.

Other examples by the industry of burdensome safety regulations relate to indirect restrictions on their choice of suppliers. Although not specifically prohibited, less expensive foreign components may not be accepted when USCG does not recognize affidavits from foreign manufacturers. Compliance with USCG regulations has been shown to add ap-

proximately 3 to 4 percent to the construction cost of a new vessel. 13

The cost impact associated with USCG regulations on the conversion of a foreign-flag vessel to U.S. flag appears to be even greater. Typical industry claims are that some expenses are required solely to comply with USCG regulations and not because of the quality or suitability of the existing vessel. Examples of reflagging requirements are the replacement of all joiner work with approved materials (to meet stringent fire-protection standards); the replacement of lifeboats and lifesaving gear; and the replacement of electrical wiring. In many cases, new drawings requiring a lengthy approval process must be prepared to obtain USCG approval. Shipbuilders have estimated that USCG requirements can add approximately 4 to 5 percent to the cost of conversion of a relatively new foreign-flag vessel to U.S. flag.

In recent years, USCG has responded to concerns that their vessel-safety requirements are too burdensome compared with other major maritime nations. For example, USCG now accepts the American Bureau of Shipping (ABS) and other international classification societies' plan review, material certificates, and onsite inspections for both new and reflagged ships. 14

USCG believes that the commercial vessel-safety requirements for U.S. ships are coming more in line with international standards, such as those of the International Maritime Organization (IMO). IMO, formerly known as the Inter-Governmental Maritime Consultative Organization (IMCO), was established in 1958 through the United Nations to coordinate international maritime safety requirements. USCG has actively participated in IMO since its existence and believes that its efforts in the international arena have resulted in bringing the safety requirements of most other major maritime nations up to those imposed by USCG. The Coast Guard notes that some safety requirements in the past resulted in overregulating, but those have been replaced and, in some instances, other shipping na-

<sup>13</sup>E. K. p<sub>n</sub>ti<sub>m</sub>ti, American President Lines, Ltd., personal communication, Mar. 21, 1983.

<sup>14</sup>National Advisory Committee on Oceans and Atmosphere (NACOA), *Marine Transportation in the United States*, January 1983,

tions (i. e., Norway) now have more stringent requirements than the United States.

A 1979 study for MarAd entitled "Cost Impact of U.S. Government Regulations on U.S.-Flag Ocean Carriers, found USCG requirement costs to be smaller than generally perceived. In fact, the annual operating costs shown due to Coast Guard regulations were a small fraction of the vessels' total operating costs. The report analyzed the increased costs of two different types of vessels and found the increase to be less than 0.5 percent of the total cost.

## SUBSIDY POLICY

The Merchant Marine Act of 1936 has been the base on which the succeeding 45 years of U.S. Government maritime subsidy policy was built. Section 101 of the 1936 Act contains the following declaration of national policy:

It is necessary for the national defense and development of its foreign and domestic commerce that the United States shall have a merchant marine (a) sufficient to carry its domestic waterborne commerce and a substantial portion of the waterborne export and import foreign commerce of the United States and to provide shipping service essential for maintaining the flow of such domestic and foreign waterborne commerce at all times, (b) capable of serving as a naval and military auxiliary in time of war or national emergency, (c) owned and operated under the U.S.-flag by citizens of the United States insofar as maybe practicable, (d) composed of the best-equipped, safest, and most suitable types of vessels, constructed in the United States and manned with a trained and efficient citizen personnel, and (e) supplemented by efficient facilities for shipbuilding and ship repair.

To implement this policy, direct construction and operating subsidy programs, based on U.S./foreign cost differentials, were established through the CDS and ODS programs. Direct cash payments from the Federal Government were to be provided to qualified applicants to defray the higher costs of shipbuilding and operation in the United States. The law required that subsidized vessels be manned 100 percent by U.S. citizens, while on nonsubsidized vessels the licensed crew had to be 100 per-

cent U.S. citizens, and the nonlicensed crew 75 percent U.S. citizens.

Since the analysis was written in 1979, IMO has imposed additional safety standards that may minimize the cost differences further.

It appears that what was once perceived as a major competitive detriment for U.S.-flag carriers is being resolved. However, most of the safety requirements imposed by the U.S. Coast Guard are based on statutory law, and if any changes to the existing requirements are needed, they must be made through legislation.

An integral part of the ODS program was the concept of essential trade routes. Subsidy was provided only for vessels operating on assigned routes and observing assigned minimum and maximum sailings in services determined to be essential to the promotion of U.S. foreign commerce, regardless of whether these routes were profitable to the lines.

The 1936 Act also included a variety of other eligibility, monitoring, and reporting requirements as a condition for receiving subsidy. These consisted mainly of requirements of corporate financial disclosure, as well as domestic trading activities, foreign shipownership, and other facts relevant to subsidy eligibility. Another provision precluded payment of subsidy in support of any service in competition with another U.S. carrier except in cases where service inadequacy could be demonstrated.

In addition to the direct subsidy aids provided under the CDS and ODS programs, the act also included two indirect assistance programs. First, earnings placed in Capital Reserve Funds (annual contributions were required) for new vessel construction were relieved of income tax liability and could therefore be used to reduce taxation. Second, the Government's lending program for ship construction, which had previously existed, was reactivated. Today, the mechanism used is not direct Government lending but Government guarantee

of commercially placed loans. This authority, contained in title XI, was added in 1938.

A variety of defense and security provisions also were incorporated. Subsidized vessel designs were to be submitted to the U.S. Navy. Any noncommercial design features recommended by the U.S. Navy were to be paid for by the U.S. Government. Subsidized ships were subject to Government repurchase, and provision was made for Government requisition of privately owned merchant ships under emergency conditions. Finally, MarAd was required to undertake an annual survey of U.S. shipbuilding capacity with the U.S. Navy to assure the adequacy of the shipbuilding mobilization base.

In the late 1960's, a comprehensive overhaul of the Merchant Marine Act was planned, and on October 21, 1970, the President signed into law amendments to the 1936 Act, known as the Merchant Marine Act of 1970. In general, it was a reaffirmation of the national policy of Federal support for the merchant marine. The fundamental policies remained the same, although several program adjustments were made in the interest of increasing effectiveness of the program. A specific pledge of Government support for a 10-year, 300-ship construction program was made.

Authorization was made for payment of CDS directly to yards, rather than to ship purchasers only.<sup>15</sup> This was intended to encourage greater shipyard participation in vessel design. It was hoped that this would lead to greater shipyard productivity.

Negotiated contracts between shipyard and purchaser were allowed for the first time. Previously, competitive bidding was required. It was hoped that shipbuilding costs would be reduced by eliminating expenses associated with bid preparation and that yards would be encouraged to develop standard market designs.

Declining CDS rates (i. e., subsidy as a percentage of total cost) were imposed as objectives for all CDS awards. The goals were a 45-percent CDS rate in fiscal year 1971 with a reduction in the ceiling of 2 percentage points a year until a level of 35 percent was reached in fiscal year 1976. These

<sup>15</sup>*U.S. Ocean Policy in the 1970's: Status and Issues* (Washington, D.C.: U.S. Department of Commerce, October 1978), p. V-38.

rates were required for negotiated contracts, while the Secretary of Commerce could waive them in competitively bid contracts.

A major innovation was the attempt to encourage the construction and operation of bulk carriers. Although CDS construction of bulkships had been authorized since 1952, no bulk vessels had been built with subsidy as of 1970. The major change was that bulkships could be granted ODS. Also, subsidy-eligibility restrictions pertaining to U.S. owners who also owned foreign-flag vessels were liberalized to allow bulk operators to replace foreign tonnage with new U.S. ships within a specified period. Also, restrictions on foreign-to-foreign trading were liberalized for subsidized bulkships because of the differences between liner and bulk operations.

The 1970 Act also revised the wage-subsidy provision of the 1936 Act to minimize operating subsidy and encourage collective bargaining. A wage index was developed, and wage increases in excess of those allowed by the index were not subsidizable.

The 1970 Act extended eligibility to establish tax-deferred Capital Construction Funds (CCF) to most U.S. operators, including nonsubsidized carriers. Previously, only ODS recipients had been eligible. Although operators could make use of CCFs, tax-deferred funds could be withdrawn only for construction or reconstruction of vessels in U.S. shipyards for deployment in U.S. foreign commerce, the Great Lakes trades, noncontiguous domestic trades, or fisheries.

The only other major provision was raising the title XI guarantee ceiling from \$1 billion to \$3 billion. Subsequently, it has been raised several times, most recently to \$12 billion.

The 1970 Act was not successful in achieving fleet growth. Rather than 300 ships built under the CDS program as envisioned in 1970, 80 were built, with another 56 converted or reconstructed with CDS funding.

CDS and ODS were intended to close the gap between U.S. and foreign costs. In the recent past, they have not been able to accomplish this. After a propitious start in the early 1970's, when CDS rates on average did fall to the 35 percent goal, rates began to rise again (reflecting both the U.S. inflation rate and the depressed state of the industry

worldwide). As pointed out previously, even a 50-percent rate—the highest level allowed by law—is insufficient to close the current differential. (A rate closer to 65 to 70 percent would be required based on some recently quoted foreign construction prices.)

On the operating cost side, the wage index system, implemented by the 1970 Act in an effort to reduce costs and encourage efficiency, has meant that wage differentials are not covered totally. Further, maintenance and repairs have not been routinely included in recent ODS contracts. Finally, fuel cost, which increased dramatically in the late 1970's to the point where it is a large percentage of total operating cost, is not a subsidizable expense.

Thus, despite substantial expenditures, CDS and ODS have not made the U.S. foreign-trade fleet competitive. Table 40 shows outlays for the two programs over time.

Shortly after the present administration took office, an interagency task force was set up to examine current maritime policies and to make specific rec-

ommendations for changes. The first major step was the curtailment initially and then the cutoff of CDS funding. For fiscal year 1982, no CDS funds were requested (\$49.5 million in carryover funds were made available), compared with an average annual request of \$132 million in the previous 4 years. It was announced that this was intended as a phasing out of the CDS program and that in the future no funding would be made available. Temporary authority (for 1 year) was granted for the building of subsidized vessels abroad.

On May 20, 1982, Secretary of Transportation Drew Lewis announced the initial elements of a new program. He stated the administration's intent to honor existing ODS contracts, and other matters (see app. A). At this time he also announced that the administration would seek support of an extension of temporary authority for subsidized U. S.-flag operators to construct or acquire vessels outside the United States and still receive ODS.

In August 1982, the Secretary of Transportation again stated that the Government would honor existing ODS contracts, but that no new contracts

**Table 40.—Maritime Subsidy Outlays—1936-60**

Fiscal year	CDS	Reconstruction subsidy	Total	ODS	Total ODS and CDS
1936-55	\$ 248,320,942 <sup>a</sup>	\$ 3,286,688	\$ 251,607,830	\$ 341,109,987	\$ 592,717,817
195W0	129,806,005	34,881,409	164,687,414	644,115,146	808,802,560
1961	100,145,654	1,215,432	101,361,086	150,142,575	251,503,661
1962	134,552,647	4,160,591	138,713,238	181,918,756	320,631,994
1963	89,235,895	4,181,314	93,417,209	220,676,665	314,093,894
1964	76,608,323	1,665,087	78,273,410	203,036,844	281,310,254
1965	86,096,872	38,138	86,135,010	213,334,409	299,469,419
1966	69,446,510	2,571,566	72,018,076	186,628,357	258,646,433
1967	80,155,452	932,114	81,087,566	175,631,860	256,719,426
1968	95,989,586	96,707	96,086,293	200,129,670	296,215,963
1969	93,952,649	57,329	94,010,178	194,702,569	288,712,747
1970	73,528,904	21,723,343	95,252,247	205,731,711	300,983,958
1971	107,637,353	27,450,968	135,088,321	268,021,097	403,109,418
1972	111,950,403	29,748,076	141,698,479	235,666,821	377,365,300
1973	168,183,937	17,384,604	185,568,541	226,710,926	412,279,467
1974	185,060,501	13,844,951	198,905,452	257,919,080	456,814,532
1975	237,895,092	1,900,571	239,795,663	243,152,340	482,948,003
1976 <sup>b</sup>	233,826,424	9,886,024	243,712,448	386,433,994	630,146,442
1977	203,479,571	15,052,072	218,531,643	343,875,521	562,407,164
1978	148,690,842	7,318,705	156,009,547	303,193,575	459,203,122
1979	198,518,437	2,258,492	200,776,929	300,521,683	501,298,612
1980	262,727,122	2,352,744	265,079,866	341,368,236	606,448,102
Total	\$3,135,809,321	\$202,007,125	\$3,337,816,446 <sup>c</sup>	\$5,824,021,842	\$9,161,838,288

<sup>a</sup>Includes \$131.5 million CDS adjustments covering the World War II period, \$105.8 million equivalent to CDS allowances which were made in connection with the Mariner Ship Construction Program, and \$10.8 million for CDS in fiscal years 1954 and 1955.

<sup>b</sup>Includes totals for fiscal year 1978 and the transition quarter ending Sept. 30, 1978.

<sup>c</sup>Includes approximately \$26 million in CDS outlays repaid to the Federal Government as of Sept. 30, 1980. Nearly \$25.3 million of this total represents subsidy granted in the construction of the tanker *Stuyvesant*.

SOURCE: U.S. Maritime Administration 7960 Annual Report (Washington, D. C.: Maritime Administration, U.S. Department of Commerce, July 1961), p. 61.

would be signed, and that the fiscal year 1982-83 moratorium on new CDS contracts would be continued.

Maritime subsidy policy clearly has been changed drastically through budgetary reductions and temporary legislative authority over the past 2 years. Strong industry opposition, especially by the shipbuilders, has occurred while U.S. liner operators, who could benefit from build-foreign provisions, have applauded the changes. Legislation has been introduced to restore construction subsidy funds for support of the U.S. shipbuilding industry, and the debate undoubtedly will continue.

In 1982, one subsidized operator, U.S. Lines, and the U.S. Government negotiated the termination of an ODS contract on some ships in return for a short-term ODS contract on other ships. Since then, other ODS operators have expressed interest in so-called "subsidy buy-outs" or the termination of their ODS contracts in return for a lump sum payment. One application was filed but later rejected by MarAd in early 1983. While the present administration has considered such a buy-out program as one method to use to phase out operational subsidies, and DOT has considered the development of guidelines, no policy on this subject had been announced as of September 1983.

It appears that after 45 years, the U.S. maritime subsidy program will soon end. Many argue that new policies are needed to take its place, but none that has been proposed has broad support. Prospects for shipbuilders and ship operators who have depended on the subsidy program are unclear. Most industry spokesmen would like to see future maritime policies include some new forms of industry support, such as indirect incentives designed to promote U.S.-flag shipping and U.S. shipbuilding. Unsubsidized U.S. competition with the rest of the world in a free and open market system is a worthy goal but does not appear feasible for our maritime industries under any likely future scenario, particularly in light of both direct and indirect subsidies provided foreign builders and operators by their governments.

#### Ship Financing Guarantees

The Federal Ship Financing Guarantee program was established in 1938 pursuant to title XI of the

Merchant Marine Act of 1936. It provides for a full faith and credit loan guarantee by the U.S. Government. Prior to the 1970's, the program grew only moderately, and at the end of fiscal year 1970 there were only \$1 billion in contracts in force.

The program was overhauled in 1972 and is now a financing guarantee program (rather than a mortgage insurance program) under which the Government guarantees shipbuilding obligations sold to investors. Such guarantees may be provided by the Federal Government covering up to 75 percent of the construction cost of vessels built with CDS assistance, and 87.5 percent of the construction cost of nonsubsidized vessels. Vessels to be used in both the foreign and domestic trades are eligible for title XI aid. They must be U.S.-flag and built in U.S. shipyards. Cargo, passenger, and **cornbkat**ion ships, tankers, tugs, towboats, barges, dredges, fishing vessels, floating drydocks, and oceanographic research and pollution-abatement vessels are all eligible. In addition, mobile offshore drilling rigs have been interpreted by MarAd as eligible, although recently the administration has sought to curb use of the authority for rigs.

The importance of the program can be seen by the amount of commercial shipbuilding using the program (see table 41). The percentage of commercial shipbuilding and conversion work financed through title XI increased from 16 percent in 1970 to 63 percent in 1981.

**Table 41.—U.S. Shipyard Orders, 1970-81, Financed Under Title XI Program**

Year	Title XI orders	
	Amount (\$ millions)	Percent of total private
1970 . . . . .	\$ 193	16.1
1971 . . . . .	358	29.5
1972 . . . . .	849	55.1
1973 . . . . .	1,241	35.7
1974 . . . . .	1,539	34.3
1975 . . . . .	971	19.3
1976 . . . . .	1,045	25.4
1977 . . . . .	1,198	31.9
1978 . . . . .	552	18.8
1979 . . . . .	1,087	37.0
1980 <sup>a</sup> . . . . .	1,338	42.9
1981 <sup>a</sup> . . . . .	1,350	62.8
Totals . . . . .	\$11,721	32.6

<sup>a</sup>Estimated.

SOURCE Compiled by the U.S. Maritime Administration, Office of Policy and Plans, from MarAd Title XI data and the Shipbuilders Council of America, *Artua/ffeporl*, 1981

Substantial growth in the program has occurred during the past decade. From 1938 to 1970, \$1 billion in guarantees was issued, while between 1970 and 1982, \$10 billion was issued. Among the factors that influenced this expansion were the Merchant Marine Act of 1970, which stimulated tanker and liquefied natural gas (LNG) tanker construction; Alaskan oil trade, which also stimulated tanker construction; and 1972 amendments to title XI, which stimulated inland tug-barge construction.

As of July 1983 the following guarantees were outstanding:

Oceangoing merchant ships . . . . .	\$4.8 billion
Offshore oil rigs . . . . .	1.4 billion
Inland river vessels . . . . .	1.6 billion
Miscellaneous . . . . .	0.2 billion
Total . . . . .	\$8.0 billion

For most of its history, title XI has been non-controversial. It has been self-supporting through fees paid by participants. These fees are placed in the Federal Ship Financing Fund, from which all MarAd operating costs associated with the administration of the program and guarantees, in the event of default, are honored. The program has experienced only 17 defaults since its inception, resulting in a combined pay-out from the fund of \$248.2 million. Of this amount, \$50 million was associated with the 1978 bankruptcy of a subsidized liner operator. Of the \$248.2 million, it is anticipated that \$155 million ultimately will be recovered by the Government.

Recently, the pace of defaults has increased. Thus far, five companies have defaulted in fiscal year 1983, resulting in Fund losses of \$55.7 million. Advances of \$31 million also have been made to 17 companies. As of July 1983, the Ship Financing Fund had assets of \$190 million. It is anticipated that there could be another \$60 million in defaults this year (before any recovery by the Government, which would reduce the exposure substantially). Overall, the risk to the Government could total \$500 million to \$600 million ultimately if all companies currently in shaky financial position were to default.

These facts have caused concern within the administration, and all advances from the Fund must be approved by the Office of Management and Budget.

One current legislative initiative that would reform the title XI program is H.R. 3399 recently introduced by Congressman Biaggi. Under the bill, an Industrial Redevelopment Bank would be established. The Bank would handle financing, co-financing, or refinancing of vessel construction or reconstruction. It would subsume the title XI loan guarantee program but would have considerably broader authority than now exists. The Bank could either invest directly in the form of equity participation or guaranteed loans, or indirectly through long-term guarantees of obligations secured by ship mortgages, leases, or stock pledges.

In addition to financing vessel acquisition, the Bank would have authority to contract directly for the construction or reconstruction of vessels in U.S. yards. This authority is pursuant to the provisions of Title VII of the Merchant Marine Act—the ‘build and charter’ authority.

Provisions of the bill would encourage construction of generic vessels in series production and increased shipyard efficiency. A primary element of the Bank's responsibility would be to allow for the domestic production of replacement vessels in the U.S. liner fleet that would be suitable for national defense support. Some provision would be available for foreign construction of subsidized vessels, but such permission would be restricted in order to protect the shipyard mobilization base. The Bank would have authority to set up R&D consortia with private sector participants who would be eligible for substantial tax benefits.

The Bank would be provided with a \$2-billion line of credit (\$1 billion in direct guaranteed loans and \$1 billion in revolving authority in the form of interim construction financing); it also would have \$2 billion in investment guarantee authority through the restructuring of existing credit programs.

Eventually, the responsibilities of the Bank would be turned over to the private sector. Initially, Federal seed money would be provided. A sunset provision in the bill would, after 10 years, either dissolve the Bank or sell it to financial institutions, export trading companies, or union pension funds. This proposal probably will be debated in the coming months as a promising alternative to direct subsidy programs.

## MARITIME REGULATORY POLICY

It may be possible to enhance competition in certain segments of the industry if the U. S. Government focuses attention on enabling the U.S. shipping industry to operate in a regulatory framework similar to that of foreign operators. Along those lines, a bill to amend the Shipping Act of 1916 (regulating liner operations) has been passed by the Senate and was pending in the House as of September 1983. As passed by the Senate and introduced in the House, this bill contains almost the same provisions as similar proposed legislation which has been debated in Congress for at least 4 years. The bill's passage is also supported by the administration.

FMC is the Government agency charged with oversight of U.S. shipping regulations. The basis for U.S. regulatory policy on shipping is the Shipping Act of 1916 as amended. The act imposes strict requirements on the competitive practices of all ocean common carriers in both foreign and domestic commerce while permitting approved antitrust immunities to shipping conferences. Prior Government acquiescence is required for all anticompetitive conference agreements, such as rate-setting, pooling agreements, or interconference agreements. Conferences in U.S. trades are required to be open to any carrier that wishes to join.

A number of practices are prohibited. One concerns the giving of deferred rebates, a practice whereby ship operators agree to return a portion of the total freight paid for services in an earlier period to a "loyal" shipper who has shipped all of his cargoes with the carrier or conference in question. This practice is common in foreign conferences. A second prohibited practice is the use of "fighting ships, whereby a carrier or conference sets one or more ships, operating at extremely low or predatory rates, in head-to-head competition with a competitor in order to drive the competitor out of the trade. Losses on the operation of fighting ships are shared by all members of the conference. A third practice outlawed is discrimination against shippers as punishment for nonpatronage. Section 14 of the Shipping Act included a more general pro-

hibition against unjust or unfair discrimination among shippers. All common carriers must offer their services on equal terms to all shippers.

The Shipping Act was revised substantially in 1961 with the passage of Public Law 87-346. Section 14 was amended to allow approved loyalty agreements in the form of dual-rate contracts, with the following limitations: penalties that could be imposed on shippers for contract violation were limited to single damages, and the maximum exclusive patronage discount was set at 15 percent.

Section 15 also was amended to restrict the conferences' ability to control membership. Previously, any conference agreement could be disapproved if it was considered unjustly discriminatory or unfair among carriers. Public Law 87-346 specified that agreements could be approved only if they allowed open access to all carriers which could and would provide regular liner service on a given trade.

Carrier agreements also could be disapproved if found to be "contrary to the public interest." Subsequent case law, affirmed by the courts, required carriers to "bring forth such facts as would demonstrate" that the agreement was required by a serious transportation need, necessary to secure important public benefits, or in furtherance of a valid regulatory purpose of the Shipping Act. The principle, known as the Svenska test, after the FMC case of that name, is considered by carriers as a major impediment to conference approval, primarily because it is difficult to define the concept of "public interest"—therefore, application (i. e., approval of agreements by FMC) is uneven and unpredictable. Pending legislation (the Shipping Act of 1983) would eliminate this "public interest" standard in most versions, but the House Judiciary Committee has favored retaining the standard.

Conferences in the U.S. trades are substantially weaker than their foreign counterparts. Members must receive FMC approval to organize pools, rationalize service, and limit sailings. They cannot limit membership, and they cannot encourage shipper loyalty through such mechanisms as deferred rebates. Independent operators can easily enter U.S. liner trades. A conference's inability to control access to the trades, whether within or outside

<sup>16</sup>See "The Difficulty of Introducing Meaningful U.S. Maritime Legislation, by Paul Richardson, October 1980.

the conference structure, means that attempts to rationalize service—even if approved by FMC—are likely to be unsuccessful. The U.S. trades suffer from chronic overcapacity. Rate wars have occurred in both the North Atlantic and Pacific trades recently. These are devastating to the weaker, high-cost conference members (which tend to be U.S. flag).

U.S. carriers also face a more significant problem than do foreign carriers in the same trades because, while theoretically all of the restrictions apply equally to all conference members, it is easier for FMC and the Department of Justice to monitor the actions of U. S. carriers, whose financial statements and business practices are open to close scrutiny.

The open conference system, as it exists in U.S. trades, is an anomaly in world shipping. The industry is constrained by Government regulation which forces on it some, but not all, aspects of competition. Conferences set rates and schedule services. But any joint planning must be approved by FMC, and direct negotiation with shippers' groups does not have antitrust immunity. Overtonnaging has detrimental effects, such as an increase in unit costs resulting in higher rates.

There are two economic alternatives to the current situation. Debate on the merits of each has continued for years, both inside and outside the Federal Government. One is price competition. Under ideal conditions, price competition would reduce prices, remove excess capacity, and create a healthier business climate for firms remaining in the industry. Each firm would determine its profit-maximizing level of output and produce accordingly. Because demand would not be sufficient to support all carriers currently operating, carriers would have to reduce prices and operate at higher capacity levels to minimize or eliminate short-run losses. Inefficient and financially weak firms would be forced out of the industry.

A study by the Department of Justice in 1977<sup>17</sup> concluded that the Nation would benefit from a more competitive environment in ocean-liner shipping markets and recommended repeal of, or

<sup>17</sup> "The Regulated Ocean Shipping Industry," a report of the U.S. Department of Justice, January 1977.

amendment to, the 1916 Shipping Act to increase competition. This philosophy also has been espoused by some opponents to the present proposed legislation who claim that the 1983 Shipping Act Amendments are inconsistent with the trend toward deregulation.

It is not clear that shipping competition could be achieved easily. Significant barriers do exist and would continue. These include the major capital requirement to enter shipping, high fixed costs, worldwide cargo-reservation schemes, and product differentiation. On a practical level, achievement of such competition could result in decimation of the U.S.-flag fleet because many foreign carriers continue to receive direct and indirect subsidies as well as antitrust immunities which could carry over into their U.S. operations.

At the other regulatory policy extreme is the closed conference system combined with the elimination of independent carriers, thus effectively closing the trades. The economic argument for permitting closed conferences is that they could rationalize trade, reducing the misallocation of resources and ending costly service competition. Excess tonnage would be reduced. The result, however, likely would be higher freight rates. The degree to which a conference would face outside competition would determine how much control it would have over rates. Given a choice between reducing costs to increase profits and raising rates to accomplish the same goal, there might not be sufficient incentive to do the former. Shippers, and ultimately consumers, would be the probable victims under such a system. A survey of shippers taken by the General Accounting Office (GAO) indicated that shippers believe the highest liner rates and greatest decline in service quality would result under a closed conference system (the other choices were open competition, restricted conference, and "other").

Changes in U.S. regulation of ocean-liner operations in the U.S. foreign trades are being considered in the proposed Shipping Act of 1983, which would

<sup>18</sup>Testimony on S. 47 by Allen Ferguson, Chairman of the National Institute of Economics and Law, before the Senate Commerce Committee, 1983.

<sup>19</sup>*Changes in Federal Maritime Regulation & Increase Efficiency and Reduce Costs in the Ocean Liner Shipping Industry*, Report—GAO/PAD-82-11 (Washington, D. C.: U.S. Government Accounting Office, July 1982), pp. 20-21.

replace the existing regulatory framework under the Shipping Act of 1916. The proposed legislation retains the open conference system for U.S. trades but clarifies and strengthens the carriers' immunity from U.S. domestic antitrust laws.

U.S. liner operators in international trades contend they have been at a disadvantage relative to their foreign competitors due to U.S. regulation of the industry. While in theory all operators in the U.S. foreign trades are subject to regulation under the Shipping Act 1916, foreign operators in many instances are, in effect, beyond the reach of U.S. regulatory and judicial control. The intent of the proposed Shipping Act of 1983 is to provide a more equitable regulatory environment for the U.S. operators by limiting their exposure to U.S. antitrust laws.

The legislation now being considered in Congress is based on a compromise achieved during the 97th Congress between the interests of ocean carriers and shippers. Under the compromise, carriers would be assured that agreements to form conferences, set rates, and rationalize service within the conference framework, which were effective under the new act, would be immune from U.S. domestic antitrust laws. To balance the strengthened conferences that would result, provisions were included to stimulate competition, such as the mandatory right of conference members to set rates independently under certain conditions and the authorization of loyalty and service contracts which could provide lower rates and improved service for certain shippers. While the proposed legislation explicitly expands the scope of agreements that may be formed only by including intermodal activities, the removal of the threat of penalty under antitrust laws would, in effect, give the carriers freedom to form stronger agreements,

In the compromise package, the greater certainty of antitrust immunity was to be provided primarily through two major regulatory changes. The first would be the removal of general competitive standards of review historically used by FMC in approving liner conference agreements. Instead, prohibited acts would be clearly specified. Potential violations of the act would be limited to those listed pro-

hibitions, and agreements would not be exposed to subjective interpretations of broad 'public interest' criteria.

As of September 1983, amendments to the proposed legislation by the House Judiciary Committee would weaken the antitrust immunity envisioned in the original compromise proposal by retaining a general standard of review to be used by FMC in addition to the specified prohibited actions.

The second element of certainty would be the consolidation of jurisdiction over ocean-liner shipping activities in FMC, subject solely to the Shipping Act. Agreements that become effective under the act would not be subject to review or penalties by other Government agencies, notably the Department of Justice. Similarly, agreements or conduct which were found to be in violation of the act would be subject to suspension, modification, or penalties only by order of FMC.

Additional substantive changes made by the House Judiciary Committee include the expiration of the antitrust immunity conferred by the bill 2 years after the study commission (on Deregulation of International Ocean Shipping, to be established by the bill) files its report, or December 31, 1988, whichever is earlier, and the elimination of filing and FMC enforcement of tariffs. Most carriers, shippers, and FMC have supported the existing tariff filing requirements, claiming that they enhanced stability and facilitated enforcement of anti-rebating laws. However, others, including the present administration, some large shippers, and the Federal Trade Commission (FTC) oppose tariff filing and enforcement on the grounds that it is unnecessary Government intervention in the marketplace and hampers competitive flexibility in setting rates. Under the Judiciary Committee amendment, carriers still would be required to publish their tariffs in a manner easily accessible to shippers and other interested persons.

The final passage of the Shipping Act of 1983, with or without recent House Judiciary amendments, is not certain. It appears, however, that an acceptable compromise is close.

## U.S. SHIPPING TAXATION POLICIES

An important aspect of U.S. shipping competitiveness versus foreign-flag fleets is this Nation's taxation policies. The following discussion will address the tax rules that apply to the taxation of the shipping income of U.S. domestic and U.S.-owned foreign corporations. The United States generally subjects to tax the worldwide income of a U.S. domestic shipping company even if the income is substantially foreign source income (determined under complex sourcing rules based on property and time spent inside and outside the United States). In most cases, the United States will allow a credit against U.S. tax liability for foreign taxes paid on foreign source shipping income. In general, shipping is treated similarly to other industries, although a few tax benefits are unique to the shipping industry. These tax benefits allow U.S. citizens owning or leasing eligible vessels that are U.S. built to obtain tax benefits through the maintenance of CCF and Construction Reserve Funds (CRF) to be used to construct qualified vessels. These tax-deferral provisions, authorized by the Merchant Marine Act of 1936 as amended are considered by many to be the most important provisions of the act.<sup>20</sup>

If the goal of the U.S. maritime policy is to promote U.S.-flag shipping and to assure fairness for the Nation's shipping industry, then tax policies must be designed to ensure tax parity with other nations. If direct Government subsidies to U. S.-flag ship operators are discontinued, as the present administration proposes, then tax parity with foreign operators takes on added significance. A major reason for the existence of huge fleets owned by U.S. interests and registered in countries such as Liberia and Panama is that those countries offer an exemption of shipping income from taxation.<sup>21</sup> Similarly, other major maritime countries such as Greece and Japan, which are not considered flags of convenience, offer significant tax advantages to shipping when compared to their domestic industries. In fact, many nations consider their in-

ternational shipping as offshore enterprises and provide special tax concessions.

In 1962, Congress specifically exempted U. S.-controlled shipping income when it enacted the so-called "subpart F" provisions amending the Internal Revenue Code. These provisions required that certain types of tax-haven income of foreign subsidiaries of U.S. companies be taxed currently, rather than when the income is distributed to the U.S. parent. The shipping income exclusion from "subpart F" was primarily for national defense reasons. It was believed by Congress that the shipping exclusion would encourage a U. S.-owned (controlled) maritime fleet.

In 1975, to achieve some parity in the taxation of shipping income of U.S. domestic and U. S.-owned foreign corporations, Congress generally ended the "subpart F" exclusion for shipping income except to the extent the shipping income of the foreign subsidiary was timely reinvested into the shipping business. Congress believed that the reinvestment rule was appropriate because of the competitive nature of foreign-flag shipping operations and in order to continue to encourage a significant U.S.-owned (controlled) maritime fleet.

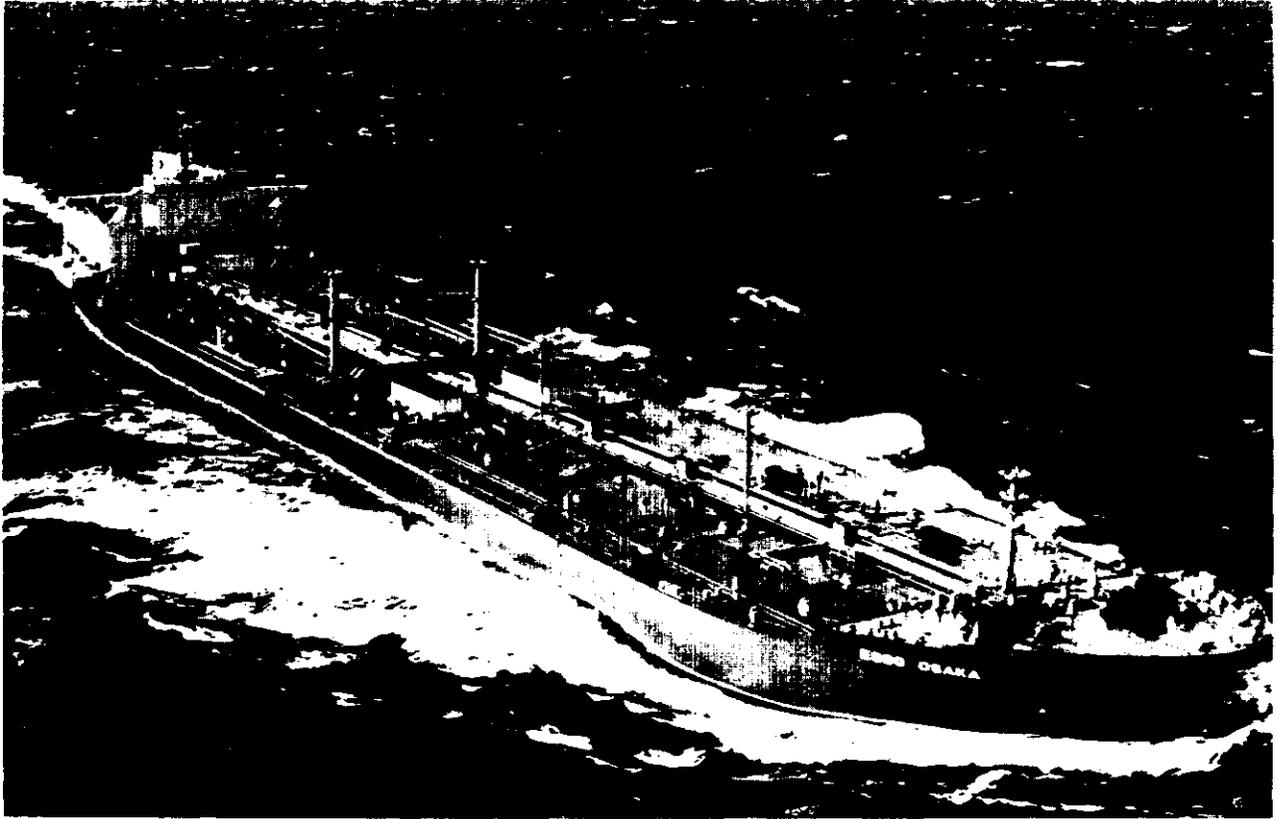
In May 1983, the Internal Revenue Service (IRS) issued final regulations for American stockholders of foreign-based companies that generate shipping income. These regulations amend the Income Tax Regulations and implement the 1975 Tax Reduction Act and 1976 Tax Reform Act. These regulations were first proposed in August 1976. The new regulations state that if less than 90 percent of the earned income is classified as "subpart F" income, all of it is subject to taxation.<sup>22</sup> The previous regulation stated that if more than 70 percent of the income was "subpart F, all of it was considered exempt.

Thus, today, U.S.-owned foreign shipping corporations, such as those "U.S. effective-controlled" fleets under Liberian or Panamanian flag, have available to them a vehicle for deferring taxes on income but only if it is reinvested in shipping

\*James Gallagher, "Maritime Tax: The Capital Construction Fund of the Merchant Marine Act of 1970," *Journal of Maritime Laws and Commerce*, p. 105.

<sup>21</sup>The Council of American-Flag Ship Operators, "Analysis of proposal to Impose Tax on CCF," March 1982.

<sup>22</sup>See *Federal Register*, May 19, 1983, p. 22512.



red

A US d g d d 280 000-dw E w b  
b a ag

and only if at least 90 percent of the corporation's income is from shipping. Some bulk operators of such foreign-flag fleets have claimed that the intent of the 1975 Act—to encourage investment in U.S.-owned ships—has not been realized because investment decisions are based not on deferred taxes but on much more significant market and price factors. Other operators—particularly in the liner trades—believe that such tax benefits are important to the future viability of the industry. These arguments require careful analysis if the overall subjects of tax parity and tax incentives for the ship-operating industry are addressed by Congress.

Certain forms of tax deferrals also have been put into effect as a means of encouraging investment in the U.S.-owned, U.S.-flag fleet. In 1970, Congress adopted a tax measure for the U.S.-flag fleet which instituted the CCF program. This program generally allows U.S. shipping companies to enter

into agreements with MarAd to establish CCFS for the replacement or addition of vessels for use in the U.S.-flag merchant marine. U.S. owners or charterers of U.S.-constructed U.S.-flag vessels operated in the U.S. foreign or domestic commerce can defer taxation of the net earnings derived from such vessels by depositing the earnings into the CCF to provide for replacement or additional vessels to be operated in the U.S. foreign, Great Lakes, or non-contiguous domestic trade. Vessels operated in coastwise or intercostal trade are not qualified. Federal income tax on such earnings (as well as investment income of the CCF) is deferred until the funds are withdrawn from the CCF for a purpose not permitted under the agreement with MarAd. Deposits of tax depreciation of vessels and net proceeds from the sale of vessels also may be made. Theoretically, the tax deferral can continue on income deposited in the CCF as long as the fundholder continues to acquire, construct, or recon-

struct qualified vessels. The tax basis (cost) of a vessel generally is reduced to the extent the vessel is purchased by a qualified withdrawal from a CCF.

The CCF program is authorized by section 607 of the Merchant Marine Act, as amended in 1970. Prior to the 1970 amendment, only subsidized ship operators were eligible for tax-deferred funds, referred to as Capital Reserve Funds and Special Reserve Funds. Today, both subsidized and nonsubsidized operators are eligible for the CCF program, and the old Capital Reserve Fund has been phased out. The CCF program is believed by U.S.-flag operators to be the key element that could place U.S.-flag ships on a tax parity with that of U. S.-owned, foreign-flag ships under "subpart F" of the Internal Revenue Code and foreign-flag, foreign-owned competitors.<sup>23</sup> presently, however, U.S.-flag, foreign-built ships are neither "qualified" for CCF withdrawals nor "eligible" to make CCF deposits.

The CRF is another tax benefit to U.S. shipowners. The CRF is authorized under section 511 of the Merchant Marine Act as amended and allows U.S. shipowners operating vessels in foreign or domestic commerce of the United States to defer the gain attributable to the sale or insurance proceeds from the loss of a vessel. The moneys deposited in the fund must be used to construct, reconstruct, or acquire vessels of U.S. registry built in the United States. Although any gains on these transactions are not recognized for income tax purposes if the deposits are properly expended for a vessel, the basis for determining depreciation of the vessel is reduced by the amount of any such gains. The ability to defer gain on certain transactions through deposits to the CRF applies only to vessel owners.

A comparison of other nations' shipping tax policies is also relevant to gaining an understanding of U.S. shipping tax parity. In Greece, for instance, no tax is levied on shipping income, only a tonnage tax similar to those imposed by Liberia and Panama. In Britain, shipowners are able to shelter current income from taxes by the use of free depreciation (1 year), or by registering in a British colony such as Bermuda or Hong Kong. In Nor-

way, the tax on current income is reduced substantially by a combination of accelerated depreciation and the use of tax-deferred replacement and repair funds. In France, tax deferral results from a combination of accelerated depreciation and the absence of any tax on operations carried on outside the country. Worldwide, most countries impose very little tax, if any, on shipping income.<sup>24</sup>

Recently, DOT outlined proposed changes to the Merchant Marine Act of 1936, necessary to implement a number of the administration's maritime policy initiatives. One major change proposes that existing and newly deposited tax-deferred moneys in the CCF program could be used to acquire, construct, or reconstruct U.S.-flag, foreign-built vessels. This proposal was also proposed and rejected by the 97th Congress in the conference report on the Maritime Administration authorization bill of 1982. This recent proposal will now be considered by Congress in the form of a legislative package.

Another recent proposal also supported by DOT and a similar proposal submitted as H.R. 2381 by Congressman Gene Snyder calls for a repeal of the 50-percent ad valorem duty on foreign parts and repairs made to U.S.-flag vessels abroad. H.R. 2381 differs from the DOT proposal by requiring the 50-percent duty be deleted only for ships that remain away from U.S. ports for 2 or more years. This proposal, as well as the use of CCF moneys to construct or acquire foreign vessels is, as expected, being opposed by U.S. shipbuilders. In a statement on behalf of the Shipbuilders Council of America, President Lee Rice explained, "the efficacy of maritime programs to provide military capability required by this Nation is being eroded by the programs put forth by the administration to allow tax-deferred CCF moneys to be used for foreign building and by the elimination of the Ad Valorem Tariff on foreign repairs." However, for the U.S.-flag vessel operator, these proposals are warmly welcomed, especially in light of the absence of future CDS funds.

Other tax issues affecting the U.S. merchant marine are taxation of vessel lease and lease/purchase and purchase/lease-back agreements. These agreements have become more common as the cap-

<sup>23</sup>*Maritime Subsidies* (Washington, D. C.: U.S. Department of Transportation, Maritime Administration, February 1983), p. 158.

<sup>24</sup>*The Journal of Commerce*, Aug. 10, 1979, p. 1.

ital requirements involved in ship purchasing have soared. Essentially, a financial institution or other organization with ample capital reserves and significant income needing tax shelter becomes the owner of record for a new ship. The vessel is then bareboat chartered to the company or person who actually wants the ship. The operator makes lease payments to the financial institution, which takes advantage of all the tax benefits available, such as interest deductions, and depreciation.

Recently, the U.S. Navy, through MSC, has inaugurated a program to acquire merchant vessels through leasing. These ships, 13 special-purpose RO/ROs under the T-AKX program and 5 product carriers under the T-5 program, will be time-chartered to MSC for a 5-year period with an option for renewal, to a total of 20 to 25 years. The vessel owner of record receives tax benefits through the accelerated cost recovery (ACRS) and investment tax credits (ITC) provisions, while the U.S. Navy receives a favorable long-term lease of the vessels. The issue of whether the Government, through leasing programs such as the U.S. Navy's, is actually losing revenue through less taxes has not been resolved.

More recently, a bill, H.R. 3110, was introduced to revise these tax benefits. The bill, titled the "Governmental Leasing Tax of 1983," would deny certain tax benefits for property used by governments and other tax-exempt entities. Under the bill, the ITC would be denied (as is generally the rule under present law) and ACRS depreciation also would be denied for property used by tax-exempt entities. Therefore, the legislation extends to agreements by foreign governments and corporations to lease American capital goods. This aspect is of concern to the U.S.-flag operators who have often built and chartered vessels to foreign governments and corporations, utilizing these tax benefits. In the past, these tax benefits have been of great

importance to the U.S. bulk fleet, and certain industry spokesmen have urged that the tax concepts in the bill be analyzed further.

Another issue is taxation of offshore wages of crew and staff. In many countries (e. g., Norway), these are treated as personal income derived under a foreign jurisdiction and are not taxed. The resulting savings in crew and staff wage costs (as well as fringe benefits, which are usually a proportion of gross wages) can be as much as 50 percent.

Accelerated depreciation of ships and equipment, and particularly containers, is also an important tax concession granted by many countries. U.S. tax policies for depreciation of ships are based on a 14.5- to 21.5-year depreciation rate for U.S.-flag ships that entered service prior to 1981, and a 5-year depreciation rate for U.S.-flag ships entering service in 1981 and after. Also, the 10-percent ITC is generally permitted with respect to the cost basis of a new investment in a U.S.-flag vessel operated in the U.S. domestic or foreign commerce. In the case of a vessel purchased with CCF funds, Congress has specifically authorized that one-half of the ITC be allowed (notwithstanding the CCF cost-basis reduction rule mentioned earlier). Availability of the other half is subject to dispute by the IRS, which has won and, more often, lost court cases on the issue.

In summary, the major tax provision that provides tax parity to U.S.-flag ship operators is the use of the CCF. Due to the absence of a shipyard CDS program in the United States, it is unlikely that the CCF will be useful in the future unless amended to permit construction of U.S.-flag ships in shipyards abroad. Further study in innovative tax policies is clearly needed to ensure that the existing tax parity of U.S.-flag ship operators with other competitive shipping nations is not eroded.

## CABOTAGE POLICIES

The Merchant Marine Act of 1920, and more specifically section 27 of the Act, is commonly re-

ferred to as the "Jones Act." Basically, section 27 requires that all U.S. domestic trade be carried on

vessels that are under U.S. registry, built in the United States, and manned by U.S. citizens. Specifically, section 27 states:

No merchandise shall be transported by water, or by land and water, . . . between points in the U.S. . . . in any other vessel than a vessel built in and documented under the laws of the U.S. and owned by . . . citizens of the U.S. . . .

Cargo reservation for American domestic shipping was first outlined in 1817 by the First Continental Congress. The First Continental Congress approved the Cabotage Law of 1817 to prevent foreign-flag carriers from entering the American domestic market. This policy has continued unbroken to the present. Over the years, many suggestions to change this policy have been proposed, but they have been largely unsuccessful.<sup>25</sup>

The preamble of the Merchant Marine Act of 1920 states the intent of Congress at that time:

It is necessary for the national defense and for the proper growth of its foreign and domestic commerce that the United States shall have a merchant marine of the best equipped and most suitable types of vessels sufficient to carry the greater portion of its commerce and serve as a naval or military auxiliary in time of war or national emergency, ultimately to be owned and operated privately by citizens of the United States; and it is to be the policy of the United States to do whatever may be necessary to develop and encourage the maintenance of such a merchant *marine* . . . .

#### The Jones Act "Fleet"

The Jones Act "fleet," as it has come to be known, consists of those vessels eligible to engage in domestic trade, whether it be inland waters, coastwise, noncontiguous, or intercostal. Eligible vessels are those built in the United States under American ownership, registered in the United States, and receiving no CDS or ODS from MarAd.

Currently, Jones Act vessels account for slightly under 50 percent of the total number of vessels in the U.S.-flag fleet and approximately 60 percent of the total U.S. deadweight tonnage. As detailed in chapter 3, 94 percent of the tonnage in the ac-

tive Jones Act fleet is in tankers. Tankers used in the transport of Alaskan oil alone constitute almost 30 percent of the active domestic fleet and nearly one-half of the total domestic fleet's deadweight tonnage.

There is no conference system operating in the domestic trade; operations are either independent or on ships owned by corporations for their own business use. The domestic fleet provides liner as well as tramp service and includes bulk carriers, tankers, conventional and containerships, and tug-barge systems.<sup>26</sup>

#### Advent of Alaskan Oil

Shifting trade patterns and a new area for shipping investments followed the production of large oilfields on the North Slope of Alaska in the mid-1970's. As detailed in chapter 3, by 1978 production from the North Slope reached 1.1 million barrels of oil per day and exceeded the west coast's demand for it. Substantial new tanker tonnage was needed to move the oil to the gulf and east coast markets. During the 1970's, 19 new Jones Act tankers with deadweights in excess of 100,000 tons were built to serve the Alaskan trade. Today, Alaskan oil production has reached 1.6 million barrels per day with projections that production will peak by 1988 and decline through 2000.

It is generally accepted that without future U.S. oil and gas discoveries, a substantial surplus of tankers will exist by 1995. Lease sales followed by exploration drilling in promising Alaska and California areas are scheduled for the next few years and should determine potential production levels. If new oil discoveries in these areas are made, the large market for domestic tankers would improve.

#### Exceptions, Waivers, and Suspensions Allowed Under the Jones Act

Over the years, circumstances have resulted in exceptions and waivers to the Jones Act. Trade with the U.S. island possessions of Guam, Tutuila, Wake, Midway, and Kingman Reef may be carried on foreign-built, U.S.-flag vessels. The U.S. Virgin Islands are exempt from all Jones Act requirements as amended in the Merchant Marine

<sup>25</sup>ZSNACOA, op. cit., p. 35.

<sup>26</sup>Ibid.

Act of 1936. This has been an especially important exemption for the Virgin Islands since the discovery of Alaskan oil. Alaskan crude oil is now shipped to refineries in the Virgin Islands on foreign-flag ships and then to the U.S. mainland, again mostly on foreign-flag vessels, even though U.S.-flag tug-barge units are also employed moving refined products to the U.S. mainland.

Other important exceptions to the act specifically apply to Alaska. These exceptions, currently receiving wide attention, are the third and fourth provisos to section 27. They are discussed in greater detail later in this chapter.

Individual waivers to the Jones Act also have been provided through private bills passed by Congress. In 1978 and 1981, Congress passed bills that permitted two passenger ships built in the United States, the *Independence* and the *Constitution*, to reflag as American ships and reenter the domestic market after having served for awhile under foreign flag.

Suspensions allowed under the Jones Act, although not common, do exist. One suspension, section 506 of the 1936 Act, gives the Secretary of Transportation the power to suspend the Jones Act to allow subsidized U.S.-flag ships, intended for foreign trade, to enter the domestic market for up to 6 months in any 12-month period. In 1980, seven subsidized U.S.-flag tankers received waivers to enter the Alaskan oil trade for up to 6 months. The operators were required to pay back a prorated share of their CDS based on the amount of time spent in the Alaskan trade. Another suspension allows the Secretary of the Treasury to grant a statutory or discretionary waiver for foreign-flag vessels on the basis of national defense needs. The 1936 Act also permits liner vessels receiving ODS to carry domestic cargoes in the Hawaii, Guam, and Puerto Rico trades with very modest payback of the subsidy.

#### Construction Differential Subsidy Payback

A very controversial provision of the Merchant Marine Act of 1936 allows MarAd to permit subsidized vessels built for foreign trades to enter domestic trades permanently, in exchange for the repayment of a vessel's CDS plus accumulated interest. A 1977 MarAd decision permitted the Sea-

train Shipbuilding Corp. to repay the CDS on a new tanker, the *Stuyvesant*, and to enter the domestic oil trade permanently. At the time, the worldwide tanker market had collapsed and there was a need for domestic tankers to transport Alaskan oil. Faced with a possible default by Seatrain on loans with title XI guarantees (amounting to about \$120 million)<sup>27</sup> on two new supertankers, and no likely foreign market for the vessels, MarAd agreed to allow the CDS repayment on one of them, the *Stuyvesant*.

The tanker operators already in service in Alaska sued to prevent this transfer. Under a 1980 Supreme Court ruling (*Seatrain Shipbuilding Corp., et al. v. Shell Oil Co., et al.*), MarAd's decision was upheld. The Court held that the broad authority of the act gave the Secretary the power to further the general goals of the act, making such transfers legal.

The Justice Department's antitrust division, in a review of the case, recently urged Transportation Secretary Dole to adopt changes in maritime subsidy rules and allow the total payback of construction subsidies so that a large group of these vessels could enter domestic trades.

Although a decision by DOT on whether to implement the rule to allow subsidy paybacks is not expected until late 1983, the controversy between both sides grows larger every day. The issues of the controversy have been debated not only among industry groups but within DOT itself. The issues debated include: projections of future Alaskan oil production; levels of risk to the Government from possible title XI loan defaults; levels of direct and indirect subsidies to different sectors; levels of actual shipping costs, as well as hypothetical charter rates; and effects of surplus capacity in various trades.

At present, according to MarAd, there is growing overtonnaging in the domestic tanker fleet. Of 40 Jones Act tankers presently laid up, 28 are expected to be scrapped, and 26 of those employed now are likely scrap candidates because of new tanker-safety requirements. When this occurs, the remaining Jones Act fleet in the Alaskan trade will

<sup>27</sup>See *Federal Register*, Jan. 31, 1983, 'DOT, CDS Repayment Notice of Proposed Rulemaking.

consist of a smaller number of larger and newer ships than is evident from today's data.<sup>28</sup> Therefore, allowing subsidized vessels to enter the domestic trade will have the greatest impact on the remaining portion of the Jones Act fleet, which is independently owned and consists of comparatively large, newer vessels. New tankers could be required in the domestic fleet beyond 1990 if substantial future Alaskan oil prospects are proven. On the other hand, an administration-backed proposal to allow Alaska to export oil would substantially lower even that demand for new Jones Act tankers.

Current Jones Act tanker operators claim they have made huge ship investments on the basis of Jones Act guarantees which would be negated if foreign-trade-subsidized owners were permitted to enter domestic trades. If the larger subsidized tankers are permitted to enter the Alaskan trade, serious overtonnaging would continue at least through the decade. Current Jones Act operators have estimated that one-quarter of the domestic independent tanker fleet is now surplus and that if CDS paybacks are allowed, the entire independent fleet in the Alaskan trade would become surplus.

Some subsidized operators, however, claim that their new, more efficient, tankers would decrease the cost of shipping Alaskan oil to U.S. refineries. They believe that by leaving their subsidized tankers in an idle market the Government may face substantial defaults of federally guaranteed loans.<sup>29</sup> It was because of a pending default on the *Stuyvesant's* mortgage in 1977 that MarAd allowed that tanker to enter the domestic trade. Current Jones Act tanker operators claim, however, that the Government would face even greater prospects of title XI loan defaults if the subsidized tankers enter the trade.

Such a suspension of the Jones Act for subsidized tankers could bring about a short-term lowering of shipping rates. However, overcapacity would be inevitable and would result in a loss of business to owners who built more costly ships for the domestic trade because Federal policies required that ap-

preach. This would result in fewer U.S.-flag ships being operated.

#### Other Proposed Changes to the Jones Act

The advent of Alaskan oil and the passage of a Federal law barring the sale of Alaskan oil in foreign markets are significant factors concerning the status of the U.S. domestic fleet. Many recent proposals to amend the act apply specifically to Alaska. The State of Alaska has a great deal at stake if certain amendments to the act are adopted.

As mentioned earlier, two exceptions to the act, the third and fourth provisos, applying specifically to Alaska, are currently receiving attention. The third proviso was adopted 60 years ago to facilitate the movement of U.S. freight around the Great Lakes area. This provision permits the use of a foreign-flag vessel during a domestic movement if somewhere along the route a Canadian railroad is used. The proviso has been rarely used, and two recent attempts to do so were unsuccessful.

The Alaska Navigation Co. had proposed to take advantage of the third proviso rule. They had hoped to operate two West German-flag ships manned by West German crews between Vancouver, British Columbia, and Seward, Alaska. This application was later withdrawn. The Fairbanks Trucking Service also filed an application which was later rejected by ICC because of deregulation of part of the domestic route. A bill, H.R. 1076, repealing the provision, passed the House in June 1983. Such a repeal would protect U.S.-flag liner operators in the Alaskan trade from foreign-flag competition.

The fourth proviso states that section 27 shall not become effective on the Yukon River until the Alaska Railroad is completed and the Shipping Board finds that proper facilities are provided for transportation by U.S. citizens. In 1977, the Treasury determined that the railroad was completed, but it is up to the Secretary of Transportation to make the finding that would make the proviso inoperative. As of September 1983, the Secretary of Transportation had not made that finding; therefore, in theory, the fourth proviso still exists.

Future proposals to modify the Jones Act will depend on many factors and will be debated widely. In view of strong support for policies inherent in

<sup>28</sup>U.S. Maritime Administration comments on "Draft Regulatory Impact Analysis for CDS Repayment Regulation," June 10, 1983.

<sup>29</sup>Comments submitted by Apex Marine Corp. to the Department of Transportation on proposed rulemaking for CDS repayment, May 2, 1983.

the act, efforts to have it rescinded in the near future may be difficult. In the long run, however, debates about costs and benefits of very restrictive provisions in the Jones Act could serve to clarify the national interest. One change that has been discussed but has not reached any legislative proposal is that of reducing or rescinding 'buy America' requirements. Some in the shipping industry believe that if owners were allowed to build or purchase their domestic trade ships from foreign sources, enough savings could be realized to either reduce freight rates or permit substantial gains for U.S. operators in new markets. U.S. shipyards have strongly opposed such views, but if current policies support unrealistically high capital costs, as claimed, they should be carefully evaluated.

'Buy America' provisions in several U.S. maritime laws and regulations are shown in table 42. It can be seen that the existing requirements for title XI-built vessels (where foreign-built machinery

is prohibited) are somewhat more restrictive than for Jones Act ships built without title XI. However, also as shown, MarAd has proposed changes to some of the title XI prohibitions.

Alternative suggestions to modify Jones Act "buy America" provisions have taken a number of approaches. It would be necessary to accommodate conflicting goals of supporting a U.S. shipyard base while lowering ship capital costs closer to world market levels. It may be possible to do this by providing some level of construction subsidy in combination with incentives for shipyards to improve productivity and freedom to purchase equipment and components from lowest price suppliers worldwide without duty. Some have also proposed applying CCF to Jones Act construction.<sup>30</sup> Another consideration in any proposed changes to Jones Act

<sup>30</sup>See C. Hiltzheimer, statement before House Merchant Marine Subcommittee, hearings on H.R. 3156, July 21, 1983.

**Table 42.—"Buy America" Comparisons**

Integral components of the hull and superstructure (steel, etc.)	Main machinery	Other machinery outfit, etc. (permitted to be foreign)	Percent of vessel cost to be domestic	Definition of vessel cost	Waiver provisions
MarAd Title IF Foreign prohibited	Foreign <sup>a</sup> prohibited	None	100 %	Material, labor, overhead	Yes, except for steel and integral components of hull and superstructure
MarAd Title XP Foreign prohibited	Foreign prohibited	None	100 % <sup>b</sup>	Material, labor, overhead	Yes 1) nonavailability 2) unreasonable delivery
USCG (Jones Act vessels— Unimproved foreign steel plates or shapes permitted)	Foreign permitted	Up to 50% of the cost of foreign items other than integral components of the hull and superstructure	Subject to other limitations	Direct material only. No labor or overhead	None
MarAd Title Xi (proposed) Foreign prohibited	Foreign permitted	Up to 50% of vessel component material cost	Subject to other limitations	Direct material only. No labor or overhead	None

<sup>a</sup>§ 5135 of the Merchant Marine Act, 45 U.S.C. § 1155 (construction differential subsidies).

<sup>b</sup>Not required by statute, but imposed by regulation (46 CFR 298.11)

<sup>c</sup>§ 27 of the Merchant Marine Act, 1920, 46 U.S.C. 863, and Vessel Documentation Act 46 CFR 67.09.

<sup>d</sup>A partial waiver has been granted for slow speed diesels built under license in the United States which incorporate a significant number of foreign components

<sup>e</sup>Vessels covered by title XI financing may incorporate foreign components and materials. However, the value of these components and materials will not be included in the determination of actual-cost title XI financing guarantees.

SOURCE: J. Hotelling, Division of Engineering, Maritime Administration, personal communication, August 1963.

provisions is that existing ship operators have made investment decisions based on assurances that current policy would continue. Modification of those policies could unfairly affect their ability to continue a viable business. However, if changes were made gradually over some reasonable period of time, the industry may be able to plan and adjust without undue hardship. This consideration argues for selective changes such as allowing a limited number of U.S.-subsidized ships or foreign-purchased or foreign-built ships to enter certain trades over set intervals—particularly where demand for shipping is rising.

One trade where Jones Act restrictions have been claimed to be economically detrimental is the Alaskan trade. In a 1982 study for the Alaska Statehood Commission, effects on the Alaskan

<sup>31</sup>Simat, Helliesson, & Eichner, Inc., "The Jones Act and Its Impact on the State of Alaska, Vol. II: Final Report," prepared for the Alaska Statehood Commission, July 1982.

economy of using foreign-flag v. U.S.-flag ships in the Alaskan trade were analyzed. The report estimated that differentials for U.S.-flag v. foreign-flag total shipping costs would range from about 10 percent (in the liner trade with the west coast) to 40 percent (in oil product shipments from west coast refineries). While the study did not analyze possible savings from using foreign-built or purchased U.S.-flag ships v. U.S.-built, U.S.-flag ships, the figures indicate a much lower range of savings for this case (roughly 2 to 10 percent). Whatever the savings, the net effect on the national economy and the maritime industries is much more difficult to evaluate but must be considered when Jones Act modifications are considered.

## SUMMARY

Four key elements of U.S. maritime policy which are subject to current debate have been analyzed above. These are:

- subsidy policy,
- regulatory policy,
- taxation policy, and
- domestic trade restrictions (Jones Act).

In addition, this chapter presented an overall discussion of how present U.S. policies developed over the years, what changes are currently proposed and how future policies should respond to changing future conditions.

Direct-subsidy policies of the past (the CDS and ODS programs) have been aimed at industry promotion and made the assumption that different sectors of the industry (i. e., shipbuilding, liner operators, bulk operators) could be helped by the same medicine. This has not proved to be the case, and the current administration appears to be directing its attention toward support of the liner operators without concurrent attention to shipbuilders or other segments of the industry. Promotion of cer-

tain U.S. liner interests is possible with indirect incentives, and this type of approach appears to be consistent with other administration policies.

Indirect subsidies such as loan guarantees to U.S. operators (the title XI program) appear to have been more successful in promoting investment in modern vessel technologies, produced at competitive prices and covering broad sectors of the maritime industry. Future policies concerning industry support, if in the national interest, should therefore include consideration of which maritime sectors can benefit from each type of promotional effort and how Federal support can encourage high productivity and efficiency.

The resolution of the regulatory policy debate appears to be near with congressional consideration of the Shipping Act of 1983. Passage of some form of regulatory changes are clearly in the interest of the major U.S. liner operators. Proper consideration of U.S. shipper interests and the broader goals of enhancing U.S. trade in the future are equally important, U.S. participation in world mar-

itime trade and shipping likely will depend on how well our regulatory policy both protects the national interests and allows for effective competition internationally.

Taxation policies for U.S. shipping interests also are based on sometimes conflicting goals of providing equivalent advantages to industries that must compete in the international market and of assuring fairness and equity among U. S. businesses. Past taxation policies (e. g., the CCF) have sought to encourage investments in new ships and to strengthen the U.S. merchant marine's competitive position. Future taxation policies require careful analysis of the many approaches available and in use to ensure that targeted industry sectors will receive the benefits.

In the future, certain domestic shipping (Jones Act) policies undoubtedly will be challenged by those who consider that present costs of U.S. domestic shipping should be reduced to the benefit of consumers. Whatever changes are proposed (i. e., allowing foreign construction of Jones Act ships),

certain industry sectors will be affected adversely. Policy makers will need to weigh costs and benefits carefully over the long range, clearly including the national interest involved with maintaining certain parts of the industrial base, such as the shipbuilding base.

Finally, future policy formulation needs a more comprehensive approach. Industry incentives may be possible to devise for most maritime segments without tying subsidies for one to subsidies for another, as in the past. For example, certain taxation incentives and foreign purchase allowances could be devised to apply to shipbuilders and ship operators without necessarily making one dependent on another. Also, incentives probably should be tied to support for the most productive elements of the industry and to the elimination of inefficiencies. Also, the incentives discussed in this chapter should be integrated with other policies, including international trade and cargo policies discussed in chapter 7.