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Cargo Preference: Bitter Pill for the U.S. Public or Pillar of Strength for the U.S Merchant Marine?

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CARGO PREFERENCE:

BITTER PILL FOR THE U.S. PUBLIC

OR

PILLAR OF STRENGTH FOR THE U.S. MERCHANT MARINE?

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"That 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 hereby declared 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, and, insofar as may not be inconsistent with the express provisions of this Act, the United States Shipping Board shall, in the disposition of vessels and shipping property as hereinafter provided, in the making of rules and regulations, and in the administration of the shipping laws keep always in view this purpose and object as the primary end to be obtained."

Section I, Merchant Marine Act of 1920

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I. INTRODUCTION

How important is the U.S. Merchant Marine to the government and people of the United States? How much should be sacrificed in favor of the continued existence of the merchant marine? These are not fair questions because there are no precise "correct" answers, nor need there be any. To put a price tag on the merchant marine is unnecessary, and the pricing process is likely to be unrealistic, incomplete, and subject to widely diverse interpretation. Benefit/cost analyses with dollar cost estimates of various government aid programs have been published, but truly quantifiable total costs and benefits of the merchant marine are virtually impossible to derive at the present due to the lack of sufficient information and inflated or prejudicial reports. What is really important is described concisely in the following:

> "It has been decided that the United States will have a merchant marine. It will be required to operate only expensive or inefficient tonnage, and its consequent high ship and labor costs will be offset by some form of government support. This has been basically a political decision."[1]

Despite great expense and the declining state of our merchant marine industry, there will be considerable support for the idea of maintaining and restoring the U.S. Merchant Marine for some time to come. Realizing this, the question now becomes, "If we are committed to the support of the U.S.

Merchant Marine, how can we make this support effective and the merchant marine more efficient and competitive?" It would be ambitious to treat the entire subject of aid to the merchant marine. This discussion will concentrate on the form of federal aid known as Cargo Preference, as this has become the principal (if not the most costly) form of federal assistance applicable to <u>all</u> U.S. flag vessels.

Leading with a brief discussion of the need for federal aid in general, the background, impact, and prospects for the future of cargo preference will be examined. It will be demonstrated that federal aid, particularly in the form of Cargo Preference, is required to maintain the merchant marine. It will also be demonstrated that federal aid and policy in its present form is not sufficient to promote growth. There needs to be significant improvement in this area if the maritime industry is to become a successful and vital force once again. Though cargo preference comprises only one part of the government's program, it serves to illustrate what is both good and bad about the conditions under which the U.S. Merchant Marine exists.

> "the international political and economic benefits associated with U.S. shipping might not individually warrant federal support...the collective value of these benefits is substantial and represents a major offset against the cost to the Nation of maintaining the essential maritime resource needed for security purposes."[2]

II. IS FEDERAL AID NECESSARY?

Since the United States Merchant Marine was instituted, "the thread of government policy used to strengthen the nation's maritime industries was rarely broken."[3] This continuing assistance by the federal government has occurred for several very logical reasons. Primarily it is understood that, "national defense, development of commerce, and protection of American interests,"[4] are paramount. Of those reasons, the national defense/security role of the merchant marine is generally agreed to be the most tangibly important and in itself may provide sufficient justification for government support.[5]

> "The most compelling justification of a government-supported merchant marine is position as a military auxiliary...the experience of two World Wars and Viet Nam has convinced many observers...of the military value of a merchant marine."[6]

It makes sense that for security purposes and during wartime or national emergency the U.S. would desire to exclusively utilize U.S. flag vessels for the carriage of military and sensitive cargoes. Without a U.S. Merchant Marine, the country would have to depend on the whims of foreign merchants, which would be a ludicrous policy. Even the critics of the merchant marine recognize its inestimable worth as a component of national security.

From an economic viewpoint, the U.S. Merchant Marine does contribute in a small, yet favorable way to the nation's balance of payments. Other claimed benefits include maintenance of a source of employment and the presence of an industrial infrastructure.[7] Overall, the economic argument is weak, but the weakness of the economic argument provides a strong reason <u>for</u> federal support. Due to the inability of the merchant marine to compete on its own and our commitment towards having a merchant marine, the necessity of federal assistance becomes apparent.

"If an American industry is to compete internationally, it must somehow offset the additional costs associated with operating within the U.S. economy."[8] This "offset" comes through federal aid to the merchant marine and may assume various forms (see Table 1). Federal assistance is always costly, but, "In an industry as highly competitive as international shipping, any government that desires to maintain a national flag merchant fleet literally has no option but to adopt some of the...practices."[9] Because the United States Merchant Marine has to trade in an international environment, it is important to understand the nature of that environment.

"International shipping does not operate in a free and open market. It has never done so."[10] Though this fact may seem obvious to most observers, some of the country's policy-makers unbelievably have little knowledge of the extent of this tremendous hurdle which faces U.S. flag vessels. Freedom in the international shipping market is the ideal situations, but is prevented from existing by one or more of the following practices:

TABLE 1

Summary of Major Government Programs 1974

Programs	Body of Enforcement	Recipients	Approximate Annual Cost	Major Purpose or Requirement
Construction Differential Subsidy (CDS) (Title V)	Maritime Subsidy Board-MarAd	All U.S. Citizen U.S. flag vessels in the foreign commerce of the U.S.	$199 million	Up to 50% of cost for competitive bidding contracts, 35% for negotiated contracts
Operating Differential Subsidy (ODS) (Title VI)	Maritime Subsidy MarAd	U.S. flag vessels operating on essential foreign trade routes (liners) since 1970 also bulk carriers	$258 million	Cost parity payments covering differential cost of crew (repair and maintenance until 1975) etc
Mortgage Guarantee (Title XI)	Division of Ship Financing Guarantees-MarAd	All U.S. built vessels (ocean and inland)	Up to 87.5% of actual costs (75% for subsidized) $7 billion 25-year financing program limit (1975)	U.S. construction for U.S. flag vessel operation
Construction Loan Guarantee	Division of Ship Guarantees-MarAd	All U.S. built vessels receiving Title XI		U.S. construction for U.S. flag vessel operation
Cargo Preference	PL-480, Dept of Agriculture, AID, Dept of State, Other government cargoes, various departments such as Defense	All U.S. flag vessels (including subsidized)	$400 million	Government owned and/or financed cargo

continued TABLE 1

Capital Construction Fund (tax exempt)	Internal Revenue Service	All U.S. citizen owners who are qualified operators		No withdrawal except for purposes of ship replacement
Ship Exchange Program	Office of Domestic Shipping-MarAd	All U.S. citizen owners who are qualified operators	$24 million	U.S. built vessels or U.S. flag vessels may be exchanged for others in NDRF
Ship Trade In Program	Office of Domestic Shipping-MarAd	All U.S. citizen owners who are qualified operators	$6 million	Subsidized operators trade in replacement vessel upon delivery of new subsidized ship
Investment Tax Credit	Internal Revenue Service	All U.S. citizen owners who are qualified operators		Investment in new or used ships
Research and Development	Admin for Commercial Development-MarAd	All U.S. maritime industry, most programs now based on cost sharing	$32 million	
Cabotage	Jones Act, MarAd	U.S. flag vessels without subsidy		Restriction of vessels to domestic routes
War Risk Insurance	MarAd (expired 1975)	All vessels in U.S. trade		

Source: U.S. Maritime Administration and Frankel, Ernst G. Regulation and Policies of American Shipping.

"- Subsidies;

- Open and hidden rebates to shippers;

- Shipping discriminations;

- Cargo reservations for national flag ships;

- "Open" and "closed" conferences to regulate freight rates on specific trade routes;

- Rate wars; and

- Bilateral shipping agreements..."[11]

Additionally the appearance of state-owned shipping companies (particularly Eastern Bloc states) has had a profound effect on the flow of trade and the pricing structure of shipping.[12] All maritime nations exert some supportive influence on their own maritime industries, and most forms of aid are more extensive than those espoused by the United States. It seems fair that a country would desire to ensure the success of its own merchant marine. To achieve this success, foreign interests have been furthered by the use of what may be called "discriminatory" practices. From Table 2 it may be seen that Cargo Preference is the most popular type of assistance by maritime nations to their shipping industries. The "favorable impact"[13] that foreign Cargo Preference policies have upon their maritime concerns is appreciable, while, "The U.S. preference laws affect only a small fraction of the nation's commerce."[14]

In this initial discussion the need for federal aid and

TABLE 2

Subsidies and Other Types of Assistance Which Nations Gave to Their Maritime Industries in 1978

Country	Operating	Subsidies Construction	Interest	Low Interest Loans	Loans
Algeria*					
Argentina*	X	X		X	
Australia*	**	X			
Belgium				X	X
Brazil*	X	X		X	
Canada	**	X		X	
Chile*	X				
Colombia					
Cyprus					
Denmark				X	X
Ecudor*					
Egypt, Arab Republic of*					
Finland				X	X
France*	**	X		X	
Garbon*					
Germany, Federal Republic of		X		X	X
Ghana*					
Greece					X
India*				X	
Indonesia*					
Iran*					
Iraq*					
Ireland*		X			
Israel*	X				
Italy*	**	X			X
Japan	**			X	X
Korea, South	***	X		X	X
Kuwait*				X	
Lebanon					
Liberia*					
Libya*					
Malaysia*					X
Mexico*	X				X
Morocco*					

Continued TABLE 2

Country	Operating	Subsidies Construction	Interest	Low Interest Loans	Loans
Netherlands		X	X	X	
New Zealand*					
Nigeria					
Norway	**				X
Pakistan*		X			X
Panama					
Peru*	X	X			X
Philippines*					
Portugal*	X				X
Saudi Arabia					X
Singapore*					
South Africa*		X	X		X
Spain*	X	X			X
Sweden*	**	X			
Switzerland					
Taiwan*					X
Thailand*					
Turkey*					X
United Arab Emirates*					
United Kingdom*	**	X			
United States	X	X			X
Uruguay*					
Venezuela*					
Zaire					

Continued TABLE 2

Country	Tax Benefits	Accelerated Depreciation	Cargo Preference	Cabotage Restrictions	Others
Algeria*			X		
Argentina*			X		X
Australia*		X		X	X
Belgium	X	X			X
Brazil*	X		X	X	X
Canada		X		X	X
Chile*	X		X	X	
Colombia	X		X	X	
Cyprus	X				
Denmark	X	X		X	
Ecuador*			X	X	
Egypt, Arab Republic of*	X		X		
Finland	X	X	X	X	X
France*	X	X	X	X	X
Garbon*			X		
Germany, Federal Republic of	X				X
Ghana*			X		
Greece	X			X	X
India*			X	X	X
Indonesia*			X		
Iran*			X		
Iraq*					
Ireland*	X	X			
Israel*	X		X		X
Italy*	X	X	X	X	X
Japan		X			X
Korea, South	X		X		X
Kuwait*			X		X
Lebanon	X				X
Liberia*					
Libya*					
Malaysia*				X	
Mexico*				X	X
Morocco*			X		
Netherlands*	X	X			X
New Zealand*			X		

Continued TABLE 2

Country	Tax Benefits	Accelerated Depreciation	Cargo Preference	Cabotage Restrictions	Others
Nigeria*			X		
Norway		X			X
Pakistan*	X		X	X	X
Panama			X	X	X
Peru*	X		X	X	X
Philippines*	X		X	X	X
Portugal*			X	X	X
Saudi Arabia			X		X
Singapore	X				X
South Africa*	X		X		X
Spain*	X		X	X	X
Sweden*		X			X
Switzerland					X
Taiwan*	X				X
Thailand*			X		
Turkey*			X		
United Arab Emirates*					
United Kingdom	X				X
United States	X		X		X
Uruguay*	X		X		
Venezuela*			X	X	
Zaire			X		

*State owned shipping lines and/or shipbuilding enterprises whose residual losses are covered by government funds. Complete data are not available for the Soviet and Eastern European communist countries' maritime industries except to note they are owned and tightly controlled by the state, as are those of the People's Republic of China and a number of the developing countries National merchant marines of less than 150,000 gross tons are excluded in this compilation.

**Operating subsidies are granted in the public interest to maintain passenger and/or cargo services to outlying islands. Commercial operation, without subsidy, could not be maintained.

***"Encouragement subsidies" to maritime transportation operating or using Korean flag ships in international trades which contribute to earnings or to conserve foreign currencies.

Source: This chart is based entirely on the data for each country compiled by the Office of International Activities, Maritime Government Printing Office, December 1978, and Heine, Irwin M. The U.S. Maritime Industry in the National Interest.

a strong shipping policy has been highlighted. There is in fact, little disagreement concerning the need for the government's support. What then becomes the issue is the matter of what types of assistance will work for the U.S. Of all forms of federal aid, it is believed that Cargo Preference is the most universally palateable and the most consistent with current trends of the "New Federalism" in U.S. government.

III. THE DEVELOPMENT OF CARGO PREFERENCE

WHAT IS CARGO PREFERENCE?

Cargo Preference is, "a massive system of indirect aid to both the subsidized and non-subsidized operators...it completely supports the operation of the tramp and unsubsidized liner fleets, and the subsidized lines are dependent on it for much of their cargo."[15] Preference cargo is generally government-generated cargo of which a certain percentage is required to move on home flag vessels. There are two types of preference which must be distinguished:

> ROUTE PREFERENCE - preference cargo moving on home flag vessels at internationally competitive rates.
>
> RATE PREFERENCE - preference cargo moving at rates above world market rates.

The history of Cargo Preference in the U.S. is traceable through several key pieces of legislation. This legislation became slightly more extensive as the years went by, but stopped far short of the kind of thorough Cargo Preference practiced by some of the more successful maritime nations. There have been heated debates over the extent and applicability of the Cargo Preference laws which have affected not only the fate of these laws, but the fate of all U.S. maritime legislation in recent years. Cargo Preference re-surfaces as a major issue each time some overhaul of the U.S. maritime policy is considered.

CARGO PREFERENCE LEGISLATION

1904 - Military Transportation Act: "preference to U.S. flag ships in the transportation of supplies for the Army and Navy in direct support of American military establishments overseas."[16]

1934 - Public Resolution 17: "where loans are made to foster exports of agricultural and other products, provision shall be made to carry them exclusively in U.S. flag ships. An exception would be permitted when the Maritime Administration certified to the lending agency that such vessels were not available as to numbers, tonnage capacity, sailing schedule, or at reasonable rates."[17]

1936 - Merchant Marine Act: "created certain classes of preference cargo - U.S. mail (Section 405, since repealed) and federal employees required to travel on U.S. ships (Section 901a)."[18]

1954 - Public Law 480: Agricultural Trade Development and Assistance Act (subsequently amended by Food for Peace Act in 1966), "provides for the overseas shipment of surplus U.S. agricultural commodities under four titles:

Title I - Sales to foreign governments for local currency;

Title II - Famine or other urgent relief assistance;

Title III - (a) Bartering of surplus commodities for strategic materials for U.S. stockpiling programs; and

(b) The Food for Development Program; and

Title IV - Added in 1959, provides long-term credit to friendly foreign nations for purchase of agricultural commodities."[19]

Under this law, the Department of Agriculture, "pays a differential to operators based on the difference between the contract rate and the international rate,"[20] which is more of a direct subsidy.

Public Law 664: The Cargo Preference Act (or 50/50 Act), incorporated as an amendment to the Merchant Marine Act of 1936 and itself amended in 1961, "intended to protect the interests of liner or scheduled service, irregular or tramp shipping, and tanker operations," and provides that, "at least 50 percent of the gross tonnage of certain government-generated cargoes shall be transported on privately-owned U.S. flag commercial vessels."[21]

1970 - Merchant Marine Act: Cargo Preference remained essentially unchanged, but direct subsidies were extended to bulk carrier operations in the hopes of eventually eliminating rate preference. The Administration of the Cargo Preference laws was placed under the Maritime Administration for monitoring and standardization purposes.[23]

1977 - Public Law 95-74: Strategic Petroleum Reserve Program, "50 percent of oil purchased overseas for the program must be shipped on U.S. flag vessels."[24]

THE CARGO PREFERENCE DEBATES

In the period from 1965 to 1970, there was an ongoing battle to formulate government policy in the face of maritime union unrest and the steady decline of the merchant marine. This period was particulary significant in the fate of Cargo Preference. The debates that raged between interested parties were illustrative of the typical bureaucratic policymaking process, and Cargo Preference emerged as a major issue that divided the maritime industry. The debate continues to this day on a different scale.

John Kilgour, in The U.S. Merchant Marine: National Maritime/Policy and Industrial Relations, does an outstanding job of presenting all the aspects of the policy debate occurring during the 1965 to 1970 period. The following discussion of the Cargo Preference degates is condensed from that work and concentrates on the Cargo Preference implications.

KEY PLAYERS IN THE GREAT DEBATE

The Johnson Administration: "pledged to come forward with a program to revitalize the U.S. fleet."[25]

SIU-AMA: The Seafarers' International Union-American Maritime Association, representing the position of the unsubsidized shipping sector. AMA's primary function is lobbying.[26]

NMU-CASL: The National Maritime Union-Committee of American Shipping Lines, representing the position of the subsidized shipping sector. CASL is also a major lobby.[27]

Nicholas Johnson: Maritime Administrator from 1964 to 1966 "with no previous maritime experience."[28]

Alan Boyd: Secretary of Transportation under the Johnson Administration, also with no previous maritime experience.[29]

Andrew Gibson: Maritime Administrator under the Nixon Administration with an intimate knowledge of the maritime industry.[30]

MAC: Maritime Advisory Committee-representing a cross section of labor and industry, formed to deal with policy problems under the Johnson Administration.[31]

IMTF: Interagency Maritime Task Force-representing concerned governments agencies, formed to assist MAC in achieving policy decisions.[32]

The Nixon Administration: promised "remedial measures far more constructive and far more comprehensive than those of his predecessor.[33]

The background to the debate began in 1963 when President Kennedy promised to supply grain to the U.S.S.R. after that country's catastrophic crop failure. The controversy over who would ship the grain precipitated union dissention and a potentially explosive situation. The unions and the industry in general wanted to ensure that they would receive their "fair share" of the grain traffic. To deal with this situation President Johnson ordered the formation of a short-term Grievance Committee and the long-term MAC to create future policy. The Grievance Committee failed largely as a result of its differences with the powerful SIU. MAC was unable to achieve any policy decisions and it soon became apparent that something else was required. The Secretary of Commerce then ordered the formation of the IMTF to "assist" MAC. In fact the IMTF held an almost contrary position to MAC and served more as a stimulus than a cooperative organization. The Maritime Administrator Nicholas Johnson, used the IMTF to further the position of the Administration and encountered vehement opposition from SIU.

The IMTF published a proposal which shocked the maritime industry. In A New National Maritime Policy, the IMTF proposed foreign building and the phasing out of all Cargo Preference. This had several very direct implications. The unsubsidized sector depended almost exclusively on Cargo Preference for its cargo and could not afford to have foreign built ships in competition. As a result, the SIU-AMA contingent shot into action to counter the proposal and to make Nicholas Johnson's position untenable. Actually, it is thought that the IMTF proposal made sense for the subsidized sector although major restructuring would be required for the U.S. Merchant Marine. The prospect of the loss of a large part of the unsubsidized sector and the shake-up of the rest of the industry proved highly distasteful to the industry and its Congressional "mouth-pieces." The MAC, which had been previously inactive, felt obliged to publish its own proposal.

The MAC report, Maritime Policy and Program of the United States, was "designed to generate agreement."[34] What the MAC report proposed was essentially the opposite of the IMTF report, in that only U.S. building would be allowed and only rate preference would be phased out (and that would occur very gradually.) The MAC report was remarkable in that it almost achieved a concensus in the maritime industry, although it did little to propose improvement or changes in U.S. policy.

Nicholas Johnson stood fast on his position, but was fighting against all odds. In his campaign to sell the IMTF proposal, Johnson made many industry enemies and more than a few diplomatic mistakes. Due to intense pressure exerted by the industry and its Congressional friends, Nicholas Johnson was removed as Maritime Administrator. The fight for foreign building was taken up by Johnson's "understudy" and new Secretary of Transportation Alan Boyd.

Boyd's appearance on the scene as a proponent of foreign building marks the emergence of Cargo Preference as the central issue. Boyd proposed foreign building and retention of Cargo Preference. The retention of Cargo Preference was intended to placate SIU-AMA. What occurred as a result of this proposal was the polarization of the two major unions SIU-AMA and NMU-CASL. NMU-CASL favored the proposal because it served their interests with lower cost ships and the ensurance of cargo in the form of Cargo Preference. Unfortunately for Boyd, SIU-AMA was not to be put off by the Cargo Preference concession. Foreign building was still unacceptable to SIU-AMA, and now the union wanted to expand Cargo Preference to commodities such as oil and sugar. SIU-AMA was probably "feeling its oats" believing that it could stall any progress in maritime policy until it obtained its desires. NMU-CASL was becoming increasingly annoyed at the SIU-AMA stand and came out in favor of the elimination of rate preference. This would of course hurt only the SIU-AMA contingent by denying them the higher-than-market rates it depended on for existence. The debate was in full swing with SIU-AMA and NMU-CASL squaring off.

A further complication for SIU-AMA was the Department of Defense's proposition of competitive bidding for cargo. This would leave the higher priced unsubsidized carriers high and dry, while the NMU-CASL factions would be able to price their services at more competitive rates. The SIU-AMA, which had started out on the offensive, was now backed into a corner. To counter the threat of the NMU-CASL and the D.O.D. proposal, SIU-AMA proposed the elimination of the "double subsidy" the practice of subsidized carriers receiving the additional benefits of Cargo Preference. What SIU-AMA wanted was for the carriage of preference cargo by unsubsidized ships alone.

During this controversy, foreign building had been lost as an issue and Cargo Preference had become the overriding concern despite Alan Boyd's futile attempts to impose the foreign building program. Boyd was doomed to failure from the beginning, learning little from the Nicholas Johnson lesson, and was defeated before the Nixon Administration took over.

The Nixon Administration was heralded by considerable optimism for the future of the U.S. Merchant Marine. The Administration had a fairly realistic approach to the problem which was aided by the wise choice of Andrew Gibson as Maritime Administrator. Gibson had a great deal of first-hand knowledge of the industry and was an adept politician. The Nixon Administration was able to pass the Merchant Marine Act of 1970 with Gibson's aid in soothing the feelings of labor and industry. The Merchant Marine Act of 1970 was a compromise in in that it buried the issue of foreign building and put the elimination of rate preference as a long-term goal. The reason the Act was acceptable to SIU-AMA is that Gibson promised that the unsubsidized bulk-trade operators would receive preference for subsidies under the Act's proposed extension of subsidies. The Act was still imperilled by the NMU-CASL/SIU-AMA feud over the "double subsidy" issue. In a deft political move, this issue was sidetracked by referring it to the Maritime Subsidy Board, allowing the Act to pass. Though this ended the period of the debate, the problems of union rivalry and the Cargo Preference issue continue to the present. The "double subsidy" issue was decided in 1975 when a court decision upheld the rule that a vessel receiving Operating Differential Subsidy must carry at least 50% non-preference cargo or experience a proportional reduction in its subsidy.[35]

The most significant aspect of this debate is not the personalities involved or even the period during which it occurred. The important feature of the debate is the atmosphere in which maritime policy was created. The very nature of the relationship between the maritime industry and government has led to the decline of the U.S. Merchant Marine. The intense combat between the different interests represented caused them to forget the true goal of a strong U.S. Merchant Marine which would be of benefit to all. "As long as tunnel-vision lobbying and administrative response continue as the modus operandi for American policymaking, American shipping and shipbuilding will continue to stagnate."[36]

RECENT EVENTS IN CARGO PREFERENCE

Cargo preference has become a popular topic, although the practice has gained a great deal of opposition for reasons explained in the "Impact of Cargo Preference" chapter of this discussion. There are several significant events which illustrate the trends in thinking about Cargo Preference. These events all deal with attempts to expand the applicability of preference laws.

When in 1970 the Maritime Administration was appointed to "keep watch" over Cargo Preference, it could be seen that controversy was in the making. It was thought at the time that the Maritime Administration's interests were linked too closely with the fate of the merchant marine, and that the Maritime Administration would be more likely to try to promote Cargo Preference for purposes of protection. This proved to be true, and the Maritime Administration established a Cargo Preference Control Center to ensure compliance with the laws.[37] This caused problems to say the least, Primarily, the Maritime Administration has no explicit authority over the application of preference programs. Disputes with affected agencies arose as a result of the attempted enforcement of Cargo Preference laws and the lack of clearly defined legal limitations. The Maritime Administration would like to see the Cargo Preference laws applied to their maximum extent, but faces stiff opposition from producers of government-generated cargo who would prefer to use cheaper foreign shipping. The Maritime Administration has done a fair job in the processing of information it receives on preference cargo but is severely limited by other agencies' non-compliance or inability to report statistics.

In 1977 the Carter Administration, in trying to build up the Strategic Petroleum Reserve Program and to counter the threat of the Energy Crisis, proposed increasing Cargo Preference to cover all imported oil under H.R. 1037. The requirement for U.S. flag vessels to carry 9.5 or 30 percent of the imported oil was considered. Both proposals were extremely costly in terms of the differential between U.S. and world market rates. H.R. 1037 was overwhelmingly defeated in Congress and the Strategic Petroleum Reserve program itself was temporarily suspended in 1979. Fueled by this success, opponents of Cargo Preference have become increasingly vocal.

In 1982, H.R. 4627 - a Port Developments bill - had Cargo Preference provisions attached to it that rekindled the old debate over the nature of such provisions. In the fight over the bill, the arguments against Cargo Preference were that it was, "a protectionist wolf cloaked in the sheep's clothing of national defense," and that, "its real purpose was to prop up a sick American maritime industry, which cannot begin to compete with its foreign counterparts."[38] This line of attack on the national security benefits of Cargo Preference has become the party line for opponents of the practice, most of whom have foreign ties or are even foreign lobbies. Domestic opponents such as the Justice Department make the attack on the grounds that such practices are market-disrupting influences and should be subject to repeal under the anti-trust laws. Proponents of Cargo

Preference still maintain that the costs associated with it are justifiable in terms of the "national defense benefits... to be derived."[39]

These events have brought Cargo Preference to a critical point in its development, Now an examination of the real impact of Cargo Preference is required to make a decision that is not emotionally involved or prejudiced by vested interests.

IV. THE IMPACT OF CARGO PREFERENCE

THE EFFECTIVENESS OF FEDERAL AID

It was previously asserted that federal aid to the U.S. Merchant Marine was required to ensure its survival. Judging from the performance of the merchant marine recently, it is obvious that aid has not been as effective as it could have been. Table 3 demonstrates the decline of the carriage of trade by the U.S. flag merchant fleet which has been quite steady. In its current form U.S. maritime policy is, in fact, inhibiting the merchant marine and needs to be restructured considerably. In this chapter, drawbacks of current federal programs will be briefly examined followed by an in-depth discussion of the effectiveness of Cargo Preference.

> "United States maritime policy has effectively kept the U.S. from employing the most economical factors of production..."[40]

> "Despite all the legislation affecting the nation's maritime interests adopted during its 200-year history, the United States still lacks a national cargo policy."[41]

> "Policies have fallen short of the legislative objective of having a U.S. fleet which carries a substantial portion of the U.S. foreign trade and provides an adequate, well-balanced fleet for national defense and national security."[42]

> "A national cargo policy should define clearly what the government could and would do to work with American shippers and U.S. flag lines in order to give preference to U.S. flag ships, providing freight rates and service are at least comparable to those offered by foreign shipping lines."[43]

TABLE 3

U.S. OCEANBORNE FOREIGN TRADE/COMMERCIAL CARGO CARRIED

TONNAGE (Millions)

CALENDAR YEAR	1947	1948	1949	1950	1951	1952	1953	1954	1955
TOTAL TONS	142.2	139.0	133.2	117.5	193.1	187.9	178.0	177.0	226.2
U.S. FLAG TONS	81.9	67.0	60.0	49.7	76.8	64.4	51.7	48.7	53.1
PERCENT OF TOTAL	57.6	48.2	45.2	42.3	39.8	34.3	29.1	27.5	23.5
CALENDAR YEAR	1956	1957	1958	1959	1960	1961	1962	1963	1964
TOTAL TONS	260.1	289.3	253.3	267.0	227.9	272.4	296.8	311.6	332.8
U.S. FLAG TONS	53.9	50.8	30.9	27.1	31.0	26.3	29.6	28.5	30.5
PERCENT OF TOTAL	20.7	17.6	12.2	10.2	11.1	9.7	10.0	9.2	9.2
CALENDAR YEAR	1965	1966	1967	1968	1969	1970	1971	1972	1973
TOTAL TONS	371.3	392.3	387.6	418.6	427.5	473.2	457.4	513.6	631.6
U.S. FLAG TONS	27.7	26.2	20.5	25.0	19.8	25.2	24.4	23.8	39.9
PERCENT OF TOTAL	7.5	6.7	5.3	6.0	4.6	5.3	5.3	4.6	6.3
CALENDAR YEAR	1974	1975	1976	1977	1978	1979	1980		
TOTAL TONS	628.9	615.6	698.8	775.3	775.6	823.1	772.2		
U.S. FLAG TONS	40.9	31.4	33.8	34.8	32.1	35.0	28.2		
PERCENT OF TOTAL	6.5	5.0	4.8	4.5	4.1	4.2	3.7		

Source: U.S. Maritime Administration annual reports.

The lack of policy and well-defined goals has prevented federal aid from succeeding. It is one thing to support the merchant marine by being generous with financial assistance, but if that assistance has no direction or aim it is tantamount to throwing money away. "Easy money" has a way of working against itself in that it, "basically discourages high risk and imaginative operations, and does not include any kind of incentives."[44] If Cargo Preference is to be successful as an aid, it must be consistently practiced in a goal-oriented fashion.

Restrictive regulations provide another reason why the U.S. Merchant Marine cannot hope to compete with foreign shipping. There are so many restrictions and agencies enforcing them that the merchant marine is unable to carry on those very practices which have ensured the growth of the foreign industry. "It is logical that the fewer restraints imposed on such trade, the greater the volume that would be available for movement by oceangoing shipping."[45] True, Cargo Preference is an artificial influence on the free-market system and our domestic laws do not encourage this, but it must be restated that international shipping is not really free.

The major problem that federal aid has caused is the almost complete dependence of the U.S. Merchant Marine on such aid for its existence. It is ironic that in attempting to promote the growth of the maritime industry, federal aid and regulation has had the opposite effect in that, "to the extent that a viable merchant marine is the goal, a fleet dependent upon subsidy, preference, and protection is its antithesis."[46] Unfortunately, in our system of government and with our standards of living, there is virtually no way the U.S. Merchant Marine can exist without federal aid, especially in the form of Cargo Preference.

> "A well-balanced merchant marine and a prosperous innovative maritime industry are considered vital components of U.S. seapower. However, U.S. shipping continues to experience substantially higher operating and capital costs than its foreign competitors. Over a prolonged period this competition has led to a general decline in the capability of the U.S. Merchant Marine. The Congress has attempted to foster development and encourage maintenance of the U.S. Merchant Marine through passage of cargo preference legislation."[47]

THE IMPORTANCE OF CARGO PREFERENCE

> "The cargo preference system is the principal form of federal assistance to the U.S. merchant shipping industry."[48]

In defining Cargo Preference it was stated that the unsubsidized sector of the merchant marine was totally dependent on government-generated cargo while the subsidized sector was dependent for a large part of its cargo, Simply stated, without Cargo Preference the unsubsidized fleet would cease to exist with few exceptions and the subsidized fleet would be seriously hurt. Though preference cargo accounts for only a small fraction of the total volume of all U.S. imports/exports, it accounts for over 80% of outbound U.S. oceanborne cargo shipments.[49]

Due to the size of our merchant marine, the allotted percentage of preference cargo cannot always be carried by U.S. ships. This leaves a rather generous portion of government-generated cargo for foreign vessels.[50] Since, "our cargo preference requirements, unlike those of many other countries, do not affect purely commercial cargoes,"[51] there is still a vast cargo resource. Cargoes which have been affected by Cargo Preference laws are listed in Table 4.

The benefits to be derived from Cargo Preference are essentially the same as those discussed in Chapter II. In Table 5, estimates of benefit/cost figures are presented from 1958 to 1967 which cast a favorable light on the U.S. Merchant Marine. Presently, the benefit/cost ratio is more likely to be closer to unity using the same methodology,

TABLE 4

MAJOR GOVERNMENT-SPONSORED CARGOES

Public Law 664 Cargoes:

Shipper

Action

Board of International Broadcasting

Agency for International Development
- Loans and Grants
- P.L. 480-Title II

Department of Agriculture
- P.L. 480-Title I
- Other Agriculture Programs

Department of Commerce
- Industry and Trade Administration
- Maritime Administration
- Other Agencies

Department of Defense
- Military Assistance Program
- Foreign Military Sales Credit
- Corps of Engineers-NEGEV

Department of Energy
- Bonneville Power Administration
- Strategic Petroleum Reserve

Department of Health and Human Services

Department of the Interior
- Bureau of Reclamation
- Other Agencies

Department of Justice

National Aeronautics and Space Administration

Tennessee Valley Authority

Department of the Treasury
- Chrysler Corporation
- Other Agencies

Department of Transportation
- Federal Highway Administration
- Urban Mass Transportation Administration
- Other Agencies

International Communications Agency

Department of State
- Sinai Support Mission
- Foreign Building Office
- Other Agencies (does not include AID)

Other Agencies

Public Resolution 17 Cargoes:

Export-Import Bank

OTHER AGENCIES (PAST):

Inter-American Development Bank

Peace Corps

General Services Administration

U.S. Information Agency (now I.C.A.)

Drug Enforcement Administration

Ecological Survey

Environmental Protection Agency

Federal Aviation Administration

International Exchange Service

Smithsonian Institution

U.S. Travel Service

Source: Maritime Administration Annual Reports

TABLE 5

Benefit/Cost Analysis of the U.S.
Merchant Marine: 1958-1967
(Dollars in Millions)

	Benefits			Costs*				
Year	Balance of Payments	National Security+	Total	ODS	Rate Preference‡	Ship Exchange Program‡	Total	Net Benefits
1967	$999	$400	$1,399	$216	$68	$64	$348	$1,051
1966	912	400	1,312	199	76	44	319	993
1965	632	400	1,032	185	68	38	291	741
1964	680	400	1,080	204	77	52	333	747
1963	631	400	1,031	192	79	47	318	713
1962	659	400	1,059	178	59	32	269	790
1961	551	400	951	167	50	12	231	720
1960	715	400	1,115	163	54	12	229	886
1959	748	400	1,148	159	37	--	196	952
1958	758	400	1,158	141	31	--	172	986
Total	$7,285	$4,000	$11,285	$1,806	$599	$301	$2,706	$8,579

* CDS has been omitted from costs because it is a subsidy solely to shipyards.

\+ Average per year; does not reflect nonquantifiable "availability" factor.

‡ Indirect subsidies.

Source: Barker, J.R. and Brandwein, Robert. <u>The United States Merchant Marine in National Perspective</u>.

because the costs associated with Cargo Preference are significantly higher now. It is considerably easier to present cost estimates in this case than it is to present estimates for benefits which are largely non-quantifiable. The costs will now be examined so that a means of improving Cargo Preference can be proposed.

COSTS OF CARGO PREFERENCE

Practically all of the costs associated with Cargo Preference come as a result of the practice of rate preference. These costs occur because of the higher-than-world market rates that the unsubsidized merchant fleet is required to charge for its services (about twice the rate foreign flag vessels charge for government-generated cargo.)[52] The U.S. taxpayer, shipper, and consumer end up sharing the burden of the costs of Cargo Preference. These costs are appreciable totalling about $5 billion between 1952 and 1972, making Cargo Preference the most expensive form of federal assistance.[53] In Table 6, Gerald Jantscher's estimates of the costs of Cargo Preference are presented. Table 7 exhibits the breakdown for the Military Sealift Command costs and current figures are added to demonstrate the fact that the price tag for Cargo Preference is getting bigger all the time. Figure 1 illustrates the nature of the growth of the costs of federal aid from 1954 through 1967 with Cargo Preference accounting for the largest portion.

The cost differential caused by rate preference has several undesirable effects. The Department of Defense, by far the largest consumer of U.S. flag shipping,[54] pays approximately twice as much for shipping on unsubsidized vessels as it would pay for foreign shipping.[55] For shipments under P.L. 480, the additional costs for shipping on U.S. vessels are not paid by the foreign buyer, but are in fact absorbed by the shipper, producer, and taxpayer.[56] As a result of this, the general price level for <u>all</u> a producer's goods is likely to increase.[57]

TABLE 6

COST OF CARGO PREFERENCE

Program or Agency	Time Period	Estimate of Cargo Preference Cost
Military Sealift Command	1952 to 1972	$3.8 Billion
Public Law 480, Title I, Food for Peace Sales Program	1955 to June 1971	840.1 Million
Public Law 480, Title II, Food for Peace Donations	1954 to 1972	125.0 Million
Foreign Aid Cargoes--AID Loans and Grants	1948 to 1970	600.0 Million

Source: Jantscher, Gerald R. Bread Upon the Waters: Federal Aids to the Maritime Industries.

TABLE 7

Commerical Payments by Military Sealift Command for Space Aboard Liners and Charter of Vessels, and Imputed Cargo Preference Laws Subsidy, Fiscal Years 1952-72, Plus Calculations for Fiscal Years 1979-82

Millions of Dollars

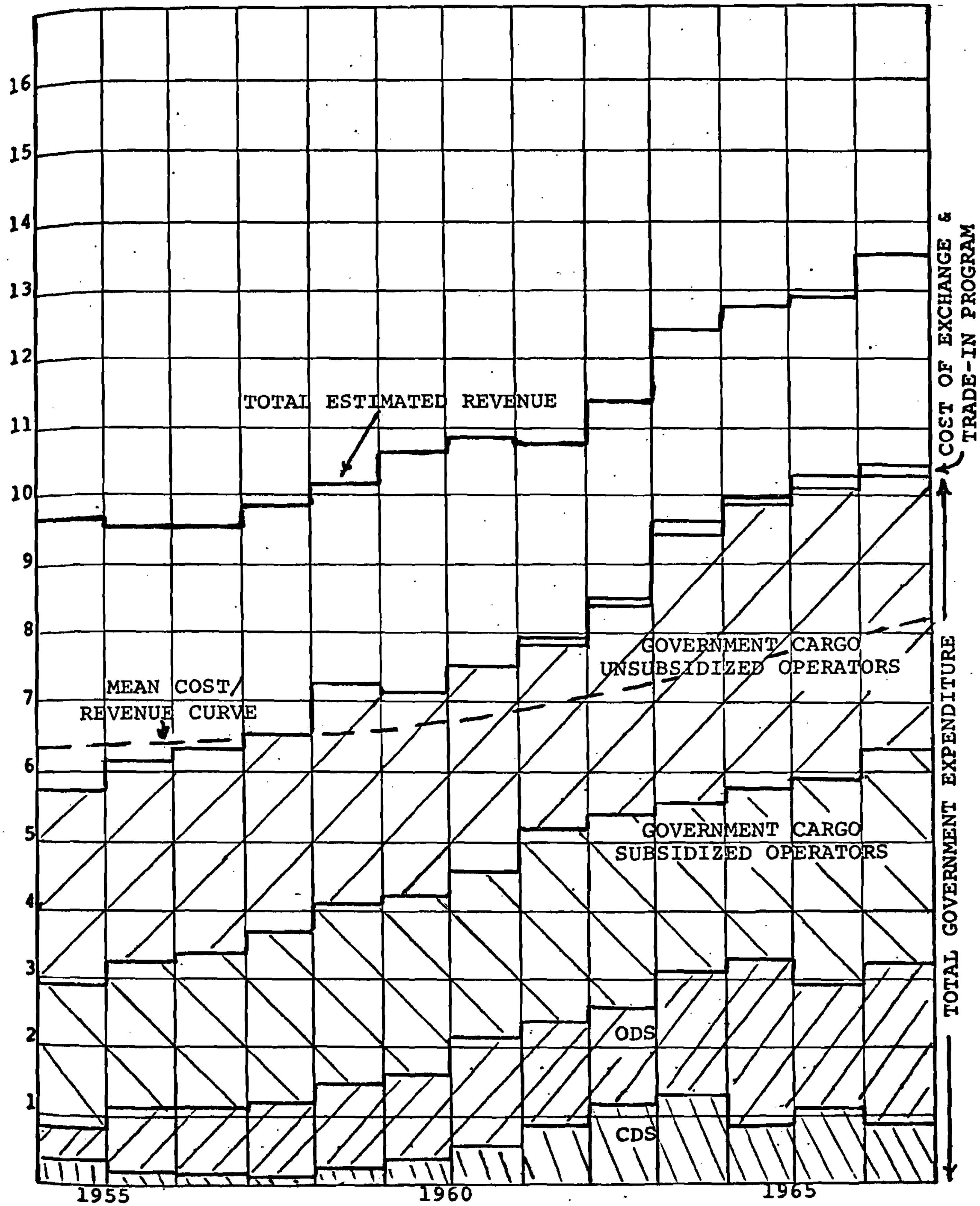
	Commercial Payments			
Fiscal Year	For space aboard liners	For charter of vessels	Total	Imputed subsidy due to cargo preference laws
1952	147.4	250.0	397.4	198.7
1953	172.8	253.8	426.6	213.3
1954	146.5	163.9	310.3	155.2
1955	142.5	66.2	208.7	104.3
1956	150.9	58.7	209.6	104.8
1957	177.6	37.4	215.0	107.5
1958	174.9	43.0	217.8	108.9
1959	179.6	63.1	242.6	121.3
1960	163.0	54.5	217.5	108.7
1961	153.0	61.8	214.8	107.4
1962	189.2	84.3	273.6	136.8
1963	203.2	82.7	285.9	143.0
1964	204.9	88.9	293.8	146.9
1965	202.1	90.1	292.2	146.1
1966	261.8	255.9	517.7	258.9
1967	300.9	371.6	672.5	294.1
1968	317.7	479.3	797.0	341.3
1969	366.1	480.3	846.4	342.7
1970	343.9	435.2	779.1	279.5
1971	306.9	340.9	647.9	201.2
1972	305.4	315.0	620.4	175.8
Total	4,610.2	4,076.4	8,686.7	3,796.3

Source: Jantscher, Gerald R. Bread Upon the Waters: Federal Aids to the Maritime Industries.

Fiscal Year	Total	Imputed Subsidy Using Jantscher's Methodology
1979	817.0	408.5
1980	1,068.3	534.2
1981	1,253.1	626.6
1982	1,433.0	716.5

Source: Defense Transportation Journal, years 1980 thru 1983.

FIGURE 1



Total Government Expenditures

Source: Frankel, Ernest G. Study of the Method, Effectiveness and Potential of Government Subsidy to the U.S. Merchant Marine.

Route preference does have an effect on the costs associated with subsidized shipping that should also be considered. There is no real way of measuring the effects, but it may inferred that the presence of guaranteed cargo for a U.S. member of a liner conference will tend to cause that member to price his services in an oligopolistic or even monopolistic fashion.[58] With Cargo Preference as a backup, the liner conference member can hold out for higher conference rates.

Other less quantifiable costs of Cargo Preference may provide the strongest argument against the practice of rate preference. First and most important is the fact that rate preference provides no incentive for the unsubsidized fleet to modernize or increase productivity. This guarantees an aging and inefficient fleet.[59] Rate preference also tends to cause waste. Because cargo is assured, the demand for space on ships having rate preference is less elastic and all available space might not be utilized.[60] On the other hand, there are simply not enough bulk and tanker vessels left in the unsubsidized sector to carry all of the preference cargo allotted.[61] Perhaps the most shameful waste results as the Military Sealift Command uses less of its chartered vessels in order to support privately-owned and operated shipping.[62] With all of the costs and waste associated with U.S. flag shipping, potential customers-given the option-will logically choose foreign flag shipping. Further, the costs of "shipping American" may influence potential foreign buyers to decide against "buying American."[63]

Given all the costs of Cargo Preference and the limited tangible benefits, how is it possible to defend the practice? Though most of the arguments in favor of Cargo Preference have been discounted, it is impossible to fully discount the value of the U.S. Merchant Marine as a vital element in our national defense. The decline of our country's international stature and economic dominance has gone hand in hand with the decline of the merchant marine. Without Cargo Preference (especially in the form of route preference) the U.S. Merchant Marine would lose its strongest form of support. Cargo Preference could of course use some improvement to ensure that the necessary sacrifice does not become too great.

V. THE FUTURE OF CARGO PREFERENCE

Cargo Preference has been described as a "less politically objectionable"[64] form of federal aid. The costs of Cargo Preference are off-budget costs which, though appreciable, are not as acutely felt as direct subsidies. Most of the rhetoric generated against the practice originates from concerns which have foreign interests excluded from the U.S. preference trade. Clever foreign lobbying and use of this country's own laws and regulations has influenced even domestic concerns to take up the fight against Cargo Preference. Paradoxically, the foreign interests are not about to relinquish their own Cargo Preference provisions. Unlike our own system of government which allows even hostile foreign nations to exert direct pressure through lobbying and other means on our policymaking process, foreign nations do not generally allow other nations to voice their conflicting opinions so effectively.

Recently, the Code of Conduct for Liner Conferences proposed by UNCTAD has forced the U.S. to think in an international way about Cargo Preference. The "cargo sharing" provisions of this code would imply that all but military preference cargo would be eliminated in favor of a more balanced trade.[65] The U.S. does not currently intend to accept the Code, although the Code is really a more favorable form of Cargo Preference for the U.S. in that the 40-40-20 cargo sharing formula covers <u>all</u> cargo including commercial cargoes not covered by our domestic Cargo Preference law. This means that 40% of all liner conference trade between ourselves and another country would be reserved for U.S. flag vessels-which is a great deal more than is currently carried. This would provide an incentive for the U.S. to build more ships and employ more personnel to handle the increased trade. Therefore, the UNCTAD Code is in fact another type of Cargo Preference which could benefit the U.S. Since the U.S. will not become party to the Code, it will have to rely on domestic Cargo Preference laws to protect its interests.

It is likely that the U.S. will not increase the extent of its Cargo Preference laws due to political pressure. For the same reasons, the laws will not be diminished either. Though there are occasional signs of hope, judging from past performance things will change as slowly as before. Nonetheless, proposals to improve our merchant marine are always welcome, though sometimes a bit idealistic.

Proposals for the future of Cargo Preference have included the total or partial elimination of Cargo Preference, the increase of Cargo Preference, the allowance of foreign building with Cargo Preference privileges, the offering of Cargo Preference to only the unsubsidized sector, and the creation of performance-based subsidies. Each of these proposals alone will not accomplish the goal of a strong merchant marine. The best solution could be a hybrid of these suggestions. In treating each proposal singly the best and the worst features of each are highlighted.

Total or partial elimination Cargo Preference means all or some of the merchant marine will suffer. Elimination of rate preference will cause the unsubsidized sector to lose its bread and butter. Rate preference, however, is the weakest aspect of Cargo Preference and could be removed with the least amount of damage, due to the already decrepit state of the unsubsidized fleet. Extension of subsidies to vital components of the unsubsidized fleet could fill the void left by the elimination of rate preference. Route preference, on the other hand, has to be maintained to ensure cargo for the encouragement of maintaining any fleet at all.

The increase of Cargo Preference is, as stated previously, not a popular or practical idea in the U.S. today. This would entail costs so great that the merchant marine might price itself out of existence. Further, there is no incentive inherent in this method. Perhaps a stepped increase in route preference to a particular company based on performance and the importance of the route would be more acceptable.

Recently foreign building was revived as an issue and is now a fact with which the U.S. Merchant Marine will have to abide. With foreign building, the existing fleet will have increased cheaper competition which will be eligible to receive Cargo Preference benefits. This is actually good for several reasons. First the competition and the availability of cheaper, more efficient shipping should cause some activity in the merchant marine. Secondly, the U.S. will be able to carry more of its preference cargo and commercial trade, favorably affecting the balance of payments. Finally, some U.S. owners of flag-of-convenience vessels could be influenced to rejoin the U.S. fleet adding immeasurably to the existing fleet. The only drawbacks to foreign building are the problems it causes for U.S. shipyards which need to be maintained at least for defense purposes.

One of the issues in the Cargo Preference debates was The practice of "double subsidy," It has been proposed that Cargo Preference should only be offered to unsubsidized operators. The removal of preference cargo from the subsidized sector would be detrimental to its profitability and could discourage expansion or modernization if no cargo was assured. Proportional reductions in subsidy or repayments for "double subsidy" vessels seems more practical.

The creation of performance-based subsidies appears to be an excellent idea. The stagnant nature of the U.S. Merchant Marine has been caused by the lack of incentive and the presence of a continuous flow of "no-strings" aid. Forcing the merchant marine to work for the aid it receives is logical, provides tangible incentive for growth and technological development, and is much less costly.

A realistic proposal for aiding the U.S. Merchant Marine should include aspects of all the previous proposals and more. It is my opinion that the eventual elimination of rate preference (with direct subsidy for vital tanker/bulk operators), a performance-based extension of route preference, allowance of a preset quota of foreign building, reduction or repayment of "double subsidy" benefits, removal of most U.S. restrictive regulations, and formation of a strong and definitive U.S. maritime policy would go a long way towards the recuperation of the U.S. Merchant Marine. I also believe the proposal would be acceptable to a greater cross-section of government and industry because it incurs less costs, requires less government intervention, and inspires the kind of competition that encourages growth.

CONCLUSION

Cargo Preference, like any other form of federal aid, has its associated costs and drawbacks. It could stand extensive "tailoring" to the real needs of the U.S. Merchant Marine, but it most definitely is necessary to ensure the survival of the U.S. flag merchant fleet at this time. Until a major restructuring of the merchant marine occurs and we assume a more objective view of the intrinsic value of this resource, the costs will be high and the industry will continue to depend on artificial assistance. The task before is to arrive at a maritime policy that is capable of fostering effective support for our once proud and tradition-filled U.S. Merchant Marine.

FOOTNOTES

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[4] Ernst G. Frankel, Regulation and Policies of American Shipping (Boston: Auburn House, 1982), p. 42.

[5] U.S. Department of Commerce, p. v-28.

[6] Kilgour, p. 18.

[7] Heine, p. 26.

[8] Kilgour, p. 19.

[9] Heine, p. 27.

[10] Ibid., pp. 168-169.

[11] Ibid., p. 169.

[12] Ibid., p. 170-172.

[13] Irwin M. Heine, "Whose Cargo Preference?" Seapower (March 1978), p. 36.

[14] Gerald R. Jantscher, Bread Upon the Waters: Federal Aid to the Maritime Industries (Washington: Brookings Institution, 1975) p. 12.

[15] Kilgour, p. 46.

[16] Heine, The U.S. Maritime Industry in the National Interest. p. 4.

[17] Ibid., p. 7-9.

[18] Frankel, p. 55

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[20] James R. Barker and Robert Brandwein, The United States Merchant Marine in National Perspective (Lexington: D.C. Heath, 1970), p. 20.

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[22] Kilgour, p. 185.

[23] Heine, _The U.S. Maritime Industry in the National Interest_, p. 34.

[24] Ibid., p. 17.

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[26] Ibid., p. 140.

[27] Ibid., p. 143.

[28] Ibid., p. 153

[29] Ibid., p. 155.

[30] Ibid., p. 184.

[31] Ibid., p. 155.

[32] Ibid.

[33] Ibid., p. 183.

[34] Ibid., p. 157.

[35] Frankel, p. 56-57.

[36] Ibid., p. 47.

[37] Kilgour, p. 47.

[38] Peter Goldmann, "Rough Ride for Composite Bill in Acrimonious Congress Debate," _Seatrade_ (April 1982).

[39] Ibid.

[40] Kilgour, p. 21.

[41] Heine, _The U.S. Maritime Industry in the National Interest_, p. 25.

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[45] Heine, The U.S. Maritime Industry in the National Interest, p. 168.

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[49] Ibid., p. 71.

[50] Committee of American Steamship Lines, U.S. Cargo Preference: Should the United States Government or Foreign Interests Control the Routing of United States Government Cargo? (Washington: CASL, 1965). p. 23.

[51] Ibid., p. 8.

[52] Kilgour, p. 93.

[53] Jantscher, p. 140.

[54] Ibid., p. 81.

[55] Ibid., p. 87.

[56] Ibid., p. 92.

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[60] Jantscher, p. 75.

[61] Heine, The U.S. Maritime Industry in the National Interest, p. 89.

[62] Jantscher, p. 85.

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[64] Kilgour, p. 19.

[65] Frankel, Regulation and Policies of American Shipping, p. 248.

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