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UNIVERSITY OF RHODE ISLAND

CAUSES OF THE DECLINE OF THE MERCHANT MARINE AND PROSPECTS FOR RENEWAL UNDER CURRENT FEDERAL MARITIME POLICY

A MAJOR PAPER SUBMITTED TO
THE FACULTY OF THE DEPARTMENT OF
GEOGRAPHY AND MARINE AFFAIRS
IN PARTIAL FULFILLMENT OF THE
REQUIREMENTS FOR THE DEGREE OF
MASTER OF MARINE AFFAIRS

BY

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KINGSTON, RHODE ISLAND
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Jan. 1, 1981

CHAPTER I

INTRODUCTION

> It was a glorious ending! Never, in these United States, has the brain of man conceived, or the hand of man fashioned, so perfect a thing as the clipper ship. In her, the long suppressed artistic impulse of a practical, hard-working race burst into flower. The *Flying Cloud* was our Rheims, the *Sovereign of the Seas* our Parthanon, the *Lightning* our Amiens; but they were monuments carved in snow. For a brief moment of time they flashed their splendor around the world, then disappeared with the completeness of the wild pidgeon.[1]

Thus eloquently writes Samuel Eliot Morison of the passing of a great era in the long and colorful heritage of the American merchant marine. So, too, he alludes to the technical genius of American shipbuilders who repeatedly throughout the years have created and sent to sea ships without peer in the world of shipping. How then has it come to pass in the late twentieth century that the United States, which depends more than ever before on commerce carried in ships, has suffered a precipitous decline in the ability of its merchant marine to provide for its legitimate commercial and security needs?

Since the end of World War II the United States has divested itself of the largest merchant fleet the world has ever known. Between 1941 and 1945 the Maritime Commission built 5,695 ships totalling more than 6.3 million displacement tons[2]. By 1946 this merchant fleet was larger than the merchant fleets of all other countries in the world combined, and it carried more than 78 percent of all U.S. oceanborne imports and exports. In the years since then, however, this great commercial force and national asset has steadily dwindled to a point where less than 5 percent of all U.S. oceanborne foreign commerce is carried in U.S.-flag merchant ships, and the ability of the merchant marine to support U.S. forces in times of overseas crisis is seriously questioned by Defense Department officials. Whether the U.S. flag merchant marine will disappear with the completeness of the wild pidgeon remains to be seen. In all likelihood it will not; but clearly there is a need for the merchant marine to fill a more equitable and proportionate role in the carriage of this country's foreign commerce.

The purpose of this paper is to identify, with particular emphasis on federal maritime policy, the reasons why the merchant marine and maritime industry of the United States have so dramatically declined in size, capacity, and competitiveness in recent years. Current and proposed government policy, particularly that of the Reagan Administration, will be examined

along with viewpoints of representative maritime industry sectors to assess the prospects for solving the problems that plague the merchant marine. Finally, recommendations will be offered which are considered most likely to improve the vitality of the merchant marine.

The subject of this paper is the active U.S.-flag merchant marine, that fleet of liners, tramps, bulk-carriers and tankers owned and operated by American citizens, registered in the United States, and employed in international commerce. Though constituting nearly one half of the total number of active merchant vessels under the U.S. flag, the coastwise, intercoastal, and noncontiguous merchant fleet is not discussed at length because it operates under the aegis of strict cabotage laws, and is thus shielded from the competitive forces which have so seriously plagued the merchant marine in international trade. The much larger U.S.-owned merchant fleet under foreign registry which has flourished at the expense of the U.S.-flag merchant marine is discussed as a seperate entity in the overall problem of American maritime decline. The U.S. shipbuilding industry, whose fortunes rise and fall with those of the merchant marine, is an inseparable part of this issue. Aside from the obvious interdependence of the two, there is a regulatory bond which links the merchant marine with shipbuilding through the federal maritime subsidy system. As federal policy and regulations are central to the theme of this paper,the merchant marine

and shipbuilding will at times be referred to collectively as the maritime industry.

The ports and infrastructure upon which maritime commerce so vitally depend are not discussed at length herein. Though not without problems that warrant examination and study, the port facilities of the U.S. are shared alike by the U.S.-flag merchant marine and the foreign merchant ships which so dominate the carriage of American imports and exports. Problems in this area, therefore, are not specifically contributory to the decline of the U.S.-flag merchant fleet.

CHAPTER II

DECLINE OF THE MERCHANT MARINE

Historical Perspective

Ever since the Godspeed, Discovery and Susan Constant brought the first permanent English settlers to the New World in 1607, merchant shipping has been a vital element in the growth and development of America. Throughout colonial times shipbuilding was one of the leading industries of the colonies. A near limitless supply of timber and ample quantities of skilled labor made the industry extremely competitive with its European counterparts, and the vast majority of American imports and exports were carried aboard American merchant ships. This proud heritage of the American merchant marine flourished into the early years of the Republic and profited by some of the earliest legislation of the new Congress, particularly with regard to cabotage laws which reserved to American flag shipping the domain of coastal and inland waters commerce. The power and achievements of the American merchant marine culminated in the age of the clipper ship whose glory, previously alluded to, flowered, then withered and vanished in a period of less than two decades in the middle of the nineteenth century.

The U.S. Civil War punctuated the demise of American preeminence in the world of commercial shipping. The loss of 110,000 gross tons of merchant ships sunk by commerce raiders and 800,000 tons transferred or sold to neutral registries during the war represented a 34 percent reduction in the size of the fleet. This, along with the earlier elimination of federal subsidies in 1858, marked the beginning of a protracted decline in the merchant marine. Its subsequent inability (or unwillingness) to readily adapt to the technological innovations of the industrial revolution—iron and steel construction and steam propulsion - and its protracted reliance on the wooden sailing ship well into the twentieth century insured that the U.S. merchant marine would be a diminutive factor in world commerce.

After the Civil War, America largely turned its back on the sea. Both the naval and the merchant fleets shrank to inconsequential size, and America, for all practical purposes, ceased to be a great maritime power. There were reasons for this beyond the failure to modernize the fleet and capitalize on the innovations of the industrial age. America's energy, manpower and investment was devoted to the settlement and exploitation of the West. The building of railroads and the development of new communities and vast natural resources in the western states and territories excited the imagination of the nation and

offered far more lucrative opportunities for investment than the moribund maritime industries of the east.

With the ultimate fulfillment of manifest destiny the United States once again turned to the outside world and regions across the sea where the newly developed industrial powers of the country could find new outlets and new sources of raw materials. The Navy experienced a renaissance in the late 1880's and 1890's. With spectacular victories in the War with Spain, it heralded a new age of naval power and status for the United States. The merchant marine, however, did not keep pace with these developments. Early naval operations of this period, both in the war with Spain and later during the 1906-07 world cruise of the battle fleet, relied almost exclusively on chartered foreign merchant ships for logistic support.

In 1855 72 percent of American foreign trade was carried in U.S. ships.[3] By 1870 this figure had dropped to less than 37 percent. Between 1870 and 1910 the wealth of the country had increased sixfold, railroad mileage four-fold, and coal production ten-fold. Over the same interval the proportion of American exports carried in U.S. ships dwindled to 8.7 percent.[4] This situation precipitated an economic crisis in 1914 when the First World War broke out in Europe. By that time only 2 percent of the world's oceangoing merchant ships

were under the U.S. flag. When Britain and Germany withdrew their great merchant fleets from the American trade the U.S. lacked the means to carry its exports in foreign commerce. Ocean freight rates soared, insurance rates climbed, and the prices of a record agricultural harvest plunged because of insufficient shipping to deliver the goods to world markets.

The dramatic achievements of the U.S. shipbuilding industry under government mandated construction programs during both World Wars are well known and to this day remain unparalleled in maritime history. By 1946 the U.S. merchant marine was once again carrying over 70 percent of U.S. foreign trade, as it had nearly a hundred years earlier. From that peak, however, the U.S.-flag merchant marine has steadily and inexorably declined in numbers, in deadweight tonnage, and in its share of participation in U.S. oceanborne foreign commerce.

Current Status

Assessing the health of the merchant marine is a many faceted problem which is highly dependent on the viewpoint of the observer and the segment(s) of the industry which one chooses to examine. The liner fleet, for instance, which is highly automated and largely intermodal operates with a modicum of competitiveness and profitability. The huge U.S.-owned fleet under foreign registry mainfests extensive U.S. corporate activity in

the world of ocean shipping. Disregarding the latter factor, however, there are several stark statistical realities which underscore the serious state of decline into which the merchant marine has fallen.

The United States is the greatest trading nation in the world today in terms of tonnage and value of imports and exports. Its high standard of living and insular position in the world relative to sources of raw materials and markets for exported goods necessitates a vast foreign trade. Ninety-six percent of this trade is carried in ships, but by 1980 only 3.7 percent of this amount was being carried by ships flying the U.S. flag. Table 1 illustrates the proportion of American shipping engaged in oceanborne trade to and from United States ports.

TABLE 1

U.S. OCEANBORNE FOREIGN TRADE (1980)

TONNAGE (millions)

	TONS	U.S. FLAG TONS	U.S. FLAG PERCENT
Liner	59.3	16.2	27.3
Non-Liner	356.7	4.1	1.2
Tankers	356.3	7.9	2.2
Total	772.3	28.2	3.7

TABLE I - Continued

DOLLAR VALUE (billions)

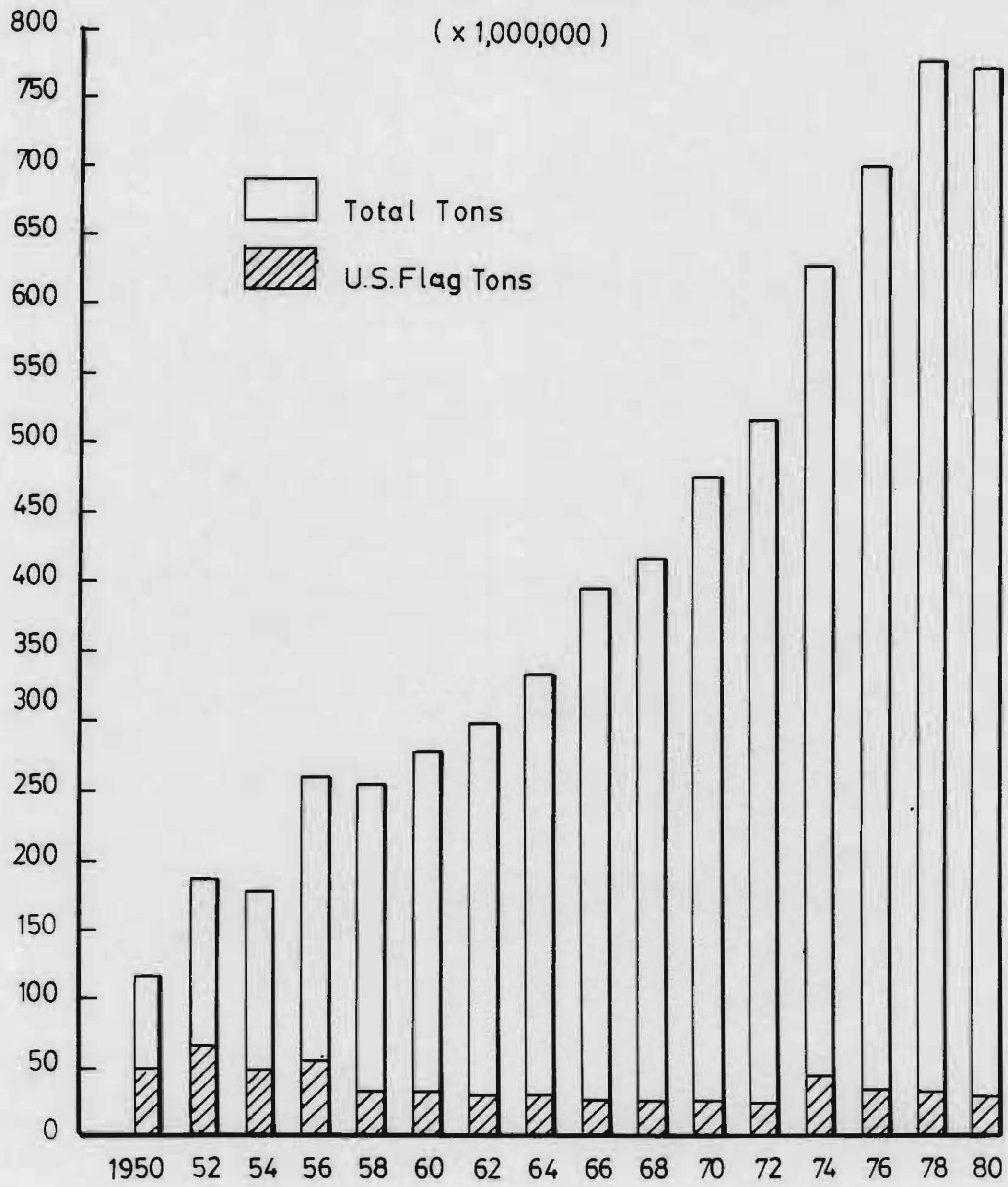
	VALUE	U.S. FLAG VALUE	U.S. FLAG PERCENT
Liner	136.9	39.2	28.7
Non-Liner	74.1	1.3	1.8
Tankers	83.3	1.8	2.1
Total	294.3	42.3	14.4

SOURCE: U.S. Department of Transportation, Maritime Administration, MARAD '81 (Washington, D.C.: Government Printing Office, 1982), p. 19, table 12.

In the perspective of the previous twenty years the figures for 1980 represent a modest increase over the average annual U.S.-flag carriage of approximately 26.8 million tons. During the same interval, however, the total tonnage carried by all countries in the U.S. trade increased steadily from 277.9 million tons in 1960 to the 772.2 million tons shown for 1980, a 178 percent increase. The overall result is that the proportion of U.S. trade tonnage carried in U.S. flag ships has steadily eroded from 11.1 percent in 1960 to a mere 3.7 percent in 1980. (See Figure 1.) Similarly, the U.S.-flag share of the total value of cargoes carried in the U.S. trade has dropped by nearly one half from 26.4 percent in 1960 to 14.4 percent in 1980. Although the value of U.S. flag cargoes increased dramatically from 6.5 to 42.3 billion dollars in the past two decades, the total value of

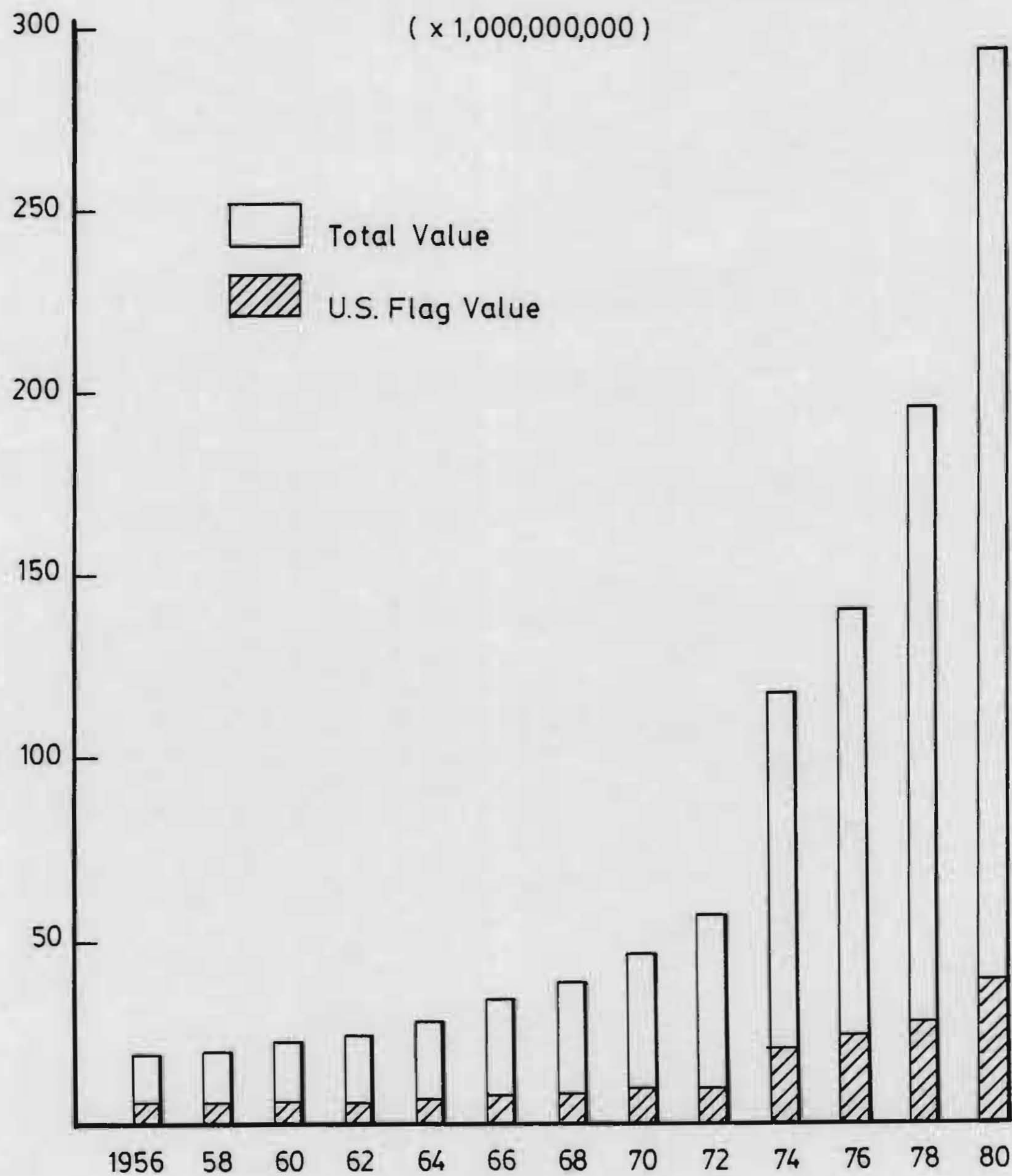
foreign trade increased by a factor of twelve from 24.7 to 294.3 billion dollars.[5] (See Figure 2). As illustrated in Figures 3a and 3b, the percentage of U.S. trade in value and tonnage carried by U.S.-flag ships has continually declined throughout the past three decades.

The U.S. participation in the non-liner and tanker trade is even more dismal than in the foreign trade as a whole. U.S. non-liners, including bulk carriers and tramps accounted for only 1.2 percent of this trade in 1980. U.S. tankers only carried 2.2 percent of oil and liquid cargo imports and exports. As of 1 January 1981 the U.S.-flag merchant marine operated only 48 bulk carriers (tankers and dry bulk) in the foreign trades, ranking twenty-third in the world in this category. The U.S. is in a position where it must rely almost completely on foreign flag shipping and U.S.-owned shipping under foreign registry to provide the essential raw materials needed to sustain the American economy and standard of living. Both of these fleets operate beyond the jurisdiction of federal laws, and will be uncertain support in time of national emergency or war.



Source: Maritime Administration Annual Reports

Figure 2: U.S. OCEANBORNE FOREIGN TRADE: Dollar Value



Source: Maritime Administration Annual Reports

Figure 3a: U.S. OCEANBORNE FOREIGN TRADE: Tons
Percent Carried in U.S. Flag Ships

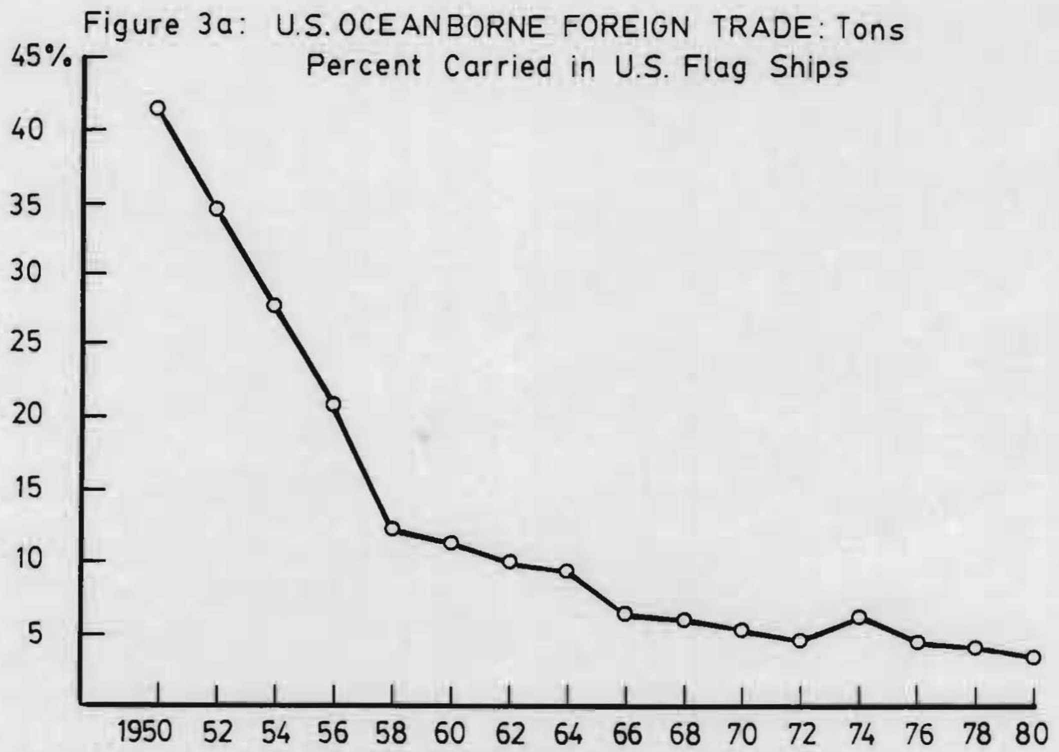
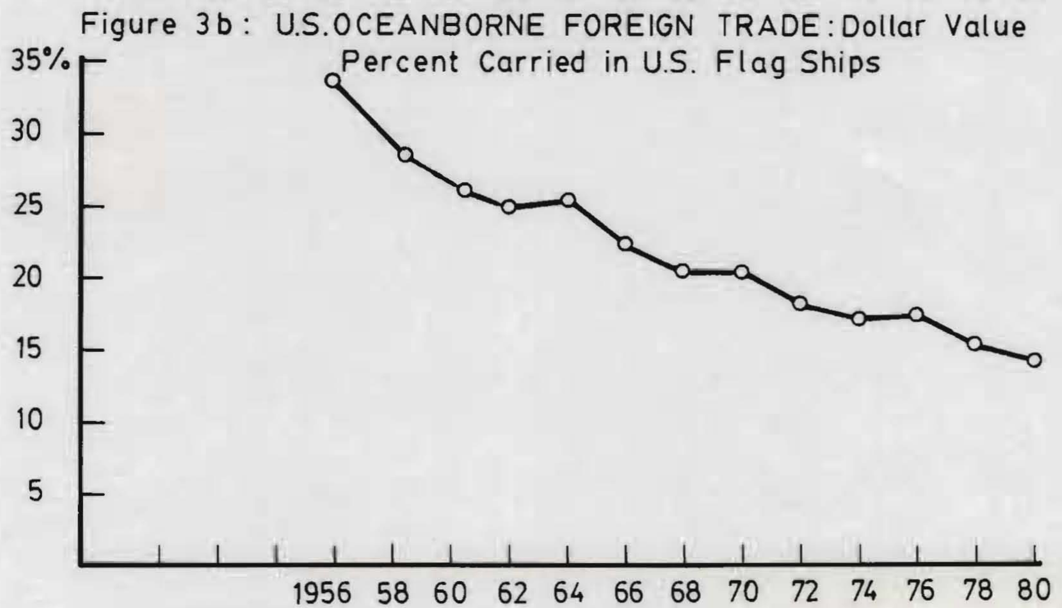


Figure 3b: U.S. OCEANBORNE FOREIGN TRADE: Dollar Value
Percent Carried in U.S. Flag Ships



Source: Maritime Administration Annual Reports

The size of the merchant marine in terms of both number and capacity of U.S.-flag ships has also declined dramatically since World War II and is another disturbing indicator of the ebbing of American maritime power since that time. The following table shows the relative ranking of the U.S. merchant marine with respect to the world's other leading maritime nations.

TABLE 2

MAJOR MERCHANT FLEETS OF THE WORLD (JAN 1, 1981)

Country	No. of Ships	Rank by No.	Deadweight Tons	Rank by Tons
Liberia	2,271	4	153,242,000	1
Greece	2,928	1	69,559,000	2
Japan	1,762	5	62,001,000	3
United Kingdom	1,056	6	42,302,000	4
Norway	616	10	38,575,000	5
Panama	2,437	3	38,011,000	6
USSR	2,530	2	21,757,000	7
United States	578	11	21,103,000	8
France	345	18	19,539,000	9
Italy	622	8	17,269,000	10
Spain	509	12	12,235,000	11
West Germany	473	13	11,803,000	12
Singapore	622	9	11,754,000	13

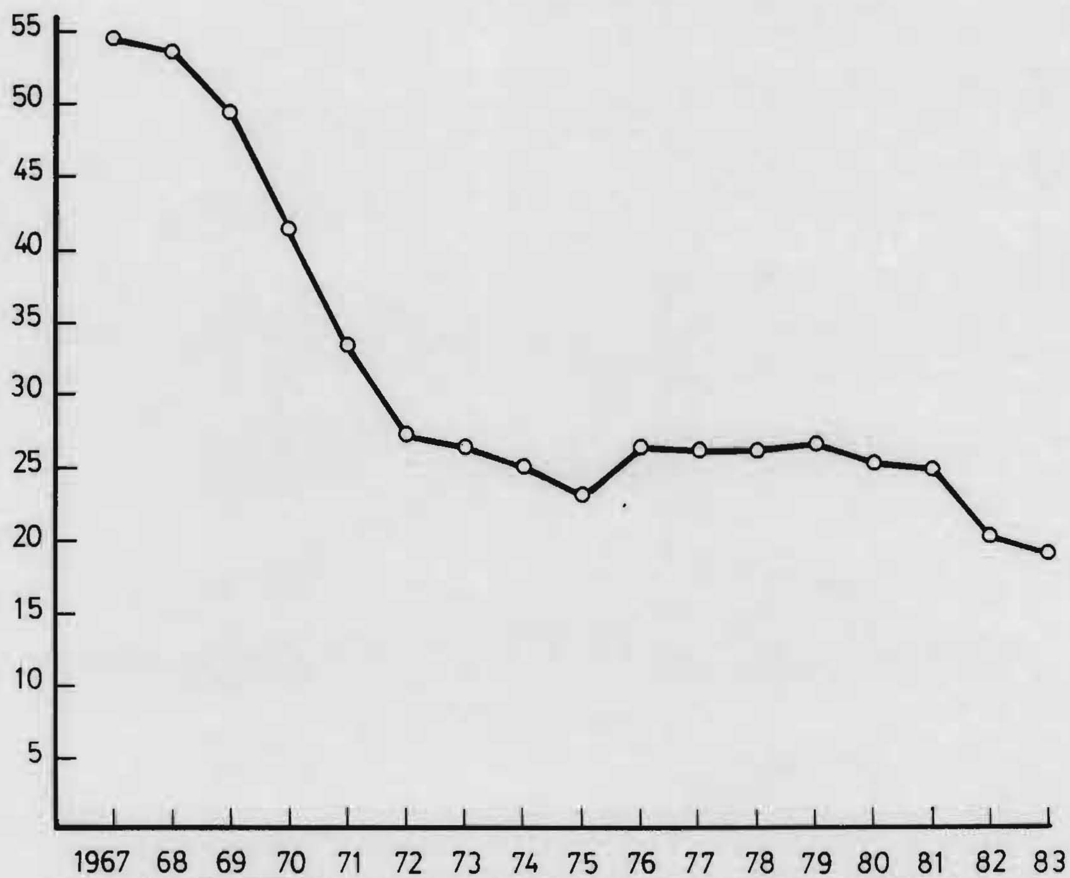
China (PRC)	695	7	10,129,000	14
India	370	17	9,221,000	15
All others	7,053	-	116,249,000	

Source: U.S. Department of Transportation, Maritime Administration, MARAD '81 (Washington, D.C.: Government Printing Office, 1982), p. 17, Table 11.

As can be seen, the U.S.-flag merchant fleet has sunk from an overall position of supremacy after World War II to positions of eighth in tonnage and eleventh in total numbers of ships in 1981. Nearly half of the number of ships and deadweight tonnage shown on the previous page for the United States is accounted for by ships engaged in the U.S. coastwise, intercoastal and noncontiguous domestic trades, and thus is not subject to international competition.

The decline of the merchant marine is chronicled in terms of men and jobs as well as ships and tonnage. Over 35,000 seafaring jobs have disappeared since 1967, a 65 percent reduction in employment of American officers, seamen and engineers on U.S. ships.[6] (See Figure 4) Part of this job loss is attributable to increased automation of ships and the replacement of labor-intensive breakbulk cargo carriers with more efficient intermodal vessels. A major portion of the decline in employment, however, is due to the disappearance of the ships themselves.

Figure 4: OCEANGOING SHIPBOARD JOBS: Monthly Average
(× 1000)



Source: Maritime Administration Annual Reports and Fact Sheets

CHAPTER III

IMPORTANCE OF THE MERCHANT MARINE

Why is a U.S.-flag merchant marine necessary in foreign commerce? There are three general reasons: national security, economic strength, and political influence.

National Security

The role of the merchant marine in national security is two-fold. First, it can operate in direct support of military operations in far-flung parts of the globe by transporting the thousands of troops and millions of tons of fuel and supplies necessary to sustain military operations overseas. Admiral Hayward, former Chief of Naval Operations, has stated that without adequate and reliable sealift none of our military plans is executable since more than 90 percent of all wartime cargo would have to go by sea.[7] Some scenarios envision the direct use of merchantmen as naval auxiliaries. The Navy's Arapaho Project is an example of how a container ship can be rapidly converted into use to carry helicopters and VSTOL aircraft.[8] Modern intermodel vessels such as the roll-on/ roll-off (Ro/Ro) ships and the LASH (lighter aboard ship)

and SeaBee (barge carrier) ships are readily adaptable for landing heavy equipment such as tanks and armored vehicles during amphibious operations or at poorly developed or damaged ports.

In its secondary security role the U.S.-flag merchant marine would be depended upon to carry the strategic materials which are vital to sustaining industrial production as well as the transportation systems of the United States in either a maritime or peacetime crisis.

If World War II, the Korean War and the Vietnam War do not provide sufficient examples of how vital a large and capable merchant marine is to carrying out military operations, the Falkland Island War waged between the United Kingdom and Argentina in 1982 should serve as an excellent example of the valuable and versatility of a flag merchant marine in time of crisis. Britain was able to rapidly commandeer and convert a broad spectrum of ships from her merchant fleet (still the world's fourth largest) to military roles. Oceanliners pressed into service as troopships, channel ferries into amphibious ships, fishing trawlers into minesweepers, a container ship into an aircraft carrier, as well as tankers and general cargo ships, bolstered a small naval task force and helped Britain win a decisive military and political victory over 8,000 miles from home base. Whether the

U.S.-flag merchant marine could meet this type of challenge today remains problematical. Whether reliable support could be expected under similar circumstances from the nearly 700 U.S. owned ships operating under foreign registry, with foreign masters and crews is also an uncertainty.[9]

Economics

There is also an economic imperative for operating a U.S.-flag merchant marine. The United States is the world's greatest trading nation, yet 96.3 percent of all cargoes (in 1980) were carried by ships registered in foreign countries. This is clearly out of proportion when compared to the percentage of other country's foreign trade carried in their respective flag ships. Other major nations of the developed world, all of whom are less dependent than the United States on seaborne commerce carry between 30 and 70 percent of their trade in their own ships as illustrated in the following examples.[10]

Country	Percent of Tonnage (1977)
USSR	50
China (PRC)	70
Greece	45
Japan	39
Norway	37

Spain	37
United Kingdom	34
West Germany	30
France	30
United States	5

From these figures it can be deduced that the U.S. flag merchant marine should be carrying at least five times as much cargo as at present. That it doesn't is not an indication of a chronic lack of patiotism among American shippers, but it is a clear indication that the U.S.-flag merchant marine lacks the competitiveness to assume its "rightful" status in the world of international commerce. In a highly competitive market shippers will move their cargoes, unless otherwise constrained, on ships providing the best service at the least cost.

Every ton of cargo carried in the U.S. trade that is not carried in American flag-ships represents an economic loss to the United States in the balance of payments. In 1979 total payments to foreign flag ship operators exceeded receipts by U.S.-flag operators by $4.07 billion.[11] Cargo tariffs go to foreign owners and wages to foreign crews. The federal government loses tax revenues and American seafarers lose jobs. Additionally, the demand for ships and nautical equipment and supplies remains low. Shipbuilders and suppliers to the maritime

industry lose potential business, and in many cases go out of business altogether.

Political Influence

The political influence of the merchant marine in the socio-economic struggle between East and West cannot be discarded. It plays an important role in introducing the national flag into all corners of the globe, exporting ideas as well as products, gathering intelligence and foreign exchange as well as raw materials, food and fuel. The advantages of this aspect of merchant shipping have not been lost on the Soviet Union which virtually doubled the size of its merchant fleet between 1960 and 1980, while the U.S. allowed its fleet to wither away.

CHAPTER IV

U.S. MARITIME POLICY

The importance of a strong national merchant marine, equal to the demands of the country's foreign trade and commerce, has been thoroughly appreciated by succeeding administrations ever since the beginning of World War I. Elaborate systems of subsidy, financial aid and regulations intended to build, promote and maintain a strong merchant marine have been employed since 1916. The policy of the federal government towards the merchant marine has been no more clearly stated than in the preamble to the Merchant Marine Act of 1936, regarded by some as the Magna Carta of the maritime industry, and which remains to this day the basis for federal maritime policy:[12]

> 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 United States flag by citizens of the United States, insofar as may be 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. It is declared to be the policy of the United States to foster the development and encourage the maintenance of such a merchant marine.[13]

Notwithstanding the remarkable growth of the merchant fleet in World War II, this federal policy toward the merchant marine has failed to achieve in more than a minimal way its intended results. Maritime Administrator H.E. Shear reporting in MARAD '81 the annual report of the Maritime Administration for 1981, has said:

> The status of the industry at that date was not good. Government programs conducted under the basic 1936 act and expanded and improved under the Merchant Marine Act of 1970 - all launched with high hopes - had failed to stem the industry's decline. A change of course was necessary.[14]

There are many causes for this, and some of them are directly attributable to the very regulatory and support system which was legislated to promote the vitality of the maritime industry. A brief survey of the government regulatory and support system follows.

The Shipping Act of 1916 (as amended)

The 1916 Act was intended to assert government control over competition-limiting practices which were frequently used by members of common carrier liner conferences. Under the Act, liner conferences operating on

U.S. trade routes must publish rates, rules, and conditions of service in tariffs filed with the Federal Maritime Commission (FMC) and make them available to the public. Advance public notice of tariff changes shall be made which the FMC may disapprove if the provisions of the Act are violated or the public interest is not served. Conference members are permitted to fix rates; regulate or prevent competition; pool or apportion earnings, losses, or traffic; restrict or regulate the number and frequency of sailings between ports; limit or regulate the volume and character of freight to be carried; and, subject to approval by the FMC, provide for exclusive, preferential, or cooperative working arrangements which are exempt from application of U.S. anti-trust laws.

The 1916 Act also specifically prohibited such competition inhibiting conference practices as deferred rebates to retain shipper patronage; "fighting ships" to drive independent competition out of the trade route; discrimination against shippers as punishment for non-patronage; and unjust or unfair discrimination against shippers.

The Merchant Marine Acts of 1920 and 1928 further established the role of government in regulating trade routes, providing contruction loans, allowing tax deferred construction funds, and providing for operational subsidies (in the form of mail contracts) to promote parity between

U.S. and foreign shipbuilding and operating costs. Section 27 of the 1920 Act is the important cabotage provision of U.S. maritime policy which establishes the coastwise and intercoastal trade as the exclusive preserve of U.S.-flag shipping, effectively eliminating foreign competition on these routes. Principles of government support and regulation established in the 1920 and 1928 Acts became part of the Merchant Marine Act of 1936 which, as amended by the Merchant Marine Act of 1970, is the basis of the federal policy towards the merchant marine today.

The Tariff Act of 1922 introduced the 50 percent ad valorem tax on all repairs, parts and equipment purchased abroad for U.S.-registered ships. This measure remains in effect today and imposes a significant element of inflexibility and expense on U.S.-flag ship operations.

Merchant Marine Act of 1936

The 1936 Act reaffirmed the need for a privately owned U.S. flag merchant marine and committed the federal government to a system of direct and indirect financial contributions which were intended to ensure its vitality. Major elements of the Act which were designed to promote the construction and competitive operation of a U.S.-flag merchant marine include:

1. The Construction Differential Subsidy (CDS) is a direct subsidy intended to offset the difference between ship construction ship costs in a foreign and U.S. shipyard. Limited to a ceiling of 50 percent of the cost of a new vessel, CDS is supposed to encourage and assist U.S. ship owners to build their vessels in U.S. shipyards. Such vessels are obliged to remain under U.S. registry for twenty-five years and are to be operated exclusively in the foreign trade of the U.S. The plans for vessels built with CDS must also be approved by the Secretary of the Navy to ensure they are suitable for rapid conversion to naval auxiliaries. Ships built under CDS are eligible to operate with the Operating Differential Subsidy.

2. The Operating Differential Subsidy (ODS) is a direct subsidy intended to offset the difference in operational cost incurred by a U.S. owner operating his ship under U.S. registry as compared to operating the same ship under foreign registry. ODS payments are made to cover the cost of crew wages, hull and machinery insurance, maintenance and repairs, and protection and indemnity insurance. Recipients of ODS must build their ships in U.S. yards. Temporary authority, since expired, was granted for ODS recipients to build aboard after the 1981 Omnibus Budger Reconciliation Act eliminated the construction differential subsidy.

3. The Capital Construction Fund (CCF) entitles U.S. flag ship operators to invest earnings from operation and sale of their ships in a tax deferred fund which may only be used for the purchase of U.S. flag vessels built in U.S. shipyards.

4. The Title XI Federal Ship Mortgage Insurance is a loan guarantee provided by the government to lenders of funds utilized for building U.S. flag ships in U.S. shipyards. The government will guarantee loans for up to 75 percent of the ships built with CDS funds and 87.5 percent of the cost of nonsubsidized ships.

The Merchant Marine Act of 1970

The 1970 Act amended the 1936 Act and reaffirmed its policy and objectives. The 1970 Act fine tuned some of the entitlements of the Merchant Marine Act to promote greater growth in the shipbuilding industry and greater U.S. flag participation in the dry bulk trades. Major provisions of the Act include:

1. A long-term government committment to revitalize the shipbuilding industry was made to encourage investment and modernization of U.S. shipyards. The government proposed to support the construction of 300 merchant ships over a ten year period.

2. Granting CDS funds directly to shipyards rather than shipowners was authorized to promote shipyard participation in vessel designs, and to promote greater efficiency and economy in ship construction.

3. Competitive bidding procedures between ship purchaser and shipbuilder were replaced by negotiated contracting. The intent was to streamline contracting procedures and encourage yards to develop and market standard vessel designs.

4. Declining CDS payments were mandated starting with a 45 percent ceiling in FY 1971 declining 2 percent per year until FY 1976 at which point the maximum ceiling would remain at 35 percent of construction cost. (The ceiling was subsequently raised to 50 percent due to a slumping market for new ships and increased foreign shipbuilding competition.)

5. ODS payments, previously restricted to liners, were extended to U.S built tankers and dry bulk carriers in an effort to encourage U.S.-flag participation in the bulk trades.

6. U.S. owners were permitted to use ODS funding for dry bulk vessels to encourage phased replacement of their foreign-built bulkers with tonnage built in U.S. shipyards.

7. Subsidized bulkers were authorized to operate in foreign-to-foreign trade routes while retaining their operating subsidy.

8. A new system of wage indexing was adopted to minimize increases in ODS expenditures and encourage owners to bargain for better wage settlements than had

been obtained from unions in the past. Wage increases beyond the index would not be covered by ODS funding.

9. Capital Construction Fund (CCF) entitlements were extended to all operators of U.S. ships in the foreign, noncontiguous domestic, or Great Lakes trade or in the fisheries.

10. A Construction Reserve Fund (CRF) was formed so that owners could invest the proceeds from the sale of their vessel, indemnities from losses of vessels, and earnings from operations without incurring a tax liability. Funds were to be used for financing construction of replacement vessels in U.S. shipyards for use in any U.S. trade route, including domestic inland and intercoastal.

From the implementation of the Merchant Marine Act of 1936 through FY 1981 the federal government has expended a total of $9,704,805,160 in direct subsidy payments to U.S.-flag ship operators and shipbuilders.[15] Since the passage of the 1970 Act, combined subsidy outlays have averaged nearly $500,000,000 per annum. Inspite of this massive federal support, the proportion of U.S. trade carried in U.S.-flag ships has continued to dwindle, and very little success has been achieved in bringing dry bulk operation under the U.S. flag. In the following sections the apparent causes for this failure will be further explored.

CHAPTER V

CAUSES OF MARITIME DECLINE

The causes of the decline of the U.S.-flag merchant marine are many and varied, its problems multifaceted, and the solutions obscured by a diversity of special interests. Almost all parties involved - those who contribute to the formulation of American maritime policy, build the ships and those who operate the fleet itself - have contributed in some way to the demise of the merchant marine. Evolving changes in the international regulatory and trade environment and the maritime industry's inability to adapt to those changes have also contributed significantly to the diminishing competitiveness of the U.S.-flag merchant marine in foreign commerce.

Lack of Coherent Policy

The U.S. maritime industry suffers severely from the lack of a clear national maritime policy and goals. The Maritime Administration (MARAD), now under the Department of Transportation, has principal promotional and administrative jurisdiction over the merchant marine, and six other cabinet level departments encompassing fourteen government agencies have jurisdiction over, or important

roles in, the maritime activities of the United States.[16] Special interest groups are well represented by twenty-five maritime trade associations, five marine industry related associations, twenty-one seafaring labor unions, five shipyard labor unions, two longshoreman unions, five labor organizations, nine independent tanker unions, and two seafaring associations.[17] These organizations, as well as environmental and consumer groups, and foreign shipping interests send a veritable army of lobbiests to the nation's capitol to help Congress hammer out maritime policy. Even the industry itself is severely fragmented in viewpoint and can offer Congress no concensus of what is best for the industry, not to mention what is best for the country. Tankers and liners are represented by two different lobbying groups. The American Institute of Merchant Shipping (AIMS) represents two-thirds of the tanker operators and the American Maritime Association (AMA) represents the remaining third. The Council of American-Flag Ship Operators (CASO) represents the subsidized liner fleet, while Sea-Land represents itself as the sole non-subsidized liner operator. The Federation of American Controlled Shipping represents U.S. owners of ships under open registries.[18]

These myriad and diverse viewpoints have made it difficult for Congress to articulate through legislation a coherent maritime policy. The recent 95th, 96th, and

97th Congresses held extensive hearings on proposed revisions to U.S. maritime policy but failed to produce significant legislation. The proposed Maritime Regulatory Act of 1982 (H.R.4374/S.1593), the most important piece of legislation to promote the merchant marine since the 1970 Act, took thirteen months to be passed by the House, but ultimately foundered in the Senate in the face of a filibuster threat by Senator Howard Metzenbaum (D-Ohio) during the 1982 lame-duck session of Congress. This type of abuse, coupled with the traditional opposition of the powerful Judiciary Committee to any maritime measures which involve easing of anti-trust policy, has hindered Congress' ability to produce legislation favorable to the liner industry. As long as Congress, as well as the cognizant federal agencies involved in maritime policy, continue to subordinate the common good of the country to the divergent special interests of their constituents in the fragmented maritime industry, maritime policy will continue to drift and the shipping and shipbuilding industry will continue to stagnate and decline. The federal government role in this process is further illuminated in the following sections discussing the causes of the demise of the merchant marine.

Failure of Direct Subsidies

The direct subsidy provisions of the 1936 Merchant Marine Act which were intended to support the growth and operation of a strong merchant fleet have in the long term contributed to its demise through competition-inhibiting regulatory stipulations. The operational differential subsidy (ODS) is designed to offset the extra cost of operating a merchant vessel under U.S. registry over what a similar vessel would cost to operate under foreign registry. The principle element in this cost differential is wages, which on U.S.-flag ships are typically two to three times greater than on a European flag ship. Theoretically the operating subsidy should allow the U.S. ship operator to compete on an equal footing with foreign operators. In actuality ODS has hurt the competitiveness of the merchant marine because it has linked ship operators to the foundering and non-competitive U.S. shipbuilding industry, subjected operators to lengthy and costly bureaucratic procedures which have impaired operational flexibility, and dulled any sense of urgency that operators may have had in dealing firmly with excessive labor union demands or seeking manpower reduction on their vessels.

Until 1981 when the Omnibus Budget Reconciliation act eliminated construction differential subsidies (CDS), operators receiving ODS were required to build their ships in U.S. shipyards. Additionally, repair and

maintenance work was required to be performed in U.S. yards. The CDS was originally intended to promote competition and expand the U.S.-built merchant fleet by offsetting the extra cost involved in building in a domestic yard rather than a foreign shipyard. In the long term this has not kept the U.S. shipbuilding industry in a competitive position. More recently the 50 percent statutory limit on CDS payments for construction of a vessel in a U.S. yard has been insufficient to achieve cost parity with foreign shipyards.

A study conducted for the Shipbuilders Council of America by Data Resources, Inc. in October 1979 highlighted the inadequacy of CDS payments by comparing costs for building various types of ships in U.S. and Japanese yards. The table below indicates how much subsidy (as a percentage of U.S. costs) would be required to achieve cost-parity for the U.S. builder:[19]

Type Vessel	C-8 Container Ship	32,000 dwt Dry Bulker	125,000 m^3 LNG	80,000 dwt Tanker
Required Subsidy	57%	63%	36%	61%

As can be seen, the ODS operator who is compelled by regulation to "buy American" will find he must pay higher prices for newly built U.S. ships, even with the CDS, than he would if he bought abroad. With the suspension of CDS

by the Reagan Administration, U.S. operators have received relief from this costly dilemma by being permitted to build abroad in less expensive foreign shipyards. The Omnibus Budget Reconciliation Act of 1981 (P.L. 97-35) authorized U.S. operators to build abroad through 30 September 1982 without losing their ODS eligibility. The build abroad provision has not, however, been renewed by Congress.

The example of two U.S. liner companies illustrates the economic disadvantages incurred by operators who remain tied to the ODS-CDS regulations. Sea-Land, Inc. planned to build twelve diesel powered containerships for its fleet. The estimated cost in U.S. shipyards was $80 million each. With CDS the cost to Sea-Land would have been $40 million each if built in U.S. yards. As the same vessels could be built in Japanese and Korean shipyards for only $30 million each, Sea-Land decided to build overseas. Not being tied to an ODS contract, Sea-Land was able to do so. American President Lines, Ltd. (APL), a subsidized U.S. liner company, bought three container ships priced at $90 million each in U.S. shipyards. The CDS paid for 49.98 percent of the cost leaving APL with over $45 million per ship to finance. APL estimated that this is at least $13 million more per ship than it would have cost to build overseas. Being tied to U.S. construction by ODS contract, APL was thus "penalized" in this case for nearly $40 million.[20]

A further disadvantage incurred by the ODS-induced requirement to build in domestic yards is the operational inflexibility that results from the greater amount of time it takes to construct a ship in a U.S. shipyard. The example cited above illustrates the point. Sea-Land received delivery of the first of its twelve container ships from Far Eastern yards within fifteen months. The remaining eleven were delivered at one month intervals thereafter. Total time from contract to last delivery: twenty-four months. APL received delivery on the first of its three container ships in thirty months. The remaining two were delivered at three month intervals. Total time from contract to delivery:
thirty-six months. Sea-Land was able to acquire four times as many ships in 33 percent less time than its subsidized competitor, American President Lines. Besides the increased financing charges resulting from the longer contract time, the subsidized operator enjoys less ability to take timely action to modernize his fleet to exploit emergent or changing business opportunities, and thus experiences another competitive disadvantage with respect to his non-subsidized U.S. and foreign competitors.
Other regulatory obligations of the operating and construction differential subsidies serve to restrict the flexibility of U.S.-flag ship operations.

In the liner trades, U.S.-flag ships operating under ODS are required to operate in government-designated essential U.S. trade routes (ETR's). This rule is designed to ensure the presence of U.S.-flag ships on routes traditionally deamed essential to U.S. economic security, and to prevent direct competition between subsidized ships on the same routes. This concept, however, introduces an element of operational inflexibility for the U.S. operator because proposed changes of service on an ETR must receive prior approval from the Maritime Administration. A lengthy review process makes it difficult for a liner operator to adjust his service to take advantage of opportune trade advantages as readily as foreign competitors can.[21]

A ship's owner's acceptance of ODS invites government intrusion into basic financial and management decisions of the company. MARAD consent is required to pay dividends, increase employee compensation, transfer funds to stockholders, transfer control of vessels, and increase indebtedness. Additionally, the shipowner must replace his subsidized vessels after twenty-five years with new U.S.-built vessels which inevitably will cost more to construct and take longer to deliver than similar vessels built in foreign shipyards.

If drawing maintenance and repair (M&R) subsidy payments under ODS, the U.S. ship operator is also

compelled to have all repair and maintenance work performed in U.S. yards.[22] This penalty and the 50 percent M&R Tariff are features unique to U.S. maritime policy which impose upon U.S. flag ship operators an additional financial and operational burden not shared by their foreign competitors. The purpose of these provisions was to promote ship repair business in U.S. shipyards by requiring all U.S. flag ships to have all non-emergency repairs performed in domestic yards. In conforming with this provision a ship operator would be giving up the operational flexibility to have repairs performed in the most convenient and economical yard, regardless of whether foreign or domestic, to minimize the impact on his ship's operating schedule. U.S.-flag ships which sometimes work the cross trades, are particularly disadvantaged because they would have to leave their trade routes and make often long and profitless return voyages to the U.S. The impact of not complying with this requirement is severe. Non-subsidized flag ships who obtain non-emergency repairs in foreign yards must pay a 50 percent tariff on the cost of repairs to U.S. Customs. Subsidized U.S.-flag operators who choose to have repairs performed overseas are in addition assessed a penalty equal to the cost of repairs which is deducted from their ODS payment. Foreign flag ships, on the other hand, are able to have maintenance and repair work performed at the most convenient and economical shipyards available.

In the fiercely competitive tanker and bulk trade, the U.S. flag fleet has not done well, carrying less than 2.5 percent of the non-liner bulk and liquid cargo tonnage carried in the U.S. foreign trade in 1980. The 1970 Merchant Marine Act tried to boost the competitiveness of the U.S. flag tankers and bulk carriers by extending ODS payments to this segment of the fleet. However, Article 804 of the Act effectively negated any incentive for U.S. tanker or bulk operators to take advantage of the subsidy because of the stipulation which would have frozen their operations of foreign flag vessels. Article 804 requires operators receiving an ODS to divest themselves and their subsidiaries of their foreign flag operations by 1990. This has thus far failed to entice U.S. citizen tanker and bulk operators to return to the U.S. flag.

The very operators at which this provision was aimed are predominantly the large U.S.-based energy and natural resource corporations and their subsidiaries who operate collectively a merchant fleet under foreign registries which far exceeds the combined size and tonnage of the U.S. flag merchant marine. For any of these companies to have returned to the U.S. flag would have necessitated relinquishing these extensive and generally profitable operations.[23]

In accepting government subsidies, U.S. ship operators have thus in many instances been bridled with

costly bureaucratic disincentives. They have sacrificed considerable latitude for making independent financial and operational decisions which could otherwise promote efficiences and opportunities for profit.

Lack of Efficiency

A lack of overall operating efficiency has contributed significantly to the non-competitiveness of the U.S. flag merchant fleet. The bottom line of merchant ship efficiency is cost per space mile or cost per ton mile. This is a function of fuel cost, operating cost, and capital costs. In the case of liner shipping U.S. cost per space mile is estimated at 12-15 cents. Foreign liner vessels operating in U.S. trades are estimated to operate at 7-10 cents per space mile.[24]

Most of the ships in the U.S. liner fleet fail to measure up because of the excessive age, less efficient power plants, and insufficient size to obtain optimum economies of scale.

A significant cost advantage is lost by not employing low speed diesel engines for propulsion. Diesels are 30-40 percent more fuel efficient than steam turbines. In spite of the high cost of fuel, which next to the crew is the highest component of total vessel operating costs, U.S. ship operators have been slow to adopt this method of propulsion, and 90 percent of U.S. liners remain propelled by steam. Because of the "buy American" provisions of the

CDS contracts, and the slowness of U.S. industry to gear up to the production of large slow-speed marine diesels, ships constructed in U.S. yards still employed steam turbines long after foreign yards switched to diesel. This extra built-in operating cost puts U.S. ships at another comparative disadvantage in this respect.[25]

Using 500-600 FEU's (1000-1200 TEU's) as a minimal benchmark cargo capacity for competitive operations , approximately 60 percent of the ships in the U.S. fleet are too small to compete effectively in foreign commerce.[26] Older vessels are also more likely to experience higher maintenance and repair costs, higher wage costs, greater fuel consumption per cargo capacity, and less efficient cargo handling facilities which necessitates longer turn-around times in port.

Significantly, the non-subsidized segment of the U.S. liner industry has fared much better than the fleet as a whole. All non-subsidized vessels are containerized, whereas only one third of the subsidized vessels are containerized. Only three subsidized ships utilize diesel propulsion, whereas 16 non-subsidized ships use diesels. Sea-Land, Inc., the only non-government subsidized operator captured 34 percent of the total U.S. liner earnings revenues during the period 1978-81. Non-subsidized liner operations earned $475 million (before taxes), while the rest of the liner fleet, all of which is subsidized, earned

$550 million (after subsidy). If subsidy payments were deducted, a loss of $600 million would have been experienced by the subsidized industry.[27] The non-subsidized operators were disadvantaged by receiving no operating-differential subsidy payments to offset crew costs. However, by being free from the regulatory obligations tied to the acceptance of ODS and CDS, Sea-Land was able to purchase large, modern and efficient ships from foreign yards to use in an operational environment less hindered by federal regulation and supervision. The fact that Sea-Land is the only one of nine remaining U.S. liner operators to operate without direct government subsidy, and the only one of those companies to regularly clear a profit, is an ironic condemnation of the subsidy system which has attempted to promote the merchant marine over the past forty-seven years. Though critics would attempt to mitigate the contrast by pointing to the strong financial backing Sea-Land has in its parent company, R.J. Reynolds Industries, there can be little doubt that R.J. Reynolds would not tolerate its shipping subsidiary for long if the bottom line did not show a profit. It is difficult to argue with success.

Crew Costs

The cost of manning U.S.-flag ships is a principal cause of non-competitiveness in the operation of ships in the U.S. merchant marine. The requirement of the Merchant

Marine Act that U.S.-flag ships must be manned by U.S. citizens, and the fact that American merchant seamen receive greater wage and benefit payments than those of any other maritime country are directly responsible for this problem.

Crew costs are between two and three times greater on a U.S.-flag ship than for a similar ship of foreign registry. Mr. Eugene Yourch, speaking for the Federation of American Controlled Shipping (FACS), has stated that 1981 crew costs on a U.S. merchant vessel with a 32-man crew computed to over $3,000,000 compared with $1,300,000 for a 32-man Italian crew on the same type vessel. Costs for a Spanish crew of the same size would only be $1,050,000.[28] Individual wages for U.S. seafarers range from $20,000 for the lowest rank seaman to $150,000 a year for ship's masters. The average work year for U.S. merchant mariners is six months; thus for a vessel operator to keep his ships employed throughout the year, it would cost him $300,000 per billet for the master with similarly doubled costs down through the vessel's payscale.[29]

Base wage and overtime wage costs represent 50% of crew costs on U.S. ships. Pension contributions, medical and welfare benefits, shipboard lodging and subsistance, standby crew costs, transportation expenditures, training costs, and protection and indemnity insurance comprise the balance of the U.S. crew costs

and the generous compensation package afforded U.S. mariners for their service.[30]

Adding to the crew cost factor in U.S. vessel operation is the fact that manning requirements for U.S. flag ships exceed those of foreign competition. U.S. operators claim they are forced to carry as much as 25 percent larger crews than are actually required to efficiently operate their ships.[31]

Crew costs clearly represent the major portion of the ODS payments made to subsidized U.S. operators and are the primary reason that operating-differential subsidies are needed to achieve operational cost parity with foreign competitors. In FY 1982 the government spent $417 million dollars on ODS, $354.6 million (85 percent) of which went to pay for wage subsidies - an average of $61,282 for each of 5,786 employees on subsidized U.S. flag ships.[32]

The failure of U.S. maritime policy is apparent in this important area of merchant ship operations. The U.S. citizen manning requirement of the 1936 Act which was intended to ensure U.S. citizen participation in the seafaring trades has, in conjunction with ODS payments, contributed to the decline of both the merchant marine and seagoing jobs for U.S. mariners by fostering a competition-stifling labor environment. Because the difference in labor and other operational costs of U.S. ships over similar foreign competitors is passed directly on

to the government via ODS, operators have not felt a competitive imperative to pursue tougher positions in labor contract negotiations and they have failed to press more vigorously for labor saving technology and reduced crew sizes.[33] The labor unions themselves have participated equally with government and industry in mismanagement of the industry but; as Frank Drozak, President of the Seafarers International Union of North America, has admitted, maritime unions have had little reason to compromise with operators whose operating costs are subsidized by the government.[34]

Demise of Free Trade

All segments of the U.S. merchant marine have been hindered in their opportunities to fill a more prominent role in world shipping because of the philosophy of "free trade" which has long been the under-pinning of U.S. commercial policy. Stated policy and regulatory actions concerning maritime commerce have largely failed to recognize that the maritime industry operates in an international arena which to a very great extent does not adhere to free trade principles.

The U.S. merchant marine has been forced in essence to compete in world trade with a different, more restrictive set of rules than foreign shipping operators. Furthermore, the U.S. trade, with the exception of cargo preference provisions applying to military, foreign aid, and other

government agency-impelled cargos, is wide open to foreign shipping. Bilateral shipping agreements among other countries, and stringent foreign cargo preference rules are gradually closing out large segments of world trade from U.S. and other third party shipping competition.

The following examples indicate the extent to which foreign countries have reserved unto their own flag ships significant portions of their international trade: Argentina, 50 percent; Brazil, 100 percent petroleum, 50 percent coffee to U.S., 100 percent paper products; Chili, 50 percent; Columbia, 50 percent general cargo, bulk, liquid and refrigerated; France, two thirds imported oil; India, 100 percent oil; Indonesia, 40 percent of all cargo with Europe; Peru, 50 percent; and Spain, 100 percent imports of petroleum, tobacco and cotton.[35]

The openness of U.S. trade to foreign competition from state-owned East European and Soviet merchant fleets offering cut-rate tariffs to U.S. shippers has resulted in a further loss of market share to U.S. ship operators.[36] This type of competition is not impelled or sustained by profit motive. It is an instrument of the Soviet State, an integral part of the coordinated and centrally directed Soviet maritime power. The chief mission of the Soviet Merchant Marine, beyond its obvious naval and political support role, is to penetrate western trade routes and gather hard currency revenues in return for providing

cut-rate service. It was estimated by MARAD in 1977 that 85-90 percent of the growing Soviet liner fleet was engaged in the cross trades.[37] Long term operations and growth of the Soviet merchant marine clearly indicate its objective of displacing U.S. and western shipping and becoming the dominant carrier on world trade routes. The implications of that development from the viewpoint of U.S./NATO security are clearly evident. Of immediate commercial concern, however, is that the U.S. merchant marine which is still operated as a private enterprise, albeit a subsidized one, cannot hope to survive and flourish in a commercial environment rife with predatory traders and rapidly disappearing cargo carrying opportunities.

Regulation of Liner Conferences

A constant corollary to the traditional American advocacy of free trade has been a deeply rooted abhorrance of any commercial activity which has the anti-competitive characteristics of trusts or cartels. This constricted point of view which dates back to the Sherman and Clayton Anti-Trust Acts of the turn of the century has worked a particular hardship on the competitiveness of the U.S. flag liner industry.

Conferences (or cartels) of liner operators serving a particular trade route have existed since the 1890's, and are the commonly accepted way of controlling competition

on all the world's major trade routes today. Conferences typically enter agreements to fix rates and regulate service to avoid "wasteful" competition in their trade routes. The Shipping Act of 1916, recognizing the fact that U.S. ocean liners operated in a world apart from domestic business enterprise, granted them immunity from U.S. anti-trust law to enable them to operate more effectively in this fiercely competitive regime.

Certain weaknesses in the 1916 Act left U.S. participants in the liner conferences at a comparative disadvantage to their foreign liner conference associates. Conferences in U.S. trade routes were required to get FMC approval before any competition-limiting agreements could be placed into effect. They must also prove the agreement to be in the "public interest". Conferences could not exclude new members or prevent them or independents from undercutting conference rates. Other specific practices such as rebates, fighting ships, discrimination against shippers, and dual rates were banned.

In spite of the 1916 Act, the Justice Department, true to its anti-trust philosophy, has interferred constantly with liner regulation over the years, effectively eroding the intentions of the Act. Speaking out on this problem Senator Inouye in recent Senate debates on anti trust immunity has stated:

> The Department of Justice and those who see our anti-trust laws as ends in themselves have made no secrets of their efforts over the years to destroy the conference system. They have recommended outright repeal of the Shipping Act; they have consistently sought to render the protections in that act meaningless by challenging conference agreements before the FMC and courts, and by virtually immobilizing carrier efforts to utilize legally authorized techniques to make liner service efficient and dependable at fair prices.[38]

In 1980, for example, the Justice Department found all North Atlantic conferences guilty of price fixing and fined them a total of $50 million.[39] In 1976 Sea-Land was required to pay a $4 million settlement for paying rebates to shippers.[40] Lengthy FMC review procedures involved in approving conference agreements and extensive vulnerability to litigation of charged anti-trust violations have burdened the U.S. conference liner operators with a degree of operational inflexibility and expense not shared by foreign liners and independents in the U.S. trade. Foreign flag liners are not subject to anti-trust laws of their flag states and do not readily acquiesce to anti-trust jurisdiction in U.S. law. Policing and prosecution of foreign violators is difficult, and abuses such as rebating continue.[41]

Flags of Convenience

U.S.-owned ships which operate under foreign registries are said to sail under "flags of convenience," or,

depending on one's point of view, "flags of necessity." As of 1978, 677 ships owned principally by U.S. petroleum and resource corporations operated under foreign registry.[42] The role this mighty U.S.-owned merchant fleet has played in the demise of the U.S.-flag merchant marine is widely debated. Created during World War II and expanded rapidly in the years since, the U.S. foreign registry fleet has been a haven for U.S. ship owners seeking economic freedom from U.S. labor union rules and high wages, as well as U.S. income taxes.[43] This fleet has allowed U.S. shipping interests to thrive and profit at sea in a manner no longer possible under the U.S. flag. It has provided a reasonable alternative to the high costs and operational inflexibility experienced under U.S. maritime policy; and in this sense the "flag of convenience" fleet has served not so much as a cause, or even a symptom, but more as a catalyst to the decline of the U.S. merchant marine.

In the preceding sections we have discussed the long-term decline of the U.S.-flag merchant marine engaged in foreign commerce, and the regulatory regime under which this has taken place. We have seen how many components of the maritime industry, labor, federal agencies, and the Congress have played a part in diminishing American mercantile seapower. In the following sections the stated policies of the Reagan Administration toward the Merchant Marine will be discussed along with current congressional and administration initiatives intended to promote revival of the maritime industry.

CHAPTER VI

FORMULATING A NEW MARITIME POLICY

> Both government and industry share responsibility for the recent decline of American shipping and shipbuilding. Both government and industry must now make a substantial effort to reverse that record. We must begin immediately to rebuild our merchant fleet and make it more competitive. Accordingly I am announcing today a new maritime program for this nation, one which will replace the drift and neglect of recent years and restore this country to a proud position in the shipping lanes of the world.[44]
>
> - Richard Nixon
> 23 October 1969

The Reagan Program

Presidential Administrations have long recognized the importance of the merchant marine to the country. They have been equally perceptive to recognize America's declining role in foreign maritime commerce, and eager to pronounce optimistic programs for recovery. None so far have succeeded in halting the decline. With the inauguration of President Reagan in January 1981, however, a new political philosphy has come into being which is substantially different in its view of government's role in business and enterprise than any other since the New Deal of the 1930's. This fresh outlook, plus a strong

committment to national defense and security matters, presages renewed hope that national maritime policy may be reforged during this Administration.

During the 1980 presidential campaign candidate Ronald Reagan enunciated his maritime policy. Decrying the erosion of American maritime strength and the resultant loss of political, economic and military influence and prestige in the preceding years, particularly during the administration of President Carter, candidate Reagan outlined a plan to restore America's maritime power by revitalizing the Navy, the merchant marine, and the shipbuilding industry. A summary of the Reagan program follows:[45]

- Establish a unified direction for all federal agencies and programs affecting U.S. maritime interests. Cooperation between the Navy, merchant marine and government departments will be established for the Navy and merchant marine.

- Undertake sufficient naval and commercial shipbuilding to ensure that the shipbuilding mobilization base is preserved. A nucleus of trained workers and production facilities must be maintained to meet future challenges to national security.

- Increase utilization of the merchant marine for navy support functions to increase mobility while reserving trained navy crews for an expanded naval fleet.

- Ensure that U.S.-flag ships carry an equitable portion of U.S. trade. Recognize the restrictive and preferential trade policies of foreign nations and be prepared to respond constructively to them to maintain our trade interests.

- Restore cost-competitiveness of U.S.-flag operation in international trade. The system of operational and construction subsidies failed to maintain parity in the 1970's. Corrective action must be taken to ensure the survival and growth of the merchant marine and shipbuilding industry.

- Revitalize the domestic water transportation system, recognizing it as an economical and fuel efficient way to link the nation's producing heart land to all four coasts and to America's international trading partners.

- Reduce the severe regulatory environment which inhibits American competitiveness. A review of the effects of restrictions will be conducted, and appropriate action initiated to reduce the operational and regulatory restrictions which prevent U.S. ships and shipyards from meeting foreign competition.

Inspite of the full support voiced for maritime revitalization by Ronald Reagan during the 1980 Presidential campaign, a fully developed and comprehensive maritime policy was still not in place as his Administration moved into its third year. Policy remained to be transformed into workable programs and legislative action.

During 1981 the most significant achievement in maritime reform was the transfer of the Maritime Administration from the Department of Commerce to the Department of Transportation. This logical step was taken in August concurrent with the appointment of Drew Lewis as Secretary of Transportation. The move, originally proposed in 1966, recognized the status of the merchant marine as part of an increasingly inter-dependent transportation system and placed it under the department most concerned

with coordinating transportation programs. Transportation Secretary Drew Lewis was a vocal and articulate proponent of maritime reform; and his appointment, along with the shift of MARAD to Transportation seemed a propitious beginning to the Reagan program.

Initial elements of the Reagan Administration maritime policy objectives were not made public until May 1982 when the President, in proclaiming 22 May as National Maritime Day, said:

> For too long, our shipping industry has been in a state of decline, and its ability to meet the nation's economic and defense needs has eroded. My Administration is firmly committed to the rejuvination of the American merchant marine.[46]

Transportation Secretary Drew Lewis, President Reagan's spokesman for maritime affairs, outline the first phase of the Reagan program on 20 May, alluding to further elements which would be forthcoming as part of a "continuing formulation process:"[47]

- Support extension of the temporary authority approved by Congress in August 1981 for ODS flag ship operators to build or acquire vessels abroad without losing their operating-differential subsidy.

- Provide immediate eligibility for reflagged vessels to carry government-impelled cargos. Public Law 664 currently requires such vessels to be registered under the U.S. flag for three years before they can carry these cargos.

- Reform the Administration of ODS by DOT/MARAD to increase operating flexibility and reduce cost of the program.

- Encourage foreign investment in U.S.-flag shipping, allowing the foreign part ownership of U.S. vessels to increase from 49 to 75 percent. This would attract needed capital to the industry, but retain U.S. management control.

- Relieve U.S.-flag ships of the 50 percent ad valorum duty currently imposed on repairs conducted abroad, allowing operators the flexibility to have such repairs performed and reduce the repair cost to the ODS.

- Reduce unnecessary regulation of the ship operating and shipbuilding industries. Establish a government-industry group to further that effort.

- Support elimination of FMC regulations governing the level of rates of liner operators in domestic trades which, under the Jones Act are reserved to U.S. built, U.S. owned and U.S. crewed vessels.

On August 5, 1982 Secretary Lewis announced elements of the second phase of the Reagan maritime program development:[48]

- Increase ceiling on Title XI ship financing guarantees for FY 1983 to $900 million from the prescribed $600 million. The additional $300 million is to be held in reserve by the Secretary of Transportation for national security purposes.

- Grant permission to U.S. flag vessel operators to use tax-deferred Capital Construction Fund (CCF) deposits to build or acquire vessels abroad.

- Expand use of non-government civilian seafarers to crew vessels operated by the Department of Defense.

Once again Secretary Lewis referred to this policy development as an evolving process which would produce further elements to address the long-standing problems of the shipping and shipbuilding industry.

Policy towards subsidies, cabotage and cargo preference, though not specifically enumerated above, were addressed by Secretary Lewis in August. The Administration favors a continuation of the FY 1982-83 moratorium on payment of CDS funds. It also is opposed to initiating any new ODS contracts, although existing contracts would continue to be honored. The domestic trade would continue to receive full protection from foreign competition under the aegis of the Jones Act which was reaffirmed by the Reagan Administration. To address the issue of cargo preference, which is increasingly practiced by foreign trading states, the Administration intends to form a study group under the Secretary of Transportation, and with representation from the State Department, to study U.S. options.[49]

The maritime program of President Reagan is consistent to a substantial degree with his philosophy of freeing private industry from dependency on direct government support, and encumbrance by excessive government regulation. It significantly marks the first fundamentally different approach to promotion of the merchant marine since the nineteenth century granting of mail contracts, the precursor of long-evolving sytems of government support and regulation now firmly established through the 1936 Act and subsequent amendments.

Congressional Action

During the first two years of the Administration nearly two dozen bills were introduced in Congress which directly pertained to the regulation and support of the U.S. flag merchant marine. Only three were signed into law by the President: MARAD Transfer (HR 4074); the 1981 Omnibus Budget Reconciliation Act, which eliminated construction differential subsidies; and the 1982 Maritime Authorization (HR-2526, HR 3982, S-1017) which allowed U.S. flag foreign-built ships to receive ODS funds through FY 1982.[50]

Other important legislation introduced in the 97th Congress which would have promoted the competitiveness of the merchant marine in foreign trade, but which failed to be enacted, included:

- H.R. 3786 - Merchant Marine Vessel Tax Amendments of 1981 - a bill which would have provided for a depreciation tax write off for U.S. built vessels of one year, and foreign-built U.S.-flag vessels of five years, which would have been more in line with foreign practice. U.S. owners now have a minimum 14.5 year depreciation write-off.

- H.R. 6979 - Competitive Shipping and Shipbuilding Act of 1982 - a bill to promote carriage of bulk cargos aboard U.S. ships in international trade.

- H.R. 4374/S. 1593 - Maritime Regulatory Reform - a bill to clarify the immunity of the U.S. liner industry from anti-trust regulations when participating in international trade as part of liner conferences.

The central issue in maritime reform which was debated in the 97th Congress was the Administration backed proposals to grant broader anti-trust immunity to the U.S. liner industry. Two bills, H.R. 4374 and S. 1593, were introduced in August 1981 and were the focus of debate for over a year. The purpose of these bills was to reaffirm the intent of the Shipping Act of 1916 to exempt U.S. flag ships operating in liner conferences in the international trade from the anti-trust laws of the United States. Proponents of the bill who represented all segments of the industry, including ship owners, shippers, labor and shipbuilders, argued that this type of regulatory reform was necessasry to allow U.S. liners to compete on an equal footing with foreign liners in the conference trades. This would be accomplished by allowing common carriers complete immunity to anti-trust laws while joining in conference activities to fix rates and condition of service; pool earnings, losses and traffic; restrict the number of sailings; prevent competition; and meet with shippers to discuss general rate levels, practices and services.[51] Such agreements would have to be filed with the FMC, but would become effective, barring FMC objection, within forty-five days of filing. Under current procedures conferences are required to demonstrate that proposed agreements meet public interest standards before the FMC will grant approval. This procedure is often costly and lengthy,

and is subject to protracted litigation and unfavorable judicial interpretations.

The House version of this bill (H.R. 4374) ultimately won broad support within Congress, the Administration, and industry; and was passed by a 350-33 vote in September 1981.

Opposition to this form of maritime reform was both impassioned and vociferous. Consumers groups and the National Farmers Union, among others, feared that the broad anti-trust immunity granted by these bills would result in higher consumer prices for imported goods and reduced competitiveness of U.S. exports as a result of higher shipping rates and less competition among common carriers. Economist Allen Ferguson, Chairman of the National Institute of Economics and Law, has asserted that shipping rates could increase 10-20 percent if anti-trust immunity is granted to liner conferences.[52]

Strong editorials in the New York Times and Wall Street Journal during the summer of 1982 opposed the impending anti-trust legislation, voicing the opinion shared by many that anti-trust immunity for the liner companies is essentially unfair to the rest of U.S. industry and the non-liner segment of the shipping industry. Others felt that cartels, another word for conferences, are in themselves essentially bad.[53] Fear of them is deeply rooted in American economic tradition as the principal nemeses of free trade. Herein lies an odd dichotomy in

President Reagan's political philosophy and his maritime policy. His advocacy of free trade and free competition would dictate opposition to anti-competitive practices of conferences or cartels, but his support of the anti-trust immunity measures of this legislation supports his policy that business should be free from excessive government regulation in order to operate most efficiently. In the case of the U.S. liner industry, the most important remaining segment of the U.S.-flag merchant marine, the Administration has recognized the key fact that U.S. liners operate in an international arena quite different from the domestic business environment, and where free trade principles no longer hold sway.

Another criticism of the Reagan position in support of liner cartels is that higher cargo tariffs resulting from less competition among carriers will transfer the burden of government operating support from the ODS subsidy payments to the consumer. It has been estimated that U.S. liners would earn an additional $1 billion dollars annually as a result of a 20 percent rise in liner freight rates. Foreign carriers would reap an additional $2 billion dollars.[54] Whether the criticism is fair is uncertain, but the position is consistent with the stated policy of the Administration "that the U.S. fleet must become competitive to the extent possible without further subsidy."[55]

Both the House and Senate shipping bills died without being enacted into law as a result of successful efforts by Senator Howard Metzenbaum and his supporters to block S. 1593 in the Senate. The year 1982 thus passed without congressional enactment of major comprehensive maritime reform.

The evolving process of maritime policy formulation continues into 1983 with the 98th Congress. A decisive breakthrough in this process occurred on March 1 when the Senate passed the Shipping Act of 1983 (S. 47) by a 2 to 1 margin. This legislation has essentially the same provisions as the controversial bills H.R. 4374 and S. 1593 which died in 1982. After years of debate and stalemates on the issue, Congress is close (pending final House approval) to granting the U.S.-flag liner industry the anti-trust immunity they have deemed necessary to enable their competitive participation in the foreign-dominated liner conferences which service U.S. trade routes. The House version of this bill, H.R. 1878, has won unanimous approval from the Merchant Marine and Fisheries committee, and is almost assured of passage when it reaches the floor of the House in May 1983.[56]

The 1983 Act greatly broadens anti-trust immunity prescribed in the Shipping Act of 1916 by deleting the requirement that conference agreements (tariffs) receive prior FMC approval before going into effect, and deleting

the requirement that conferences must demonstrate that proposed changes to tariffs meet a public interest standard. Conference agreements under the new Act would become effective 45 days after filing with the FMC. In essence, anti-competitive measures can go into effect without approval from a regulatory agency. The burden of proof for challenging them now lies with the complainant.[57]

Other salient points of the 1983 Act include:[58]

1. The FMC will enforce cartel agreements which are filed with it.

2. Conferences serving the U.S. cannot restrict membership.

3. Ocean carriers are only subject to the jurisdiction of the FMC, not the Federal Trade Commission (FTC) or the Justice Department.

4. Individuals can no longer collect treble damages under the Clayton Act in suits against conference members.

5. Conferences can post intermodal rates through to inland destinations or origins.

6. Shipper's Councils are not allowed by the Act, although small shippers can join together in joint ventures.

If the 1983 Shipping Act achieves its intended purpose it should permit greater cooperation and rationalization of services among ocean carriers, and allow harmonization of U.S. shipping practices with those of foreign competitors and fellow conference members. Towards this end it sets out as policy objective the development and maintenance of "an efficient ocean transportation

system through commercial means, with minimum government involvement in order to serve the needs of United States foreign commerce."[59] Maritime Administrator, Adm. Harold E. Shear has said, "The Shipping Act of 1983 is the cornerstone of our policy because reforms in the U.S. regulation of ocean shipping are vital to the recovery and competitiveness of the U.S.-flag liner operations in our export-inport trade."[60]

The most severely depressed segment of the U.S. shipping industry is that of the bulk carriers which now haul less than 4 percent of all U.S. bulk imports and exports. Legislation to promote this sector of the merchant marine was introduced in the House by Representative Lindy Boggs in February 1983 as the Competitive Shipping and Shipbuilding Act of 1983 (H.R. 1242). It is identical to H.R. 6979, introduced but not acted on in 1982, and is a cargo reservation scheme designed to boost the percentage of bulk cargos carried on U.S. flag ships and increase the demand for U.S.-built ships.[61] It has been estimated that 184 bulk carriers would be required in 1998 to carry 20 percent of U.S. bulk cargos. One hundred fifty-eight new U.S.-built ships would be required to meet this goal.[62] Rep. Boggs maintains, "Passage of this legislation will help achieve one of the long-standing objectives of the Congress as well as one of President Reagan's goals, that is, to ensure an American

merchant fleet capable of carrying a fair portion of our Nation's foreign trade."[63]

Specifically, the bill requires the reservation of 5 percent of all U.S. bulk imports and exports (by tonnage) to U.S.-flag ships in 1984. The amount will increase 1 percent per year for the next 15 years until 20 percent of all bulk imports and exports are carried in U.S. ships. Guideline rates for the carriage of bulk cargos on U.S. ships would be established by the Secretary of Transportation. The Secretary is also tasked with estimating after enactment of the law the current costs of operating various classes of U.S. bulk carriers, and the cost of constructing various classes of U.S. bulk carriers in U.S. shipyards. The cost of each activity would be required to be 15 percent below the Secretary's base-line estimate within two years of the bill's enactment.[64]

Cargo preference legislation has traditionally garnered strong support from labor and shipbuilding interests, but has in the past been vigorously opposed by non-maritime elements of the business community, particularly importers, exporters and farmers. It is generally believed that the requirement to ship on more expensive U.S. vessels takes the competitive edge off U.S. exports and increases the cost of foreign imports. The provision of H.R. 1242 which mandates 15 percent reduction in ship operating and and construction costs is intended to assuage such concerns.

The prognosis for ultimate passage of this legislation is uncertain. While this bill effectively addresses a serious deficiency in the U.S.-flag merchant marine and is consistent in concept with foreign shipping practices, it represents a form of remedy to America's maritime malady which the Reagan Administration has heretofore chosen not to embrace. Though recognizing that foreign cargo alloction requirements pose a challenge to U.S. operators[65], the Administration has not gone beyond considering options and entering into consultations with European and Japanese trading partners on the issues of bilateral cargo agreements and response to the UNCTAD liner code.[66]

The previous pages have discussed legislative measures now pending which would provide major support to both the liner and bulk segments of the maritime industry. On January 26, 1983 Senator Inouye of Hawaii introduced legislation (S. 125) into the Senate to appropriate $200 million for FY 1984 to reactivate the construction differential subsidy which was discontinued by the Reagan Administration in 1981. The bill also would authorize raising the statutory $12 billion ceiling on the Title XI construction loan guarantees program to $15 billion.[67]

The introduction of this bill highlights the concern of many members of congress and the shipbuilding

industry that the Reagan Maritime policy is not doing enough to save, let alone promote, U.S. shipbuilding. Senator Inouye states, "The Congress has been waiting over two years for an alternate proposal from the Administration and it has not been forthcoming. In the interests of national security and a strong merchant marine, I do not believe we can delay any longer."[68]

The renewal of CDS, is contrary to the objectives of the Reagan maritime policy. Current treasury deficits, government-wide funding cutbacks, and the failure of billions of dollars in past subsidies to produce a strong merchant marine make it unlikely that the Reagan Administration will approve this bill.

The Reagan Administration's committment to the nation's shipbuilding base is currently manifested in two programs: the Title XI construction loan guarantee program, and the massive navy shipbuilding and conversion program. The Administration has proposed a $900 million ceiling on loan guarantees for FY 1984 which it believes adequate to cover anticipated needs.[69] Naval construction and sealift conversion and charter programs are expected to boost production in U.S. shipyards. Thirty-two vessel construction and conversion contracts were let by the government to private yards in 1982 as the beginning of the 600 ship Navy buildup got underway. The Navy's "T Ship" program, intended to provide sealift capability

for logistic support, should provide substantial work for shipyards not otherwise capable of complex naval construction. Contracts for nine new construction sealift vessels and twelve merchant ship conversions were let with seven private shipyards under this program in 1982.[70]

CHAPTER VII

CONCLUSIONS

The stated maritime program of the Reagan Administration represents a clear departure from the costly and ultimately unproductive course that federal policy has pursued since 1936. In this sense it represents a step in the right direction towards restoring the economic vitality of the U.S. Merchant Marine. The program suffers, however, from two major problems: lack of comprehensiveness and slowness of implementation. The piecemeal approach to addressing the problems of the merchant marine has resulted in an uneven and inequitable implementation of new policy.

Legislation currently pending in Congress promises to provide substantial increases in the size and competitiveness of the merchant marine. The Shipping Act of 1983, almost assured of passage, should enable U.S. liners to compete in the liner conference trades on a much more equitable footing with their foreign competitors. The Competitive Shipping and Shipbuilding Act of 1983 has the potential, if passed, to provide substantive growth in the U.S.-flag bulk carrier fleet and a large boost to the U.S. merchant shipbuilding industry.

The elimination of the construction differential subsidy in 1981 marks a watershed in modern U.S. maritime policy, and along with a proposed phaseout of operating differential subsidy marks the beginning of the end of direct and massive cash support to the maritime industry by the federal government. This is an encouraging step because it finally breaks the burdensome link which has bound U.S.-flag operators to an inefficient shipbuilding industry.

The elimination of CDS and the proposed elimination of the 50 percent ad valorem maintenance and repair tariffs could be a major blow to the U.S. shipbuilding and ship repair industries if swift and decisive action is not taken by the Administration to provide compensating incentives for investment in this sector of the industry. Continuance of the highly successful Title XI loan guarantee program, the capital construction fund, and the construction reserve funds should be continued. Low interest loans, accelerated depreciation, and additional tax breaks should be considered to encourage ship owners to buy from U.S. yards.

The Reagan navy and military sealift shipbuilding programs will provide enough work to sustain a substantial portion of the U.S. shipbuilding base until long term policy solutions are implemented. A prolonged dependence on government contracts alone, however, will not encourage fundamental changes in efficiency which will allow U.S. yards to compete with foreign shipbuilders. For a truly

healthy commercial maritime industry measures must be implemented to wean U.S. shipbuilders away from heavy dependence on military shipbuilding contracts.

The future for a U.S.-flag bulk cargo fleet rests with the fate of H.R. 1242 which has not yet been acted upon by Congress. Its passage would promote through cargo reservation schemes substantial real growth in the bulk cargo fleet over the next 16 years. However, several major problems have the potential to block this measure. First, major U.S. corporations with a proprietary interest in the shipping of bulk cargos are very comfortable conducting their trade under "flags of convenience." They cannot be expected to support the creation of U.S.-flag bulk cargo fleet that would run in competition to their foreign flag assets and increase shipping costs. Similarly, American importers and exporters who would experience higher shipping costs on U.S. ships can not be expected to support this measure. Thirdly, the Boggs bill runs ahead of the Reagan Administration policy on cargo preference, which has not yet been fully enunciated.

The Administration must determine its policy on the cargo preference issue before Congress enacts any form of enabling legislation. It should decide to implement a system of bilateral shipping agreements between the U.S. and its major trading partners, or, in the case of liners, become a party to the UNCTAD liner code. The U.S. should recognize that free trade and open markets do not prevail

in the world of shipping. As the Administration acknowledged this reality in supporting the anti-trust immunity measures for liner conferences, so should it also be prepared to relinquish its free trade posture in the area of cargo reservation. Otherwise cross trade shipping forced out of foreign trade routes by other countries' bilateral agreements and the UNCTAD liner code will increasingly flock to the still-open U.S. trade, resulting in over tonnaging of U.S. trade routes and untenable competition for U.S. flagships. In implementing a cargo reservation policy government would ensure U.S.-flag shipping an equitable portion of U.S. foreign trade and increase the demand for U.S.-built ships. Shippers might not be universally satisfied with this arrangement, but at least it would be consistent with world practice.

Much remains to be done if the Reagan program is to be translated into a new and comprehensive maritime policy for the United States. Accelerated regulatory reform, enhanced economic incentives, and a more realistic and pragmatic U.S. role in the international ocean shipping regime is essential to success in this endeavor. The government must take the lead in shaping this new policy; but a new cooperative spirit among the diverse elements of the maritime industry, labor, and government - something heretofore lacking - will be essential if a successful strategy for maritime recovery is to be evolved.

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