Cargo Preference and Reservation - Preserving U.S. Flag Service: Alternatives

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PART I

Introduction

In early May 1983 the Executive Committee of the Great Lakes Commission adopted a resolution which called on the Congressional sponsors of the Competitive Shipping and Shipbuilding Act of 1983 (S. 1000 and H.R. 1242) to amend the legislation. The legislation would require many U.S. bulk commodity importers and exporters to ship a percentage of their products on U.S. flag vessels. The percentage would begin at 5% and increase by a percent annually for 15 years until a 20% level was reached.

The Commission's resolution which had been recommended for adoption by the Transportation and Economic Development Committee's subcommittees stated that the legislation should contain a permanent waiver from the flag requirements for bulk commodities shipped through Great Lakes ports. It is believed that the legislation would result in higher transportation costs for certain waterborne commodities moving through Great Lakes ports, particularly grain. Also, a substantial diversion of cargo from Great Lakes ports could result if the legislation becomes law. For these two basic reasons, the Commission stated that it was opposed to the proposed legislation, "at this time" because it did not contain such an exemption (waiver).

This position on the legislation was not changed at the GLC's Semi-Annual meeting in late May. During the summer, the issue remained an agenda item for subcommittee conference calls. The transportation subcommittee directed staff to prepare a paper addressing the issue of cargo preference - cargo reservation policy as it affects the Great Lakes with a particular emphasis on alternative approaches to assisting the U.S. Merchant Marine.

Overview

The United States can be considered an "island nation." Growing international ocean trade along with a strong naval capability have combined to create a substantial high seas military presence as well as a strong dependence on ocean commerce. Total U.S. foreign trade amounted to $472 billion in 1980, a startling increase from $83 billion in 1970. This figure was 18% of the gross national product for 1980. The great majority of this foreign trade - over 90% - was represented by waterborne commerce. In 1980 921.4 million tons was recorded, basically balanced between imports and exports. Although U.S. foreign trade is dominated by waterborne carriage, substantial rail and truck traffic exists between the U.S. and Canada and Mexico along with a small volume but expanding overseas air freight service.

The importance of overseas and coastal transportation manifested itself early with respect to North America. The exploration era by European societies was initially totally dependent on sea-going reconnaisance. After colonial footholds were established on the salt-water littoral, ocean commerce became the underpinning for mercantile imperialism. The two-way transoceanic

exchange of goods fostered a system of mutual dependence until political revolution severed the maritime links and forged a new commercial seascape. With Independence, the fleet of merchant ships flying the U.S. flag increased in number as well as carrying capacity. In 1850, 65% of U.S. foreign trade was being carried in U.S. flag vessels. However, for the latter half of the century a gradual erosion in U.S. vessel merchant tonnage occurred so that by 1900 only 9% of U.S. foreign trade was moved in U.S. bottoms. The Shipping Act of 1916 encouraged a major expansion in U.S. shipbuilding as a prerequisite for joining the Allied war effort. However, the Great Depression and its companion, high tariffs, caused another downturn in merchant activity. The need for sufficient merchant logistics capability again was recognized in 1936 with the passage of the Merchant Marine Act of 1936. It is generally acknowledged that through various measures, the Act was intended to raise U.S. flag carriage to 50% of overseas cargoes. During World War II, the U.S. embarked on a crash shipbuilding program that laid keels for over 5700 substantial-size vessels, many of them versatile break-bulk, general cargo ships. From a post-war peak in 1947 when 57% of U.S. export/import cargoes were moved under U.S. flag, the percentage has declined precipitously: 1950-42%; 1955-23%; 1960-11%; 1964 to present-4.5%.

Cabotage cargo preference and reservation laws and related regulations are intended to shore up the fortunes of the U.S. merchant fleet. These cargo requirement measures represent one approach to restoring U.S. flag service to the commercial seas. There are other proposals and means by which the same goal can be pursued. The purpose of the discussion paper is to review governmental maritime policy with regard to cargo preference and reservation measures and discuss possible alternative approaches to present policies.

Maritime Policy: Cargo Preference and Reservation

A U.S. cargo preference policy was first formalized in 1904 when legislation was passed generally requiring U.S. flag or U.S. owned vessels to carry seaborne supplies for the Armed Services. The Act does not mandate carriage in privately owned U.S. flag vessels. Difficulties in moving supplies during the Spanish-American War and similar legislation among European countries prompted Congress to act. The Act provided for a waiver if freight charges for U.S. carriage were determined to be "excessive or otherwise unreasonable".

Thirty years later, Congress adopted a resolution which stated that all goods financed through loans by the federal government shall be carried exclusively by U.S. flag ships provided rates are reasonable and ships are available - waivers were permitted. However, because the resolution was not law, had a rather specific historical context (trade agreement with China) and has been mostly applicable to Eximbank loans, the resolution has not had a significant impact on U.S. foreign cargo movements. At present, 75 percent of Public Resolution 17 cargoes are transported by U.S. flag merchant vessels.

Public Law 664 (Cargo Preference Act of 1954) expanded cargo preference policy for government-generated cargoes. The law became part of the Merchant Marine Act of 1936 and made permanent the percentage (50%) shipping requirements that had become part of many economic and foreign military assistance statutes. This legislation has been subject to, at times, divergent interpretations by government agencies responsible for particular cargo movements. The result has been numerous compliance controversies and the appearance of

government indecision regarding fulfillment of legislative intent. Also, cargo preference policy, as embodied in the law, has been challenged outside of the government by an array of interests.

In more recent years, new efforts, both legislative and administrative, have been made on behalf and against cargo preference policy. In 1977 an attempt to require that at least 9.5% of imported petroleum cargoes be shipped on U.S. flag vessels foundered in the House. Opponents charged that the measure supported by President Carter was, in reality, a political payoff of maritime interests. An attempt to require geographical allocation of preference cargoes (10% minimum per four coasts) thorugh administrative rule-making was initiated in late 1980 by the Maritime Administration (MarAd). Resistance by tidewater interests, criticism of the timing of the action as being politically motivated, and second thoughts by the Administration (concern over administrative complexity) all combined to diffuse the effort. A deep-draft user fee/cargo preference bill was introduced in 1981 by Representative Jones (D-NC) that would require, among other things, bilateral agreements between the U.S. and its major trading partners regarding mutual cargo sharing. A 40-40-20 arrangement (40% for each partner, 20% by others) for dry bulk cargoes to be obtained within a ten year period was part of the proposed legislation. This bill was also diverted on its way toward passage.

In 1982, Represenitive Boggs (D-LA) introduced H.R.6979 that called for a 20% U.S. flag share of bulk cargoes within a 15 year period following enactment. This cargo reservation bill encountered resistance from traditional sources and eventually was resurrected in the present 98th Congress with certain significant changes. In the legislation (H.R. 1242) was drafted to include a section on guideline rates (maximum U.S. flag rates for specific movements) and a waiver provision if U.S. flag vessels were not available within the established rates. Congresswoman Boggs' bill in 1982 had 80 cosponsors; this year her revised version has 147 cosponsors. In the Senate, Senator Trible (R-VA) has introduced a companion bill, S. 1000. However, the Senator has also introduced similar legislation (S. 1624) that essentially differs from his other bill by increasing the mandated shipbuilding cost reduction to 20% (from 15%) and adding special tax credit provisions for shippers complying with the proposed law and incentives for shipyards. The cargo reservation measures for bulk cargoes have been strongly objected to by agricultural export and coal shipping interests as well as others. Opponents contend that the inevitable increased shipping costs will interfere and disrupt overseas marketing of products and may require costly and logistically difficult diversion of cargoes from usual route patterns.

On another front Representative Jones, the Chairman of the Merchant Marine and Fisheries Committee, introduced H.R. 2692 (The Government-Impelled Cargo Act of 1983) in April. In July, S. 1616, a similar but not identical bill, was introduced in the Senate by Senator Stevens of Alaska. The House legislation follows formal oversight hearings by Jones' committee investigating several agency preference compliance controversies. Also, the committee published a report on 2-17-83 which addressed the difficulties of enforcement and implementation of current cargo preference law. It was recommended that revised legislation be drafted to remedy perceived problems in cargo preference law. The Jones' legislation would repeal and replace existing cargo preference laws. Several significant changes in H.R. 2692 include:

1. Expansion of 100% cargo preference requirements to all water-borne cargo affecting the national security of the United States. This category would include, among others, petroleum procurement for the Strategic Petroleum Reserve (SPR), all materials procured for the National Defense Stockpile (NDS) and all motor vehicles and household goods of U.S. governmental employees when such transportation at government expense is authorized by law.

2. "U.S. flag vessel" is defined to include a 25 year old maximum eligibility requirement - can be older if substantially re-built within last 5 years and if not built in the U.S. but is redocumented under U.S. standards and less than 5 years - a present three year waiting period practice would be statutorily removed. Language regarding "competitive rates" gives new meaning for agency compliance with respect to securing U.S. flag service. For liner vessels, rates are those conference rates for similar cargoes and bulk vessel rates are based on an independent formula S. 1616 mandates a 15-year old vessel threshold for preference eligibility (bulk or liquid cargo).

3. Regarding non-national security cargoes, the legislation specifies more precisely the application of preference requirements for direct and indirect government generated "or involvement" cargo.

4. Equitable routing of cargo subject to the Act (10% minimum for each of four coasts) would be required "to the extent practicable." S. 1616 does not contain a similar provision.

5. Section 7 addressing compliance clarifies existing policy and makes more stringent agency compliance procedures. This section also promotes advance notice provisions for solicitation of U.S. flag vessel service.

Recent Congressional efforts to restrict the application of cargo preference laws have taken several different tacks. One approach is a bill, introduced by Congresswoman Smith (R-Neb) in 1982, that would have exempted dry bulk cargoes from pertinent laws. Senator Dixon (D-IL) proposed that in an effort to reduce costs, only those U.S. vessels which would deliver preference cargo at the lowest landed cost could be used. His bill, S. 2511, would have induced more shipments through Great Lakes ports. This year several agricultural district representatives including Nebraska's Smith sponsored a bill that would exempt ag-exports financed under new blended credit programs from cargo preference. They also support proposed legislation to prohibit the Commodity Credit Corporation from paying excess costs attributable to preference requirements for subsidized agricultural exports. Similar legislative efforts have been advanced in the Senate. Rep. Smith also has introduced House Congressional Resolution 136 which states opposition to further expansion of cargo preference through the H.R.1242 bulk cargo reservation bill. Fifty-nine of her colleagues have signed it.

The present federal administration has reaffirmed, albeit with some equivocation, its support for cargo preference. Secretary Dole (DOT) has recently said "support of the existing cargo preference laws is a confirmed element of the Administration's maritime policy." Maritime Administrator Shear has also recently stated before several Congressional committees that the Administration continues to "strongly support these laws (cargo preference) and, where required, would support an appropriate clarification of existing law." The Administration, though, is firm on the point that expansion or contraction of the scope of current law is not warranted and would oppose any such effort.

During the last two years, several controversies have arisen over the application of cargo preference law to certain government generated cargo. In 1981 a 100,000 metric ton U.S. butter sale to New Zealand through USDA's Commodity Credit Corporation was negotiated. As of October 31, 1982 only 27% of 77,000 metric tons had been shipped under U.S. flag. MARAD and the chairman and ranking minority member of the Merchant Marine and Fisheries Committee along with others maintained that the sale was concessional and not a commercial sale as maintained by the USDA. It was pointed out that the U.S. had extended credit to the New Zealand Dairy Board thus supposedly triggering preference requirement eligibility. Also in 1981 the acquisition of 1,600,000 long tons of Jamaican bauxite for the National Defense Stockpile through a combination cash purchase and barter of surplus agricultural commodities caused a preference stir. All of the bauxite was eventually shipped on foreign flag vessels. Again, MARAD and several congressmen protested the GSA's announced intention to use foreign flag vessels because suitable U.S. vessels of a certain size with special unloading equipment were not available. Preference supporters pointed to the non-commercial aspects of the transaction.

Other problems with the application of cargo preference have come to light. Oil destined for the Strategic Petroleum Reserve has moved from Alaska and foreign countries. The Department of Energy maintained that the Alaskan shipment (U.S. flag because of the Jones Act) counted toward the 50% preference requirement. However, others vigorously protested that such shipments should be considered separate referring to logical and historical interpretation of the law. A recent subsidized sale of commercial wheat flour to Egypt became controversial when the Agriculture Department indicated that cargo preference would not apply. The White House intervened and cargo preference will now apply to the million ton sale. Great Lakes interests including the Great Lakes Task Force and the Great Lakes Commission mounted a campaign to seek an equitable percentage of these shipments, whether U.S. flag or other, for Great Lakes ports. Because of numerous factors including a shipping policy of lowest landed cost, the amount moved through the lakes so far has been sadly disappointing.

An encouraging event in August, 1983 points to some improvement in agency implementation of cargo preference. The Agriculture Department has agreed to use U.S. flag vessels to the extent that they are available at reasonable rates for a government-supported sale of butter and processed cheese to Egypt. However, new export blended credit programs and those tied to Payment-In-Kind sales may cause future difficulties with compliance.

Part II of this paper includes an issue-specific format. Major issues that have a bearing on cargo preference and reservation law will be discussed. Following each of the issue paragraphs will be a section proposing alternative actions to be considered.

PART II

Seven intercontinental oceans and various land-pinched seas are the principal backdrop for the global maritime industry. The vessels, shipyards, ports and terminals figuratively make the world go round. Ocean-borne movement of oil, grain, iron ore and coal is critical to the industrial and resource supplying nations. The maritime activities of many countries are so important that the assurance of an appropriate maritime role for them has become a major goal of federal policy. Some countries consider their nation's vessel fleets as tools of foreign policy and in particular cases extensions of military power and national prestige. Whatever the reasons for the maintenance of national merchant fleets, their prominence in international trade is growing.

In the United States, maritime policy was given substantial recognition with the passage of the Merchant Marine Acts of 1920 and 1936. Known as the Jones Act, the 1920 legislation reserved for U.S.-built and crewed vessels all domestic waterborne passenger and commodity movement. In its express declaration of policy, the 1936 Act stated the U.S. merchant marine was intended to carry, in addition to all of the country's domestic waterborne commerce, a substantial share of exports and imports and be capable of military support in time of war or national emergency. Today, the domestic cabotage provision remains relatively intact, but faithful adherence to the other two goals is certainly lacking.

In the Great Lakes, all of U.S. intralake movements are, of course, under U.S. flag. In 1981, 121 million tons moved through the system. In 1982, fewer tons were carried; only 67 lake vessels were active - there are around 120 lakers in the Great Lakes dry bulk fleet today. The number of active and reserve lakers has been steadily declining in recent years, but total deadweight tonnage has been increasing. The basic reasons for this are: cargo tonnage declines related to economic conditions and the retirement of older vessels combined with larger capacity craft being gradually introduced. The U.S. flag liner presence in the Great Lakes has suffered a much more serious fate. As the number of these vessels has steadily declined, their presence in the lakes has also diminished because cargo opportunities have nearly dried up. For years, Great Lakes and St. Lawrence Seaway maritime interests have endeavored to come up with a winning solution to the cargo generation problem. The "chicken or the egg" dimension of the situation, that is, which should and can come first - the cargo or the vessels, has stymied transportation planners.

Efforts to improve the U.S. maritime industry include cargo preference, reservation and cargo-sharing policies. These policies though do not always work toward the Great Lakes advantage. The following series of issues are briefly presented along with alternative approaches to policy objectives inherent in the issues.

<u>U.S. Merchant Marine Fleet Sufficiency: General Trade, Strategic Mineral Resources and Defense</u>

With less than 5% of U.S. export and import tonnage carried in U.S. flag ships, it is quite apparent that one of the goals of the Merchant Marine Act of 1936 (substantial share of such cargoes) is not being met. According to

MARAD, there are around 835 vessels in the U.S. merchant marine - as of 9/1982. However, this figure includes 266 government-owned vessels, 240 of which are not in active service because they are part of the National Defense Reserve Fleet. The category for privately-owned, active and ocean-going comprises around 500 vessels at approximately 18,000,000 deadweight tons. The average age of the U.S. flag fleet is 25 years in contrast to a 10-year average for the maritime countries of Japan, France, West Germany and Norway. Although not part of the American merchant marine, over 600 vessels under foreign flags are owned by U.S. companies or foreign affiliates. These foreign-built, "runaway" or "convenience" flags are crewed by foreign nationals and many are oil tankers dedicated to that trade. This so-called effective controlled fleet would be conceivably available for use in national emergencies but some critics suggest that the questionable dedication of the crews under difficult circumstances and the lack of reserve trained seamen to substitute, if needed, point to problems.

The U.S. cannot easily chart a maritime policy course through the sea of conflicting and competing international policies. For a variety of reasons many countries have expanded their merchant fleets. For example, Brazil increased the size of its commercial fleet from 2 to 8 million dwt from 1970 to 1980. That country's substantial sea-going presence has also boosted its shipbuilding industry where annual production capacity now is around 2 million dwt. The Brazilians along with dozens of other maritime nations sustain their maritime industries with complex subsidy programs and stiff cargo preference requirements. Even Canada has aggressively supported its maritime industry through direct subsidy and accelerated depreciation for marine equipment. Many of these foreign flag fleets are permitting downward pressure on rates and forcing other countries like the U.S. out of the commercial sea lanes. For the U.S., the maneuvering room to dramatically change the situation has few possible routes.

One area that has come under increasing scrutiny is the carriage of strategic mineral resources. Critically important minerals for American industry such as maganese, cobalt and nickel are dependent on foreign flag movement. In fact, only about 20% of our strategic mineral imports could be accommodated by U.S. carriers considering the present fleet size. Representative Jones' bill, H.R. 2692, would control for the possibility of problems by requiring all cargo determined to affect national security (military, oil for the SPR and materials for the National Defense Stockpile) to be carried under U.S. flag. The basic objective of this provision is to ensure an uninterrupted flow of these goods to the U.S. in time of national emergency or international dispute. It would provide the necessary vessel base to maintain trade; if not provided for, the vessel base may not be sufficient for contingencies.

One of the main objectives of a merchant marine is the potential double duty for military sealift. Today, the number of militarily useful dry cargo ships in the merchant marine is around 440. Some of these vessels are privately owned and currently in service, but most are part of the National Defense Reserve Fleet, the Ready Reserve Fleet (capable of quick activation) and the Military Sealift Command. The Joint Chiefs of Staff have stated that sealift would provide about 90% of dry cargo needs and 99% of petroleum product movement in the event of a transoceanic military crisis. 1983 Naval exercises and the current Indian Ocean prepositioning deployment has

stretched U.S. sealift capacity thin. In contrast to the U.S., the Soviet Union has embarked on a large cargo shipbuilding program which emphasizes military-commercial compatibility. Their high seas logistics support capability is far ahead of U.S. levels according to military experts. In 1983, the Soviets had a merchant force of 2,456 vessels, sixth largest in the world. The projection of naval power around the globe is a key element in U.S. military posture. Also, the necessary logistical support for distant land operations plays an important backup role. Without a sufficient merchant marine, our global military strength is severely handicapped.

The Navy, cognizant of its sealift needs, has begun a sealift enhancement program to improve capability. As part of a prepositioning strategy, the Navy has chartered 17 ships and stationed them in the Indian Ocean. An additional 12 cargo vessels are under contract to be built. This fleet, when operational, will provide support for a 48,000-man force. Conversion programs are another facet of the program. The Great Lakes shipbuilding industry (Bay Shipbuilding) is currently refitting a general cargo vessel with cranes as part of the Navy's T-AK Support Ship Conversion program.

Alternatives:

1. Support diversion of defense expenditures to non-combat, support ships from expensive combat vessel category. Particularly, fewer carrier task forces which have been criticized as inflexible and vulnerable may be one approach.

2. Support for H.R. 2692 provision which would reserve all strategic minerals imports for U.S. flag.

3. Propose legislation which would acknowledge U.S. laker vs. Canadian laker rate differentials and target special operating subsidies for U.S. vessel operations in the Great Lakes.

4. Support reflagging legislation for a limited number of specific vessels which would require U.S. maintenance and crews. This approach is currently underway with pending Cunard passenger vessel legislation.

5. Support more vessel conversion Navy programs that would enhance opportunities for Great Lakes yards. As part of this approach, urge more defense-related features for cargo vessels to ensure potential multi-purpose use.

6. Oppose waiver requests of Jones Act legislation for domestic coastwise and inland bulk cargo thereby providing incentive for U.S. operations to build for projected business. Also, oppose strenuously Jones Act repealer legislation, H.R. 3807, introduced by Frenzel (R-MN).

7. Support maintenance of construction and operating differential subsidies for merchant marine.

8. Support regulatory reform - particularly increased coordinated ratemaking and expedited rate approvals.

9. Support Great Lakes feeder service (general cargo) to St. Lawrence River consolidation points. Presumably, circuit vessels would be U.S. flag.

10. Explore RO/RO rail or truck service between particular U.S. Great Lakes ports.

11. Explore means of training reserve seamen for use in case of national emergency.

12. Support cargo preference proposals to expand military national security cargoes to include "all equipment and supplies bought for" all services including the Coast Guard and all required transportation of military personnel household goods and motor vehicles. These provisions are contained in H.R. 2692.

13. Extend coastal threshold for Jones Act application from present 3 miles to 200 miles.

14. Oppose protectionist legislation for non-maritime industries, e.g. steel, autos and textiles in order to encourage world-wide free trade.

15. Support deep-draft port development legislation with the proviso that commodities to be benefitted will not detract from cargo opportunities for the Great Lakes.

Cargo Sharing

When trading nations arrange to divide up their maritime cargoes among themselves according to some set percentage or formula, the result is referred to as cargo sharing. Such sharing is not an official policy of the United States, but is implemented occasionally through bilateral negotiations as part of trade relations. Twenty-eight countries operate under such bilateral agreements. The actual splitting of cargoes between two countries may not involve all category cargo, but usually a majority of it, thereby preserving some flexibility in ocean transport.

A more formalized and broad-reaching cargo sharing development is the pending, late-1983 implementation of the U.N. Conference on Trade and Development's Code of Conduct for Liner Conferences (UNCTAD). A growing number of countries (63 presently) have ratified the Code which would allocate all general cargoes on the basis 40-40 percentage for trading partner's vessels and 20 percent to third countries - determined on an annual basis. The Code theoretically applies only to conference carriers but there is a possibility that it may affect independent carriers through cargo denial and competitive pressure. Also, there is mounting interest, particularly among the developing countries, to extend the Code to bulk carriage. The U.S. is not a signatory and the current Administration has stated its opposition to the plan. With respect to U.S. - signatory trade, 60% of the applicable cargo would be available for cross-trading countries. There is some indication that European signatory countries may not hold the U.S. to strict adherence to the formula, and have inferred that it is not applicable to inter-European Community trade.

The competitive problems inherent in cargo-sharing are obvious. With assured tonnages, national fleets can become lax regarding operating costs. Freight rates would be subject to only periodic adjustment and contingent on bilateral negotiations. Even though liner conferences engage in oligopolistic practices, rate difficulties could be exacerbated under the UNCTAD Code. The situation for the Great Lakes if UNCTAD were adhered to could result in the loss of foreign liner service. This prospect would doom area general cargo generation potential because U.S. liner service is marginal at this time.

Alternatives

1. Continue present practice of bilateral negotiation on cargo sharing outside of UNCTAD Code.

2. Propose refinements and clarification to Code for developed nations trading that would carve out more flexibility for cargo sharing formula.

3. Challenge foreign nations discriminatory shipping practices in world forum.

4. Abide by UNCTAD Code and build up merchant marine for compliance.

5. Negotiate with UNCTAD signatories an exemption arrangement for the Great Lakes because of unique circumstances.

Bulk Cargo Reservation

The envisioned increase in U.S. export-import flag tonnage resulting from bulk commodity percentage requirements may carry with it some disadvantages for Great Lakes commercial navigation. The grain diversion prospects and higher grain transportation costs point to lost sales and fewer dock hours at particular regional ports. In a national perspective this kind of legislation has merit. However, certain commodity categories such as grain and coal would sustain increased competition for international sales because of higher transportation costs. World market conditions for these commodities vary considerably, therefore the degree of disadvantage would also vary periodically.

On the other hand, the possible benefits to the Great Lakes region also present themselves. In 1980, less than 5% of dry bulk trade between the U.S. and Canada was carried on American vessels. The Great Lakes Task Force has identified a total of 7,315,400 additional tons that would sail on U.S. carriers at the 20% percent level under H.R. 1242. Coal and iron ore flows to Canada would account for over half of this amount. However, most of the additional tonnage identified for Seaway movements is counted in the questionable grain trade category. The higher costs for coal and iron ore transportation under U.S. flag would not likely result in source diversion. The complex interlocking transnational ownership of ore mines and steel mills in this area along with investment considerations would likely prevent damage to the Lake Superior District ore industry. The coal shipments to Canadian utilities and mills are also relatively captive and would not be much affected as far as supply source. Overseas coal movements could be disrupted because of market competition and slim margins - same as for grain.

These cargo reservation proposals would certainly stimulate U.S. flag crew expansion and the shipbuilding industry. The Maritime Trades Department of the AFL-CIO has estimated that H.R. 1242 would allow 9,000 additional seamen to be employed and result in up to 268 new vessels built over a 15-year period. The actual number of vessels is, of course, dependent on export-import trade growth as well as the vessel size and mix to specifically accommodate future trade. For example, a study conducted by the Center for Naval Analyses predicts that over 200 bulkers (40,000 dwt class) and 100 plus vessels (60-80,000 dwt class) would eventually be built under H.R. 1242. One fact is for sure though and that is the Great Lakes shipyards would not get their fair share of total construction contracts due to Seaway-size restrictions on vessel passage (for ocean vessels). Some Great Lakes shipyard interests do maintain that new vessels for the program (salties and lakers) could be built in the region and believe they will. The question remains - how many?

MARAD's Great Lakes Office which has been keeping track of the U.S. Great Lakes dry bulk fleet points out that fleet size and business prospects are inextricably linked to the fortunes of the American steel industry. Unless long-term steel production in the region can be sustained at reasonable levels, the evident trends underway will continue. MARAD states that there is no need for new bulk carrier construction for U.S. Great Lakes trade until at least 1985. If cargo reservation (like H.R. 1242) becomes law, there may be already sufficient reserve capacity in the U.S. Great Lakes fleet to handle the percentage requirements without additional vessels being built.

Alternatives:

1. Exempt Great Lakes ports from percentage U.S. flag requirement.

2. Exempt only particular commodities such as agricultural products or adjust percentage requirements by commodity.

3. Require U.S, flag bulk vessel service for the Lakes in order to prevent diversions.

4. Raise business volume threshold from $1 million to ? million.

5. Include sunset provision (legislation automatically expires unless renewed). This provision would allow time to evaluate results.

6. Reduce percentage requirement level or phase-in over longer period of time.

7. Emphasize S. 1624 approach which establishes incentives for shipyards and tax credits for shippers - adjust levels to mitigate Great Lakes region impacts.

8. Encourage shipbuilding in Great Lakes region through loan guarantees or subsidies to specific shipyards or vessels built at specific yards.

Cargo Preference

Through allocation of fixed quotas of commodity traffic under national flags, cargo preference rules have become the centerpiece of many national maritime programs around the world. In the U.S., preference cargoes (designated under the principal controlling laws) constitute between 25 and 30% of U.S. liner cargoes. The preference cargo tonnage generated by individual agencies is quite variable as is the preference percentage (see appendix sheet #1). For example, in 1979 the Federal Highway Administration (DOT) had 1,781 metric tons at 99% U.S. flag whereas Defense had 111,808 MT under its Foreign Military Sales Credit Program at 56% U.S. flag. As indicated earlier in this paper, the preference representation in the bulk trades is almost negligible. As a world-wide phenomenon, preference policy is gaining momentum fast. The UNCTAD Code, when fully in effect, will provide a formal umbrella for what exists today as widespread and diverse policies.

Many preference laws are cargo or trade specific in contrast to the all-inclusive nature of the UNCTAD approach. For example, Brazil carries all of its petroleum cargoes in its vessels as well as 100% of wheat and coal imports. Indonesia allocates 45% of its European cargoes to its flag. Spain completely restricts to its national vessels many imports such as petroleum, tobacco and cotton. And in France, 40% of coal imports must be hauled under its flag. These examples only scratch the surface. It is obvious that current U.S. policy of relatively restricted cargo preference requirements is running against the international current but remains faithful to the perceived need of less government intervention in private enterprise.

A major difficulty the U.S. faces with expansion of preference law is accommodating increased tonnage on a diminishing vessel base. Another issue concerns whether to expand the government generated eligibility category or begin to move in the direction of privately-controlled cargoes like cash grain and coal. This quandry is neatly illustrated by two current bills, H.R. 2692 (government-impelled) and H.R. 1242 (cargo reservation). Both are discussed in other parts of this paper. One issue that baffles even proponents is what to do about higher transportation costs attendant to U.S. flag shipping. A Brookings Institution economist has estimated that compliance with cargo preference laws had cost the federal treasury $5 billion in additional shipping costs between the 1940's and early 70's. It should be noted that cargo preference usually results in higher freight rates with one exception, liner trades where most carriers are members of conferences with no variance in rates. This concern has several facets related to labor productivity and general operating costs but also is specifically applicable to individual commodities. The captiveness of a market, elasticity price factors and diffusion of higher costs outline relevant aspects of this issue. Another point regarding transportation costs is that cargo preference may help to keep U.S. liner costs down through the dubious rescue of "rust buckets." Because preference cargoes are awarded on a competitive bid basis, there are incentives to keep costs down, but at what expense - safety and seaworthiness?

Alternatives (many applicable to other issue areas also pertain)

1. Support H R. 2692 and/or H.R. 1242 or with qualifications, including revising preference percentage for PR 17 Eximbank-financed cargoes from 50% in H.R. 2692 to 100% which is existing policy.

2. Support measures to increase cargo fleet size (and capacity) to allow for preference expansion.

3. Fine-tune existing laws to permit more P.L. 480 and other Lakes region government-impelled cargo to move through Lakes ports - see other related issues and Agriculture alternatives section.

4. Support clarification of agency discretion in determining preference cargo eligibility - possibly concentrate authority in DOT.

5. Oppose legislation and rulemaking attempts to exempt traditional preference cargo from future consideration - e.g., recent Defense Department attempts to exempt certain Nato-bound military cargoes to the degree that U.S. carriers have a reasonable amount of business in commercial trade to area.

6. Consider "lowest landed cost" allocation basis for all preference cargoes.

Cargo Preference: Geographical Allocation

A 10 percent minimum allocation of preference cargoes to each of the four U.S. seacoasts (including the Great Lakes) is provided for in H.R. 2692. This routing provision is not couched in "no exceptions" language but is qualified as "to the extent practicable." The apparent loophole was intended to provide some administrative flexibility but, nevertheless, the Reagan Administration claims that it would impose an unreasonable burden on federal agencies which control cargoes. Maritime Administrator Shear, in presenting Administration views at a Congressional hearing in June 1983, said such redirecting of cargoes from their normal routing could entail excessive handling and increase related damage as well as result in possibly higher ocean freight differentials than would ordinarily be the case. Also, he pointed out that percentage coastal shares for certain individual transactions such as Eximbank connected movements would create undue routing complexity for private shippers involved.

One reason why geographic allocation rules are thought to be necessary is the fact that railroad rate practices do, at times, conflict with Great Lakes shipping goals. Railroads desire to maximize revenues by arranging longest practicable hauls thereby bypassing the Lakes with cargo that often originates in the region. Instances of rate discrimination and the practice of equalizing rates from multiple interior points to tidewater port ranges point to rail/lake-ocean competition problems.

The proposed 1980 MARAD rule that would promote a "proportional distribution" of cargo under the Cargo Preference Act - 1954 would have mandated a minimum of 10% of the applicable category shipments to the respective coasts. H.R. 2692 is broader than this failed effort in that Public Resolution 17 (Eximbank) cargoes would also be included but again is weaker because it does allow the "practicable extent" loophole.

The arbitrary assignment of preference cargo to particular coastal areas would probably result in higher agency incurred transportation and handling costs, at least initially. There is also some difficulty with matching shipping point and logical ocean route for historical trade patterns. However,

because these preference programs are deemed to be part of the nation's domestic policy and also have a major impact on local economies, there is sufficient justification to ensure a more equitable national impact. As far as individual port participation within a port range or coast, the tendency toward load centering and concentration has been a natural development. But, after a period of time of stable balancing of commodity flows, vessel service could expect to become more regular with the likelihood of other ports becoming more competitive.

A related issue concerns equitable U.S. vessel service for Great Lakes ports with respect to MARAD operating subsidies. When the Seaway is open, government subsidies apply, however, at end-of-season shutdown the usual trade pattern is disrupted and subsidies may end. Great Lakes interests have urged alternate routing arrangements by the government in order to maintain continuity of service on a year-round basis.

Alternatives:

1. Support mandatory percentage coastal allocation of preference cargoes through legislation or rulemaking. H.R. 2692 is aimed in this direction but only "to extent practicable."

2. Support percentage allocation that would not be minimum "across the board" but on a proportional basis keyed to factors such as production points, rail service, seasonal transportation availability and labor rates.

3. Contest railroad discriminatory rates as port rate equalization measures. Most suitable approach is through ICC-initiated investigation where burden of proof rests with rail concern.

Cargo Preference: Agriculture

In recent years, agricultural commodities have represented the majority tonnage category actually moved under cargo preference laws. In an example year, 1979, over 55 percent of all U.S. generated tonnage that was carried aboard U.S. flag vessels was in this category and almost all of it was P.L. 480 cargo. Without oil imports for the SPR, the percentage would be (and has been) much higher. The 1954 Agricultural Trade Development and Assistance Act (P.L. 480) requires at least half of government-generated foreign agricultural products transactions (subsidized sales and donative transfers) to be carried in U.S. vessels - waivers are permitted if vessels are not available at reasonable rates. In 1979, 62% of Title I (sales) eligible cargoes was moved by U.S. flag and 48% of Title II (donations) cargoes made the list. Compliance has been reasonably good in this commodity area and detractors of preference application have been lobbying intensively for charges.

The transportation cost issue is number one for opponents. Often-cited is a 1982 GAO report which stated that if cargo preference had not been required in 1981 for Title II commodities, $15.6 million could have been saved. This figure is based not just on foreign flag substitution but consolidation of cargoes. At present, the cost differential between foreign and U.S. flag ranges between $40 and $60 a ton. The Agriculture Department has estimated that preference requirements have cost the government (Commodity Credit

Corporation) $363 million since 1978. There is no question that the subsidized distribution plans aid American agriculture by establishing market demand and outlets for chronic surplusses. However, there is some merit to the claim that more tonnage could be shipped if preference were not a factor. The solution is a balance between the two objectives.

With bulk cargo reservation, the transportation cost impact will be substantially larger than for just ag-aid cargoes. Using current USDA-determined differential of $52.98 per metric ton and applying it to the estimated 153 million MT grain exports for 1983, the additional transportation costs would amount to $405 million at the 5% reservation level. Congresswoman Smith (R-NE) has predicted that the 5% level would result in the loss of 14,185 agriculture sector jobs through lost sales and local economic impacts - estimate is based on export employment figures (USDA).

In the Great Lakes P.L. 480 cargoes are all product shipments. These "value-added" cargoes make a significant contribution to the eight Great Lakes ports that have historically handled them. The Lakes received 33 percent of total U.S. Title II allocations in 1982 even though U.S. vessels were mostly absent (see appendix sheet #2). With roughly 50% of these cargoes bound by U.S. flag requirements, the lakes share is maintained because of favorable total landed cost bids. However, the experience with Title I cargoes and unbagged whole grain movements has not been good. In addition, the subdsidized and preference-eligible Egyptian wheat flour sale has provided only .4% of total U.S. amount (50% shipped as of 8-14-83) for Great Lakes port distribution.

There has been a great amount of attention directed at possible preference application to the blended-credit and P.I.K. programs for agricultural exports. The effort, to blend interest-free credit with loan guarantees, is intended to make American farm exports more attractive to foreign buyers. It is quite apparent that cargo preference would raise the transportation costs and partially offset some of the financial benefit of the program. For this reason the controversy continues to simmer.

Alternatives

1. Continue vigilance on P.L. 480 port allocations with special attention to administrative practices that could alter status quo negatively, e.g. bridge ports.

2. Support geographic allocation of government supported agriculture shipments with respect to other than P.L. 480 Title II cargoes.

3. Support efforts to require recipient countries to calculate their cost of a U.S. flag on the basis of foreign flag rate accepted irrespective of U.S. coastal range - this would put Great Lakes on even footing with other ranges for lowest landed cost determination (Title I).

4. See appendix sheet #3. Review recommendations for Title II policy changes as outlined in remarks prepared by Daniel Shaughnessy for presentation before House Foreign Affairs Committee - P.L. 480 oversight hearings, April 29, 1982. Mr. Shaughnessy is president of the Western Great Lakes Maritime Association, Inc.

5. Support continued agricultural aid programs to build demand and relieve surplusses.

6. Support long-term grain deals, contract sanctity and oppose grain embargoes.

Transportation Costs

U.S. flag vessels crewed by American personnel and built in U.S. shipyards have significantly higher operating costs than do most vessels operating under other flags. Because ocean freight rates often fluctuate in response to market situations, to give a fixed percentage differential could be misleading. Nevertheless, some examples can illustrate the dimension of the problem. Recently, a 41,000 M.T. grain shipment could have been shipped via foreign flag for $70 per ton less than on a comparable U.S. flag. This amounts to a 250% difference in transportation costs. Presently, the differential (foreign flag advantage) ranges between 350 percent (30,000 dwt vessel) to 400 percent (660,000 dwt) on export coal. Shipboard labor costs - manning regulations and power plant characteristics, explain only part of the difference. Foreign built vessels can be much less expensive. For example, a large 110,000 dwt ship would cost around $100 million from a U.S. shipyard, but a Korean yard could deliver it for 60% less.

Most major maritime countries in the world have supported their shipbuilding industries and national vessel fleets with elaborate and complex subsidies. For privately owned U.S. flag lines, these government support programs around the world have put pressure on rate competition, exacerbating differentials that already exist, even when U.S. vessels make use of U.S. subsidy programs.

The higher transportation costs pose significant problems for general U.S. flag trade as well as the government generated cargo category. Whether it is a partially subsidized commercial sale (e.g. Egypt wheat flour) or a completely subsidized donative transfer (e.g. P.L. 480, Title II), the government incurs greater program costs which limits potential application. A provision for a percentage U.S. flag movement of cargo, bulk or other, not generated by the government would exact the same penalties but the burden would fall on the private sector. Agricultural export interests maintain that the world competitive environment and small margins on grain sales could jeopardize this trade sector if preference policy is extended to all grains. Coal export interests are also adamant along the same lines.

Federal operating subsidies are one means of continuing the existing rate differentials. The Reagan Administration is attempting to phase these programs out as a means of supporting unfettered enterprise as well as correcting for large budget deficits. The restriction of cargo preference to government-impelled cargo rather than extension of it through cargo reservation (H.R. 1242, S. 1624) to ordinary commercial trade would control possible problems that could beset international sales. Transportation rates reflect the full range of operational costs including fuel, loading, insurance, labor, plant amortization, transit time and inland movement connections. Ocean freight rates follow world economic trends. Changes in world fleet capacity, global fuel costs and the inherent foreign flag advantages are not readily controllable through U.S. action. For this reason, there are no easy, short-term solutions to the cost problems.

Alternatives

1. Support continuation of operating differential subsidies to dampen pressure on shipline profits.

2. Support current federal policy regarding individual consideration of bilateral cargo sharing agreements.

3. Resist adoption of UNCTAD-type liner reservation formula - to prevent an acceleration of non-competitive (higher rates) shipping practices.

4. Encourage government R & D spending for vessel technology thereby promoting more efficient operations, thus rate reasonableness.

5. Support selective wage and work rules concessions for shipboard labor.

6. Oppose cargo reservation requirements for private commercial cargoes. This measure reduces impact of higher transportation costs on an increasing number of shippers.

Maritime Policy Reform: Subsidies and Regulation

In addition to cargo preference and reservation subsidy measures, governmental promotion includes other channels of assistance. Direct subsidies for construction and operation, tax write-offs and deferrals, loan guarantees and revision of regulatory rules have all been used to sustain American commercial shipping. Intercoastal trade, including the Great Lakes, is not eligible for subsidy programs. The subsidies have amounted to about 60% of the total "assistance" package. During the 70's, measurable maritime assistance was put at around $550 million a year by the U.S. National Transportation Policy Study Commission. This figure represented 16% of U.S. shipline revenues during the period. Nevertheless, the U.S. direct subsidies were at least twice as much as that available in many other maritime countries. In those countries, financial assistance is more subtle through tax policy, cargo preference and government ownership share of fleets and shipyards. The continuance of these subsidies at historic levels is under review by the U.S. government with indications that both subsidy programs will be phased out, but operating subsidies much more gradually because of subsidy contract schedules. Budget pressures and free trade promotion policy are cited as reasons.

The Administration has also proposed several substantial changes in existing law aimed at reducing government restrictions imposed on U.S. carriers. One statutory change would be to allow U.S. ship operators to construct, convert or acquire vessels outside the U.S. and still be eligible for operating subsidies. Another proposal would be to permit (encourage) foreign investment in U.S. flag vessels by increasing limits on foreign ownership from 49% to 75%.

Reform proposals circulating in and out of Congress are intended to lighten the regulatory burden on U.S. liner companies in their increasingly competitive environment. Expediting FMC procedures is an integral element along with promotion of volume-time rates, more rate-making flexibility and coordinated conference rate action. These efforts come on the heels of partial rail and motor carrier deregulation in 1980.

Alternatives

1. Support coordinated approach to subsidy withdrawal and cargo preference measures so that one helps to offset the other.

2. Support rate regulatory reform measures to encourage more competitive service. For example, allow business entry to be freer and mandate tariff filing.

3. Support federal study of impacts on Great Lakes region and shipyards of changes in federal maritime assistance efforts as well as other reform proposals.

4. Support federal action to provide "equitable service" through mandatory alternative routes when Great Lakes/Seaway system navigation is closed. This would allow operating subsidies to continue.

Shipbuilding

Although this issue area is linked with overall maritime policy affecting the merchant marine, the labor and materials input factors are important enough to address separately. Shipbuilding is relatively labor-intensive. On small projects the economic beneifts are localized, but on large vessel construction the impact can be nationwide. For example, a super carrier now under construction at Newport News, VA is keeping 20,000 on-site workers busy but a total of 300,000 people thorughout the country (45 states) are employed in subcontracting roles. It is important to note that in most large shipyards the great majority of regular contract work is Navy-related. When Great Lakes shipyards land contracts, the regional steel industry also responds.

World shipbuilding is highly competitive. Japan leads the way with modern, highly productive yards. Over the last 6 years, Japan has had nearly 50% of all new vessel orders. Their total order book today is four times that of their nearest competitor, Korea - 10 million to 2.5 million gross tons. The Soviet Union's shipyards are incredibly busy with internal orders - they added 107 dry cargo ships in 1982, the greatest one-nation fleet expansion for the period. In the Great Lakes, U.S. shipyards are suffering from a severe decline in orders. 1982 was the first year in a decade in which no new bulk carriers were completed in the region. New commercial orders outside of several military contracts are scarce.

Employment in private U.S. shipyards, according to the U.S. Bureau of Labor, was 169,900 as of June 1982. Another 81,000 were employed in Navy yards. The bulk cargo reservation bills before Congress would produce many new vessels and create an estimated 150,000 man/years of employment - about 8,000 new jobs. This figure does not include supplier employment. Opponents of these bills point to the possibility of a foreign trade decline and resultant off-setting job loss related to a less competitive posture in export coal and agricultural product sales.

Alternatives:

1. Support those measures already identified as aiding the merchant marine.

2. Oppose "build foreign" policy the Administration is experimenting with.

3. Support compromise efforts aimed at partial foreign building but with American ship crews.

4. Advocate changes in federal procurement for military vessel contracts that would encourage more diverse regional participation.

5. Support continued development of sealift capacity for prepositioning of combat forces and materiel support.

These issues and accompanying alternatives sections are intended to promote reasoned discussion of cargo preference and cargo reservation governmental policies by the Great Lakes Commission.