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CARGO PREFERENCE

H.R. 1037 AND S. 61

BACKGROUND

With the enactment of the Merchant Marine Act of 1936, the United States government set forth a policy of encouragement for our nation's commercial shipping industry. From that time on, the U.S. Flag Fleet has been granted a number of subsidies and special tax advantages. In spite of this, competition from unregulated foreign shipping has caused our merchant marine to fall into a period of decline. In some quarters, the primary blame for the decline of the U.S. Flag Fleet has been placed at the feet of the maritime unions. It is suggested by some that their requirements as to the number and type of crews a vessel must maintain and the salaries which these crews must be paid are largely responsible for the loss of cost competitiveness of U.S. ships. Others point to the various regulatory agencies which place far stricter requirements on U.S. registered ships than are found to apply to foreign flag ships. Whatever the causes, increasing amounts of cargo imported to the United States are being carried by foreign flag ships. It is interesting to note that in a number of instances, the ships are owned by American-based companies but are registered under what are termed "flags of convenience." The controversy over the American Merchant Marine has recently flared with the move toward requiring a specified percentage of oil imports to be carried on ships of U.S. registry.

STATUS

On January 4, 1977, John Murphy, Chairman of the House Merchant Marine and Fisheries Committee, introduced HR 1037. This

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bill and its Senate companion, S. 61, are commonly referred to as "Cargo Preference" bills. The House bill was referred to the subcommittee on the Merchant Marine, which held five days of hearings. The hearing dates were March 1, 2, and 16 and April 6 and 20. The full committee approved the measure after markup by a vote of 31 to 5. In the Senate, the bill has not been marked up as of this date. Hearings have been held, but no further action is anticipated until such time as the House concludes its action.

PROVISIONS

The House-approved version of the measure requires that 4½% of all oil imported into the United States after the date of enactment be carried by U.S. ships. This percentage continues until 1981, when the percentage will rise to 9½%. Originally the bill called for 20% of oil imports to be carried by U.S. flag ships, with the percentage rising to 30% in 1985. The present figures represent a compromise which was sought by the White House. In the Senate, the original figures of 20% and 30% remain in the legislation; however, it is anticipated that these will be changed either in markup or in conference committee if the bill should pass the full Senate.

ARGUMENTS FOR: EMPLOYMENT OF MARITIME TRADES

One of the major arguments set forth by the advocates of Cargo Preference is that it will increase employment in the maritime industry. They point to the decline of employment in U.S. shipping as having serious consequences for the nation's economy and for our ability to maintain our merchant marine fleet. They note that employment has declined from 56,000 in 1970 to 44,000 today, largely as the result of the use of more modern tankers which require smaller crews and have larger capacities.

ARGUMENTS AGAINST: THE COST OF ADDITIONAL BERTHS

The opponents of Cargo Preference point to the fact that the institution of this particular policy to increase the number of berths available to American seamen would result in unjustified costs. It has been estimated that the cost of each additional job may be as high as $111,000 per year. This cost would be borne by the American taxpayer through increased prices for gas and oil and through the concommittant inflation. It is also noted by Cargo Preference's opponents that the reason for the loss of American berths is that the maritime unions have raised the costs of American crews to the point where they are no longer economical. This, they assert, is partially the cause for the movement by American companies to register their ships under what are commonly termed "flags of convenience." They note that fully 57% of the ships carrying oil to the U.S. are of this type. A recent Washington Post article dealing with the transportation of oil cited an Exxon spokesman who stated that one of the main reasons Exxon used foreign registry was that foreign crews, while just as competent as American crews, were far cheaper and that the higher cost of an American crew was ultimately paid by the consumer.

ARGUMENTS FOR: CARGO PREFERENCE INSURES ACCESS TO TANKERS IN NATIONAL EMERGENCIES

Proponents of Cargo Preference argue that in times of national emergency we must depend on our domestic shipping to provide sealift capabilities for our nation's oil supply. They argue that in the event of another Arab-Israeli war, we may find that foreign tankers will not carry our oil imports for fear of retaliation from OPEC countries. They also note that the American Merchant Marine has traditionally been a major asset in times of conflict.

ARGUMENTS AGAINST: TANKERS NOT THE PROBLEM IN TIMES OF NATIONAL EMERGENCY

Opponents of Cargo Preference note that while the Department of Commerce asserts that the Merchant Marine is necessary in times of conflict, the Department of Defense asserts that it is not the tankers which would be the problem in time of conflict, but rather the access to foreign ports. They also say that the use of U.S. flag ships could actually be a hindrance in such times as they might not be able to go places where ships registered in other nations could. Further, in the specific instance of an Arab-Israeli war, they contend that the real problem will be access to oil, not the shipping by which to carry it. They note that the establishment of a strategic petroleum reserve is aimed at just such a contingency.

OTHER CONTROVERSIES

A major controversy has grown over the refusal of Chairman John Murphy, House Merchant Marine and Fisheries Committee, to allow the minority members of the committee an opportunity to subpoena certain Administration witnesses. The controversy stems from an alleged violation of Rule III (F) of the rules of the Committee on Merchant Marine and Fisheries. This rule states the following:

> The minority members of the Committee shall be entitled, prior to the completion of the hearings and

> upon request to the Chairman by the Ranking Minority Member or by a majority of the Minority Members, to call witnesses selected by the Minority to testify with respect to the measure or matter pending, at least one day during the hearing...

The basis of the alleged violation of this rule stems from Representative Pete McCloskey's unsuccessful attempt to call a number of witnesses from within the Administration who were known to oppose the principle of Cargo Preference. These witnesses included Secretary of the Treasury Michael Blumenthal and Secretary of Commerce Juanita Kreps. On August 3, 1977, Representative McCloskey sent a letter to House Speaker Tip O'Neill outlining his complaint and asserting that the integrity of the House had been impinged. As yet, the matter remains unresolved.

A second point of controversy has grown out of a memorandum sent from the White House advisor Stu Eizenstat to President Carter. After outlining the various options available to the President, the memo concludes,

> While we feel that cargo preference is a flawed concept, it appears to be the only immediately available alternative that can significantly strengthen the maritime industry. In light of your committment to the industry and the likelihood that rejection of cargo preference will be seen as a broken promise, we support the limited cargo preference option outlined above. [Underscoring added.]

However, on the first page of the memo, the following passage appears in the third paragraph, reflecting a definite discrepancy:

> Charlie Schultze, Mike Blumenthal, and Dick Cooper feel that no [underscore added] version of cargo preference is acceptable. They feel that the principles involved - our committments to free trade and to the fight against inflation - cannot be breached. [Underscoring added] They argue that the economic costs of cargo preference outweigh its benefits. Moreover they feel that even a modest cargo preference bill entails a dangerous precedent that may later be extended by Congress, or imitated by other nations.

COST OF THE PROGRAM

There have been a number of conflicting estimates of the cost of cargo preference. One estimate, from the Government Accounting Office, places the cost of $240 million per year, assuming 8 MBD level of oil imports. This seems somewhat incongruous, however, as the GAO has stated that it anticipates a level of imports of

10.3 MBD by 1985, the year for which the $240 million estimate applies. At this level of imports, extrapolating from the GAO's other figure, the cost of cargo preference would be $309 million. Even this number, however, is probably too conservative. The GAO acknowledges that there are numerous cost factors that it has failed to take into account.

Of more credibility, although not the highest figure, is the estimate of the Federation of American Controlled Shipping. Their cost, adjusted for the lower 9½% rate, and assuming an 8 MBD level of imports, would be $941.9 million. At the 10.3 MBD level, the FACS estimate would amount to $1.213 billion. The Commerce Department has recently estimated the cost at $110 million by 1985. This figure, however, is generally acknowledged to be so low that it lacks credibility.

A more realistic estimate should take into account certain factors. First among these is the fact that the current shortage of tankers is expected to disappear by 1985. If this is the case, the market will be far less competitive than it is now, and prices will tend to rise with or without cargo preference. The impact of cargo preference will be the most severe in the setting of rates for tanker tonnage. These rates will be the highest and, as a result, other rates will tend to rise to their level. Further, they may result in retaliatory measures from other maritime nations leading to additional costs in lost cargo. This also precludes a rise in the percentage of cargo mandated for American shipping, an unlikely assumption.

Realistically, the cost of cargo preference probably will be considerably more than the GAO estimates. They assume that the total impact on each gallon of oil will be on the order of .6¢ per gallon. This figure, however, is debatable in light of the 2.4¢ estimate of FACS and other higher estimates from responsible sources. A more realistic figure would be in the range of 1.6¢ per gallon, in constant dollars. If the shortage of tankers should become severe, however, this figure could be much higher. Assuming the 1.6¢ cost, the total cost of cargo preference between now and 1985 could be as high as $5.6 billion. It could range from $628 million to $808 million per year. If the percentage is raised, this could obviously become even more significant. For example, if the 30% figure (which remains in the Senate version of the bill) is enacted, the cost of cargo preference will be between $1.96 billion and $2.6 billion by 1985, depending on the level of imports. This could place the total cost at as much as $17.5 billion for the seven years between now and 1985.

Milton R. Copulos
Policy Analyst -- Energy