

BEFORE THE
INTERNATIONAL TRADE COMMISSION
WASHINGTON, D.C.

INVESTIGATION No. 332-325

Economic Effects of Significant U.S. Import Restraints –
Fifth Biennial Update

POST HEARING STATEMENT
OF THE
MARITIME CABOTAGE TASK FORCE

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I. INTRODUCTION

This is the sixth occasion upon which the Maritime Cabotage Task Force (MCTF) has commented on the record of subject investigation for the purpose of challenging the Commission's proposition that the Jones Act (Section 27 of the Merchant Marine Act, 1920) is an import restraint under common principles of international trade practice that imposes a significant – albeit rapidly disappearing – “welfare cost” on the U.S. economy. Over the last decade, the Task Force, and to a lesser extent, the General Accounting Office, have found fault with: (a) the Commission's methodology and portrayal of the Jones Act fleet; (b) the Commission's underlying assumptions that foreign vessels and crew could operate in U.S. domestic commerce without incurring the compliance costs associated with U.S. laws and regulations applicable to U.S. operators in the same trades, and that foreign vessels would do so at a substantial discount from U.S.-flag rates; (c) the suspect nature of the imputed “welfare costs” reported by the commission based on the flawed methodologies and assumptions; and (d) the Commission's failure to consider offsetting economic and national security benefits derived from the Act when computing its purported economic cost.

To its credit, the Commission has made limited changes to address some of these concerns – e.g., changing from a rate-based to a cost-based analysis, incorporating sensitivity analyses designed to allow for differing views as to the extent to which cost differentials would translate into reduced shipping costs as a result of the application of U.S. laws, etc. – but in general those criticisms remain as valid today as when first expressed.

The Task Force does not intend to re-state here its arguments on these points that are contained in its prior submissions for the record and which are incorporated herein by reference. Nonetheless, the following excerpt from the Introduction to the Task Force's Post-Hearing Statement submitted in anticipation of the Commission's Third Biennial Update in 2002 is repeated here because it encapsulates both the MCTF's position and the underlying national and economic security interests preserved by the Act in all its variations:

As a sovereign state, the United States of America has a recognized interest in maintaining its national and economic security against all threats, foreign and domestic. While international trade plays an important role in our national economy, the desire to facilitate trade is at all times secondary to those broader national security interests. The domestic transportation system of the United States is at the core of both national defense and economic security. Recognized by a Presidential Commission in 1998 as one of eight critical infrastructures essential to the functioning of our economy, the domestic transportation system supports both our national economic welfare and our national defense.

Nothing better underscores that importance – and the heightened national interest in maintaining both economic and physical control over that system – than the events of [September 11, 2001]. ... As the Commission once again undertakes to study the effect that elimination of U.S. maritime cabotage laws would have on the U.S. economy, it would do well to remember those events and the view of at least one expert on maritime and port security that such events “exposed to plain view the soft underbelly of globalization.”¹

Since 1789, the maritime cabotage laws of the United States have played a key role in ensuring the safety, security, and economic competitiveness of U.S. waterborne domestic commerce. As a result, the United States now possesses a domestic marine transportation system without equal in the world. On a per ton-mile basis, 14 percent of the freight carried in the United States annually moves by water for 1 percent of the nation's for-hire transportation cost.² Since 1990, when the Commission first began to study domestic shipping as part of this investigation, the cost per ton-mile for cargoes shipped in those trades has increased by less than

¹ Commander Stephen Flynn, U.S. Coast Guard, Senior Fellow, Council of Foreign Relations, as quoted by the Washington Post, January 3, 2002 at A1 (“Where Sea Meets Shore, Scenarios for Terrorists”).

² USDOT Bureau of Transportation Statistics, National Transportation Statistics 2002. Based on data for 2001, the most recent year reported by BTS. The share of cost (0.13 percent) is based on operating revenues of domestic transportation providers for all services. Table 3-18; Appendix A, Water Transport.

a penny,³ notwithstanding a 55 percent increase in the CPI over the same period.⁴ These economic benefits are due in part to the substantial increases in productivity in coastwise marine transportation achieved during the last 10 years; in part to the highly competitive nature of the trades themselves; and in part because the cabotage laws have ensured that competition in those trades is conducted on a level playing field. Thanks to the cabotage laws, the coastwise shipping market remains free from the distortions that characterize international shipping as a result of foreign subsidies and other market distorting practices.⁵ As a result, new entrants and existing owners alike are willing to invest the millions of dollars needed to support the continued growth that has characterized the coastwise fleet over the last decade.

As the Commission undertakes its Fifth Biennial Update, the Task Force strongly urges it to incorporate the lessons learned over the last five reports by:

- Recognizing the right of sovereign states to impose restraints on trade in the interest of national and economic security, particularly where, as here, the activity in question takes place wholly within the state seeking to regulate that activity; and
- Recognizing that the economic impact of trade elimination cannot be assessed in a vacuum, as the Commission seeks to do, and considering the national and economic security interests served by the very policies the Commission seeks to liberalize, as well as other competing trade policies;⁶

³ From 0.95 cents per ton-mile in 1990 to 1.03 cents per ton mile in 2004. *Id.*

⁴ *Id.*; Bureau of Labor Statistics Inflation Calculator.

⁵ The problem posed by such practices from the U.S. perspective is that vessels subject to U.S. tax and other regulatory regimes are at an economic disadvantage when forced to compete in markets dominated by “non-market” players making “non-economic” decisions. Where shipping is not regulated – or taxed – as simply another business, as occurs in many maritime countries, companies operating under those policies are immunized from the economic pressures of the commercial market. As a result, it becomes difficult, if not impossible, for vessels operated under policies that subject them to the competitive pressures of the commercial marketplace, as occurs under U.S. law and maritime policy, to compete economically with ships immune to those same pressures. See, “Maritime Policy Initiatives 2000: Report of the NDTA Military Sealift Committee Working Group on Maritime Policy”, Washington, DC (April 2000) at 85.

⁶ For example, the United States currently (2000) runs a \$15 billion trade deficit in ocean freight services, a figure that has more than doubled since 1990 when the Commission first undertook this investigation. USDOT, Bureau of Transportation Statistics, “U.S. International Trade and Freight Transportation Trends” (2002) at 81-83. The additional imports of such services projected by the Commission in its 2002 Update following the elimination of the Jones Act would add approximately \$1.3 billion to that deficit.

Because these issues have been discussed extensively in prior Task Force submissions, the Task Force here limits its comments to issues arising from the Commission's Fourth Biennial Update published in 2004 and events that have occurred since that date.

II. ECONOMIC IMPACT OF JONES ACT

In the course of its five previous attempts to portray the Jones Act as a barrier to the import of shipping services that imposes costs on the U.S. economy by denying access to assumed lower-cost foreign shipping for domestic services, the Commission has produced estimates of those costs ranging from a high of \$9.8 billion dollars (1991) to a low of \$119 million (2002). Interestingly, each successive update of the 1991 report has produced a significantly lower estimate of economic impact, to the extent that the low end of the current range of estimates is only 1.2 percent of the amount claimed by the Commission in 1991. Either this represents an astounding increase in the economic efficiency of the Jones Act fleet over the eight years covered by the reports (i.e., a 98.8 percent increase), or the Commission's methodology is flawed in some significant respect.

| USITC Estimated Cost of the Jones Act | | |
|---------------------------------------|------------------------|--------------------------------------|
| Year | Amount (\$ Billion) | Remarks |
| 1991 | 9.800 | High end estimate |
| | 3.600 | Low end estimate |
| 1993 | 3.100 | |
| 1995 | 2.800 | |
| 1999 | 1.300 | |
| 2002 | 0.656 | Complete elimination |
| | 0.261 | Liberalize U.S. build only |
| | 0.262 | 50% realization of cost differential |
| | 0.119 | 25% realization of cost differential |

In its Fourth Biennial Update the Commission implicitly acknowledged the latter by admitting that the challenge of modeling the importation of services is beyond the capability of the USAGE-ITC model used by the Commission in its previous studies.

Previous versions of the Import Restraints study have provided quantitative estimates of the economic effects of Jones Act restrictions. The current report does not provide a model-based evaluation of the economic effects of the Jones Act. Modeling of outright import

prohibitions is demanding, and the current version of the USAGE-ITC model does not include this capability.⁷

Notwithstanding this admission, the Commission a few pages later repeats the now admittedly suspect findings of its 2002 Report.⁸ The Task Force suggests that now may be the time for the Commission to drop the Jones Act inquiry from this investigation. The results as summarized above certainly do not lend much credibility to the validity of its computations and the Commission admits that modeling the Jones Act is beyond the capability of its current analytical model. Nor do the sources cited by the Commission in support of its estimates, the most recent of which is now over 12 years old.⁹ While this may seem to some to be an academic exercise, the fact is that persons opposed to the Jones Act use the Commission's findings as the basis for attacks on the Jones Act, placing at risk the substantial national and economic security interests served by the Act.¹⁰

III. COST OF DOMESTIC SHIPPING SERVICES

A consistent theme of previous Commission reports under this investigation is that the higher costs of United States-flag, coastwise qualified (i.e., U.S. built, U.S.-owned, and U.S. citizen crewed) vessels imposes economic costs on areas subject to the coastwise laws and that allowing foreign vessels into those trades would benefit consumers in those areas by the differential between the capital and operating costs of United States-flag and foreign-flag vessels. In addition to the Task Force's long-standing objections to this methodology – including not insignificantly the issue of the application of U.S. laws on foreign ships operating in U.S. domestic commerce, and the economic impact of such application on foreign operating costs – recent events call into question the underlying validity of the Commission's assumptions.

The non-contiguous trades – i.e., trades between the contiguous United States and Alaska, Hawaii, Puerto Rico, and Guam – should be the most sensitive to any increase in the cost of owning and operating United States-flag shipping because they depend exclusively on such

⁷ The Economic Effects of Significant U.S. Import Restraints, Fourth Update 2004, United States International Trade Commission, Publication 3701, Washington, DC (June 2004) at 92.

⁸ *Id.* at 96-97.

⁹ *Id.* at 97.

¹⁰ *See, e.g.*, Rob Quartel, Jones Act Reform Coalition (“Jones Act Costs the U.S. \$10 Billion”)(1995); *and* Rep. Ed Case (D HI)(“Jones Act costs Hawaii \$600 million annually”)(2003).

shipping for transportation to and from the contiguous United States, with little or no competition from U.S. rail or trucking services. Thus, with the generally increasing cost of U.S.-built ships, U.S. crews, U.S. insurance and maintenance and repair in U.S. shipyards, one would reasonably expect the cost of Jones Act shipping to consumers in those areas to have increased accordingly. Yet a study recently released by the U.S. Maritime Administration found just the opposite – freight revenues in each of those trades have continued to decline since the early 1990's, notwithstanding the 55 percent increase in the CPI over that same period as noted above.

- Hawaii – real revenue per FEU¹¹ has declined by approximately 1.3 percent annually since 1991;
- Guam – average freight revenue per FEU declined an average rate of 2.2 percent;
- Puerto Rico – average revenue per FEU declined by nearly 39 percent over the period 1991-2003; and
- Alaska – real rates in this trade have declined nearly 23 percent from 1991 to 2003.¹²

In 2005, as a result of the disruption to U.S. energy supplies due to Hurricanes Katrina and Rita, the United States issued limited waivers to the Jones Act allowing foreign tankers to transport petroleum products to and from areas affected by the storms. The Commission's previous analyses assume that given the opportunity foreign vessels would replace United States-flag in those services at substantially lower rates reflecting the cost differentials used in those analyses.¹³ In fact, this did not occur. Despite the stress placed on the domestic industry as a whole by the widespread damage caused by the storms, U.S. oil companies made limited use of the waivers, and, where foreign tankers were used, their rates closely approximated U.S. domestic rates. In short, foreign shipowners sought to maximize their own returns from

¹¹ Forty-Foot Equivalent Unit – a standard measure of containership capacity.

¹² Competition in the Noncontiguous Domestic Maritime Trades, U.S. Department of Transportation, Maritime Administration, Washington, DC (May 2006) at vi-vii.

¹³ For tankers the differential was \$8,700 per day or 13%. Fourth Update, Table 5-1 at 97.

engaging in U.S. domestic commerce, not to pass the benefit of their lower operating costs to the U.S. consumer. There is no evidence to suggest that this would not occur if the Jones Act were eliminated in its entirety, thus negating any economic benefit claimed by the Commission.

IV. OFFSETTING ECONOMIC EFFECTS

In its Post Hearing Statement submitted as part of the Commission's Fourth Update, the Task Force cited a U.S. Navy estimate that the national security cost of eliminating the Jones Act would be "hundreds of millions" of additional dollars, including developing federally-owned facilities for the construction and repair of Navy ships, employing additional seafarers on inactive ships to replace the jobs lost to non-citizen crews, and maintaining more vessels in reduced operating status to replace U.S.-flag vessels no longer available to meet defense shipping needs.¹⁴ Moreover, these would not be one-time costs, but rather would continue into the indefinite future as such capabilities would have to be maintained so long as the United States intended to preserve its national security.

The Commission's response to this issue was that non-economic objectives such as national defense are achieved most efficiently through targeted, direct interventions like a Naval subsidy.¹⁵ In effect, move from a market-based approach that has proven effective in reducing the cost of domestic waterborne transportation – by 99 percent since 1990 based on the Commission's own estimates summarized above – to the public sector, further burdening the Federal budget and the U.S., economy generally. This makes no sense.

V. CONCLUSION

It is the Task Force's belief that if the Commission were to proceed as suggested in its earlier submissions and supported herein, it would find that, as the Task Force has long maintained, the Jones Act and related maritime cabotage laws indeed serve important U.S. public policy interests, including economic and national security, to the net benefit of the Nation and its citizens. This has been recognized by U.S. Presidents, and Congressional and military leaders for over 200 years and it is time for the U.S. International Trade Commission to do so as well.

¹⁴ Department of the Navy Memorandum LA-63/61S, Ser. 1735, dated 7 August 1997 (discussing H.R. 1991, 105th Congress, a bill to "reform the coastwise, inter-coastal, and noncontiguous trade shipping laws").

¹⁵ Fourth Update at 98.

In its deliberations, the Commission also is urged to consider carefully the fact that support for the U.S. ownership, U.S. documentation, and U.S. build requirements of the Jones Act is the stated position of the present Administration as has been the case for every administration in recent history. Presidents Reagan, George H. W. Bush, and Clinton, and now President George W. Bush, have publicly stated their support for the Jones Act and for the nation's commercial and defense maritime interests that are dependent upon it. As former Secretary of Transportation Mineta stated during his confirmation hearing --

“The Jones Act should be maintained. The Jones Act is an essential element of U.S. maritime policy that provides important economic and national security benefits to the nation, such as support of the U.S. shipbuilding and ship repair industries, and maintenance of a labor base of skilled American mariners.”

The uncertain accuracy, flawed assumptions, and lack of balance noted by the GAO in 1998 as having characterized previous Commission studies in this series have had the unfortunate result of providing aid and comfort to those opposed to this key element of U.S. economic and national security policy. The Fifth Biennial Update now underway provides the Commission with an opportunity to set the record straight in this regard.

The Commission may continue to argue as it has that it is doing no more than remaining within the parameters of its investigation as set forth in the 1988 request of the Senate Committee on Finance and the U.S. Trade Representative's 1992 request for periodic updates of that investigation. The Task Force suggests that it may be time to reassess this policy, particularly in the case of national policies, like the Jones Act, where the policies targeted by the Commission targets in its investigation serve vital national and economic security interests. Indeed, given the findings of its previous updates and the Commission's own admission in its Fourth Update of the inability of its model to provide quantitative measures of the impact, if any, of the Jones Act, the Task Force respectfully submits that now may be time for the Commission to exclude Jones Act services from the scope of its investigation.