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January/February 2011

The MARITIME EXECUTIVE

INTELLECTUAL

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Micky

Arison

Chairman & CEO, Carnival Corp.





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BY ROBERT C. SPICER



Why America Needs the JONES ACT

By H. Clayton Cook, Jr.

“The Jones Act is an essential feature of U.S. national security policy as it provides required capacity to support national security needs and avoid complete dependence on ships controlled by foreign nations. Since the U.S. maritime position in international trades has declined significantly in the last three decades, the Jones Act is the primary market for U.S. shipyards and operators, and its maintenance is key to American Shipping Company’s continued success.”

**– AMERICAN SHIPPING
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THE JONES ACT IS PERIODICALLY CRITICIZED BY RICARDIAN economists and certain elements in U.S. society and by non-citizen maritime interests seeking to penetrate the U.S. market. However, it serves as an incentive to maritime sector investment by providing a barrier to entry for lower-cost foreign carriers that are not subject to the same wage, labor and environmental regulations as U.S. shipbuilders and operators.

Legal Precedents and the Concept of “Dual Use”

The reservation of the economic benefits of the nation's domestic waterborne commerce to U.S. citizens owning and operating vessels built in the United States was first introduced by the Continental Congress and later incorporated in our Navigation Act of 1817 (1817 Act). Our "Jones Act," Section 27 of the Merchant Marine Act of 1920, now codified as Section 55102 of Title 46 of the United States Code, is simply its most recent form. In the post-World War II world, we have seen similar reservations of commercial opportunities for U.S. citizens, with broad support in both Republican and Democratic circles, in the Outer Continental Shelf Lands Act of 1953, the Fishery Conservation and Management Act of 1976, the Law of the Sea, Exclusive Economic Zone Proclamation of 1983 (EEZ), and the American Fisheries Act of 1998. In economic terms, the Jones Act is neither a U.S. nor an international anomaly. Worldwide, EEZ national-build requirements are widespread. Consider the current situation in Brazil.

The first naval battle of our War of Independence involved the June 1775 seizure of the HMS *Margaretta* by two patriot-armed commercial sloops in waters adjacent to Machias, Maine. The importance of the commercial vessel and privateer fleets commissioned by the Continental Congress and by the individual states was manifest in both the Revolutionary War and the War of 1812. The 1817 Act simply confirmed the importance of this U.S.-owned and U.S.-built "dual-use" tonnage.

Commercial vessels were converted to war time use by the Union and the Confederacy. President Theodore Roosevelt's Great White Fleet required the support of commercial colliers. In the run-up to and during World War I, the U.S. found itself lacking vessels for its commercial trades and its North Atlantic wartime requirements. The Shipping Act of 1916 and the Merchant Marine Acts of 1920 and 1936 were intended to prevent a recurrence of these problems. The 1916 Act addressed U.S. citizenship. The 1920 Act dealt with the role of our domestic trades in meeting these objectives with its Section 27 U.S.-built requirement. The 1936 Act required U.S. ownership of U.S.-built vessels for participation in Maritime Administration (MARAD) "differential subsidy" programs that allowed the U.S.-flag owner to approximate the operating and capital costs of lower-cost foreign competitors with reserve funds to provide a tax "neutrality." The Merchant Ma-

Aside from its strategic importance, a revitalized maritime industry would boost the struggling U.S. economy, relieve highway congestion, and create badly needed jobs.

rine Act of 1970 extended the differential subsidies to the international bulk trades and provided a revised Capital Construction Fund (CCF) tax-deferral program for the liner and bulk trades and Great Lakes and non-contiguous domestic services.

The 1936 Act helped to support our U.S. shipyards in the run-up to World War II. The 1970 Act ushered in a decade of U.S. shipyard expansions and series productivity improvements. The decade witnessed new vessel concept designs by U.S. naval architects and marine engineers for container, LASH and Ro-Ro vessels. These were built by U.S. shipyards, financed by U.S. banks and leasing companies, and proven as first-in-service designs by U.S. and international carriers. The designs for these 1970 Act dual-use vessels incorporated national defense features funded by the U.S.

In the 1980s, "subsidies" became politically unfashionable. Following the Reagan Administration's termination of the differential subsidy programs and unable to compete in operating or capital costs, U.S. international fleet operators who had provided the Department of Defense (DOD) with access to the majority of its dual-use tonnage sold their fleets to foreign shipping lines or simply ceased international operations. With the termination of these programs, the shipyards that had been the largest private sector employers in Massachusetts (General Dynamics in Quincy), Pennsylvania (Sun Shipbuilding & Dry Dock in Chester) and Maryland (Bethlehem Sparrows Point in Baltimore) were closed. Other yards on the East, Gulf and West Coasts were downsized or converted from commercial to military production, and the jobs associated with the supplier infrastructure simply disappeared.

Today, our U.S. shipyards build few large commercial vessels. The lack of multiple-vessel series contracts and volume purchases of ship components makes new vessels significantly more costly than foreign builds. Yet the U.S. shipbuilding industry remains strategically important and cannot be sustained by military orders alone. Recent foreign-partnering, series-production successes at the Aker yard in Philadelphia and National Steel & Shipbuilding in San Diego have confirmed that these yards can build commercially priced vessels for the Jones Act market.

America's Marine Highway

The merits of maritime alternatives to highway-based truck transportation are well recognized. The urbanized northeastern seaboard of Jean Gottmann's Megalopolis is well-suited to Atlantic Coast Ro-Ro services that would provide a water alternative to highly congested Interstate 95 and Interstate 81. This "highways to waterways" shift can bring more fuel-efficient transportation, lower highway and bridge maintenance charges, and improved air quality and safety.

The Energy Independence and Security Act of 2007 contained provisions establishing a formal marine highway program within the federal government. The act required the Department of Transportation (DOT) to establish a program for the designation of transportation projects to mitigate landside congestion and the designation of water transportation routes as extensions of and alternatives to the existing surface modes. Special attention was to be given to coastal corridors. But the act failed to provide funding.

Congress and the Administration have provided modest amounts for the America's Marine Highway (AMH) Program, which have been used for shipyard grants and port infrastructure improvements. However, private sector entrepreneurs are the real "drivers," and the program must attract these to succeed. Successful alternatives to highway transport require frequency of service and multiple-vessel fleets with individual vessels costing \$100 to \$200 million and a fleet in the \$1 billion range. Attracting this type of investment in the private sector will be difficult, if not impossible, and provides an obvious basis for the use of MARAD Title XI financing guarantees and other U.S. government assistance.

Rebuilding America's Shipyards

The U.S. shipbuilding industry serves both military and commercial markets, and it cannot be sustained by either market standing alone. When shipyards close – with skilled workers laid off and efficiencies and institutional knowledge lost – they are not easily reconstituted. In Louisiana, the state's largest private sector manufacturing employer, Avondale Shipyard – having been converted from commercial to military construction to survive – now faces closure when it completes its current U.S. government contracts in 2012.

Today, DOD and DOT are engaged in a project to develop and design, and see to the construction and operation of, a series

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of dual-use vessels that will be both commercially viable and capable of meeting a portion of DOD's military sealift needs. The project envisions a Ro-Ro vessel that can be constructed in series, benefitting from shipyard learning curves and quantity purchasing to reduce the per-ship costs for prospective owners. The I-95 corridor is at the heart of this, and one of the main attractions is the use of LNG dual-fuel engines with DOD paying for the increased costs as "national defense" features.

If successful, this DOT/DOD project will meet the objectives of both DOT's America's Marine Highway Program and DOD's Strategic Sealift Program. It will help sustain and perhaps revitalize the struggling domestic shipbuilding industry that is essential to the construction and repair of the DOD fleet. This important effort would not be possible without Jones Act protection. Will it succeed? I look at Saltchuck's TOTE and its successful Portland-to-Anchorage Ro-Ro service with NASSCO 2003-built, \$150 million Ro-Ros. TOTE has publicly stated that an I-95 corridor Ro-Ro service with U.S.-built Ro-Ros would be feasible if more favorable shore-side labor agreements could be achieved. So I am optimistic.

Persuasive Economic Benefits

I'm sometimes told that a particular project cannot succeed because the cost of the Jones Act vessel is some multiple of the cost of a similar foreign vessel. But isn't the real test whether the vessel's fully financed cost will fit into a business plan that will provide acceptable returns to investors? When I inquire about this and the use of MARAD programs to reduce the vessel's fully financed costs, I am often told that "No, no, the computations have not been done because the U.S. price is just too expensive." So I wonder about the relevance of these foreign shipyard price comparisons and view them with some skepticism.

Critics are fond of saying that the Jones Act only benefits a small number of unionized shipyard workers. But the U.S.-built requirement benefits workers in both union and non-union shipyards and component manufacturing jobs across the U.S. It benefits employees at naval architect firms and ship classification societies, in ship broker and ship insurer firms, and at banks and ship financing and law firms. And it protects the substantial federal, state and local tax revenues involved.

The American Shipping Company's Web site catalogs the current Jones Act benefits as "\$14 billion in annual economic output and 84,000 jobs in U.S. shipyards, 70,000 jobs working on or with Jones Act vessels, and over 39,000 vessels of all sizes representing an investment of \$30 billion." A 2010 PriceWaterhouseCoopers



study for the Transportation Institute concluded that, for the most recent year for which information was available, the Jones Act was responsible for 499,676 Jones Act-related jobs, \$100.3 billion in economic output, and \$11.4 billion in federal, state and local taxes. So on this benefits issue I am a bit of the view that, while everyone is entitled to their own opinions about the merits of the Jones Act, they are not entitled to their own Jones Act "facts."

Critics also say that the Jones Act stifles domestic trade vessel investment. But I believe the very opposite is true – that the Jones Act provides an attractive investment environment in which barriers to entry are high and investor returns are reasonably assured. I look to the more than \$5 billion in Jones Act trade renewals and expansions of the past decade as evidence of this proposition. And I look to the \$1.2 billion Aker Philadelphia Shipyard/Overseas Shipholding Group petroleum tanker project as evidence of the Jones Act trade's attraction to thoughtful non-citizen investors such as the



Oslo-based, predominately Norwegian-owned American Shipping Company, which considers the Jones Act to be "key to American Shipping Company's continued success." **MarEx**

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