Maritime Revitalization

For Principals Meeting
6-23-93

DISCUSSION DRAFT --- DISCUSSION DRAFT

SUMMARY

This memorandum presents three options on maritime issues:

1. Allow DOD to meet its sealift requirements in whatever manner DOD determines to be most effective and selectively phase-out indirect maritime subsidies.

Since defense needs have long provided the rationale for subsidies to the maritime industry, DOD should have principal responsibility for determining the extent of its sealift requirement and the manner in which that requirement is met. Indirect subsidies not needed to support a defense mission may be phased out.

DOT has revised

2. Increase the number of liner vessels in the U.S. flag fleet receiving covered by direct subsidies from 52 to 79 and expand indirect subsidy programs.

Supporting the maritime industry may be important for reasons beyond defense. DOT proposes this package to support the U.S. flag fleet engaged in international trade. Indirect subsidies are provided to other maritime constituencies, including shipyards.

3. Provide direct subsidies for 30 or 52 liner vessels in the U.S. flag fleet, and a) do not expand indirect subsidies or b) convert these indirect subsidies into direct subsidies.

As in option 2, support is provided for the maritime industry, but in a more direct and straightforward manner. The Administration would support either 30 ships (DOD's estimated maximum requirement) or 52 ships (the number of liner ships now under contract). In addition, the Administration would either (a) oppose the expansion of indirect subsidies which come at the expense of other industries and consumers or which hinder the missions of other Executive agencies, or (b) support the conversion of these indirect subsidies into direct payments to U.S.-flag ship operators.

INTRODUCTION

U.S. Ship Operators. The U.S.-flag fleet is evenly divided between vessels engaged in domestic trade (and therefore protected by the Jones Act from foreign-flag competition) and vessels employed in international trade. The international trade fleet consists of 95 liners (ships designed principally to carry goods in containers) and 60 bulkers (ships that carry loose cargo such as liquids and ore).

The principal issue in this memorandum is whether expiring subsidy programs should be replaced with new subsidies for U.S.-flag liners engaged in international trades. If these programs are not replaced, U.S. operators are likely to reflag their vessels. Ships operating under foreign flags would continue to be U.S.-owned and U.S.-controlled; their U.S. crews, however, would be replaced by foreign mariners. U.S.-flag liners in international trades now provide approximately 10,000 seafaring jobs and another 3,500-5,000 landside jobs. Regardless of Administration action, some of these jobs will be lost to productivity gains (manning requirements on newer ships are 30 percent less than on older ships).

Current government programs (described at TAB A) provide maritime interests with both direct and indirect subsidies. Direct subsidies are used principally to support the 3,500 of the mariner jobs and the 1,500 landside jobs associated with the U.S.-flag liner fleet engaged in international trade. The plethora of indirect subsidies support a wide range of maritime interests. These subsidies impose heavy costs on other U.S. industries and consumers, and have hindered the missions of some Executive Branch agencies.

U.S. Shipyards. Executive Branch agencies unanimously support the following Administration efforts:

- seek to reinvigorate multilateral negotiations to eliminate subsidies;
- explore the possibility of working with Congress on Gibbons-like legislation;
- complete the preparation of a Congressionally-mandated plan to help yards convert from military to civilian markets.

Budgetary Context. Most of the spending proposals outlined below would logically be structured as mandatory spending. If so, the Budget Resolution for FY94 requires that offsets be found to make the proposals deficit neutral. Such offsets--which have not yet been identified--would have to come from the mandatory side of the ledger. While any savings from the existing subsidy program could then be used for new discretionary outlays, they could not be used as offsets for the new mandatory spending.

If these proposals are put forward as discretionary spending, savings from existing programs could be used to offset partially the cost of any new program. The net cost of any new program would compete for funding against other Presidential priorities. These priorities would likely be located in the same appropriations subcommittee (Commerce, Justice, and State). For 1994, the funding allocation for the House subcommittee is $1.2 billion below the President's request in outlays.

Option 1. Meet Defense Needs through DOD Programs;Phase-out Indirect Subsidies.

Rationale. Subsidies for the U.S. Merchant Marine have always been justified principally by their role in providing a needed defense capability--sealift capacity for use in military emergencies. With the end of the Cold War and the drawdown in defense spending, DOD's sealift requirements and hence the magnitude of needed maritime subsidies has declined. DOD is currently reviewing its sealift requirements. Although this process is not yet complete, DOD has already concluded that its future requirements will not exceed 20-30 liner vessels. It will have no need for bulk vessels.

Description. This option would allow DOD to meet its sealift requirements in whatever manner DOD determined to be most effective. Among the alternatives being considered by DOD are: direct subsidies to U.S.-flag liners, contingency contracts with commercial operators, the use of ships owned by coalition partners, the requisitioning of U.S.-owned vessels, and the expansion of the government fleet. Current subsidy programs would be renewed only if DOD found it to be cost effective to do so.

This option would also selectively phase out any indirect maritime subsidies that are no longer required to support defense needs. Such indirect subsidies might include tax preferences and restrictions in the Shipping Act of 1984. The Administration could, if it wished, examine the political viability of changing cargo preference laws and the Jones Act.

Budget Costs. The total 10-year cost of this option, while unknown, will be less than the cost of any other option considered here.

Arguments in favor:

- Any subsidies provided for genuine defense needs would enjoy broad support. Their rationale would be clear, well understood, and widely accepted.

- DOD would have an incentive to meet its sealift requirements in the most cost efficient manner.

- Phasing out indirect subsidies would increase the international competitiveness of U.S. exports while saving consumers more than $2 billion per year in added shipping costs, about 80 percent of which is paid to foreign-flag ship operators.

Arguments Against:

- Depending on DOD needs, could sharply reduce the number of maritime jobs protected by government programs.

- Would provide fewer ships and therefore potentially less flexibility in times of national need than would other options.

- Phasing-out indirect subsidies would be very contentious politically.

Option 2. Increase Direct and Indirect Subsidies to a Broad Range of Maritime Interests

Rationale. This option is designed to keep large numbers of U.S.-flag vessels employed in international trades. These vessels would provide a contingent sealift capacity that could be useful for the military. In their discussion, however, the NEC Deputies could identify no specific economic rationale why this segment of the maritime industry should be protected from international competition. Subsidizing this segment of the maritime industry in order to "preserve jobs" would leave the Administration hard pressed to explain why it should not also subsidize every other industry that suffers job losses.

This option is also intended to build the broadest coalition of maritime interests in support of expanded subsidies to ship operators. Under this option, the Administration would support any Congressional effort to expand subsidies to a wide range of maritime interests, rather than oppose them as unnecessary.

Description. The option would increase the number of liner vessels receiving direct subsidies, and expand the scope of indirect subsidies now provided to ship operators and other maritime interests. The option has seven main elements:

1) *Increase to 79 from 52 the number of liner ships receiving direct payments*. DOT would be authorized to sign 10-year contracts providing 79 ships with $2.5 million per ship per year in the first four years, and $2.0 million per ship per year in the last six years. (Current direct subsidy payments average $3 million per ship per year.) In the first two years, new contracts would be limited by savings made available from the existing program.

2) *Expand tax subsidies to ship owners*, including a 4-year accelerated depreciation for vessels; deductibility of CCF deposits under the Alternative Minimum Tax, and permitting use of CCF fund for leased vessels. The first two provisions, combined with a proposal to tax the income of CCFs, would have a net revenue loss of $190 million over five years. Treasury notes that the leasing provision--difficult to estimate due to its vagueness--would increase the overall revenue loss.

3) *Expand cargo preference laws to include foreign assistance cash transfers*. Current cargo preference requirements increase government shipping costs by about $590 million per year. This measure would require cash transfers--an important tool of U.S. foreign policy which has not been previously subject to cargo preference--to be used only for the purchase of U.S. goods that are shipped on U.S.-flag vessels.

4) *Relax restrictions on the use of foreign-built vessels carrying preference cargo.* Under current law, foreign-built vessels are eligible to carry preference cargoes after a three year waiting period. This measure would eliminate that waiting period.

5) *Expand the Jones Act* provisions to include cruises that leave a U.S. port, enter international waters, and return to the same port -- the so-called "cruises-to-nowhere."

6) *Allow non-subsidized, foreign-built vessels to receive subsidies.* This would allow carriers to minimize their costs. This measure would be opposed by U.S. shipyards, although their support might be gained by the next provision:

7) *New funding for Title XI loan guarantees.* This measure would provide $75 million/year in FY 94-98 to support ship construction in U.S. shipyards.

Budget cost: Over 10 years, the known provisions would increase mandatory outlays by $2.05 billion, while decreasing domestic discretionary outlays by $567 million. Certain tax provisions would increase the cost of this option by an as yet undetermined amount.

Arguments in favor:

- By subsidizing most of the 95 U.S.-flagged liner vessels now engaged in the international trades, this option would provide greater flexibility in times of national need.

- Expanding cargo preference would ensure that U.S. aid dollars support U.S. industry and U.S. carriers.

- Since foreign-built vessels are less expensive, relaxing the foreign build restrictions in cargo preference laws will reduce carriers' costs.

- Expanding the Jones Act might create a market for U.S. built and operated cruise ships.

Arguments against:

- Subsidizing 79 vessels is unnecessary. This would be two or three times the maximum number of ships DOD estimates are needed to meet its sealift requirements. It would increase by more than one half the number of U.S.-flag liners receiving subsidies.

- Each element of the tax package is at odds with the Administration's overall tax policies. Moreover, providing subsidies through the tax laws would be highly inefficient, for the subsidies would be based on carriers' tax attributes rather than on the sealift services that they provide.

- Expanding cargo preference would: help U.S. ship operators at the expense of U.S. exporters; limit presidential flexibility in the use of an important foreign policy tool; undermine the use of cash transfers for debt repayment and balance-of-payments assistance; and contravene U.S. efforts in Uruguay Round to reduce foreign use of tied aid.

- Expanding the Jones Act as proposed could result in the disappearance of "cruises-to-nowhere" and, if so, hurt related U.S. industries and reduce revenues for port cities.

- Immediate support for Title XI loan guarantees is premature. The congressionally-mandated Working Group on the U.S. Shipbuilding Industry is analyzing all measures that would assist the conversion of the U.S. shipbuilding industry and will present its findings to the relevant Cabinet members later this summer. (Current Administration efforts on shipbuilding, which enjoy the support of all Executive Branch agencies, are described in TAB B.)

- Expanding indirect subsidies would complicate U.S. efforts to negotiate and end to foreign shipbuilding subsidies.

- Announcing a reduction in the waiting period for the eligibility of foreign-built ships in cargo preference would reduce U.S. leverage in negotiations to eliminate shipbuilding subsidies.

<u>OPTION 3.</u> <u>Provide Direct Subsidies to U.S.-Flag Liner Ships</u>

<u>Rationale</u>. Like option 2, this option is designed to keep vessels employed in the international trades sailing under the U.S. flag. However, it does so in a more direct and straight-forward fashion, providing the industry with greater incentives to become more competitive. It also limits those direct subsidies to either 30 ships (DOD's current estimate of its maximum need) or 52 ships (the current number of ships under contract)--numbers which could be easily justified to critics of subsidies.

<u>Description</u>. This option would provide direct payments for 30 or 52 liner ships. DOT would be authorized to sign 10-year contracts providing $2.5 million per ship per year in the first four years, and $2.0 million per ship per year in the last six years. New contracts in the first two years would be limited to savings made available from the existing program.

<u>Budget Cost</u>. Over ten years, direct subsidies for 32 ships would increase mandatory outlays by $500 million, while reducing domestic discretionary outlays by $358 million. Direct subsidies for 52 ships would increase mandatory outlays by $975 million and reduce domestic discretionary outlays by $358 million.

Two sub-options exist regarding indirect subsidies:

a. Oppose any expansion of indirect subsidies, including those provided through tax laws, cargo preference laws, the Jones Act, and the 1984 Shipping Act. Oppose--as premature--funding for Title XI loan guarantees until NEC Deputies and/or Principals consider proposals developed by the Working Group on the U.S. Shipbuilding Industry.

b. Convert existing indirect maritime subsidies into direct subsidies. Oppose--as premature--funding for Title XI loan guarantees until NEC Deputies and/or Principals consider proposals developed by the Working Group on the U.S. Shipbuilding Industry. Costs: converting cargo preference to direct subsidies would be deficit neutral. If the government paid directly the indirect subsidies now paid by shipping customers and consumers because of the Jones Act and the Shipping Act, the costs would be substantial.

Pros:

- Per ship payments are the most efficient means of providing industry subsidies.
- Restricts or eliminates indirect subsidies that come at the expense of other industries or hinder the missions of other Departments.
- Converting indirect to direct subsidies provides U.S. ships with greater incentives to become more efficient and actively engage in international competition
- Immediate announcement would meet the industry's request for a clear indication of Administration's policies in this area.

Cons:

- Provides less support than sought by industry.

DECISION:

_____Approve Option 1

_____Approve Option 1 as amended

_____Approve Option 2

_____Approve Option 2 as amended

_____Approve Option 3a

_____Approve Option 3a as amended

_____Approve Option 3b

_____Approve Option 3b as amended

TAB A: BACKGROUND ON CURRENT MARITIME SUBSIDIES

The federal government now subsidizes ship operators through a variety of programs, including:

1) *Operating Differential Subsidies.* Under the ODS program, the federal government entered 20 year contracts with U.S.-flag liner operators. These contracts provided that the federal government would pay the difference between wages on U.S.-flag ships and wages on their principal competitor's foreign-flag ships; in some cases, the government also undertook to pay the differential on other costs such as maintenance and repair. ODS contracts now cover 52 liner ships and 28 bulk ships. ODS payments in 1993 are expected to total $244 million, for an average per ship subsidy of about $3.0 million.

   To qualify for ODS payments, vessels must meet a number of restrictions. ODS liners must:

   - be U.S.-built, U.S.-flag, and at least 51 percent owned by U.S. citizens.
   - provide service on "essential trade routes".
   - receive approval from the Maritime Administration before: altering trade routes; affiliating with foreign-flag service; leaving U.S.-flag service; or operating in domestic trades.

2) *Ocean Freight Differential (cargo preference) program.* Cargo preference laws require certain federal programs to ship between 50 and 100 percent of their cargo on U.S.-flag ships. OMB estimates that in 1993, cargo preference requirements will increase government shipping costs by about $590 million over world shipping rates. These costs will be borne by the Departments of Defense, Agriculture, Transportation, State, the Agency for International Development, and the Export-Import Bank.

3) *Capital Construction Funds (CCFs).* Owners of U.S.-flag, U.S.-built ships may shelter income by placing it in a CCF. Taxes on both the income placed in a CCF and the interest earned by the CCF are deferred indefinitely. CCF balances are now approximately $1.2 billion.

4) *Title XI.* Under this program, the federal government guarantees private loans made to the purchasers of U.S.-built ships. Loans were last guaranteed under this program in 1992. In 1993, $48 million was appropriated for the program, but no loans were guaranteed. No funds were requested for this program in the President's FY 1994 Budget. The government's outstanding contingent liability under this program now stands at about $2 billion.

5) *Jones Act.* Like most other seafaring nations, the U.S. provides cabotage for its ship operators--all domestic waterborne trade must be carried on U.S.-flag, U.S.-built ships. The Jones Act fleet accounts for about 50 percent of the privately-owned oceangoing U.S.-flag fleet.

6) *The Shipping Act of 1984*. Since 1916, the U.S. has allowed U.S. and foreign carriers serving U.S. trades to participate in international shipping cartels known as conferences. The Council of Economic Advisors and the Department of Justice estimate that the Act raises shipping prices at least 10 to 15 percent, providing U.S and foreign carriers with a subsidy valued at $2-3 billion per year (because of their low market share, U.S. carriers receive only 20 percent of this subsidy). The Federal Maritime Commission disputes these results, and asserts that Conferences have little effect on long-term shipping prices.

Shippers continue to press for relief from strictures imposed by the Act, and are likely to try and block any new subsidies for carriers without some action to address their concerns. The law regulating conferences was last amended in 1984. In 1990, the Advisory Commission on Conferences in Ocean Shipping brought together carriers and shippers to seek consensus on further changes to the Act. No agreement was reached.

TAB B: U.S. Shipbuilding and Current Administration Efforts to Assist the Industry

Large U.S. shipyards are now almost completely dependent on the Navy. Of the 87 ships currently on order or under construction, 86 are for the Navy. With the drawdown in defense spending, naval orders are expected to decline substantially. The problems faced by U.S. shipyards are thus similar to those faced by other defense contractors--namely, how to shift from military to civilian production.

The U.S. industry is currently not competitive in the global market. It is less efficient than its foreign competitors and has had little experience in the commercial market since the early 1980s when the U.S. ended construction differential subsidies and increased naval orders. U.S. yards are also disadvantaged by the subsidies granted by foreign governments to their own shipyards. As a result, U.S.-built ships are more expensive than foreign-built ships. According to the ITC, price differentials have reached 100 percent.

The Bureau of Labor Statistics estimates that U.S. shipyards employed 123,900 workers in 1992 (down from 171,600 in 1982). The shipbuilding industry estimates that, absent government assistance, 70,000 more shipbuilding jobs could be lost. Even with government assistance, however, shipbuilders estimate that the transition from military to civilian production will lead to a loss of 20 percent of current employees as some skills will no longer be needed.

Actions Currently Underway by the Administration. All agencies support the following Administration efforts now underway:

1. Seeking to Reinvigorate Negotiations to Eliminate Foreign Shipbuilding Subsidies. U.S. negotiators are currently engaged in efforts to restart negotiations on the elimination of foreign subsidies. The elimination of such subsidies has been one of the key objectives of the U.S. shipbuilding industry.

2. Exploring the Possibility of Working with Congress on Legislation to Support this Effort. In the last Congress, bills were introduced in both the House and the Senate providing the means to retaliate against ship carriers who purchased subsidized foreign-built vessels. These measures are intended to speed multinational agreement on the elimination of foreign shipbuilding subsidies. Agencies are exploring the possibility of working with Congress on legislation this year.

3. Preparing Congressionally-Mandated Plan for the U.S. Shipbuilding Industry The FY 1993 National Defense Authorization Act required the Administration to establish a working group charged with preparing a plan to help U.S. shipbuilding industry become competitive in international commercial markets. The working group is considering a series of measures, including the use of Title XI loan guarantees for ship construction, defense conversion funds, ARPA R&D projects, and Export-Import financing. The group will present its proposals to the relevant Cabinet members this summer, so that the Administration can submit a plan to the Congress by the statutory deadline of October 1, 1993.

From DOT For Principals Meeting 6-23-93

Maritime Revitalization

Privately Owned U.S.-Flag Merchant Fleet

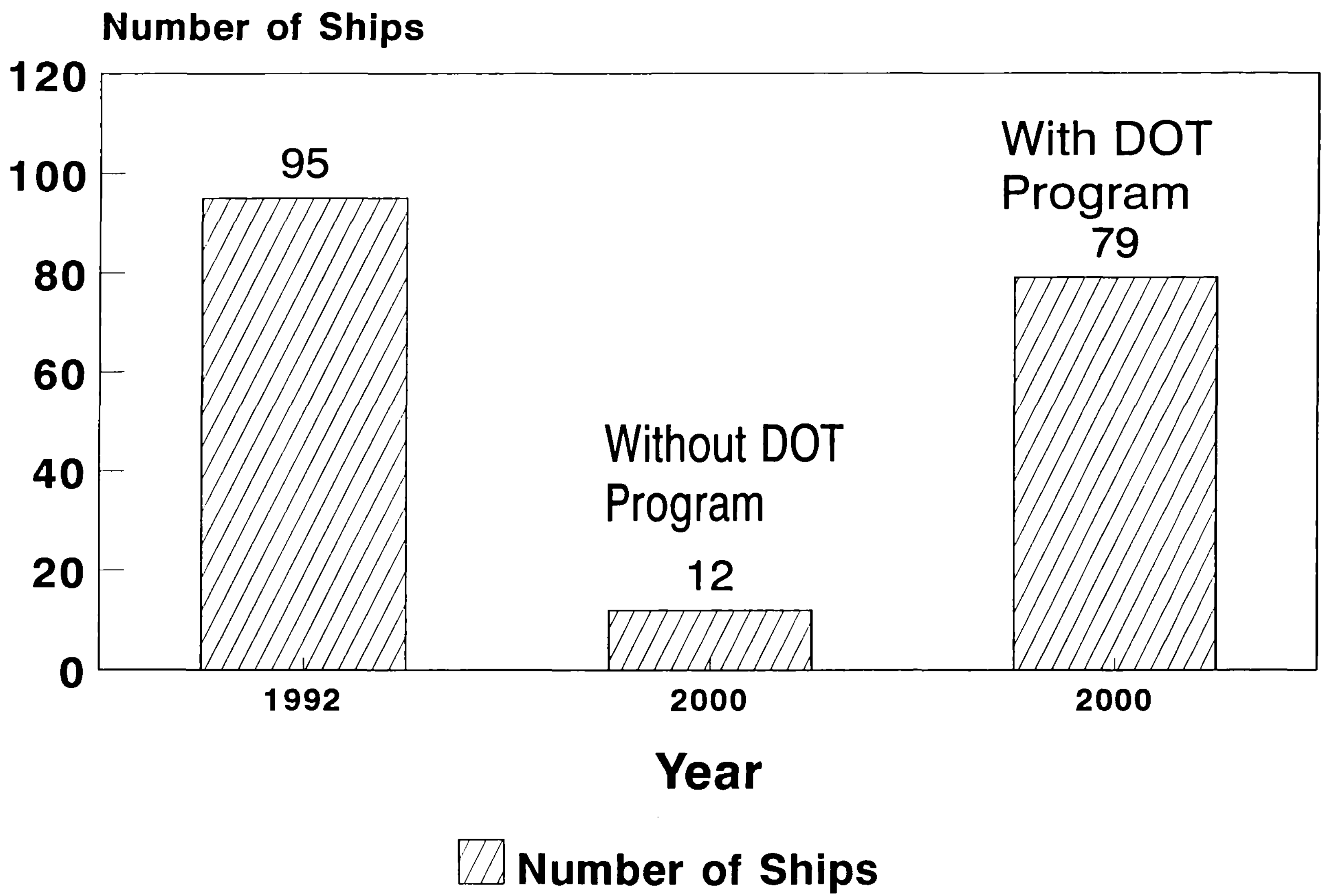
Between 1970 and 1992, the size of the privately owned fleet fell from 1,579 ships to 336 ships.

The U.S.-flag fleet ranks 15th in the world by number of ships.

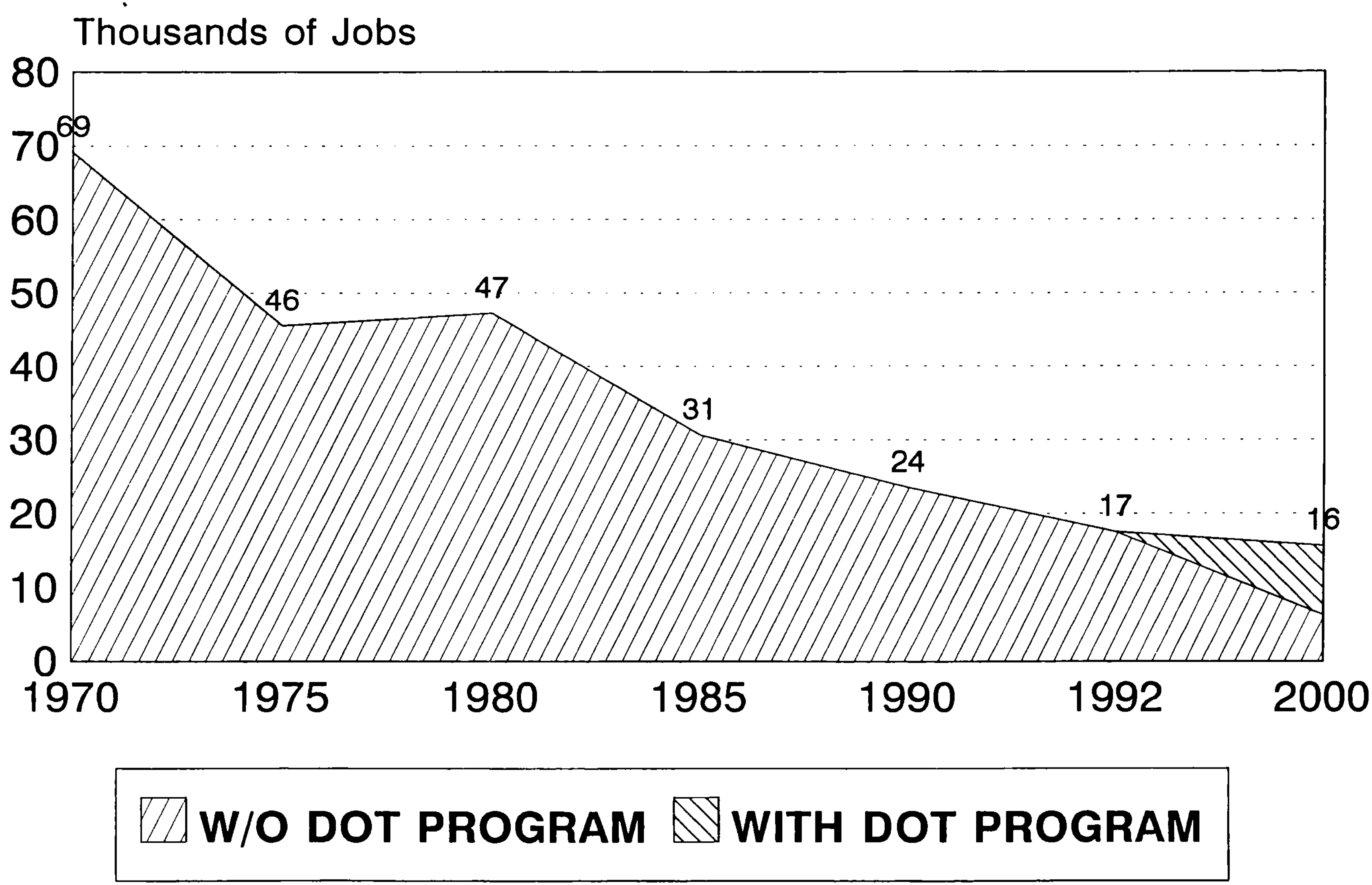
In 1991, the U.S.-flag fleet carried 4 percent of our total foreign trade, virtually unchanged from 1980.

In 1991, the U.S.-flag liner fleet carried 17 percent of our foreign liner trade, down from 27 percent in 1980.

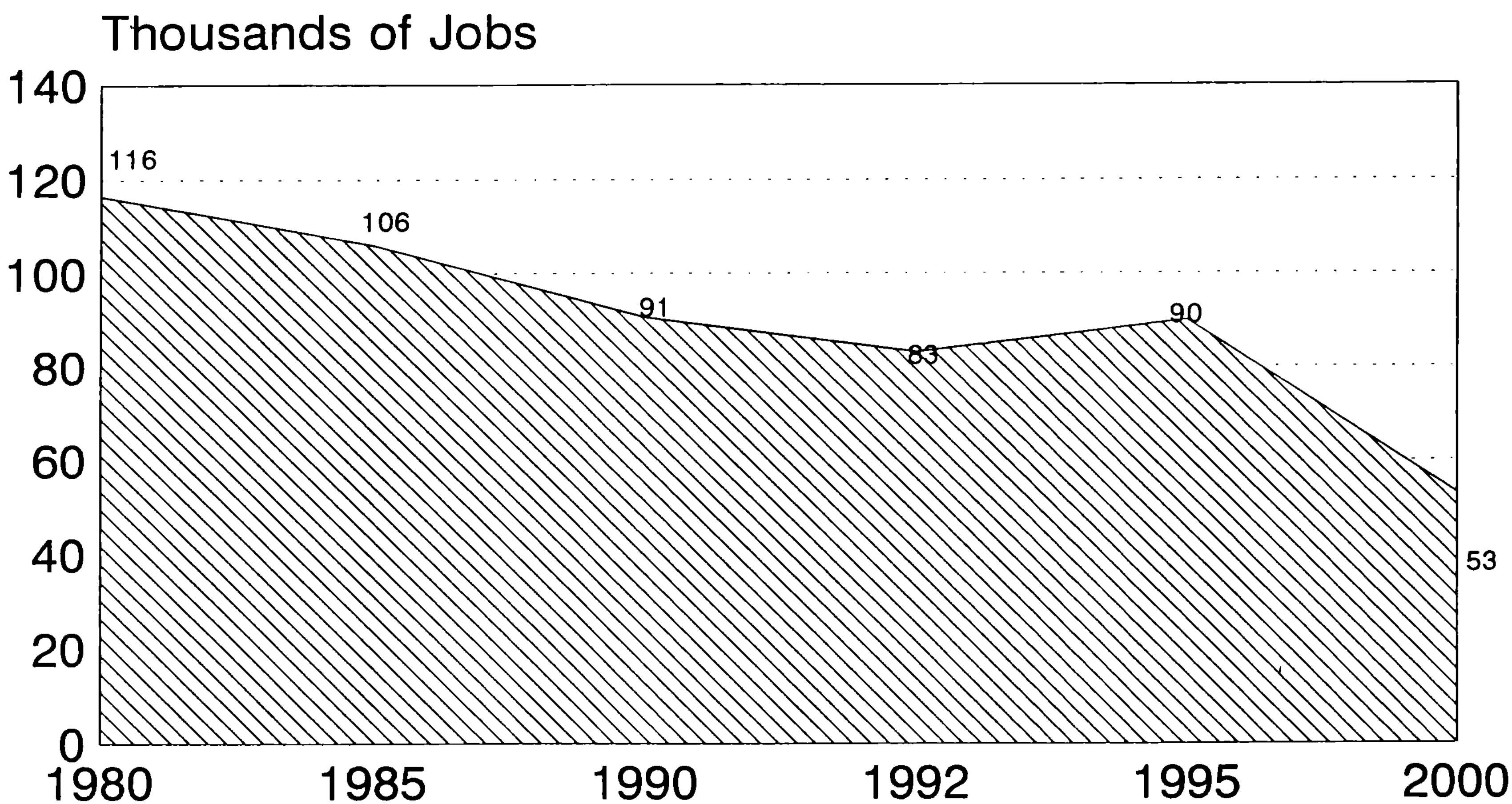
Privately Owned General Cargo Foreign Trade Merchant Fleet of the United States



SEAFARING EMPLOYMENT 1970-2000



SHIPBUILDING EMPLOYMENT
1980-2000



Includes only direct employment.
Excludes employment in the supplier industry (approximately 2:1).

Fallout From Failure to Act:

The best American companies will leave, and flag their ships elsewhere.

Fewer Defense sealift ships will be available, forcing greater reliance on foreign ships and expensive, unproductive inactive reserve ships.

Fewer job opportunities means seafarers will leave for other jobs, exacerbating sealift crewing problems.

Ramifications for the Administration

LABOR

There is the potential for a major setback with organized labor by failure to move. The AFL-CIO has targeted this initiative.

CONGRESS

Twelve maritime bills already introduced since January; 3 are major maritime reform bills.

There is strong, long-run bipartisan support in both Houses for maritime programs covering ships, jobs, ship construction and cargo preference.

MARITIME REVITALIZATION

DOT PROGRAM

- In FY 94, a new 10-year Liner program for up to 79 ships.
- $2.5 Million per ship per year FY 94-97
  $2.0 Million per ship per year FY 98-03
- All operators would be deregulated.
- Foreign vessel acquisition permitted.
- Provide $200 Million FY 94-96 for Title XI guarantees to support $2-4 Billion in U.S. construction and jobs.

MARITIME REVITALIZATION
DOT PROGRAM

Coast Guard to conform U.S. construction and and operational requirements to international standards.

President reaffirms Cargo Preference.

Support use of commercial practices in cargo preference trades to reduce costs.

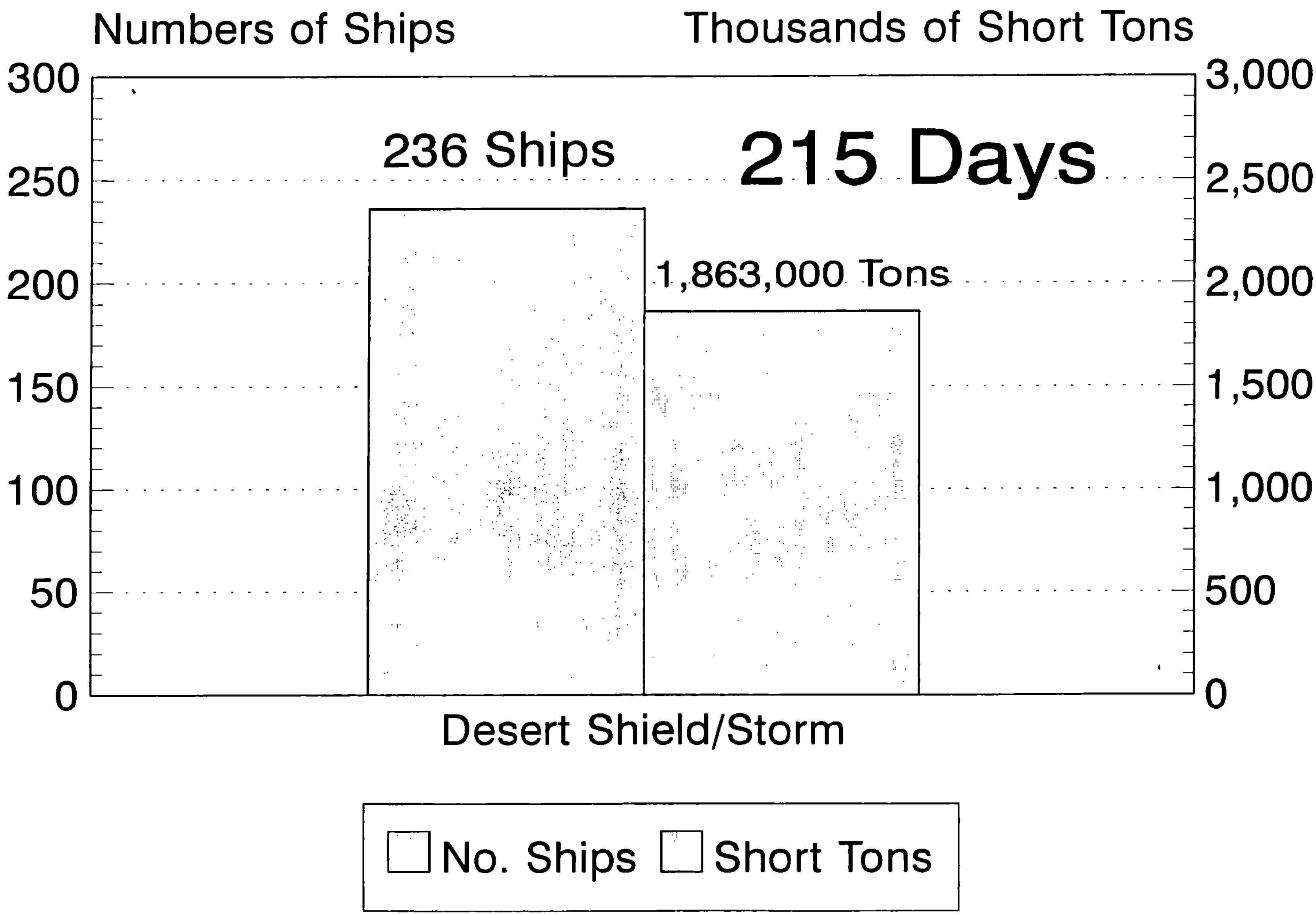
Support efforts to stop foreign shipyard subsidies.

Support Defense Conversion in U.S. shipyards.

DOT PROGRAM OUTLAYS
(MILLIONS OF DOLLARS)

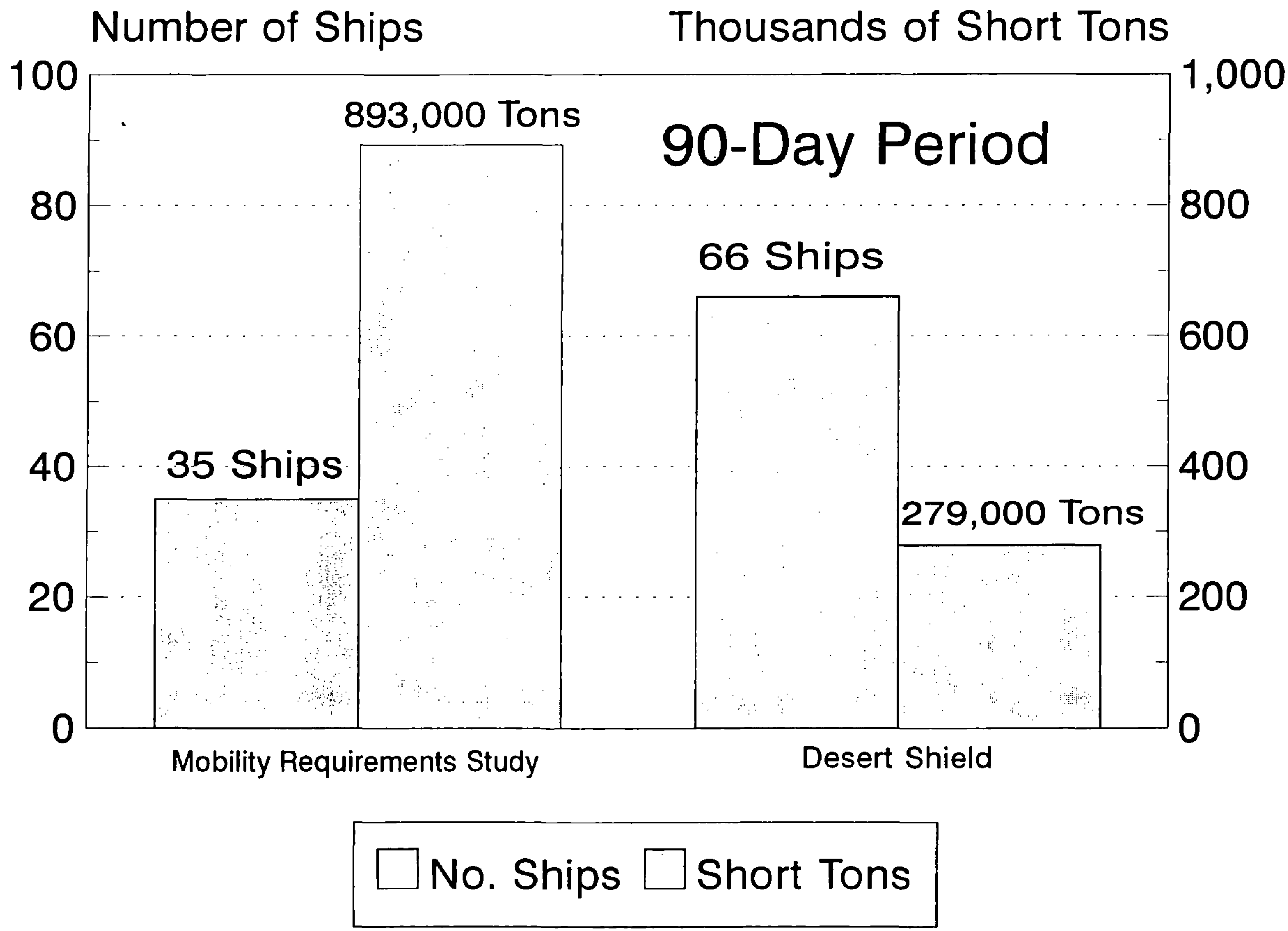
Fiscal Year	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	TOTAL
ODS Budget Baseline	241	242	239	213	62	8	6	5	0	0	1,016
New DOT Program	240	224	251	226	170	164	164	163	158	158	1,918
Title XI Guarantees	75	75	50	–	–	–	–	–	–	–	200
Net New DOT Program Outlays 1/	74	57	62	13	108	156	158	158	158	158	1,102
Total Ships in Program	65	61	79	79	79	79	79	79	79	79	

DOD Requirement for Ships from the Commercial Fleet
During Operations Desert Shield/Desert Storm



August 7, 1990 - March 10, 1991.

DOD Requirement for Ships from the Commercial Fleet



Operation Desert Shield data from August 7, 1990-October 31, 1990.

SEVENTY-NINE SHIP PROGRAM

- A SEVENTY-NINE SHIP PROGRAM WOULD MAINTAIN EXISTING U.S.-FLAG LINER SERVICES AND MARKET SHARES IN FOREIGN TRADE.
- PROVIDES CAPACITY AND SEAFARERS FOR DOD TO MEET THEIR IMMEDIATE NEEDS.
- PROVIDES CAPABILITY TO INITIATE SUSTAINMENT FLOW DURING THE DEPLOYMENT PHASE.
- A MILITARY REQUISITION OF 30 SHIPS LEAVES FORTY-NINE SHIPS REMAINING IN COMMERCIAL OPERATION.
- THE REMAINING SHIPS WOULD RESULT IN SIGNIFICANTLY REDUCED SAILINGS ON EXISTING SERVICES, BUT WOULD ALLOW SERVICES TO CONTINUE AT A MINIMUM LEVEL, I.E., BAREBONES OPERATION. WOULD PROVIDE ABILITY TO REINSTATE FULL SERVICE AFTER MEETING CRISIS.

DOT Revitalization Program Summary

- MAINTAINS AN ACTIVE U.S. COMMERCIAL FLEET AND SHARE OF INTERNATIONAL COMMERCE

- PROVIDES TRAINED AND EXPERIENCED MERCHANT MARINERS TO CREW DOD-OWNED AND ESSENTIAL CIVILIAN SHIPS

- PROVIDES SUFFICIENT SEALIFT RESOURCES TO MEET DOD's REQUIREMENTS IN BOTH MOBILIZATION AND NON-MOBILIZATION SCENARIOS

- PROVIDES A MARITIME PROGRAM THAT CAN BE SUPPORTED AND APPROVED BY CONGRESS

DATE: June 22, 1993
TO: Carol Rasco
FROM: Paul Weinstein,
Mike Schmidt
RE: June 23 Principals Meeting on Maritime Policy

This Wednesday, June 23 (tomorrow), there will be a Principals meeting to discuss a draft decision memorandum for the President on maritime issues. The memorandum was prepared by an NEC-led Interagency Working Group on Maritime Issues that examined maritime policy options. On Monday, June 21, we attended a Deputies meeting that discussed this memorandum, and based on comments made during the meeting we put together this memo to brief you on this issue for the Wednesday Principals meeting.

BACKGROUND

Why This Issue Has Suddenly Become a Priority

About two weeks ago, Secretary Pena and Senator Breaux urged the President to put forth an Administration position/proposal on maritime subsidies now rather than wait until August or September as had been planned. In their opinion, without the support of the President, this issue will go nowhere on the Hill.

The Draft Memorandum

The draft decision memorandum that you will be discussing on Wednesday asks you to consider options that address three related maritime issues:

- Whether to provide new direct subsidies for the U.S.-flag fleet;
- Whether to provide new subsidies for U.S. shipyards before the Working Group on the U.S. Shipbuilding Industry submits its report in August;
- Whether to change the indirect subsidies now provided to the U.S.-flag fleet and to U.S. shipyards.

The draft memorandum that you will be discussing on Wednesday will combine these issues into two or three broad policy options for the President to consider. This memo will summarize the key points that pertain to each of these three issues, and then briefly discuss how these issues will be combined into the broad options for Wednesday's meeting.

DIRECT SUBSIDIES FOR THE U.S.-FLAG FLEET

The issue of providing subsidies to the U.S.-flag fleet is central to the draft decision memorandum and is the most important policy issue that you will be discussing on Wednesday. Key points about this issue include:

- **Background:** Currently, the Operating Differential Subsidy (ODS) program subsidizes 80 U.S.-flag fleet ships by paying the difference between wages on U.S.-flag ships and wages on their principal foreign-flag competitor's ships. ODS subsidies, which totaled $244 million in 1993, are intended to ensure a contingent sealift capacity for the Department of Defense in times of military conflict. Existing ODS contracts are scheduled to expire in 1997. U.S. liners have announced that they will reflag their ODS subsidized ships when their contracts expire unless the government announces a new subsidy program.

- **DOD Study on Contingent Sealift Needs:** A Department of Defense study is currently underway to determine the number of non-military ships that will be needed to ensure a contingent sealift capacity and whether or not those ships will have to continue to be U.S.-flag ships (versus contracting out with our allies' flag-ships or other options). Unfortunately, this study will not announce its results until August, but they do know that the number of ships that they are talking about will be no more than 30 ships total.

- **Current Fiscal and Budgetary Realities:** The current Budget Agreement calls for any new spending on programs like maritime subsidies to be pay-go neutral. Therefore, any proposed subsidies must find corresponding offsets in the budget. Additionally, it would be difficult to go forward with a new subsidy program at this point in the 1994 budgetary process with a messy reconciliation ordeal just around the corner.

- **Defense versus Sectoral Issue:** This issue can be viewed as both a sectoral and a defense issue. As a defense issue, the question is how many ships are needed for contingency sealift capacity, and must we rely on U.S.-flag ships for this capacity? As a sectoral issue, the question is how do we deal with a sector that is highly dependant on these direct subsidies and will see anywhere from 5,000 - 15,000 jobs lost if the liners reflag?

- **A Sectoral Option:** The Department of Transportation sees this issue more as a sectoral issue. Their ultimate goal is to define a minimum subsidy package that will guarantee a viable U.S. Merchant Marine fleet. They argue that some number of ships above the DOD's need (30 maximum) will have to be subsidized, because no carrier can financially accept having all of its ships called up in the event of a national emergency. They suggest subsidizing between 50-90 ships.

- **A Defense Option:** The Department of Defense (and everyone else at the Deputies meeting aside from the Department of Transportation) leans more towards viewing this issue as a defense issue. They argue that DOD (and not DOT) is the best judge of how many ships are needed and how these ships should be contracted (whether through subsidies to U.S.-flags or some other method), and that DOD should probably pay for whatever option it recommends out of its own budget. This viewpoint also takes current fiscal and budgetary realities into consideration.

SUBSIDIES FOR U.S. SHIPYARDS

Key points include:

- **Background:** The FY 1993 National Defense Authorization Act required the Administration to establish a working group charged with preparing a plan to help the U.S. shipbuilding industry become competitive in international commercial markets. The working group is considering a series of measures, including the use of Title XI loan guarantees for ship construction, and the use of defense conversion funds. The group will present its proposals sometime in August, so that the Administration can submit a plan to Congress by the statutory deadline of October 1, 1993.

- **Relevant Options:** Because the working group has not yet released its results, the only options being considered right now are whether to include shipyard subsidies in negotiations over this maritime package, or to wait until the working group has finished its study of the issue in August and introduce the shipyard issue as a separate package (most Deputies opted to wait until the working group had concluded its work in August).

INDIRECT SUBSIDIES AFFECTING THE U.S.-FLAG FLEET

Finally, the draft memorandum that you will be discussing on Wednesday will touch on a series of indirect subsidies that affect the U.S.-flag fleet. They include:

- **Cargo Preference:** Current cargo preference laws require certain federal programs to ship between 50 and 100 percent of their cargo on U.S.-flag, U.S.-built ships. In 1993, these cargo preference requirements will increase total government shipping costs by about $590 million over world shipping rates. Cargo preference subsidies provide about 10 percent of U.S.-flag liner revenues. A number of agencies propose eliminating <u>civilian</u> cargo preference requirements, at a savings of approximately $200 million.

- **Conference Pricing in the 1984 Shipping Act:** Since 1916, the U.S. has allowed U.S. and foreign carriers serving U.S. trades to participate in international shipping cartels known as conferences. The law regulating these conferences was last amended by the 1984 Shipping Act. It is estimated that these conferences raise shipping prices at least 10 percent, providing U.S. and foreign carriers with a subsidy valued at $2-3 billion per year. Several agencies have proposed that the Shipping Act be amended to reform or eliminate conferences.

- **The Jones Act:** The Jones Act requires cargo shipped between U.S. ports to be shipped on U.S.-flagged ships. The Jones Act fleet currently accounts for about half of the privately owned, oceangoing U.S.-flagged fleet. It is estimated that the Jones Act increases shipping costs by over $1 billion per year. The Council of Economic Advisors has proposed that the Jones Act be reviewed and possibly scaled back.

OPTIONS THAT YOU WILL BE CONSIDERING ON WEDNESDAY

Unfortunately, the NEC is rewriting the draft decision memorandum for Wednesday's meeting even as we write this memo. Because of this, we are not exactly sure how the final draft options will be structured. However, based on comments from yesterday's Deputies meeting, they will probably read something like this:

OPTION 1: Allow DOD to determine and pay for its contingent sealift capacity needs; do nothing on shipyard subsidies until August; put all indirect subsidies "on the table" in negotiations to be eventually phased out (this option, or some form of it, is the option that everyone except for DOT supported).

OPTION 2: Go with DOT's sectoral option (50-90 flag ships subsidized); include something about shipyard subsidies in the package; no changes on current indirect subsidies.

OPTION 3: Some proposal in between Options 1 and 2.

CONCLUSION

We would be happy to provide you with whatever additional materials or information you might need. If you want additional briefing on this before the meeting, please call either one (or both) of us.

Maritime Revitilization Mtg -6-16-93

- Deputies meeting this Friday
- Principals Mtg on Wednesday
- Decision memo to President after Dep & Princ. OK
  - draft Memo outlines area of disagreement, in group
- Each one of these issues coming up seperately in Congress, and Admin. must take a stand on the issue

Mike S

THE WHITE HOUSE

WASHINGTON

June 14, 1993

MEMORANDUM FOR NEC WORKING GROUP ON MARITIME REVITALIZATION

FROM: John Goodman

SUBJECT: Next Meeting

Michael and I have scheduled a meeting for 5:00 pm on Wednesday, June 16 in room 476 OEOB. The purpose of the meeting is to review where we stand on various maritime issues. We will be presenting a short paper at the meeting outlining our understanding of points of agreement and disagreement. A revised version of this paper will be submitted to the NEC Deputies prior to their meeting on Friday.

THE WHITE HOUSE

WASHINGTON

June 14, 1993

MEMORANDUM FOR THE OFFICE OF THE VICE-PRESIDENT
THE DEPARTMENT OF STATE
THE DEPARTMENT OF THE TREASURY
THE DEPARTMENT OF DEFENSE
THE DEPARTMENT OF JUSTICE
THE DEPARTMENT OF AGRICULTURE
THE DEPARTMENT OF COMMERCE
THE DEPARTMENT OF LABOR
THE DEPARTMENT OF TRANSPORTATION
THE OFFICE OF MANAGEMENT AND BUDGET
THE U.S. TRADE REPRESENTATIVE
THE COUNCIL OF ECONOMIC ADVISERS
THE NATIONAL SECURITY COUNCIL
THE AGENCY FOR INTERNATIONAL DEVELOPMENT

FROM: Bowman Cutter BC

SUBJECT: Meeting on Maritime Issues

The NEC Deputies will meet on Friday, June 18 from 3:30-5:30 pm in the Roosevelt Room of the West Wing to review the Administration's position on maritime issues. A background memo will be circulated on Thursday.

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DECISION MEMORANDUM ON MARITIME ISSUES

OVERVIEW

This memorandum presents a range of options regarding U.S. maritime industries. It raises three broad questions:

(1) Should direct subsidies be granted to the U.S.-flag fleet?

(2) Should indirect subsidies be granted to the U.S.-flag fleet?

(3) Should the Administration continue its present course of action regarding the U.S. shipbuilding industry?

Depending on answers to these questions, subordinate options in each section are presented.

I. DIRECT SUBSIDIES FOR U.S.-FLAG VESSELS IN INTERNATIONAL TRADES

Background

The U.S.-flag fleet engaged in international trades consists primarily of liners and bulkers. Liner ships are designed to carry goods in containers. Bulkers carry loose cargo such as grain, ores, and liquids. Currently, there are **[130]** ocean-going liners and **[188]** bulkers operating under the U.S. flag. (These ships represent approximately **[60]** percent of the entire U.S.-flag fleet. The remaining **[40]** percent serves domestic waterborne commerce and is protected by the Jones Act.) The Department of Transportation estimates that approximately 10,000 mariners and 5000 land-side workers are employed directly by the U.S. flag-fleet.

U.S. flag ships are required to employ U.S. seafarers. Under the Operating Differential Subsidy (ODS) program, the federal government entered 20-year contracts with U.S.-flag operators. These contracts require the government to pay (among other things) the difference between wages on U.S.-flag ships and wages on their principal foreign-flag competitor's ships. ODS contracts now cover **[54]** liner ships and **[28]** bulkers. ODS payments in 1993 are expected to total **[$244]** million, for an average per ship subsidy of about **[$3.2]** million.

ODS subsidies are intended to ensure a contingent sealift capacity for the Department of Defense. DOD is currently reviewing its sealift requirements as part of its bottom-up review. Although this process is not yet complete, DOD has concluded that it ~~has~~ will have no need for bulk vessels and that its future requirements would be no greater than 20-30 liner vessels. (For this reason, the subsidy options concern only liner vessels.)

DOD is not certain that continued subsidies represent the best use of scarce defense resources. In reviewing its needs, DOD is evaluating the cost of alternative solutions: using the ships of coalition partners, chartering commercial vessels, ent~~ering contracts with foreign-flag vessels~~, requisitioning U.S.-owned vessels, or expanding the government fleet.

ODS contracts are scheduled to expire in 1997. U.S. liners have announced that they will reflag their subsidized ships when their contracts expire unless the U.S. government announces a new subsidy program. In addition, they have stated they will order new ships meeting foreign rather than U.S. standards. **If no action were taken and U.S. carriers currently operating under contract reflagged, DOT estimates that approximately 3,500 seafaring jobs and approximately 1800 direct land-side jobs would be lost after 1997.**

Budgetary Context. The proposals outlined below would be structured as mandatory spending. The Budget Resolution for FY94 requires that offsets be found to make the proposals deficit neutral. The offsets would have to be found on the mandatory side of the ledger. While any savings from the existing ODS program could be used for new discretionary outlays, they could not be used as offsets for the new mandatory spending.

Options

If a new subsidy program for liners is created, decisions must be reached on the following four issues: the amount provided per ship, the number of ships to be subsidized, the starting date of the program, and the origins of the ships able to enter the subsidy program.

A. Amount of Subsidy per Ship

The Department of Transportation has proposed a 10 year program beginning in 1994 in which operators would receive $2.5 million/year/ship in the first 4 years and $2.0 million/year/ship in the next six years. DOT has proposed that new contracts in the first year be limited to savings made available from the existing program. (A proposal introduced in the House calls for a similarly structured program, but with subsidies of $2.3 million and $2.1 million.) Some members of the working group have proposed an auction system in which DOT would announce the number of vessels and allow U.S.-owned carriers to submit bids for the amount they would accept to keep a specified number of ships under U.S. flag.

Option 1. DOT Proposal

Pro:

- Specifying the amount of subsidy per ship provides a clearly understood and certain commitment to liners
- Program is relatively easy to administer

Con:

- Program may overpay for services. Carriers might be willing to offer services for less money.

Option 2. Auction System

Pro:

- Auction offers the possibility of buying services more cheaply than under DOT proposal
- Auction sends signal that Administration prefers market-oriented solutions

Con:

- With only two major U.S.-owned liner companies, Auction system may not lead to lower costs. six firms total.

Decision:

___Approve Option 1 (specified amount)

___Approve Option 1 as amended

___Approve Option 2 (auction system)

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B. Starting Date of Subsidy Program

The DOT program would begin in FY 1994. At their May 15 meeting, the NEC Deputies decided that budgetary considerations militated against the introduction of any subsidy program prior to FY 1995.

Option 1. Support Subsidy Program in FY 1994

Pro:

o Financing may be easier to obtain if Congressional sponsors manage to include proposal in reconciliation.

Con:

o No money included in budget for maritime subsidies
o Would complicate reconciliation
o Not necessary--carriers only want announcement of support now; funding need not start until FY 1995.

Option 2. Announce Support for Subsidy Program in FY 1995

Pro:

o Would be sufficient to prevent reflagging
o Consistent with Administration's earlier policy statements

Con:

o Budget situation next year will remain as, if not more, difficult

Decision:

___Approve Option 1--begin program in FY 1994

___Approve Option 2--announce support for subsidy program in FY 1995

B. Number of Liners to be Subsidized

The working group has considered the number of liners that should be subsidized. The potential number ranges from 0 to 90. Rationales can be identified for four specific breakpoints: 90, 54, 30, and 0. Ninety is the number proposed by DOT. Fifty-four is the current number of liners under subsidy. Thirty to zero is the number of liners that OD may ultimately consider necessary. On the basis of a payment system beginning in 1994 proposed by DOT, OMB has estimated the additional cost of each proposal over a ten year period. (See attached spreadsheet for details.)

Option 1. 90 Vessels-----DOT Proposal

Ten-year cost: $1.7 billion

Pro:

- o Provides for 3 times maximum DOD requirement. DOT calculates that this multiple is required so that contracted ships will always be close enough to port to provide ~~surge~~ [illegible] sealift capacity.
- o Closest to industry request for a 110-vessel program
- o - Provides flexibility in contingency planning in times of war (conflict)

Con:

- o 90 exceeds DOD's maximum needs. DOD is able to provide surge capacity on its own and does not need subsidized U.S.-flag fleet for surge capacity.

Option 2. 54 Vessels------Status Quo

Ten-year cost: $995 million

Pro:

- o Maintains current number of ships under contract

Con:

- o Exceeds maximum DOD needs.

Option 3. 30 Vessels to 0 Vessels-----DOD's Maximum and Minimum Requirement

Ten-year cost: Maximum $502 million

Pro:

- o Limits subsidy to DOD's needs
- o Sends signal that any subsidy must be justified by specific national need

Con:

- o Will be seen as insufficient by carriers and their supporters

clarify that if DOD decides to fulfill requirement in some way other than using U.S. flags, 5 a net-zero option in terms of this paper

DRAFT---------DRAFT---------DRAFT---------DRAFT---------DRAFT

Decision:

_____Approve Option 1--90 ship subsidy

_____Approve Option 2--54 ship subsidy

_____Approve Option 3--30 ships

(4)
_____Approve actual DOD need, ranging from 0 to 30 ships

_____ option 5 - whatever DoD decides, it's their $

D. Origin of Ships Eligible for Subsidies

Only ships built in U.S. shipyards are eligible for participation in the ODS program. Thus, direct subsidies for carriers also provide indirect subsidies for U.S. yards (whose production costs, according to the ITC, are nearly double those of foreign yards). The Department of Transportation proposes that this requirement be changed and that carriers be permitted to receive subsidies on vessels built abroad. Presumably, DOT would have to certify that these foreign-built ships had not benefited from any subsidies.

Option 1. Make Foreign-Built Ships Eligible for Subsidy Program

Pro:

- Enables carriers to purchase ships from most efficient producers
- Lowers cost of operations for U.S. carriers
- Favored by U.S. carriers

Con:

- Reduces demand for U.S.-built ships at time when U.S. yards are seeking to convert from military to civilian production
- Opposition by U.S. yards may affect support for subsidies to carriers

Option 2. Maintain U.S.-Build Requirement for Subsidy Eligibility

Pro:

- Continues support for U.S. yards at time when they are seeking to convert from defense to civilian ship construction
- Favored by U.S. yards

Con:

- Raises the cost of remaining in the U.S.-flag fleet

Decision:

___Approve Option 1

___Approve Option 2

Political Hot potato

II. INDIRECT SUBSIDIES FOR U.S.-FLAG VESSELS

The Department of Transportation proposes a number of indirect subsidies for U.S.-flag vessels, including reductions in taxes, extensions of cargo preference, and expansion of the Jones Act. Every one of these proposals helps U.S. carriers at the expense of other industries and Administration goals and is therefore opposed by other agencies.

A. Taxes

DOT proposes that the Capital Construction Fund (CCF) be modified to allow withdrawals for leased vessels, the Alternative Minimum Tax (AMT) adjustment be repealed, and operators be permitted 4-year accelerated depreciation. As a budget offset, DOT proposes that accumulated earnings of the CCF be taxed.

The Department of Treasury estimates that the net revenue loss from the DOT proposals for the first five years of the program would be $190 million. Treasury did not estimate the effects of the leasing provision which would greatly increase the overall revenue loss. Treasury did not compute revenue losses beyond five years.

General considerations

Pro:

o ???????

Con:

o Providing subsidies through the tax laws complicates tax administration and has a differential impact on taxpayers depending on their other attributes.

o Revenue loss from the proposed tax subsidies would exceed the revenue increase from taxing current investment earnings of CCF deposits, violating the pay-as-you-go provisions of the Budget Enforcement Act.

Option 1. Permit Use of Capital Construction Fund (CCF) for Leased Vessels

Owners of U.S.-flag, U.S.-built ships may shelter income by placing it in a CCF. Taxes on both the income placed in a CCF and the interest earned by the CCF are deferred indefinitely. CCF balances can currently be used only for the purchase of U.S.-built ships. CCF balances are now approximately $1.2 billion.

Under the DOT proposal, CCF funds would be permitted to be used to reduce the principal amount (as determined under regulations) of a qualified lease of a qualified vessel.

Pro:

o Provides greater flexibility for carriers in use of CCF funds through leasing generally, and through leasing of foreign-built vessels.

Con:

o Permits "double dipping." A lessee could use funds from one CCF to make payments on the lease while another CCF was used by the lessor to acquire the leased vessel. Such double dipping would allow tax deductions that, in present value terms, would exceed the value of the vessel.

o Confers tax benefits to the parties of the lease and thereby enhances the ability of taxpayers to traffic in CCF tax benefits. It has been long-standing tax policy to restrict the ability of taxpayers to transfer tax benefits to nontargeted taxpayers.

o Revenue loss would be substantial, but due to vagueness of DOT proposal, Treasury has not been able to estimate total revenue loss.

Decision:

____Approve DOT proposal allowing withdrawals from CCF for leased vessels

____Maintain current CCF program

Option 2. Make CCF Deposits Deductible under Alternative Minimum Tax (AMT)

Under the AMT, corporations recompute taxable income without the use of special exclusions, deductions, or credits and apply a lower tax rate (20 percent rather than 34 percent) to that broadened base. The corporation is required to pay the greater of its regular tax or its alternative minimum tax. For purposes of computing the AMT, amounts deposited in CCFs are not deductible. Furthermore, earnings on these funds are not excludable from gross income for AMT purposes.

Under the DOT proposal, amounts deposited in CCFs would be deductible under the AMT. Since the DOT also proposes that earnings on CCF deposits be taxable, the inclusion of these earnings would no longer be required for computing AMT.

Pro:

o Provides additional support for carriers

Con:

o Provides a benefit not available to other taxpayers and undercuts the rationale for the AMT

__Decision:__

____Approve DOT proposal repealing AMT adjustment

____Maintain current AMT system

Option 3. Adopt 4-Year Accelerated Depreciation for Vessels

Under present law, the cost of vessels documented under U.S. laws and operated in foreign or domestic commerce of the U.S. is recovered under the regular tax over 10 years using the 200 percent declining balance method. [Under the alternative minimum tax, taxable income is recomputed using two depreciation modifications for vessels: 1) a recovery period of 18 years using the 150 percent declining balance method for the depreciation adjustment, and 2) a recovery period of 18 years using the straight line method for the adjusted current earnings adjustment.]

The Administration's FY94 Budget includes proposals that are intended to stimulate new investment, including a temporary ITC and a reduction in depreciation adjustments required to compute AMT. For vessels, the depreciation adjustment would be computed using 120 percent declining balance over ten years.

which under current law

The DOT proposal would allow the cost of U.S.-flag vessels **[includ~~ing~~ foreign built vessels]** to be recovered over four years under the regular tax. DOT did not propose changing the depreciation of vessels under the alternative minimum tax.

Pro:

- Provides a benefit estimated at $310 million over five years

Con:

- Present 10-year recovery period is shorter than economic life of most vessels. Existing class lives should not be altered without evidence that the new class life reflects the anticipated pattern of real economic loss.

Decision:

____Approve DOT proposal providing 4-year accelerated depreciation

____Maintain current accelerated depreciation system

B. Cargo Preference

Cargo preference laws require certain federal programs to ship between 50 and 100 percent of their cargo on U.S.-flag, U.S.-built ships. OMB estimates that in 1993 cargo preference requirements will increase government shipping costs by about $590 million over world shipping rates. These costs will be borne by the Departments of Defense, Agriculture, Transportation, State, the Agency for International Development, and the Export-Import Bank. Cargo preference subsidies provide about 10 percent of U.S.-flag liner revenues.

The Department of Transportation proposes the expansion of cargo preference; other Departments support the conversion of cargo preference subsidies into direct payments.

Option 1. Subject Cash Transfer Programs to Cargo Preference

AID provides foreign assistance in a variety of ways, including commodity import programs, capital and technical assistance projects, sector assistance, and cash transfers. Cash transfers are generally conditioned on specific macroeconomic policy reforms, and the funds are transferred to the recipient government at the time the reforms are accomplished. The U.S. government also uses cash transfers to provide security assistance.

The Department of Transportation supports legislation requiring that 70 percent of all cash transfers be used to purchase U.S. goods and be subject to cargo preference. The State Department, AID, and the Defense Department strongly oppose such a change.

Pro:

- Ensures that U.S. aid dollars support U.S. industry and U.S. carriers

Con:

- Limits presidential flexibility in the use of an important foreign policy tool

- Cash transfers often used for debt repayment. Proposal would undermine this purpose.

- Contravenes U.S. efforts in Uruguay Round to reduce foreign use of tied aid.

- Would help maritime industry at expense of U.S. exporters. Recipients of cash transfer assistance already import approximately 10 times more from the U.S. than the value of the cash transfer assistance provided by the U.S. The proposed change would raise the cost of transportation, thereby reducing the amount that could be spent on U.S. goods.

- Requirement for oversight of private sector activities in recipient country would hamper U.S. efforts to encourage economic liberalization in these counties.

Decision:

___Adopt DOT proposal making cash transfers subject to cargo preference

___Maintain exemption of cash transfers from cargo preference

Option 2. Issue Executive Order Directing All Federal Agencies to Adhere to the "Letter and Spirit" of Cargo Preference Laws

Agencies disagree over the application of cargo preference laws. The Department of Transportation proposes that an Executive Order be issued directing all federal agencies to adhere to what it views as the "letter and spirit" of the laws. The effect of such an order would be to include a greater amount of cargo under preference provisions. The Department of Agriculture and the Agency for International Development believe that they are already following cargo preference laws and oppose this measure. ~~They argue that it would raise the cost of their shipments and therefore decrease the actual volume.~~

Decision:

___Issue Executive Order on cargo preference

___Do not issue Executive Order on cargo preference

Option 3. Make Foreign-Built Vessels Eligible to Carry Civilian Preference Cargoes without a waiting period

Pro:

o Foreign vessels are much less expensive than U.S. vessels and would therefore increase the potential profits from carrying civilian preference cargoes and/or lower costs

Con:

o Removes indirect subsidy for U.S. shipyards and would therefore be opposed by U.S. yards

Decision:

group agrees on this

___Adopt DOT proposal allowing eligibility of foreign-built vessels

___Make no change in current requirement that cargo preference vessels be built in U.S.

Option 4. Replace Cargo Preference with Direct Subsidies to U.S.-Flagged Vessels

The Department of Agriculture and AID propose eliminating cargo preference requirements and transferring all estimated savings to the Department of Transportation. These funds, which OMB estimates at approximately $590 million, would then be given directly to eligible U.S. carriers.

Pro:

o Cargo preference requires the use of inappropriate U.S.-flag vessels--such as tankers, t'ween deckers, and tug/barge combinations--which were never intended for the movement of bulk cargoes. They are inefficient and more costly, and therefore have a detrimental effect on foreign assistance programs.

o Recipient third-world countries are often urged to liberalize external trade regime and reduce tariff barriers making their external trade as efficient as possible. Cargo preference requirements appear hypocritical.

Con:

o Such changes would be politically contentious.

Decision: AID

____Adopt ~~DOT~~ and DOA proposal, initiating legislation that replaces cargo preference with direct subsidies

____Maintain current cargo preference system

C. Expanding the Jones Act

Like most other seafaring nations, the U.S. limits cabotage to its own ship operators. All domestic waterborne trade in the U.S. must be carried on U.S.-flag, U.S.-built ships. The Jones Act fleet accounts for more than 40 percent of the privately-owned oceangoing U.S. flag fleet. A 1991 ITC study estimated that Jones Act restrictions imposed costs on shippers of $1.25 billion per year. (DOT believes this to be an overestimate.)

Excluded from Jones Act restrictions are cruises which leave U.S. ports, exit U.S. territorial waters, and return directly to U.S. ports--the so-called voyages to nowhere.

The Department of Transportation proposes that the Jones Act be expanded to cover these cruises.

Pro:

- o Provides larger market for U.S.-flagged, U.S.-built vessels

Con:

- o Makes cruises more expensive

- o Complicates international negotiations for the reduction of shipbuilding subsidies. U.S. negotiators have already asked for a permanent derogation for the Jones Act fleet. Expanding the Jones Act might require U.S. concessions on related issues.

Decision:

____Expand the Jones Act

____Make no changes in Jones Act

III. SUPPORT FOR U.S. SHIPYARDS

Background

Large U.S. shipyards are now almost completely dependent on the Navy. Of the 87 ships currently on order or under construction, 86 are for the Navy. With the drawdown in defense spending, naval orders are expected to decline substantially. The problems faced by U.S. shipyards are thus similar to those faced by other defense contractors--namely, how to shift from military to civilian production.

The U.S. industry is currently not competitive in the global market. Some estimates place U.S. productivity at half the level of foreign competitors. U.S. built ships are consequently far more expensive than foreign-built ships. According to the ITC, price differentials have reached 100 percent. U.S. yards are also disadvantaged by the subsidies granted by foreign governments to their own shipyards.

Current employment in U.S. shipyards stands at 119,000 workers--down from 167,000 in 1982. The shipbuilding industry estimates that, absent government assistance, 70,000 more shipbuilding jobs could be lost. Even with government assistance, however, shipbuilders estimate that the transition from military to civilian production will lead to a loss of 20 percent of current employees as some skills will no longer be needed.

Actions Currently Underway by the Administration

1. Engaging in Multinational Negotiations to Eliminate Foreign Shipbuilding Subsidies

U.S. negotiators are currently engaged in efforts to restart negotiations on the elimination of foreign subsidies. The elimination of such subsidies has been one of the key objectives of the U.S. shipbuilding industry.

2. Exploring the Possibility of Working with Congress on Legislation to Support this Effort

In the last Congress, bills were introduced in both the House and the Senate providing the means to retaliate against ship carriers who purchased subsidized foreign-built vessels. These measures are intended to speed multinational agreement on the elimination of foreign shipbuilding subsidies. Agencies are exploring the possibility of working with Congress on legislation this year.

3. Preparing Congressionally-Mandated Plan for the U.S. Shipbuilding Industry

The FY 1993 National Defense Authorization Act required the Administration to establish a working group charged with preparing a plan to help U.S. shipbuilding industry become competitive in international commercial markets. The working group is considering a series of measures, including the use of Title XI loan guarantees, defense conversion funds, ARPA R&D projects, and Export-Import financing. The group will present its proposals to the relevant Cabinet members this summer, so that the Administration can submit a plan to the Congress by the statutory deadline of October 1, 1993.

All agencies, as well as industry, believe that the working group is proceeding in the appropriate manner.

Options

DOT proposes that new funds ($75 million/year) be made available for Title XI without waiting for the working group to present its proposals this summer. These loan guarantees would support ship construction in U.S. shipyards. Outlays are not currently in the President's budget.

Pro:

o Makes funds immediately available for the construction of U.S.-built vessels

Con:

o Immediate support for loan guarantees is premature. The congressionally-mandated working group is analyzing all measures that would assist the conversion of the U.S. shipbuilding industry and will present its findings to the relevant Cabinet members later this summer.

o $75 million in annual outlays is based on an estimated 9 percent default rate. Potential defaults, and therefore outlays, are much greater.

Decision:

___Await proposals of working group before considering Title XI guarantees

___Adopt specified Title XI guarantees

___Adopt Title XI loan guarantees as amended

OPTIONS FOR MARITIME REVITALIZATION -- ASSUMED MANDATORY SPENDING

New Direct and Indirect Subsidies, Begin in 1994

(Outlays in Millions of Dollars)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	TOTAL
BASELINE											
ODS Budget Baseline through 1998 (DISCRETIONARY)	204	208	213	202	56	--	--	--	--	--	883
Proposal I -- 90 Ships											
New subsidy program, up to 90 liners, phase-in 1994.....	96	109	195	198	180	180	180	180	180	180	1,678
Tax program modifying CCF, indirect subsidy \1.............	38	38	38	38	38	?	?	?	?	?	190 +
TOTAL (new mandatory outlays)....................................	134	147	233	236	218	180	180	180	180	180	1,868 +
ODS Liner Budget (Continued discretionary outlays) \2...	108	90	62	43	14	0	0	0	0	0	316
Proposal II -- 54 Ships (current number subsidized under ODS)											
New subsidy program, up to 54 liners, phase-in 1994 \3.	68	80	98	110	100	108	108	108	108	108	995
TOTAL (new mandatory outlays)....................................	68	80	98	110	100	108	108	108	108	108	995
ODS Liner Budget (Continued discretionary outlays) \2...	108	90	62	43	14	0	0	0	0	0	316
Proposal III -- 30 ships (possible maximum defense requirement)											
New subsidy program, up to 30 liners, phase-in 1994 \4.	25	38	38	50	52	60	60	60	60	60	502
TOTAL (new mandatory outlays)....................................	25	38	38	50	52	60	60	60	60	60	502
ODS Liner Budget (Continued discretionary outlays) \5...	160	143	116	80	26	0	0	0	0	0	525

\1 Treasury provided a preliminary five-year, $190 million estimate for only part of DOT proposed CCF program; the estimate included repealing the Alternative Minimum Tax adjustment, and accelerating depreciation for ships to 4 years from 10. The estimate excluded allowing withdrawls for lease payments. Treasury does not compute tax expenditures beyond 5 years.

\2 Figures assume costs related to the following number of ships estimated to remain under ODS until the operators' contracts expire: 27 ships in 1994, 22 in 1995, 15 in 1996, 10 in 1997, 4 in 1998, and 0 in 1999 through 2003.

\3 Figures assume a phase-in schedule of 27 new liner ships in 1994, 32 in 1995, 39 in 1996, 44 in 1997, 50 in 1998, and 54 in 1999 - 2003. The new program (1) provides subsidy of $2.5 mil./ship through 1997, decreasing to $2 million/ship in 1998-03, same as Proposal I and III, and (2) covers 54 ships, as covered by the existing subsidy program.

\4 Figures assume a phase-in schedule of 10 new liner ships in 1994, 15 in 1995, 15 in 1996, 20 in 1997, 26 in 1998, and 30 in 1999 - 2003. The new program (1) provides subsidy of $2.5 mil./ship through 1997, decreasing to $2 mil/ship in 1998-03, same as Proposal II and III, and (2) covers 30 ships, possible upper limit for Defense-based needs.

\5 Figures assume more ships remain under ODS given the smaller size of Proposal III program: about 42 in 1994, 37 in 1995, 30 in 1996, 20 in 1997, 7 in 1998, and 0 in 1999 - 2003.