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So Long, American Flag: It Was So Nice to Fly You

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IN AN ARTICLE PUBLISHED one year ago in this journal,* the author asked a series of questions about the future existence of a viable American merchant marine. In an attempt to stimulate thought about measures that might be taken to reverse the decline of the U.S. maritime industry, the article took a Socratic approach. The several questions it asked can be briefly summarized as follows:

- Is the Congress able to pass legislation that would eliminate most, if not all, of the shackles that put the American merchant marine at a disadvantage in world competition?
- Is it willing, after two hundred years of misguided effort, to separate aid to American shipbuilders from a system of archaic restrictions on American ship operators?
- Is the administration, and this means chiefly the Department of Defense (DoD), sufficiently concerned about the emergency manning of the Ready Reserve Fleet (RRF) by qualified merchant seamen to provide the funds necessary to make up the difference between the wages foreign seamen get and those an American shipowner must pay to provide American seamen with a decent standard of living?

I

Shortly after the article appeared (and totally unrelated to it), the Bush administration proposed a sixteen-point program that, if adopted, would have gone a long way toward retaining at least a nucleus American merchant fleet for

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* See Andrew E. Gibson, "After the Storm," *Naval War College Review*, Summer 1992, pp. 21–27.

the future. However, after arguments within the administration, and particularly after amendments by congressional committees in response to constituent pressure were in place, the program was doomed. In spite of all the hopeful rhetoric that had been generated, the answer to the questions posed above was a resounding "No"!

While the committees gave serious consideration to much of the administration's program, behind-the-scenes lobbying was such that even in greatly amended form the program was never brought to a vote. Had it been, in its final form it contained so many provisions objectionable to the administration that it would undoubtedly have been vetoed.

First and foremost among the things that contributed to the program's demise was the timing. Though President Bush had been in office for almost four years, the program was offered only on the eve of the November 1992 elections. Even at that, much of the program's substance came not from the Maritime Administration but from two major American companies, each of which had recognized that it could not live long under the existing restrictions. Both of them, American President Lines and Sea-Land, declared publicly that if those restrictions could not be eliminated, they would have to lower the U.S. flag from the sterns of their ships, replacing it with that of another country. In the meantime, because they wanted to remain under the American flag, the two companies would do everything possible to encourage enactment of meaningful maritime reform legislation.

What drove those companies in that direction? Let us examine each firm separately.

Sea-Land is unsubsidized. Accordingly, it has wide latitude in its operations: like those of a foreign shipping company, its operations are guided primarily by managerial judgment. It can enter any trade route it wishes without commitment to the type or duration of the service it will provide. It also has the decided advantage of operating the U.S.-built part of its fleet in the protected trade between American ports, a trade denied to a subsidized company.* Its ships operating to Puerto Rico, Alaska, and Hawaii, not being subject to foreign competition, have provided much of the company's profits. Another part of its business that has (until recently) been profitable is the carriage of military cargoes, primarily containerized goods and equipment for U.S. troops and their families overseas. This cargo is also protected from foreign competition, but unlike for the coastal trades, the law does not mandate that ships carrying these cargoes be U.S.-built to qualify. Only United States registry is required, meaning that the

* This trade is protected by the Jones Act. Part of this 1920 law reserves all trade in coastal waters and to offshore states and possessions (Hawaii, Alaska, Puerto Rico, and Guam) to vessels built, crewed, and owned by Americans.

vessels have to be U.S.-owned and crewed by Americans. This important part of Sea-Land's business began to diminish with the draw-down of U.S. troops overseas. Therefore, with the exception of its domestic fleet, by 1992 the company no longer had any business reason to bear the added cost imposed by American registry.

American President Lines (APL) had quite a different problem, although the decline in military cargoes has affected it as much as Sea-Land. In order to keep the U.S. flag flying on its ships engaged in foreign trade, APL's crew wages are subsidized by the Maritime Administration. But the subsidy contract expires in 1997, and the Bush administration had made it plain that the contract would

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not be renewed. APL made it equally plain that it could not wait until 1997 before acting; even with the subsidies supplied by the government, APL had recently been barely breaking even. Plainly, without government help there was (and is) no hope of the line's surviving as an American-flag operator.

Although the Bush administration can be faulted for its failure to promote the merchant marine during its first three and a half years, the blame cannot be put to Andrew Card, Bush's final secretary of transportation. Members of the Senate Commerce Committee warned Mr. Card during his confirmation hearing in January 1992 that they expected him to produce a maritime program soon. Within a few months he was leading the effort to develop a consensus within the administration for a new initiative, and in presenting the resulting program to Congress he was the chief spokesman. His was the most impressive effort undertaken on behalf of the American merchant marine in recent years.

Card drew attention to the serious decline of the country's shipping assets. He noted that the United States now ranked sixteenth in the world, with only 393 seagoing merchant vessels. He projected that by the turn of the century—that is, in less than eight years—this fleet would shrink to 117 ships if no action were taken. By then, all that would remain would be old ships, and most would be sailing with Jones Act protection. Active merchant seamen, who in 1960 had totaled 100,000, in 1992 numbered only 27,000. A drop of another two-thirds by the year 2000 was projected.

In presenting the administration's program to Congress, Secretary Card stated at the outset that there was no intention of changing any existing requirement of the Jones Act, and that the proposed program was directed solely to U.S. ships operating in foreign trade. While the Jones Act is in need of substantial revision, his decision to avoid trying to change it was, unfortunately, politically wise; as

modest as the proposed program was, it was guaranteed to draw enough fire without assaulting a law that many consider untouchable.

II

Of Card's sixteen program elements, only five required legislation. All five were intended to make investment in U.S. ships more attractive. The first of them dealt with the fact that many foreign shipowners pay no taxes. Those who do, enjoy tax advantages generally unavailable to Americans. Some countries allow profits earned from ship operations to be placed in a tax-deferred account to be used for the improvement of existing ships or acquisition of future tonnage. Though Americans have a similar tax shelter, these funds can be used for domestic building only; therefore, domestic yards being as expensive as they are, except for those few ships built for the coastal trades the provision is almost worthless. The new program would allow such money to be used for building U.S.-flag ships abroad.

A second proposal by the administration was to relax the requirement that owners be U.S. citizens to participate in maritime promotional programs such as carrying military and foreign aid cargoes. Secretary Card reasoned that such a change would allow American shipowning companies to attract more foreign equity and that it would make it easier for U.S. shipping companies to enter into joint ventures with foreign partners.

Third, a 120-year-old law imposing a fifty-percent tax on all repair work done in foreign shipyards, a burden borne by no other country's ship owners, would also have been reduced incrementally over a five-year period. One wonders why its final elimination should take five years; as things turned out, the burden will remain.

As its fourth legislative point, the administration intended to attract newer and more efficient ships to carry cargoes covered by the cargo preference laws (e.g., those in the domestic trade). It was to be done by abolishing a requirement that a ship must be under American registry for three years before she is eligible to participate. Obviously, the three-year waiting period was designed to discourage Americans from using foreign-built ships. With few exceptions it has been completely successful; as a result, most of this country's foreign aid cargoes are transported in ships that should have been scrapped years ago. Because of their inefficiency, too much of the public funds intended to feed starving people overseas goes in fact to maintain worn-out vessels. Few if any of these ships were considered worth using in the recent Gulf war.

The fifth and final provision requiring legislation was a proposal to reestablish a tax deferment formerly given for income from ships owned by Americans but operated under a foreign flag. The Bush administration's proposal was intended to encourage increased American investment and participation in international

shipping. Without exception, such American-owned ships are available to the government for use in time of emergency. The deferment was canceled in 1986 at the urging of one of the maritime unions, which imagined that U.S. multinational companies would then be forced to register their ships under the American flag and accordingly to employ American seamen. Just the opposite has happened. These American companies must compete with foreigners employing Third-World crews and paying little in taxes, if anything. As a result, these U.S. companies are slowly getting rid of their ships. This is hardly in the national interest. The present owners—the major American oil, aluminum, and steel companies, who are increasingly dependent on the flow of raw materials from abroad—are also becoming more dependent than ever on foreign-owned, foreign-flag ships. However, the Secretary deferred this proposal, sending it to the Department of the Treasury to be "considered comprehensively" in the future. In so doing he probably condemned it to a bureaucratic purgatory.

III

The program's eleven other proposals would have required no legislation. One was to abolish the requirement that a shipowner have government approval to transfer an American-registered ship to a foreign flag, a regulation that applies to all ships, even those in which the government has no equity interest. No foreign investor in his right mind would accept such a restriction. In the future, few Americans will be willing to do so either. The Secretary's proposal, in any case, limited the provision to ships that "are not militarily useful." Since that determination undoubtedly would have been made by DoD, an American owner could still have gone bankrupt awaiting a decision.

The most controversial aspect of the Secretary's program would have virtually eliminated the current requirement that in order to participate in government programs, ships must be built in American yards. Though this intent was clearly implied, it was not specifically stated; nonetheless, it was not missed by the American shipbuilders. No effort to appease them succeeded. The program did, however, address a project that the shipbuilders have been actively promoting—their attack on foreign shipbuilding subsidies. The program stated that "the Administration will continue to work vigorously toward the elimination of subsidies provided by foreign governments to their shipyards." It went on to say that "where neither elimination of subsidies nor agreements are attained, the Administration will pursue disciplinary measures against [such] countries. . . ."

What had led to the U.S. shipbuilders' charge of discrimination? After the Civil War, when American shipbuilders could no longer sell their wooden ships in foreign markets, the high cost of American iron and steel became their explanation for their subsequent inability to compete in building iron and steel vessels. There was considerable merit to this argument, but the fact remained

that the U.S. shipbuilders lost their ability to sell abroad. After American steel became cheap early in the twentieth century, the blame for the builders' failure was laid to the high cost of American labor—again, with some validity. By the 1980s, however, it had become apparent that American shipbuilding labor rates were virtually equal to those in Great Britain and Japan and were well below those in the Scandinavian countries, the Netherlands, and Germany. A new villain had to be found to explain the shipbuilders' inability to compete: it turned out to be foreign subsidies. The new claim had such obvious appeal that it found members of Congress eager to lend support, and it was never seriously challenged.

Claims of unfair international competition are heard by the U.S. Federal Trade Commission, and if it sustains them the Commission can order punitive action. The FTC, a non-political arm of the government, did hear the shipbuilders' arguments and concluded that while the cost difference between U.S. and average foreign building was an estimated 96 percent, world shipbuilding costs would rise, if all subsidies were eliminated, by only 5.9 percent. In short, American shipyard costs were so out of line that "the elimination of subsidies is unlikely to make US shipyards competitive." The shipbuilders cried "foul" and urged passage of Congressman Sam Gibbons's bill retaliating against those benefiting from subsidies.* This bill would have barred any foreign ship built with a government subsidy from calling at a United States port until the shipowner had repaid it.

Whenever legislation has been proposed to aid the U.S. merchant marine, the shipbuilders have shown their muscle in Congress, demonstrating that if a bill does not provide substantial assistance for the shipbuilders, it is going nowhere. Secretary Card's efforts were to be no exception. Congress made it clear that unless the provisions of the Gibbons bill were included in the package, there would be no package. When the Secretary's legislation went to the Senate, it was rewritten so that any U.S. shipbuilder's complaint against a foreign line would be heard by the Federal Maritime Commission (FMC) and that if the claim was sustained, the FMC could take action that precluded the offending line from trading to the U.S. In this amended form the Gibbons bill was effectively attached to the administration's program.

The underlying assumption seemed to be that the Germans, French, British, Japanese, Italians, etc., would all stand still while being subjected to such claims without attempting to retaliate. In fact, the indirect subsidies provided by the Jones Act and the tax on foreign repairs have not escaped their attention. However, the "offending" companies would obviously be entitled to due process, and the charges would have to be fully examined. It is doubtful that

* Sam Gibbons (D-Fla.) is vice-chairman of the House Ways and Means Committee and chairman of the Sub-Committee on Trade.

American shipbuilders have much interest in demonstrating to the public their low level of productivity. Apparently their congressional supporters hoped that by making these threats they would force foreign governments to come meekly to a bargaining table. This was a highly dubious prospect.

The final provision of the administration's initiative was called the Contingency Retainer Program. It was intended to provide the funds necessary to offset U.S. crew costs currently provided by Federal subsidy. The plan was patterned after the Civilian Reserve Airlift Fleet program, in that a certain number of ships (in fact, seventy-four) would be placed at the disposal of the government in time of emergency in return for an annual payment.

The plan had flaws. The first was that the companies had already agreed to make their ships available, without any payment. This concession was obtained by the Military Sealift Command (MSC) years ago as a condition for allowing the firms to bid on MSC contracts. The second problem involved the high level of funding for the seven-year program. The initial payment was to be "$2.5 million per ship per year for the first two years, phasing down to $1.6 million per ship in the final year." The figure was undoubtedly established to offset the high crew costs incurred by both Sea-Land and American President Lines. However, by using the wage rates currently being paid by many unsubsidized companies

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and by scaling down crew size through the use of existing technology, the necessary offset cost could have been reduced substantially. In the event, Congress insisted on up-front budgeting for the program, and that required DoD support. Since that support was lacking, Card could not earmark the necessary funds in the time available.

Probably the most important problem with the Contingency Retainer Program was that the payment appeared to be a subsidy to the ship operators. While there is much talk of the need to provide trained crews for the Ready Reserve Fleet, the proposal failed to establish the necessary linkage. Worse, the American shipowner has never successfully made the case that he is competing against very efficient foreigners and that his income is derived from rates identical to theirs. He has rarely convinced the public that he cannot survive if he must pay costs significantly higher than those of his competitors. In contrast to the ship operators, the shipbuilders have been clever: they have managed to appear to be unsubsidized. Even when the U.S. government subsidized shipbuilding overtly, the shipowner had to assume the stigma of accepting the subsidy and passing it along to the builders, whose prices were fifty percent higher than those

in the rest of the world. The high cost of ships built to trade only in the U.S. domestic market is paid, in the form of higher prices for the goods they buy, by the consumers who live and do business in Puerto Rico, Alaska, and Hawaii. Building primarily for the Navy, the shipbuilders have no foreign competition. The taxpayers have willingly paid billions of dollars for naval programs over the last twelve years to improve the country's defenses, but, lacking a foreign benchmark, they have never seriously questioned the high cost of the ships produced.

In the event, because the contingency retainer program presented by Secretary Card looked like a federal subsidy to a private industry, the Department of Defense balked at making the payment involved. While it was being debated within the administration, a memorandum was signed by the Assistant Secretary of Defense for Production and Logistics stating that the armed forces would not need American President Line and Sea-Land ships for "surge shipping" in any future contingency foreseen "in the most demanding scenario." He added that "the issue of the two major U.S. flag containerships operators disposing of their U.S.-flag fleets is primarily an economic issue, rather than a national security issue, and should be treated accordingly." Although senior military officers continue to give U.S.-flag shipping verbal support, asserting the defense need for a strong merchant marine, that statement appears to be the position of the Department of Defense today.

IV

The Clinton administration may attempt to bring forth some form of legislation to assist the maritime industry later this year. If it does not, Congress will. This effort it will succeed only if some fundamental lessons from recent experience are learned.

First and foremost, legislation to aid the shipbuilders must be separated from that intended to promote the merchant marine. It is clear that neither the Congress nor the administration is willing to provide subsidies sufficient to allow the shipbuilding industry to produce ships for the world market. One reason for the U.S. shipbuilders' campaign *against* foreign subsidies instead of *for* them for themselves is that to compete against a country like Germany, whose shipyard workers receive at least five dollars an hour more than American workers, they would need many times the support the Germans provide for their own shipbuilders. It should also be remembered that the German shipowner has no requirement to buy from the domestic builder, and he does not. The German shipbuilder receives government subsidies to enable him to compete effectively against the Chinese, Taiwanese, and Koreans—and he does.

When the debate is once again renewed, it might be helpful for the Navy to state the building capacity needed to build and modernize its fleet. To date, the

Navy has resisted doing so. Its traditional position has been that it needs more capacity than it has funds to sustain, and that this difference has to be made up by commercial building. If the Navy believes this, then it might also demonstrate how this can be done. It is also important for the policy makers to become fully aware that "in the most demanding scenario" there is no time to build even a single ship. One goes to war with what one has. Hence the argument that a shipbuilding industrial base has to be maintained for use in time of war to build merchant ships is without foundation. It is true that a viable commercial ship *repair* industry is required to activate the RRF, but that sector is totally separate from naval shipbuilding. (Ship repair is in fact an efficient part of American industry, and it derives more than half of its business from foreign shipowners. It is worthy of much greater recognition than it receives.) If the Navy accepts the shipbuilders' thesis that, in time, they could learn to compete successfully with the foreign builders, then it, as the domestic builders' only customer of significance, might develop some of its building programs in such a way as to assist the transition. To allow the builders to continue holding the U.S. shipping industry captive will only kill the shipping industry. It will not aid the shipbuilders.

The question of how the U.S. shipbuilder can regain a place in the foreign market is not a new one. In 1868, a congressional committee inquiring into "the causes of the great reduction of American tonnage in the foreign carrying trade" quickly shifted its emphasis to concentrate not on the plight of the merchant marine but on that of the shipbuilder. Shipowners attempted to explain to the committee why they could no longer buy from U.S. yards: not only were costs too high, but the American shipbuilders lacked the experience necessary to build iron ships competitively. One witness noted that the first vessels would be experimental, and that it might take four or five years to acquire the necessary skill to build iron ships "as cheap and as good as they were now built on the Clyde." He also noted that "very few shipowners were willing to try that experiment." In other words, no shipowner in foreign trade was then, or is now, going to buy a ship unless the quality, price, and delivery date are guaranteed.

The second lesson of recent experience is that the only justification that the DoD might accept for use of its funds to support the merchant marine is to provide crews for the RRF. In 1990, while the reserve fleet was being activated for Desert Shield, Secretary of Transportation Samuel Skinner noted that "putting less than half of the emergency fleet [the RRF] in service has nearly exhausted the nation's supply of merchant mariners." In a few years, as the number of ships purchased for the RRF increases and the number of mariners declines, activating the fleet will be impossible. Theoretically, the Navy could develop a reserve program to man the RRF from other sources, but this can be done only, if done properly, at a higher cost.

If the billions spent to acquire and maintain the RRF are to have future value, payments should be made directly to those for whom they are intended, in return for a reserve commitment. However, if the shipping companies are to be involved, it should be only as the government's administrative agent. To do otherwise, as has been seen in the recent legislative effort, would carry the stigma of a "subsidy." More than one hundred years of various subsidies, no matter how disguised, to assist the maritime industry has ultimately resulted in failure. The programs have not worked, either because a later congress or administration was unwilling to provide the necessary funds, or because the bureaucratic process inevitably involved drove many of the most competent operators to other flags.

All the arguments in this essay supporting the merchant marine are defense oriented; that is because, in the United States, these are generally familiar and easily understood. It is an unfortunate fact that within the largest trading nation on the earth, the economic advantages of maintaining a viable merchant fleet are not generally appreciated. Yet other people, notably the Japanese and many Europeans, still maintain merchant fleets although they have little or no defense requirement to do so. These countries not only place no excessive burdens on their merchant marine, but they are highly supportive, both inside and outside of government.

All these nations have a standard of living that approaches or exceeds that of the United States. Their fleets are modern and efficient. Clearly, they are not cheap. Yet they fly their nations' flags. These states understand that, in the last analysis, only in this way can they be sure of controlling their foreign commerce. The United States has had this lesson brought home repeatedly. However—partly because the lesson has not had to be relearned in recent years, and partly because many of our policy makers assume that past problems will not happen again—the lesson has had no value. When that which has happened before, happens again, those in power will be thunderstruck. All that they will be certain of is that they are facing a condition without precedent. What *we* can be certain of is that they will be wrong, and that they will probably be unable to find an economical way of setting things right again.

Ψ