Impact of the Coastwise Trade Laws on the Transportation System of the United States of America

Statement In Support of the Coastal Shipping Competition Act
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Introduction

Mr. Chairman, we are here to express our support for any effort that would unburden the economy of the Commonwealth of Puerto Rico from the unfair and unreasonable restrictions that stem from dispositions of the Merchant Marine Acts of 1920 and 1936 on trade conducted between the Commonwealth and the United States mainland. The “cabotage” laws impose significant restrictions on commerce between Puerto Rico and the U. S. mainland by requiring that merchandise and produce shipped by water between U.S. ports be shipped only on U.S.-built, U.S.-manned, U.S.-flagged, and U.S.-citizen owned vessels. The world's shipping business is rife with ineffective and expensive bits of protection. America's Jones Act is one.[1]

Throughout the world, much of the maritime industry is heavily protected. Dozens of countries, including the United States, require that government-owned or-financed cargo travel only on ships that fly that nation's flag. America and more than 40 other nations also have laws barring foreign-flag ships from "cabotage," or plying for trade between domestic ports; a Norwegian freighter, for example, can't carry U.S. goods from New Orleans to Baltimore. Indeed, the 1920 Jones Act generally restricts such trading to ships that not only fly the U.S. flag but also are built in the United States, are owned by U.S. citizens and employ only U.S. workers. Because such restrictions boost shipping costs, American consumers pay the price. An analysis by the U.S. International Trade

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[1] Gerald A. Pollack, *Promoting The U.S. Flag Merchant Marine*, **Business Economics**, April 1991, v. 26 no. 2 p. 45(6). From that article the following quotation provides a usefull background.

The nation's policy of promoting the U.S. flag merchant marine goes back to the early days of the Republic. The basic premise was and continues to be that, for national security reasons, the United States needs a merchant marine that is completely subject to national control in times of emergency.

The dual instruments of this promotional policy have been:

1. Absolute protection against foreign competition in domestic commerce (referred to within the industry as the domestic trades), consisting of the movement of cargoes from one U. S. port to another;[1]

2. Under the 1936 Act, subsidies in international commerce (the foreign trades), consisting of the movement of cargoes between ports in the United States and other nations.

These subsidies are intended to offset the higher costs of U. S. ships and thereby place them on a more even footing with their international competitors. In broad profile, these policies constitute a two-track system - unsubsidized ships for the domestic trades and subsidized ships for the foreign ones.[1] No law keeps unsubsidized ships from international commerce but their high costs usually do, except for government-impelled freight, where preferences apply. Such freight chiefly comprises agricultural cargoes under foreign assistance programs, items procured for or owned by the military, and cargoes underwritten by the Export-Import Bank. On the other hand, those receiving subsidies in international commerce are generally denied access to the domestic trades.

Commission suggests that repealing the Jones Act would cause U.S. shipping prices to fall by 57 percent and swell national income by about $3 billion a year.

The most recent victim of this rule was the federal government itself when it decided to tap its strategic petroleum reserve in January, 1991. The oil had to be shipped from storage caverns in Louisiana and Texas. But there were no American tankers available. So the government found itself in the absurd position of having to waive its own law.

Maritime transportation and the economy of Puerto Rico

The essential geographical characteristic of Puerto Rico is being an island. Its essential economic characteristic is being open to commercial and capital flows. Puerto Rico is one of the most open economies in the world. Yet, this openness is also characterized by being overwhelmingly dominated by its commerce with the United States mainland. The Commonwealth of Puerto Rico's dependence on external trade is clearly reflected by the following macroeconomic indicators.

GDP in fiscal 1995 has been reported by the Puerto Rico Planning Board in its annual report to the Governor[2] at approximately $42.4 billion. Exports and imports were, respectively, estimated at $23.8 and $18.9 billion. That year, 89 percent of exports ($21.1 billion) went to the mainland U.S. Manufacturing represents 41.8 percent of GDP. Virtually all exports are manufactured goods. These can be classified mostly within the following categories: manufactured or processed foods and beverages; chemical products; drugs and pharmaceuticals; electronic components and computers; electrical machinery; and professional and scientific instruments. The Commonwealth government estimates that, by weight, 96.7 percent of exports to the U.S. mainland are

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[2] *Cf.* Puerto Rico Planning Board, **Informe Economico al Gobernador 1995**, *Apéndice Estadístico*, Estado Libre Asociado de Puerto Rico.

transported by vessel. The highest value products are transported by air. These constitute 40 percent of the value of exports.

Imports of Puerto Rico from the U.S. mainland are so significant that the Commonwealth ranks 12 among all nations as an importer of U.S. goods and services. Of a $42.4 billion GDP in fiscal year 1995, $18.8 billion were imports and $12.2 billion were exports. Almost 90 percent of exports, or $21.1 billion, went to the mainland U.S. When analyzed by weight, 96.7 percent, of exports were shipped by vessel to the U.S. mainland. A very significant portion of imports are used by Puerto Rico's industries as inputs in the manufacture of products exported. Moreover, of the products imported from the United States in fiscal 1995, 98.5 percent by weight, and 63 percent by value, were transported by vessel.

In fiscal year 1995, personal consumption expenditures on food totaled $4,247.0 million. The government estimates that at least 50 percent of total personal consumption expenditures on food are supplied by imports.

The net effects of the Merchant Marine Acts

Being treated as an extension of the United States coastline by the protectionist merchant marine statutes has imposed a heavy and unfair cost on United States citizens in Puerto Rico. Being an island, Puerto Rico does not have any alternative means of transportation than by sea for most of its commerce with the United States mainland. Thus, under the protection of federal statutes, a monopsony has been siphoning scarce resources from the poorest U.S. jurisdiction to sustain a segment of U.S. industry that has become uncompetitive due precisely to the protection it has enjoyed.

The Jones Act was passed in 1920. The justification for keeping it has always been national security. In a war, it is argued, America needs a merchant fleet, so the industry must be protected in times of peace. Although saving jobs is also touted as a justification, this can no longer be seriously argued due to the dwindling number that still remain, even under the protection of the statutes. It has not worked.

In 1950 American-owned merchant ships made up nearly a quarter of the world's fleet. Today their share is less than 3%. American shipbuilding, despite the Jones Act, is all but moribund thanks to the much lower prices of ships made in East Asia. Meanwhile, the costs of protection have been huge. A study in 1986 by the Institute for International Economics reckoned the annual cost to consumers from the Jones Act was $1 billion a year. It put the annual cost of each job saved by maritime protection, including direct subsidies, at $270,000.[3]

The main effect of the Jones Act has been to benefit not domestic shippers but their rivals in rail, trucking and air freight. They are not forced to use American-built vehicles. Even the security argument is out of date. Nowadays, merchant ships can easily be chartered on the world spot market-as were half the ships used by the Pentagon to take equipment to the Gulf.

Aircraft, rather than ships, are often more crucial for today's armed forces. America also has national-security rules that mean its airlines must have majority stakes in American hands, but the government is thinking of relaxing that. And no one has ordered American carriers not to lease European-built Airbuses from Japanese banks. America is now leading a commendable push for expensive shipbuilding subsidies to be phased out. Some countries want the Jones Act to be repealed as their price for agreeing to that. Unfortunately, America refuses to consider it.

Paradoxically, because of the Merchant Marine Acts, Puerto Rico has been placed at a disadvantage with other members of the NAFTA, specially with respect to Mexico.

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[3] *Cf.,* Dentzer, Susan, A seafaring story of trade woes, **U.S. News & World Report**, December 6, 1993, v.115, no. 22, p. 55.

Although the Commonwealth of Puerto Rico and the United States should be considered the senior partners in a common market, the Cabotage laws , in practical terms, constitute a protective barrier that favors Mexican and Canadian ports of origin and destination against producers in Puerto Rico. These two members of NAFTA are exempt from the Merchant Marine Acts. Moreover, ground transportation is also an alternative in the case of Mexican and Canadian producers or consumers.

The Merchant Marine Acts inflict costs to the Puerto Rican economy. These are borne by businesses and consumers. Dollar amount estimates of this subsidy to the U.S. shipping industry differ. However, one thing is clear, under the prevailing highly competitive world conditions even marginal differences in cost can make the difference with respect to investment decisions, location-wise.

Conclusion

The Merchant Marine Acts of 1920 and 1936 constitute an anachronism in times when globalization has become synonymous with modernization. The Unites States has become a world leader promoting the dismantling of protectionist barriers that hurt competition and impose hidden taxes on American consumers. In this context, the continuation of a clearly protectionist set of measures that can no longer be justified in terms of any of its original objectives constitutes a policy contradiction that must be done away with. Moreover, Puerto Rico bears a disproportionate burden due to an industry subsidy that has become distorted and that does more harm than good to the industry it is supposed to help.

Mr. Chairman, one of Puerto Rico's most strategically important national and economic assets is its harbor in San Juan. Given its central location in the Caribbean, this port has an excellent opportunity of developing into a key transshipment point. This goal is made more difficult by the additional costs and restrictions imposed as a result of the cabotage laws.