

ESSAYS IN INTERNATIONAL FINANCE

No. 23, June 1955

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MARINE POLICIES:
SOME INTERNATIONAL ECONOMIC
IMPLICATIONS

WYTZE GORTER



INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS AND SOCIOLOGY

PRINCETON UNIVERSITY

Princeton, New Jersey

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International Finance Section

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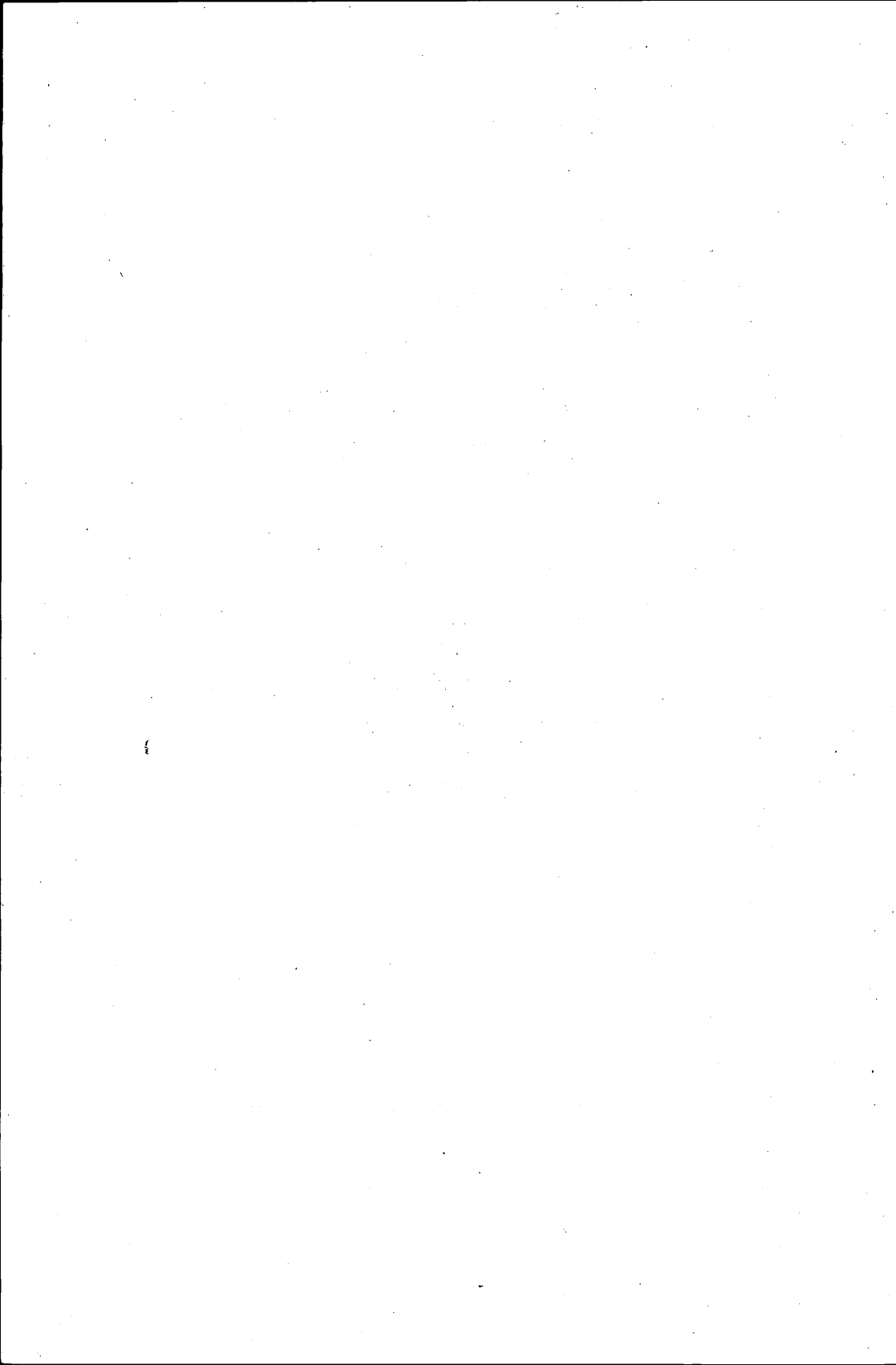


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I. INTRODUCTION

MORE merchant vessels fly the United States flag than any other. The ports of the United States handle more foreign-trade cargoes than those in any other country. But the United States is not a "maritime" nation. Shipbuilding and ship operation rank far down on the list of industries, whether measured by number of employees or value of output. The active merchant fleet, presently consisting of only about one-third of the total merchant marine, lifts hardly more than a quarter of the cargo tonnage transported in the water-borne foreign trade of the United States.

This small industry nonetheless attracts much attention, both at home and abroad. At home, its vociferous lobbyists wage an unceasing campaign for Congressional and executive attention. The voluminous official records of hearings, exhibits, reports, and legislation silently attest to their success. Abroad, changes in the merchant marine policies of the United States are always newsworthy; after all, ocean shipping is one of the most international of industries. Those who have been involved in the formulation and administration of merchant marine policy have often ruefully discovered that this is a hypersensitive area of international and domestic political and economic relations.

The postwar course of world events has prompted increased concern over the international economic implications of the maritime policies of the United States. Both the Gray and Randall Commission reports, for example, called attention to cargo preference legislation as an important illustration of a discrepancy between merchant marine policy, on the one hand, and the avowed philosophy behind foreign economic policy in general, on the other. Both reports urged that these preferences be abandoned. In contrast, a recent Department of Commerce report on maritime subsidy policy recommended continuation of cargo preference. Although the President did not accept this recommendation and requested that the Department investigate other means by which to aid

the merchant marine, he did approve the controversial cargo preference bill in the autumn of 1954.

These developments are manifestations of the conflict of interests that has influenced merchant marine policy for many years. Were it not for the threat of war, the opponents probably would be the usual two: the industry, interested in its survival, and the alliance of other groups advocating the most economic allocation of the world's resources. The demands of national security are of course very prominent today, and they seem likely to transcend the objective of a low cost maritime policy. The result is that the battle lines of the conflict over shipping policy are not clearly marked.

By stressing the military importance of shipping, the spokesmen for the industry have often successfully diverted attention away from the international economic impact of their policy suggestions. This has been to their immediate advantage. We may nonetheless reasonably question whether the national interest has best been served by this diversion. The dollar earnings of certain of the important military allies of the United States are in some measure dependent upon the participation of their merchant fleets in United States foreign trade. A weakness in their dollar position certainly cannot be considered as helpful to the military posture of the western bloc.

It must be recognized that we cannot always determine what *the* national interest is. When speaking of economic policies affecting foreign countries as well as the United States, we customarily refer to this interest as involving military, political, and economic considerations. Any economic policy is tempered by political and military factors. Thus *the* national economic interest alone cannot be fully served; neither can the military or the political. Given the problem of trying to satisfy national needs in all three areas, a particular policy may be best for all combined but not wholly satisfactory for any of them. Nevertheless, insights valuable to sound judgment can be gained from an examination of national policy from the admittedly restricted viewpoint of the economist, military expert, or skilled diplomat. The recent stress on the military aspects of merchant marine policy suggests that the time may be ripe for another look at the policy through the eyes of the economist interested in its international economic repercussions.

For present purposes, United States maritime policy can be divided into five basic segments: construction-differential subsidies, cabotage regulations, control of competition, operating-differential subsidies, and cargo preferences. No consideration will be given to port and harbor regulations, navigation laws, and marine insurance laws, to name a few other policy areas affecting maritime affairs, for their differential im-

pact upon foreign merchant fleets and the economic welfare of other countries is small relative to the five major policy groupings listed above. Moreover, in many instances the policies omitted from discussion here apply equally to foreign and domestic citizens under terms of the various treaties of friendship, commerce, and navigation.

II. SHIPBUILDING SUBSIDIES

Except during periods of such high demand that foreign yards are choked by a large backlog of orders, shipbuilders in the United States cannot compete successfully with foreign competitors. Constructing a ship requires much skilled labor and many crafts are needed. During nonwar periods very few vessels of the same specifications are built by any given yard. Nearly every ship is a custom job, especially fitted for a particular operator. A relatively small number of ships slides down the shipways each year. Shipbuilding is therefore not suited to the assembly line methods characteristic of so many of the large and successful industries in the United States. Thus, despite an apparently greater output per manhour in the United States than elsewhere, higher labor costs raise the cost of American-built vessels well above those of their foreign rivals. For example, the Federal Maritime Board in its February 1954 report on the sales prices of "Mariner" class vessels estimated the cost in Britain of building 20 knot combination or 18 knot freighters to be 40 to 46 percent below the cost in United States shipyards. The Board estimated that the British yards required nearly a fifth more man-hours of direct labor than the American to do the same work but found average hourly wage rates in the United States yards in 1951 (the year of comparison) to be over three and a half times those in the British yards.

Construction-differential subsidies, authorized by the Merchant Marine Act of 1936, equalize the foreign and domestic prices of merchant vessels, subject to the limitation that the subsidies may not exceed 50 percent of the American price: Our shipbuilders also receive other help from the Government. Only American-built ships may be used in the coasting and noncontiguous (United States to territories and possessions) trades and on voyages performed under an operating-differential subsidy contract; and all United States-flag ship operators must pay duty on vessel repairs (other than emergency) made by foreigners in their ports. The Government as a matter of course orders its ships from American yards. In addition to these and other comparable but less important forms of assistance, the Government both guarantees and provides ship loans on liberal terms and gives generous turn-in allowances on old vessels if the operator agrees to build a replacement

in a domestic yard. It recently has encouraged domestic tanker construction by offering the operators of such vessels profitable ten-year charter arrangements for the transportation of petroleum for the Military Sea Transportation Service.

These add up to an impressive variety and total of preferential treatments to American shipbuilders, but they probably are currently at least having only little effect upon the welfare of foreign yards. Although orders placed with foreign yards have declined recently, their backlog in most instances is still very large. As of January 1, 1955, the shipyards of the world reported 1347 merchant vessels (1000 tons and over) totalling 11.2 million gross tons in the category of "new construction in hand or on order." A year earlier the figures were 1423 vessels and 13.1 million gross tons. United States shipyards accounted for only 48 ships (0.7 million gross tons) of these totals on January 1, 1954. At the beginning of the present year they contributed a mere 14 vessels amounting to 0.2 million gross tons: 1.7 percent of the world total. Adding the 44 naval vessels of 0.3 million displacement tons under construction in private yards still leaves the United States total internationally unimpressive.

III. CABOTAGE RESTRICTIONS

The regulation of the coasting trades dates from almost the beginning of the United States as a sovereign nation. The general rule is that only American-flag vessels can operate in the intercoastal, coastwise, and noncontiguous trades of the United States. Exceptions are occasionally granted, a recent example being the action of Congress in 1953 (P.L. 124) permitting Canadian ships to participate in the United States-Alaska trade; this permission was given because of a shortage of American-flag vessels to carry freight and passengers on this route, so important to national defense.

Inasmuch as foreign-flag merchantmen for all practical purposes have been excluded from the coasting trades for well over one hundred years, this aspect of United States maritime policy can hardly be said *currently* to induce any important foreign economic repercussions. Information is not at hand, but it may be that some countries have imitated the United States by adopting similar cabotage laws. If so, this may have given at least some temporary help to their merchant shipping industries, but it is most doubtful that any such help necessarily affected the American merchant marine.

IV. CONTROLLING COMPETITION

In general, the U.S. Government does not object to shipping conferences: privately-operated and controlled rate-making bodies which are similar to but less stable than cartels in that they permit entry of new firms and do not allocate total sales among themselves according to any prearranged scheme. American shipping concerns have been specifically exempted from prosecution under the Sherman Act for participation in these conferences despite their collusive nature. Still, the American Government, although it does not set ocean freight rates, may disapprove of a specific conference agreement on the ground that it is unduly discriminatory. In this event, under the terms of the Shipping Act of 1916, the American signatories cannot participate in the conference under the terms of the agreement. For a similar offense, foreign-flag vessel operators can be penalized by denying them the use of United States ports.

By its passive attitude toward shipping conferences the U. S. Government may contribute to the overtonnaging of many trade routes. The available evidence suggests that during a period of slack demand, conference freight rates, set by mutual agreement, are probably somewhat higher than they would be in a freely competitive market and that vessels tend not to be taken out of service as soon as they would be in a more competitive market. At the same time, maintaining the supply of ships and rates under conditions of slack demand probably tends to result in lower profits for the operating ships than would be the case under free competition. Still, many regard this as a reasonable price to pay for rate stability and controlled competition. Unfortunately, neither the proponents nor opponents of the conference system have so far been able unequivocally to prove their case. The most we may therefore conclude is that insofar as American acceptance of the conference system prevents "cutthroat" competition detrimental to foreigners, it contributes to the well-being of their merchant fleets. So far as it results in overtonnaging and lower profits, it works against them.

To date the consensus of the shipping fraternity, American and foreign, is that conferences do more good than harm. Shippers often disagree, objecting in particular to the dual rate system—lower freight rates for shippers agreeing to employ conference shipping companies exclusively for given periods—which restricts their freedom of choice. The conferences contend that without this contractual arrangement, or the deferred rebate scheme, they would lack the steady volume of dependable cargoes necessary to permit regularly scheduled (i.e. liner) service.

In any case, the conclusion seems warranted that in the control of

competition, too, the maritime policies of the United States probably do not adversely affect foreigners. In large measure the United States has merely adopted the time-honored solution to the problem of regulating competition among carriers flying many flags. It has acted as the other maritime nations have, recognizing that legal complexities bar effective governmental or even international control. It has condoned the conference system of self-regulation by the shipping industry. For such, foreign shipping companies are probably thankful.*

V. SHIP-OPERATING SUBSIDIES

Foreign-flag shipping companies are unfavorably affected by the operating-differential subsidy program of the United States although the damage to them is probably less than most casual students of the problem believe. Under this subsidy scheme, taking its present power under the Merchant Marine Act of 1936, qualified operators who are willing to submit to the requirements of the subsidy law are granted subsidies sufficient to cover the difference between their operating costs and those of their foreign rivals. Included in these costs are outlays for insurance, maintenance, repairs not covered by insurance, wages and subsistence of officers and crew, and other expenses in which the Federal Maritime Board finds that the American shipping company is at a "substantial disadvantage" in its competition with vessels of a foreign country. About 50 percent of the American dry-cargo, merchant marine in the foreign trade was receiving subsidy support at the end of 1953. These vessels accounted in 1953 for just over one-third of the commercial dry-cargo tonnage transported by the American-flag merchant marine in the nonmilitary foreign commerce of the United States.

The existence of preference cargoes makes it difficult to determine whether the subsidized operators would have realized profits adequate to keep them in the industry without government subvention. Many nonsubsidized companies did. Some indication of the importance of the subsidy can be gained from the following figures. In 1951, for example, the profits before taxes of the shipping business of the subsidized operators totalled about \$70 million. Net operating-differential subsidy payments have been officially estimated at roughly \$37 million. For the period 1946-1951, the Treasury Department found that the ratio of net returns to net worth for subsidized operators was higher than for non-subsidized operators by roughly the ratio of net subsidy payments to

* For an excellent study of shipping conferences, see Daniel Marx, Jr., *International Shipping Cartels: A Study of Industrial Self-Regulation by Shipping Conferences*, Princeton: Princeton University Press, 1953.

the net worth of the subsidized operators. More specifically, for a representative sample of nonsubsidized shipping lines the rate of return before taxes (including in some cases earnings from nonshipping operations) on net worth was found to average 10.7 percent for the six-year period following World War II. For the subsidized lines it amounted to 16.5 percent, with the net subsidy totalling 6.0 percent of net worth for the subsidized lines.* Without the help of subsidies it is likely that *some* of the subsidized companies would not have continued operations for profits differ widely and fluctuate sharply as between companies. Profits from alternative investments might well have attracted some away from shipping, especially those who charter vessels and so can relatively easily leave the industry; operators owning their ships are much more likely to stay on.

We can conclude that the operating-differential subsidy program prevents the more efficient foreign shipping companies from realizing higher earnings. Subsidies of this sort encourage the maintenance of larger shipping facilities than would otherwise be the case and the net returns of the industry are therefore spread among more operators than would remain in business if none was subsidized. How much more those would earn who would survive if there were no subsidies is difficult to determine, but some very rough estimates can be made. In 1951 the *gross* revenues of the subsidized lines totalled \$528 million. If all of this had been earned by foreign-flag merchantmen, their earnings in United States foreign trade would have increased by nearly 50 percent.

Let us assume, conservatively, that half of these earnings would have accrued to foreigners in the absence of the subsidies. What effect would this have had upon the dollar earnings of foreign maritime nations? Assume most liberally that three-fourths of the increase in earnings would have come from shippers paying in dollars. In the balance of payments, those earnings, on the basis of recent experience, would have been offset by about one-half by port expenses in the United States. After allowing for these expenses the estimated increase in dollar net earnings for that year would have totalled a bit less than \$100 million—not a large sum in the balance of payments of the major maritime nations with the United States but significant enough, one would think, to warrant foreign shipping concerns and their governments urging, on economic grounds, elimination of the operating-differential subsidy program of the United States.

Some observers have been surprised that the subsidy has not attracted as much attention and comment as, say, the quantitative restrictions

* U.S. Treasury Department, *Scope and Effect of Tax Benefits Provided the Maritime Industry* (Supplementary Report), November 1, 1952, pp. 144-145.

imposed on the importation of cheese under the Defense Production Act of 1950. After all, the operating-differential subsidy scheme provides the ultimate in "tariff" protection: it equalizes foreign and domestic costs. Surely the responsible officials in foreign governments know that the cost-equalizing principle, effectively applied, destroys the *raison d'etre* for international trade, and that in an industry where they often have a comparative advantage. Why, then, is the principle apparently accepted without vociferous objection?

Three factors, among others, appear largely to account for the relatively serene acceptance of the subsidy scheme and its implications by foreign shipping companies and governments. First, the subsidies are paid only to qualified operators offering regularly scheduled service on essential trade routes. These operators are members of international steamship conferences, which ordinarily set freight rates only upon unanimous approval of their members. This means in effect that the rates will be sufficiently high to be compensatory for the highest-cost operator in the conference. Subsidized American-flag operators presumably have low costs and so are not in a position to argue effectively against rates profitable to higher-cost rivals in the same conference.

The cartel-like conference thus protects all its members from the vicissitudes of open price competition. Shipping companies usually do not want to engage in price competition. This being so, they have little interest in their competitors' costs. They may, of course, wish that their rivals' costs were so high that even at very high freight rates they would sustain losses, but in practice they need not be concerned about costs incurred by their rivals since under the conference system prices cannot be cut simply because one operator's costs permit him to do so profitably.

Second, in recent years, despite the American subsidies, foreign-flag operators have enlarged their share of commercial cargoes in the foreign trade of the United States. In the dry-cargo segment, pertinent here, foreign vessels lifted 44 percent of our imports and 39 percent of our exports in 1946. By 1953 their shares were 70 percent of the imports and 76 percent of the exports, and they lifted 80 million long tons as compared with 35 million tons in 1946. Had they carried all the dry cargoes handled on subsidized sailings by their American competitors in 1953 (10 million long tons), they would have raised their shares only to 79 percent of imports and 85 percent of exports. However, removal of the subsidy would not have raised the foreign-flag shares to this amount because some of the subsidized carriers would probably have remained in operation and the cargoes of those that did not would have been divided among both American and foreign-flag companies.

Third, direct and open retaliation by foreign governments against the subsidy probably could not long succeed. Any maritime nation is both an exporter and an importer of shipping services. This means that a discriminatory act against the merchant marine of another nation, while perhaps temporarily beneficial to the favored ship operators, can readily be countered by similar action by the government of the injured merchant marine. This latter action will, in turn, hurt the merchant that benefited from the original discrimination. Thus, unlike the situation in which a tariff is imposed to help a local nonexporting industry, retaliation in maritime affairs hits the very industry that at first benefits from discrimination.

Furthermore, foreign governments probably regard it as futile to attempt to match subsidies with the United States. It is also likely that the American system of subsidies gives foreigners a bargaining point in international negotiations with the United States. By pointing to the existence of these subsidies and their possible harm to foreign shipping lines, foreign governments may be able to wring concessions from the United States in other areas. At the same time, there is no evidence that the U.S. Government has been unduly embarrassed by the operating-differential subsidy. While certainly not wholly consistent with the rest of our foreign economic policy, it is not sufficiently out of line to constitute a serious stumbling block obstructing trade and other international agreements. Compared with exchange controls and cargo preferences, it is indeed a mild and relatively inoffensive means of supporting a merchant marine.

VI. CARGO PREFERENCE

On August 26, 1954, under an amendment to the Merchant Marine Act of 1936, the temporary cargo preference legislation of the United States acquired permanency in a law designed "to provide permanent legislation for the transportation of a substantial portion of [United States] waterborne cargoes in United States-flag vessels." This amendment, popularly known as the "Cargo Preference Bill," provides that:

whenever the United States shall procure, contract for, or otherwise obtain for its own account, or shall furnish to or for the account of any foreign nation without provision for reimbursement, any equipment, materials or commodities, within or without the United States, or shall advance funds or credits or guarantee the convertibility of foreign currencies in connection with the furnishing of such equipment, materials, or commodities, the appropriate agency or agencies shall take such steps as may be necessary and practicable to assure that at

least 50 per centum of the gross tonnage of such equipment, materials, or commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers), which may be transported on ocean vessels shall be transported on privately owned United States-flag commercial vessels, to the extent such vessels are available at fair and reasonable rates for United States-flag commercial vessels, in such manner as will insure a fair and reasonable participation of United States-flag commercial vessels in such cargoes by geographic areas*

The exact language of the law is important because in no other way can the inclusiveness of the cargo preference legislation be so easily understood. The law further provides that if Congress, the President, or the Secretary of Defense declares that an emergency exists requiring waiver of cargo preferences, they may be temporarily suspended. The law does not apply to cargoes carried by the Panama Canal Company (owned by the Government). Nor does it affect the 1934 statement (Public Resolution Numbered 17) in which Congress expressed its desire that exports financed by *loans* made by the Reconstruction Finance Corporation, the Export-Import Bank, or any other agency of the Federal Government be shipped exclusively on United States-flag vessels. The Maritime Administration has authority to recommend the granting of exceptions to this rule, such recommendations to be based upon a finding that there are not enough American-flag vessels, or their capacity is insufficient, or their sailing schedules inappropriate, or their rates unreasonable. In practice, except for retaliatory purposes, the Maritime Administration has recommended that at least 50 percent of these cargoes be transported in foreign-flag vessels.

During the recent controversy over cargo preference legislation, proponents of the new law pointed out that, in addition to the noted 1934 legislation and the 50-50 provision incorporated in postwar foreign aid legislation, cargo preference had a precedent dating back fifty years. The Act of April 28, 1904 provides that United States-flag vessels be employed to transport ". . . coal, provisions, fodder, or supplies of any description, purchased pursuant to law, for the use of the Army or Navy." The law also provides that this need not be done if the rates are "excessive and unreasonable."

Neither the 1904 nor the 1934 legislation attracted much attention until cited in the arguments about cargo preference after World War II. Before 1941 shipments under Export-Import Bank loans were a very small part of total foreign trade cargoes, as were armed forces traffic. But since World War II, military cargoes, moved under the direction of the Military Sea Transportation Service, have been very substantial

* *Public Law 664*, ch. 936, 83d Cong., 2d sess.

indeed, amounting, for example, to about 13.1 million long tons annually for fiscal years 1952 and 1953.

Throughout the public discussion of cargo preference legislation the shipping industry spokesmen were careful to stress that cargo preference would apply only to Government-financed cargoes and they pointed out that these shipments would decline as the aid programs of the Federal Government dwindled. This emphasis, whether by design or accident, tended to create the impression that these cargoes were not overly important. The available figures belie the impression of relative insignificance. For example, in 1952 privately operated United States-flag vessels handled an estimated 40.0 million long tons of dry cargoes in the military and foreign export trades of the United States. Shipments under the Mutual Security Program accounted for 4.8 million long tons. An additional 11.7 million tons were troop-support and other armed forces cargoes transported by this fleet for the Military Sea Transportation Service. On the assumption that these estimates are correct, cargo preference actually accounted for two-fifths of the export cargoes of the American-flag merchant marine engaged in the military and foreign trade in 1952.*

* The available cargo tonnage statistics only permit estimates that should be used with caution. In the interests of clarity and in the hope that some readers will be challenged to develop better estimates, the method used here is spelled out in detail.

The figures (all in millions of long tons) were derived as follows:

| | |
|--|-------------|
| (1) Commercial nonaid cargoes | 23.5 |
| (2) Department of Defense—controlled aid shipments, and “special category” items | 1.4 |
| (3) | <u>24.9</u> |
| (4) MSA shipments | 4.8 |
| (5) (—) “(2)” above | 1.4 |
| (6) | <u>3.4</u> |
| (7) Military Sea Transportation Service dry cargoes lifted by commercial vessels | 13.1 |
| (8) (—) “(2)” above | 1.4 |
| (9) | <u>11.7</u> |
| (10) (3) + (6) + (9) | <u>40.0</u> |

“Commercial nonaid cargoes” do not include exports of aid cargoes aboard United States-flag vessels or armed forces (“troop-support”) cargoes. “Department of Defense-controlled aid shipments” include aid program shipments aboard MSTs vessels as well as regular commercial vessels of United States registry. “‘Special category’ items” are handled by commercial vessels. Statistics covering these exports are combined with the Department of Defense-controlled aid shipments for security reasons.

Line (2) was added to line (1) to yield a total for commercial shipments, excluding some aid cargoes on United States-flag vessels and including (unavoidably) some shipments aboard MSTs vessels.

Line (2) was subtracted from line (4) to derive a “net” figure for aid shipments

The *payments* made to commercial vessel operators for carrying Government-financed cargoes are equally impressive. From April 3, 1948 to June 30, 1954, the Foreign Operations Administration and its predecessors paid about \$1 billion for shipping services. One can safely assume that under the 50-50 program at least half, or \$500 million, went to American shipping companies. To this should be added a sum exceeding \$1.24 billion—the amounts received by “commercial interests” (excluding private shipyards) from the Military Sea Transport Service for fiscal years 1951-53 inclusive.

If foreign-flag operators had been permitted to lift half of the aid cargoes handled by American-flag ships, about \$250 million would have been added to their receipt of dollars between 1948 and 1954. Had they lifted even one-half of the military cargoes in 1951-1953 they would have increased their earnings by approximately \$600 million. These are indeed sizeable sums. On an annual basis they would total about \$240 million. Net, after port expenditures, this would amount to nearly \$120 million per year.

While it is true that civilian aid programs will probably decline, they are still quite substantial; currently, economic (non-military) aid is flowing at an annual rate of about \$1.5 billion. Military programs overseas are not likely to diminish rapidly for some time. Thus, despite the decline in civilian aid shipments, Government cargoes will probably continue to bulk large in the operations of American shipping companies.

aboard non-Department of Defense-controlled vessels. This “net” figure is smaller than the actual net amount because “special category” items and some Department of Defense-controlled aid shipments lifted by MSTs vessels have been deducted.

Line (2) was also deducted from the total of MSTs cargoes lifted by commercial vessels (line 7) to derive an estimate of the volume of troop-support cargoes carried by private commercial vessels for the MSTs.

Adding lines (3), (6) and (9) therefore gives an estimate of commercial plus aid plus troop-support cargoes handled by the privately-operated American-flag merchant marine. All MSTs cargoes have been assumed to be outbound and handled by American-flag operators. This assumption does not significantly affect the estimate. Only a very small fraction of the MSTs cargoes is inbound or shipped aboard foreign-flag vessels.

The statistics were obtained from the following sources. For United States exports of foreign and domestic merchandise aboard United States-flag vessels, U.S. Department of Commerce, Bureau of the Census, “Water-borne Foreign Trade Statistics,” *Summary Report FT 985*, June 15, 1954, p. 9; for MSTs cargoes handled by commercial vessels, Military Sea Transportation Service, *Financial and Statistical Report* (the figure given for 1952 is the average for fiscal years 1952 and 1953, measurement tons converted to long tons using a storage factor of .70-1.75 measurement tons = 1 long ton); for MSA shipments, U.S. House of Representatives, *Departments of State, Justice, and Commerce Appropriations for 1955*, Hearings Before the Subcommittee of the Committee on Appropriations, 83d Cong., 2d sess., p. 357, from a table submitted by the Maritime Administration.

As expected with such large sums at stake, and with their share of aid cargoes limited by law, foreign maritime nations have protested against the cargo preference legislation of the United States. They have criticized the inconsistency between the nondiscriminatory freer trade policies advocated by the United States on the one hand, and the employment of a quota-type restriction implicit in cargo preference, on the other. The Department of State has received a number of "aides memoires," memoranda, and notes "verbales" from the foreign embassies in Washington. This, of course, was not unanticipated.

Somewhat unexpected, however, were the rather widespread adoptions of cargo preference laws—either in imitation of or retaliation against the United States. Last year the State Department reported that cargo preference provisions had been written into trade agreements involving twenty countries. It also noted that a Pan-Arab merchant fleet, protected by a 50-50 agreement providing that half of all cargoes moving between Arab and non-Arab countries would be lifted by this fleet, was under consideration at Cairo.* The most striking recent example of cargo preference is the agreement between Mr. Aristotle Onassis and King Saud. Under this agreement, Onassis will provide a tanker fleet of at least 500,000 tons registered under the Arabian flag. Except for Arabian American Oil Company tankers in operation before December 31, 1953, the ships of Onassis' Saudi Arabian Maritime Company will carry all the oil shipped out of Arabia by vessel. Needless to say, the American oil companies have protested and the contract at the time of writing is under further discussion.

Economists generally agree that cargo preference is detrimental to world trade and should be abandoned. Many steamship operators view the matter differently. They argue that without American cargo preference on aid shipments, the foreign exchange control regulations of other nations would deny United States lines the right to compete for the traffic. Foreigners retort by pointing out that they could get more needed aid per dollar of grant if they were permitted to use their own vessels and to spend the dollars granted on goods, not on services they can easily provide for themselves. American shipping men rebut that exchange control regulations on nonaid commerce are already so strict that United States vessels are badly handicapped in foreign trade.

These charges are difficult to substantiate. Records of the State De-

* U.S. Senate, *Cargo Preference Bill*, Hearings Before a Subcommittee of the Committee on Interstate and Foreign Commerce on S. 3233, 83d Cong., 2d sess., 1954, pp. 9-10. See also "The Arab World," *The Egyptian Economic and Political Review*, Cairo: Industrial Research Organization, November 1954; U.S. Department of State, *The Department of State Bulletin*, July 12, 1954, pp. 63-69.

partment and Maritime Administration reveal fewer overt acts of exchange discrimination against United States-flag shipping than the industry's protests would indicate. It is to be noted, moreover, that most of the protests registered by the industry involve trade with Latin America, which has received only very small amounts of aid, rather than with Europe and Asia, the major recipients of aid.* One may well wonder, therefore, how cargo preferences on aid shipments provide retaliation against these foreign restrictions. They are essentially compensatory and not retaliatory.

United States shipping companies no doubt have been hurt by foreign exchange and other discriminatory regulations. So have other sellers of American merchandise and services. It is pointless to try to determine in each case who shot first in the war of discrimination. All participants have been both helped and hindered by the gunfire of cargo preference and exchange control. From the standpoint of international economic welfare, all nations, including the United States, may be judged losers. For the latter, the losses are especially significant. The costs of aid are higher than they would otherwise be. Foreigners, denied the chance to economize dollar exchange on shipping services, merely buy less from other American sellers. Underdeveloped countries, yearning for merchant navies of their own, imitate cargo preference. The end result is overtonnaging and economic waste all round. No country wins this war. Resources are wasted, the wrong things are produced, and the benefits of competitive world trade are reduced.

VII. CONCLUSIONS

Without the assistance of the subsidies, cargo preferences, cabotage restrictions, and other promotional and restrictive devices created by the Federal Government, the American merchant marine would be much smaller. Each of the maritime policies examined here was specifically designed either to prohibit foreigners from competing freely with Americans or to eliminate the foreigners' advantages by subsidizing their United States competitors. The well-stocked United States arsenal of trade restrictions has been liberally used.

* See U.S. Senate, *Discriminatory Acts of Foreign Governments Affecting Our Merchant Marine*, Hearings Before the Subcommittee on Merchant Marine and Maritime Matters of the Committee on Interstate and Foreign Commerce, 82d Cong., 2d sess. At that time, 1952, the State Department listed Argentina, Brazil, Chile, Colombia, Ecuador, Uruguay, Venezuela, Canada, France, Italy, South Africa, Spain, Egypt, Turkey, Portuguese East Africa, and Kenya Colony as discriminating against the United States Merchant Marine. Nine of these sixteen countries employed cargo preference or exchange controls to favor their own or other than United States merchant fleets. The Italian and Turkish preferences were very minor.

Speaking broadly, the international economic impact of United States shipping policy is similar to that of tariffs, quotas, bounties, and the rest of the anti-free market legislation applicable to international commodity trade. Foreign ship operators and builders are hurt by our maritime policies while their American counterparts are helped (temporarily at least) at the expense of other Americans—certainly the other exporters and perhaps the taxpayers as a group. But this general observation is not very useful. It does not tell us which aspects of United States merchant marine policy have especially onerous international economic consequences. From a purely economic standpoint, all the policies considered together are to be condemned but some deserve more condemnation than others.

The construction-differential subsidy program and the closely related shipbuilding policies have not as yet significantly affected foreign shipbuilders. Except during the war years, United States shipyards seldom produced more than 10 percent and often less than 5 percent of the annual output of the world's shipbuilders.

Cabotage restrictions affect foreign exporters of shipping services in much the same way as embargoes affect foreign exporters of merchandise. No doubt their removal would help foreign-flag vessel operators. Their gain, however, would at best be relatively small for only about 4 percent of the world's merchant marine is employed in United States domestic trade.

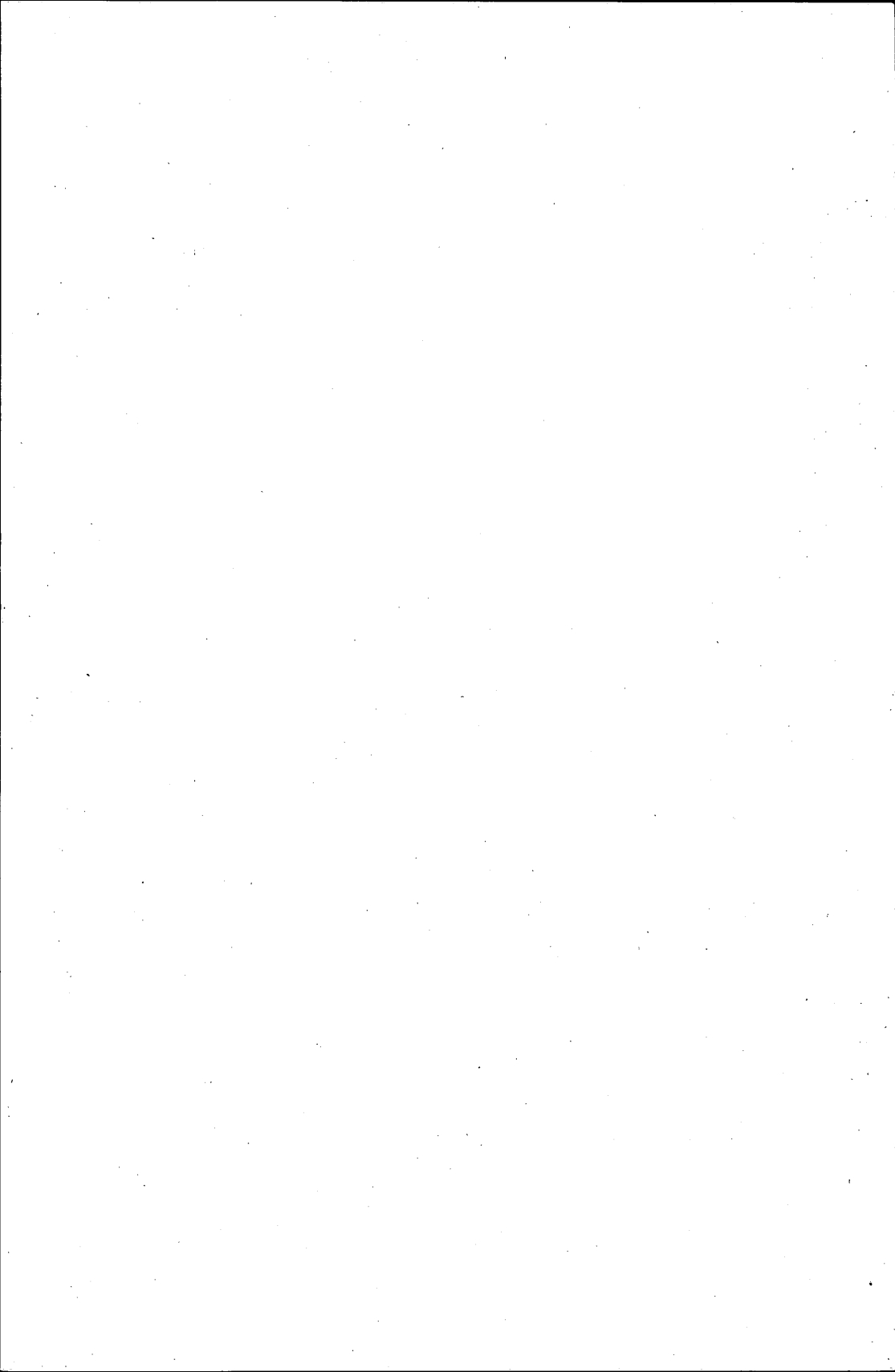
As cost equalizers, operating-differential subsidies also adversely affect foreign shipping companies. How much, cannot be determined. Our estimate suggests that the increase in foreigners' dollar receipts, had they received one-half of the earnings of the American operators in 1952, would have been relatively small.

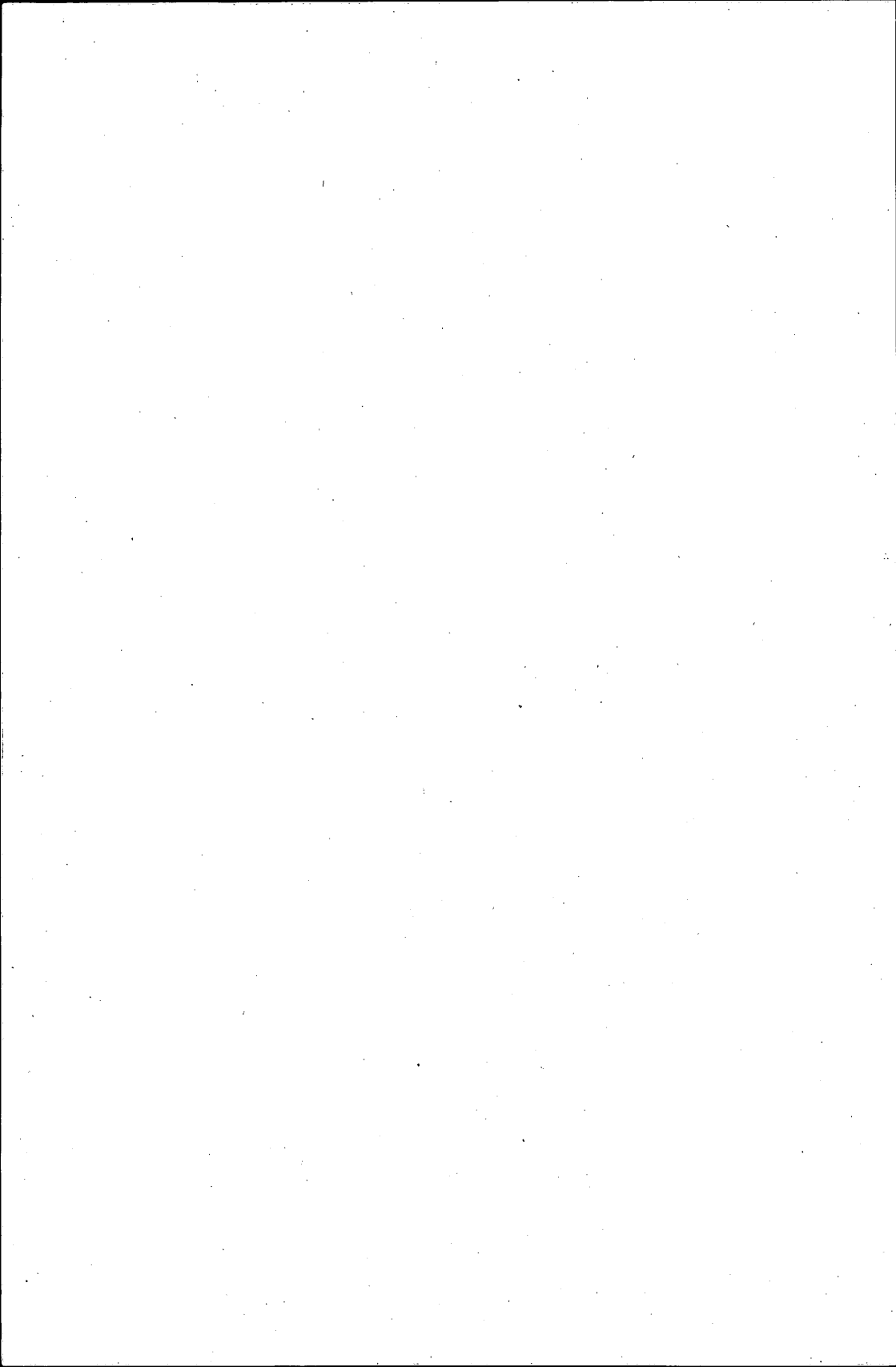
The subsidies affect costs, not revenues. Coupled with shipping conferences and their cartel-like arrangements for fixing rates, they help create a surplus of vessels. Despite this, the dislike of rate wars makes most vessel owners, foreign and American alike, willing to accept conference rule and the subsidization of American-flag vessels. No important retaliatory economic policies designed to negate United States operating-differential subsidies are likely to be adopted by foreign governments. Under the conference system, and despite the United States subsidy, foreign shipping lines have enjoyed a growing share of United States foreign trade cargoes and revenues since 1946. This shows that though at any time cargo preference and the operating-differential subsidies may have roughly the same effect upon the dollar earnings of foreign-flag lines, under the subsidy scheme foreigners are not arbitrarily prevented from increasing their share of cargoes. At present, the

economic impact of the operating-differential subsidy appears insufficient to warrant any important change in the merchant marine policies of foreign governments.

Cargo preference has had significant international economic repercussions. Foreigners, although free to sail their ships in the foreign trade of the United States, cannot compete for some cargoes. Administrative decision has supplanted the judgment of the market. Other countries have installed cargo preference schemes in retaliation or in imitation, with unfortunate effects upon world shipping. Needed adjustments in the volume of shipping space available, already hampered by the operation of shipping conferences, are further blocked by the arbitrary allocation of cargoes to national-flag vessels. Measured in money, the elimination of cargo preferences, operating-differential subsidies, and cabotage restrictions might add as much as \$200 million to the net dollar earnings of foreign maritime nations. It might, of course, add considerably less if, in response to these policy changes, American shipping lines transferred their operations to foreign flags, thereby reducing their costs of operation and permitting them to continue their services.

Perhaps the most important international economic implication of United States maritime policy is its effect upon the attitudes of foreign government officials. This is particularly true of cargo preference. It is one of a number of postwar commercial policies blatantly running counter to the avowed international economic policy of the United States. Foreign observers often consider these divergencies very important signs of "true" American policy. They cite them as evidence that the United States is not a reformed protectionist nation. Each new trade restriction reinforces this conviction. This encourages retaliation and measures of self-protection. Both are inimical to the best economic and political interests of the United States and the other nations of the free world.





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