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International Finance Section

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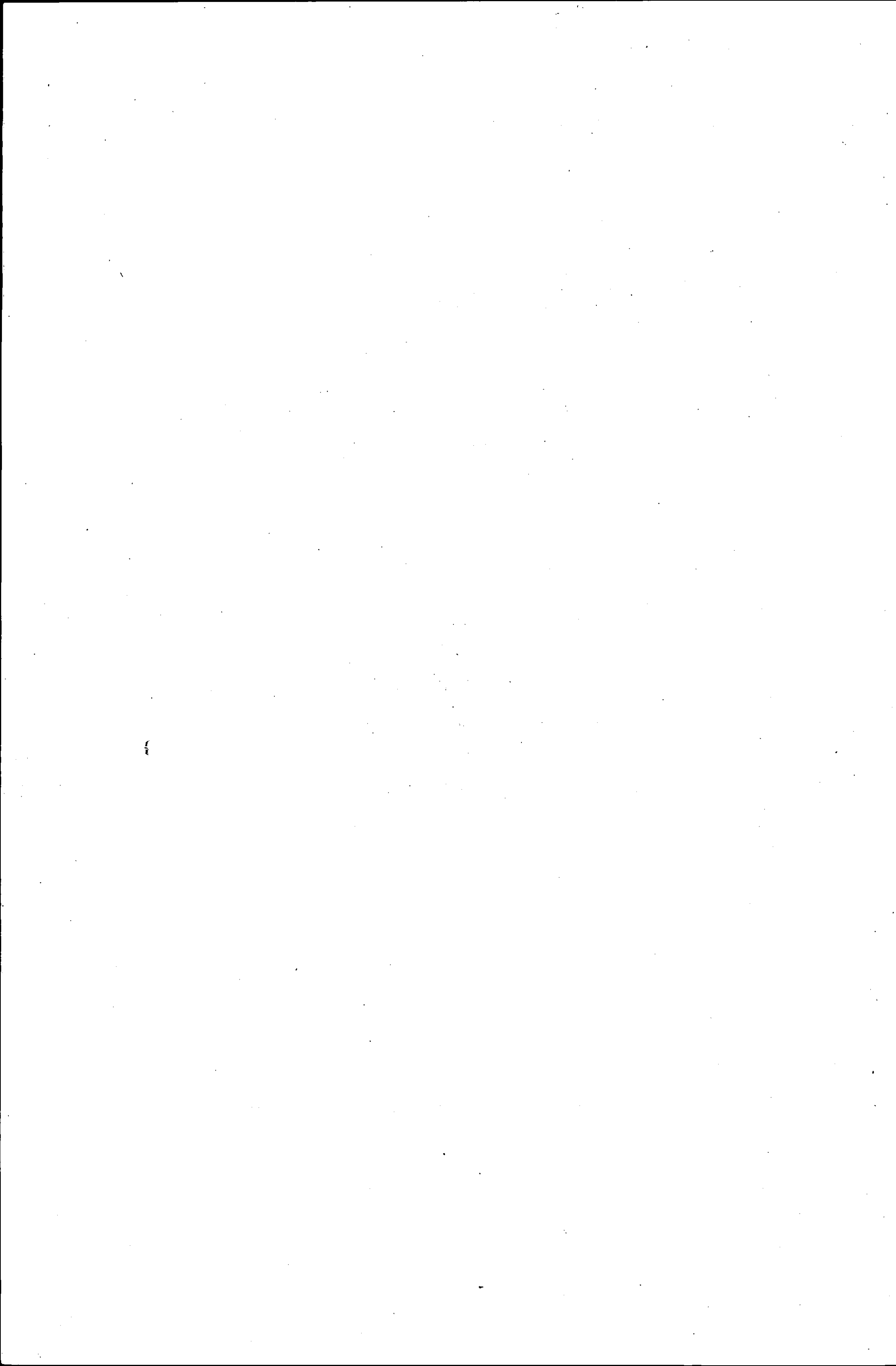

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I. Introduction

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 nonsubsidized 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 maritme 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