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The Maritime Security Program (MSP) in an International Commercial Context: A Discussion

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ABSTRACT

The Maritime Security Program (MSP) is a national defense sealift program that provides commercial assistance to ocean ship operators, primarily containership operators. A rationale for the commercial assistance is to assure a continuing presence of U.S.-flag ships in international trade. Another rationale is to assure, in the event of a national defense need, the availability of an adequate number of trained and experienced ship personnel who are U.S. citizens to operate these and other ships. This report discusses the MSP in an international commercial context. Maritime policies of other nations may adversely affect the U.S.-flag containership industry. These policies could be addressed in international negotiations. This report will be updated as warranted.

The Maritime Security Program (MSP) in an International Commercial Context: A Discussion

Summary

The Maritime Security Program (MSP) is a national defense sealift program that provides commercial assistance to ocean ship operators, primarily containership operators. The MSP makes ships and ship crews, and the intermodal transportation and communication network of the ship operator, available for sealift to the Department of Defense upon request. These ship services, if required, would be compensated at commercial rates. A substantial portion of ship crews for reserve ships for military sealift are drawn from the trained and experienced ship crews associated with U.S.-flag ships, many of which are in the MSP. The MSP is funded from the civilian side of the federal budget, rather than from the military side. The MSP is administered by the Maritime Administration (MARAD) in the U.S. Department of Transportation, in consultation with the U.S. Department of Defense (DoD). The MSP program was established in 1996 to replace the Operating Differential Subsidy (ODS) program that was established in 1936.

The MSP provides $2.1 million per ship per year through FY2005. The MSP is authorized at $100 million each year through FY2005, enough to fund 47 ships per year through the life of the program. The program is subject to annual appropriations. The Clinton Administration requested $97.650 million for the MSP for FY1999, and Congress enacted that amount of funding. Forty-seven ships are in the MSP; 39 of them are containerships. There are 57 privately owned, U.S.-flag containerships in U.S. foreign trade, none in foreign-to-foreign trade, and 23 in domestic trade. All 47 ships qualified on the basis of military usefulness. Ten companies have ships in the MSP.

U.S.-flag containerships transport 8.6% of U.S. ocean-borne commercial foreign trade, measured in tons, and 9.9% measured by value. The U.S.-operated containership fleet is significantly larger when foreign-flag ships controlled by U.S. citizens are included. Since 1970, many nations have been increasing the size of their merchant marine as a means of projecting visibility and earning hard currency.

One key rationale for the commercial assistance funding in the MSP is to assure a continuing presence of U.S.-flag ships in international trade. The key rationale for the MSP is to assure, in the event of a national defense need, the availability of an adequate number of ships, and trained and experienced ship personnel who are U.S. citizens to operate these and other ships. Some suggest that alternative approaches to these goals would be preferable.

This report discusses the MSP in an international commercial context. Maritime policies of other nations that may adversely affect the U.S.-flag containership industry could be addressed in international negotiations. In such negotiations, the MSP may be an issue. A U.S. response to such objections in the past has been that: (1) the MSP is a small program having a largely military objective; (2) the United States already has some of the most market-based national maritime policies among maritime countries; and (3) the United States is ready to negotiate more market-based maritime policies as soon as "a critical mass of countries" is willing to do the same.

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The Maritime Security Program (MSP) is a national defense sealift program that provides commercial assistance to ocean ship operators, primarily containership operators.[1] A rationale for the commercial assistance is to assure a continuing presence of U.S.-flag ships in international trade. Another rationale is to assure, in the event of a national defense need, the availability of an adequate number of trained and experienced ship personnel who are U.S. citizens to operate these and other ships.

This report discusses the MSP in an international commercial context. Maritime policies of other nations may adversely affect the U.S.-flag containership industry. These policies could be addressed in international negotiations.

The Maritime Security Program

Program Overview

The MSP makes ships and ship crews, and the intermodal transportation and communication network of the ship operator, available for sealift to the Department of Defense upon request. These ship services, if required, would be compensated at commercial rates. A substantial portion of ship crews for reserve ships for military sealift are drawn from the trained and experienced ship crews associated with U.S.-flag ships, many of which are in the MSP. The MSP is funded from the civilian side of the federal budget, rather than from the military side. The MSP is administered by the Maritime Administration (MARAD) in the U.S. Department of Transportation, in consultation with the U.S. Department of Defense (DoD).

The MSP program[2] was established in 1996 to replace the Operating Differential Subsidy (ODS) program[3] that was established in 1936. The ODS had the same purpose and form as the MSP, with 2 notable exceptions. First, the ODS required ships in the program to serve specified traffic lanes at specified levels of service. The ODS requirement to serve specified traffic lanes at specified levels of service reduced the operating flexibility of ship operators to respond to changing market conditions. The MSP does not require that ships serve specified traffic lanes or provide specified levels of service. Second, the ODS reimbursed ship operators for their higher crew, insurance, maintenance and repair costs.[4] ODS payments to ship operators averaged $3.9 million per ship per year, compared to the MSP which pays a fixed amount of $2.1 million per ship per year that is not indexed to keep up with inflation and that is intended to compensate ship operators principally for the higher cost of employing U.S.-citizen crews.[5]

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[1]Arlene E. Wilson and Jeanne J. Grimmett contributed to this report.

[2]The Maritime Security Act of 1996, P.L. 104-239, October 8, 1996, 110 Stat. 3118.

[3]June 29, 1936, ch. 858, 49 Stat. 1985. The Operating Differential Subsidy program is Title VI, beginning at 49 Stat. 2001.

[4]U.S. Department of Transportation, Maritime Administration, *A Report to Congress on U.S. Maritime Policy*, May 1998, p. 10.

[5]U.S. Department of Transportation, Maritime Administration, *Report to the Chairman, Senate Committee on Commerce, Science, and Transportation on the Issue of Introducing*

(continued...)

A rationale for terminating the ODS and replacing it with the MSP was to improve the operating flexibility and financial performance of ship operators, while reducing the cost of the program to federal taxpayers. Only a few ships remain in the ODS, and the year 2002 is the expiration date of the last contracts. Funding for ODS payments to these ships is part of the omnibus appropriation legislation for FY1999 that Congress enacted during the week of October 19, 1998.

The MSP authorized $2.3 million per ship for FY1996,[6] and it authorizes $2.1 million per ship per year for FY1997 through FY2005.[7] The MSP is authorized at $100 million each year through FY2005,[8] enough to fund 47 ships per year through the life of the program. The Clinton Administration requested $97.650 million for the MSP for FY1999, and both the House and Senate passed bills to appropriate that amount of funding.

Funding is subject to annual appropriations. The contracts with ship operators are for one year and they renew automatically each year through the end of FY2005 provided adequate funding is available. The MSP allows ship operators to cancel their contract without penalty.

Forty-seven ships[9] are in the MSP; 39 of them are containerships.[10] There are 57 privately owned, U.S.-flag containerships in U.S. foreign trade, none in foreign-to-foreign trade, and 23 in domestic trade.[11] Of the 23 privately owned, U.S.-flag containerships in U.S. domestic trade, 22 are in non-contiguous U.S. trade, and 1 is in U.S. coastal trade. Commercial conditions in the industry are discussed in further

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[5](...continued)
Competitive Bidding to the Maritime Security Program (MSP), P.L. 104-239, June 1, 1997, p. 2. As the title of this report indicates, the report discusses the issue of introducing competitive bidding for MSP contracts. Another report on this topic is U.S. General Accounting Office, *Maritime Security Fleet; Factors to Consider Before Deciding to Select Participants Competitively*, September 1997, GAO Report Number GAO/NSIAD-97-246.

[6]FY1996 funding under the MSP was moot because the MSP legislation was enacted after the close of FY1996.

[7]Section 2 of P.L. 104-239, at 110 Stat. 3120.

[8]Section 2 of P.L. 104-239, at 110 Stat. 3126.

[9]In order to qualify, each selected ship must be registered in the United States (i.e., it must be a U.S.-flag ship) within a year after being accepted. The ship must be kept in active commercial service during the entire contract period.

[10]Five of the 8 non-containerships in the MSP are LASH (i.e., barge carrying) ships. The other 3 non-containerships are roll-on roll-off ships (sometimes referred to as ro-ro ships). Ro-ro ships are meant to carry wheeled vehicles and equipment that is loaded on the ship by driving over a plank from the port to the ship. Source: U.S. Department of Transportation, Maritime Administration, *MARAD 97*, p. 1.

[11]U.S. Department of Transportation, Maritime Administration, *U.S. Merchant Marine Data Sheet; Status as of July 1, 1998*, p. 3.

detail below. All 47 ships qualified on the basis of military usefulness.[12] Ten companies have ships in the MSP.[13] Twenty-one companies submitted applications to participate in the program; they offered 94 ships for the program.[14]

Participation in the MSP requires committing 100% of the capacity of a ship to participate in the Voluntary Intermodal Sealift Agreement (VISA). VISA provides sealift support to the Department of Defense upon request, compensated at commercial rates. MSP vessels provide approximately 137,000 TEUs (twenty-foot equivalent units)[15] of ship capacity to VISA; non-MSP ships that participate in the VISA program provide an additional 28,000 TEUs.[16]

The MSP authorizing legislation permits the Secretary of Transportation (typically acting through MARAD) to include ships in the MSP that he determines are necessary to maintain a U.S. presence in international commercial shipping.[17] The rationales for this commercial assistance in the MSP are: (1) to assure a continuing presence of U.S.-flag ships in international trade; and (2) to assure an adequate number of trained and experienced ship crews who are U.S. citizens for use in crewing these and other ships at the request of the Department of Defense, compensated at commercial rates.

MARAD goals for the MSP over the next 10 years are to:[18]

- foster and maintain a United States merchant marine capable of meeting economic and national security requirements;
- improve the vitality and competitiveness of the United States foreign-trade liner fleet and the seafarers who serve on board the ships;
- reverse the decrease in the number of ships in the U.S.-flag fleet;
- stabilize the number of mariners available to crew U.S. merchant vessels;

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[12]Memorandum from United States Transportation Command to the Director, Joint Staff, Under Secretary of Defense (Acquisition and Technology), dated November 21, 1996. It states "We are confident the ships selected [for the MSP] are highly militarily useful...."

[13]*MARAD 97*(cited in footnote 10) p. 1.

[14]Ibid., p. 2.

[15]TEU refers to the size of a container that can hold cargo ready to be transported. TEUs are a standardized measure (i.e., length in feet) of the size of containers. These containers typically are intermodal units because they can be stowed on an aircraft or attached to a truck chasis with wheels and then pulled by a truck over the highway.

[16]U.S. Department of Transportation, Maritime Administration, *Maritime Administration, Draft Strategic Plan, 1998-2002,* December 1997, p. 21.

[17]P.L. 104-239, Section 2, 110 Stat. 3119.

[18]*A Report to Congress on U.S. Maritime Policy* (cited in footnote 4) pp. 10-11.

- achieve adequate manning of merchant vessels for national security needs during a mobilization;

- ensure that sufficient civil maritime resources will be available to meet defense deployment and essential economic requirements in support of our national security strategy; and,

- ensure that the United States maintains the capability to respond unilaterally to security threats in geographic areas not covered by alliance commitments, and otherwise meets sealift requirements in the event of crisis or war.

Commercial Conditions in the U.S. Containership Industry

U.S.-flag containerships transport 8.6% of U.S. ocean-borne commercial foreign trade, measured in tons, and 9.9% measured by value.[19] During the 1987 to 1997 period, a high point was reached in 1989, when U.S.-flag containerships transported 19.1% of U.S. ocean-borne foreign trade measured in tons and 23.3% measured by value. These percentages declined each year after 1989. The U.S.-operated containership fleet is significantly larger when foreign-flag ships controlled by U.S. citizens are included. For example, Sea-Land, a U.S.-based carrier, operated the world's largest fleet of containerships (196,000 TEUs) in 1996. Sea-Land's position (with 212,000 TEUs) dropped to number 2 in 1997. In first place in 1997 was Sea-Land's business partner, Maersk (with 244,000 TEUs). Sea-Land's position would have been number 3 in 1997 if the operations of Hanjin and DSR-Senator were combined (at 222,000 TEUs).[20] Hanjin bought a majority stake in DSR-Senator during 1997.

The number of ships in the U.S.-flag, privately owned fleet of large oceangoing vessels has been declining in recent decades. In 1970, there were more than 900 general cargo, dry bulk carriers and tankers in the U.S.-flag fleet, totaling over 15 million deadweight tons (DWT).[21] Today, there are 209 U.S.-flag, privately owned tanker, dry bulk and containerships, totaling over 11 million DWT. In addition, there are 26 U.S.-flag, privately owned roll-on roll-off ships with over 500 thousand DWT, and 24 ships of other types[22] with nearly 650 thousand DWT, for a combined total of 259 U.S.-flag, privately owned, large oceangoing ships with a combined carrying capacity of over 12 million DWT.[23]

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[19]These numbers are for 1996, the most current year for which numbers are available. Source: *MARAD 97* (cited in footnote 10) p. 52.

[20]*American Shipper,* September 1998, p. 78.

[21]*A Report to Congress on U.S. Maritime Policy* (cited in footnote 4) p. ii.

[22]These 24 ships are comprised of breakbulk ships, partial containerships, refrigerated cargo ships, barge carriers and specialized cargo ships.

[23]*U.S. Merchant Marine Data Sheet; Status as of July 1, 1998* (cited in footnote 11) p. 2.

The productivity of the privately owned, U.S.-flag fleet has improved substantially since 1970. The U.S.-flag liner fleet engaged in foreign trade in 1995 carried over 42% more cargo than in 1970.[24] It did so in far fewer, but larger, vessels. The average capacity of U.S.-flag liner vessels has grown from 12,000 DWT in 1970 to nearly 28,000 DWT today.[25] Today, "30 ships can carry in a year what it took well over 100 ships to carry 30 years ago."[26] Further growth in ship productivity is expected. In 1995, 35% of containerships calling at U.S. ports exceeded 4,000 TEUs, and by the year 2010, 60% are expected to exceed this size.[27] "Ships, particularly containerships serving major liner trades, are expected to increase in size, moving toward a capacity of 10,000 TEUs."[28]

Only the United Kingdom, Norway, Japan, and Liberia had larger fleets than the United States in 1970. The United States and these other 4 nations combined had more than half the capacity of the world merchant fleet of 300 million DWT. The total worldwide containership capacity at the end of 1997 was 4 million TEUs. Each of the 5 largest carriers had about 5% of the world market.[29] No single carrier controlled more than 8% of the world market. Another 30 companies each held about 1% of the world market. "Even today, after the recent round of mergers, the shipping industry can still be considered highly fragmented."[30] Between now and the year 2002, "American carriers will continue to own and/or operate both U.S.-and foreign-flag ships in international trade."[31]

[24]*A Report to Congress on U.S. Maritime Policy* (cited in footnote 4) p. ii.

[25]Ibid.

[26]*Maritime Administration, Draft Strategic Plan, 1998-2002* (cited in footnote 16) p. 1.

[27]*A Report to Congress on U.S. Maritime Policy* (cited in footnote 4) p. iii.

[28]*Maritime Administration, Draft Strategic Plan, 1998-2002* (cited in footnote 16) p. 12.

[29]*American Shipper*, September 1998, p. 78.

[30]Ibid.

[31]*Maritime Administration, Draft Strategic Plan, 1998-2002* (cited in footnote 16) p. 12.

Foreign Maritime Policies and the U.S.-Flag Containership Industry

Since 1970, many nations have been increasing the size of their merchant marine as a means of projecting visibility and earning hard currency,[32] while the percent of U.S. ocean-bourne international trade carried by the U.S.-flag fleet has been declining. Principal reasons for the decline may include the following:[33]

- The level of protection for seafarer health, welfare and safety may be lower on non-U.S. flag ships.

- The regulatory framework in several countries, including key U.S. trading partners, may restrict free market access, or otherwise permit discriminatory practices against U.S.-flag vessels in international trade, thus enabling foreign vessels to operate at lower cost, or with substantial preferential treatment compared to U.S.-flag carriers.

- Foreign-flag ship operators often do not pay corporate income taxes.

- Foreign-flag ship crews often pay no personal income tax.

- The only U.S. corporate or income taxes paid by foreign-flag owners are taxes paid on their U.S. shore-based facilities and personnel, which in many cases are nonexistent. By comparison, vessels operating under the U.S.-flag are subject to all the taxes and regulatory laws applicable in the United States.

Possible Future International Negotiations

World Trade Organization (WTO) provisions do not cover transportation services, although inclusion of transportation services under the WTO has been a goal of international negotiations in which the United States has participated for several years. For example, the United States and other countries participated unsuccessfully in negotiations having the goal of including maritime transportation services under the General Agreement on Trade in Services (GATS) during the Uruguay Round. Subsequently, a Negotiating Group on Maritime Transport Services (NGMTS) was created to carry out negotiations in the maritime transportation services sector within the GATS framework. The negotiations were to be comprehensive in scope, aiming at commitments in international shipping, auxiliary services (such as ship repairs and ship crews), and access to port facilities, leading to the elimination of restrictions by a fixed date.[34] Domestic ocean shipping was excluded from the topics subject to negotiation. The group was directed to conclude negotiations and make a final

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[32]*A Report to Congress on U.S. Maritime Policy* (cited in footnote 4) p. ii.

[33]Ibid.

[34]Statement from the Office of the U.S. Trade Representative, February 1, 1996.

report, including a date for implementation of the results of the negotiations, not later than June 1996.[35]

Forty-two WTO members participated in the NGMTS, and another 15 members were observers. In July 1995, the European Union (EU), Canada, Australia, New Zealand, and Japan presented offers[36] or resubmitted their Uruguay Round offers. In December 1995, 7 countries (Brazil, Chile, Colombia, the Ivory Coast, Korea, Mexico, and Nigeria) announced plans to present offers. Other countries included maritime commitments in their GATS schedules. The United States did not make an offer. The U.S. position was that it would consider submitting an offer only if offers from "a critical mass of countries" would result in substantially liberalized trade in maritime services.[37]

Participating countries also produced a draft model schedule for achieving commitments in various maritime sub-sectors that would address standard GATS objectives such as market access and national treatment. The U.S. view was that the draft model was deficient because it did not provide an opportunity for participants to schedule market access and national treatment commitments in multi-modal transportation services. Many participating countries reacted positively to a U.S. proposal to improve the draft model schedule, but a consensus (the level of agreement consistent with GATS negotiations) was not achieved.[38]

During these negotiations, the U.S. took the position that "the United States already maintains a high level of access in its maritime sector — as indicated by the 96% of our foreign trade that is carried in foreign-flag vessels — and needs to maintain its support programs, small as they are, to help assure the availability of national flag tonnage for sealift purposes."[39]

WTO member governments agreed on June 28, 1996, to suspend negotiations on maritime transport services, and to resume them at the time of the next round of comprehensive negotiations on trade in services that was mandated to begin in the year 2000.[40] "The decision to suspend the negotiations was strongly supported by MARAD and other members of the U.S. delegation."[41] Participating governments agreed that commitments could be modified up to the end of July 1996. They further agreed that after that date, governments would not apply any measures affecting trade in maritime transportation services in such a manner as to improve their negotiating position, except in response to measures applied by other countries. Governments are

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[35]Ibid.

[36]An offer consists of the concessions that a country is willing to make in the particular area of negotiations.

[37]Statement from the Office of the U.S. Trade Representative, February 1, 1996.

[38]Ibid.

[39]*A Report to Congress on U.S. Maritime Policy* (cited in footnote 4) pp. 29.

[40]Press Release 51, July 1, 1996, from the Office of the U.S. Trade Representative.

[41]*A Report to Congress on U.S. Maritime Policy* (cited in footnote 4) pp. 29.

free to apply measures that maintain or improve the liberalization of maritime transportation services.[42]

A strategic goal of MARAD for the period 1998-2002, is to:[43]

> negotiate agreements, understandings and arrangements to reduce barriers that restrict access to foreign transportation markets, add to costs, limit revenues, and impede efficient operations of the U.S. maritime industry in international trade; and negotiate reciprocal foreign market access treatment for U.S. carriers in international trade, including landside access to port facilities, the ability to establish connecting truck and rail services, and access to foreign trade cargoes.

MARAD has had, and continues to have, bilateral negotiations with various nations on various issues, most notably perhaps in a current context are on-going negotiations regarding China's prohibition on virtually all foreign transportation company operations in China. MARAD's strategic goal regarding negotiations during the period 1998-2002 affirms its commitment to such negotiations. Additionally, as discussed above, multinational negotiations, probably under the auspices of the World Trade Organization, might eventually result in changing some of the maritime policies of other nations that may adversely affect the U.S.-flag containership industry. Such trade liberalization would promote the maritime policy that Congress enunciated in Section 14 of the Maritime Security Act.[44]

In such negotiations, the MSP may be raised as an issue by foreign governments. A U.S. response to such objections in the past has been that: (1) the MSP is a small program having a largely military objective; (2) the United States already has some of the most market-based national maritime policies among maritime countries; and (3) the United States is ready to negotiate more market-based maritime policies as soon as "a critical mass of countries" is willing to do the same.

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[42]Press Release 51, July 1, 1996, from the Office of the U.S. Trade Representative.

[43]*Maritime Administration,Draft Strategic Plan, 1998-2002* (cited in footnote 16) pp. 27-28.

[44]P.L. 104-239 (cited in footnote 2), at 110 Stat. 3137.