

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672
1472 SCOMM 55: JNT. SPEC. COMM. ON STATE TAX POLICY, 1986-1987

1272

The Impact of the Act on the Crude Oil Trades

With regard to crude oil, the Required Freight Rate (RFR) analyses indicated the differential between U.S.- and foreign-flag tanker operations in the Valdez to Los Angeles service is \$1.39 per long ton. For shipments from Valdez, transshipped at the Panama Canal and sent onward to the U.S. Gulf Coast, the differential would be \$5.67.

Assuming an average annual U.S.-flag shipment rate of 80 million tons per year, with two-thirds moving to California and one-third to the Gulf Coast via Panama, the annual cost penalty ultimately being borne by Alaska through the netback mechanism is \$225 million. Clearly, the Jones Act's major impact on Alaska is in the sphere of crude oil shipments.

ALASKA'S ECONOMY AND THE MERCHANT MARINE ACT OF 1920
(The Jones Act)

A Follow-Up and Review of
The Jones Act and its Impacts on the State of Alaska
By Simat, Helleisen & Eichner, Inc.
For the Alaska Statehood Commission
20 September, 1982
Arlon R. Tussing and Associates, Inc. (ARTA)
Juneau - Seattle - Anchorage

EXECUTIVE SUMMARY
(Principal Findings)

This paper was prepared by Arlon R. Tussing and Associates, Inc. (ARTA) for the Alaska Statehood Commission as a follow-up, review, and interpretation of the analysis and findings contained in The Jones Act and its Impact on the State of Alaska, by Simate, Helleisen & Eichner, Inc. (SH&E). The following are among the most important inferences that readers can draw from the SH&E study and from this review.

1. The "cabotage" laws of the United States, of which the Jones Act is the keystone, impose substantial costs on the U.S. economy, in the form of higher oceanborne freight charges, and the diversion of cargo to more expensive transportation modes.

These costs of the cabotage laws are imposed disproportionately on Alaska. The state's physical separation from the other states makes it depend disproportionately on ocean transport for its interstate commerce. In addition, Alaska's large size and primitive land-transportation network make it depend disproportionately on ocean transportation for its intrastate commerce.

2. Because Alaska's economy is small and distant from major markets, the Jones Act creates a DOUBLE cost penalty for Alaskans. The state is generally a price-taker for both its imports and its exports; thus, the Jones Act adds to the prices of Alaska's imports and subtracts from the prices of the state's exports.
3. The "Jones Act penalty" (the additional cost of using U.S.-built, U.S.-owned, U.S.-registered, and U.S.-manned vessels in place of the lowest-cost transportation) tends to be greatest for commodities having a low ratio of value to weight or to volume.

The cost of Alaska from the Jones Act penalty on the outbound shipment of crude oil probably overshadows all other costs of the Act. SH&E's analysis implies that

the law currently reduces the wellhead value of Alaska crude oil by about \$225 million per year. Consideration of the worldwide surplus of foreign-flag tankers raises this penalty to about \$310 million per year. Taking account of current trends in West Coast oil-price formation increases the potential penalty at the wellhead to \$630 million per year.

The state government's share of increased (or decreased) wellhead revenue is now about 28 percent. This approach yields a direct revenue cost of the Jones Act to Alaska's treasury in the range of \$63 to \$176 million per year.

4. The IMMEDIATE effect of removing either the Jones Act requirements or export restrictions on Alaska crude-oil shipments would probably be minor: The North Slope crude-oil producers have already invested in Jones Act tankers and have made throughput commitments to an oil pipeline across Panama. Also, the incentive of Alaska crude-oil producers to seek transportation-cost reductions is weak, because the combination of royalties and severance taxes, "windfall-profits tax", and federal and state income taxes leaves the producers less than 10 percent of any increase in wellhead prices stemming from lower ocean-transport costs.

Some latitude would remain for non-producers purchasing "in-kind" royalty oil from the state to use lower-cost shipping services.

5. The prohibition on exporting Alaska crude oil depresses its "netback" price (and thereby state oil revenues) more than does the Jones Act; repeal of the prohibition would make the Jones Act nearly moot with respect to crude-oil prices.

Alaska's Congressional delegation might therefore employ its political efforts most effectively in trying to block extension of the oil export prohibitions of the Export Administration Act (which expire in 1983), rather than in mounting new legislation to repeal some of the present Jones Act provisions.

6. The direct cost of the Jones Act to Alaska's PRESENT export industries other than petroleum is probably small. Some of these industries tend to be oriented to overseas markets where the Jones Act is irrelevant. Others can take advantage of low-cost Southbound "backhaul" rates unrelated to the nationality of the vessel.
7. The direct cost of the Jones Act on Alaska's general-merchandise imports is impossible to measure with

confidence, but it is probably minor. There is vigorous intermodal competition on routes between the Northwest and Alaska's "Railbelt" (which contains most of the state's population and economic activity).

Transportation costs to and between Alaska ports other than those serving the Rainbelt are mostly a function of the small scale and sporadic character of shipments, rather than the nationality of shipping or vessels. A number of methods by which shippers could circumvent Jones Act cost penalties are virtually unexploited; this situation supports the inference that these penalties are insignificant.

8. The largest adverse effects of the Jones Act for Alaska are likely to be IN THE FUTURE, as transportation costs for crude-oil and other minerals can be an important factor determining the economic feasibility of developing specific deposits. Transportation costs between Alaska and the Lower 48 that are higher than those between Alaska and foreign countries also strengthen the tendency of Alaska's resource-industry markets and sources of investment capital to be in the Far East rather than the Lower 48.
9. The most promising Alaska strategy to modify the Jones Act would aim at obtaining the support of U.S. maritime unions and shipping companies (or at least their neutrality) for allowing foreign-owned and foreign-built ships to operate in the "coastwise" trade, while retaining U.S. labor, safety, and environmental standards.

One basis for this strategy might be the thesis that allowing foreign-built ships in the coastwise trade would increase employment in the U.S. merchant marine. The Jones Act has probably contributed to the virtual disappearance of the U.S. coastwise shipping industry (except for shipments of petroleum by tanker, and service linking Alaska and Hawaii with the mainland). A first tactic in such a strategy would be for the state to commission a study of the effect of the U.S.-tanker requirement in the Jones Act on U.S. merchant-marine employment.

The SH&E report. The SH&E report is well written, comprehensive, and insightful, and contains little with which APTA have substantive disagreements. Its quantitative (dollar-denominated) findings about the economic effects of the Jones Act in Alaska suffer from the same disabilities that beset almost every "counterfactual" analysis -- every study that attempts to describe the world that would exist "if only" some circumstance or set of circumstances were different from present reality.

In any analysis of this sort, the investigators have almost infinite discretion in choosing assumptions about which factors to hold constant, and how far to trace the indirect effects of the assumed change. Thus, ARTA probably would have made different assumptions from those employed by SH&E, and emphasized different factors, but we do not thereby mean to fault the SH&E team for the assumptions and methodology they selected. Our object here has been to organize, integrate, and present essentially the same insights as the SH&E report in a way which, we hope, is more directly focused on Alaska's policy choices.

The following material has been selected from the report prepared by ARTA and is intended to further explain the major issues of importance to Alaska and to amplify the principal findings.

All of the material is intended to convey the original work and thoughts of ARTA, although it has been selectively edited and arranged for the purposes of this report.

THE IMPACT OF THE JONES ACT ON ALASKA

The Jones Act Cost Penalty. Whatever transportation-cost penalty the Jones Act carries is imposed disproportionately on the Alaska economy. In general, the relatively small size of Alaska's economy makes it a "price-taker" in national and international markets. Higher transport costs are thus added to the cost of Alaska's imports, and subtracted from the market prices of her exports.

Alaska's position as a price-taker means that its economy tends to suffer a double penalty from any adverse transport-cost differential. In general, the state's exports to lower-48 markets will have lower prices at their point of origin than would otherwise have been the case. The most obvious impact of this kind is on the state government's natural resource royalties and severance taxes, which are keyed to netback prices.

An even more important effect of higher transport costs in the long run may be to shift economic margins: Investors might view a certain natural-resource venture (a new oil discovery, for example, or a copper mine) to be economic if the netback value of the crude oil or ore reflected foreign-flag shipping costs, but as uneconomic if the wellhead or mine-mouth return had to absorb U.S.-flag shipping rates. Higher import costs for capital goods and for supplies used by industry may also help shift economic margins, making otherwise economic ventures unattractive to investors.

Although the Jones Act's economic effects are overwhelmingly negative for Alaska, there are few markets or aspects of Alaska's economy for which removal of the Jones Act structures would make much immediate difference. Except for the Railbelt area (Anchorage, Seward and Whittier, north through the Matanuska Valley to Fairbanks), the cost of ocean transportation is dominated by its seasonality or sporadic character, by the small scale of shipments, and by directional imbalance. For much of Alaska, it is not likely that the potential of competition from foreign-flag carriers would have much impact on costs.

The Railbelt, where most of Alaska's ocean-transportation demand originates, is served by a variety of shipping companies and modes of transportation. For the general mixed-merchandise trade in consumer goods and miscellaneous industrial supplies and building materials, the transportation business is highly competitive and continually changing. Containerized and roll-on/roll-off trailers seem to be the most efficient mode for most of this business and, as SH&E show, their costs are not strongly related to the nationality of the operations. Differences in the efficiency of shore-based activities can easily cancel out any difference in capital and manning costs between U.S.-flag and foreign-flag operations. Adding foreign-flag shipping companies to the present mix would in principle strengthen competition, but the true impact is hard to pin down.

The biggest cost impacts of the cabotage laws will be on commodities with low ratios of value to weight or bulk, where there is little practical alternative to oceanborne transportation. Crude oil is of course the outstanding example, and is Alaska's chief export commodity. Other Alaska bulk commodities -- ores, for example, may be seriously affected at some time in the future by the Jones Act cost penalty.

There are exceptions to the general rule that Alaska is a price-taker in its sales and a price-taker in its purchases. From 1973 to 1980, for example, Alaska-produced crude oil was subject to federal price ceilings at the wellhead. As a result, Lower-48 refinery prices for that oil were cost-plus prices, reflecting the regulated wellhead price plus transportation costs. (North Slope crude oil, however, was actually priced on a netback basis from 1977 through mid-1979 notwithstanding federal price controls, because the federal ceilings were higher than the market value of the oil.)

The pricing of petroleum products refined in Alaska is another exception to the rule that the Jones Act means higher prices for Alaska consumer goods. High transportation costs for crude oil exported from Alaska result in lower crude-oil costs for Alaska refiners, and at least potentially, lower petroleum-product prices for Alaska consumers, because the local refiners need only match the price of North Slope crude oil in outside markets less transportation -- as opposed to the combination of Lower-48 prices plus transportation that governs the Alaska prices of most consumer goods.

Those petroleum products produced by two or three of the Alaska refineries (jet fuel and distillate fuel oil) tend to sell in Alaska for less than West Coast prices, while motor gasoline (produced only by Tesoro) sells at somewhat more

than the Los Angeles price, but at less than the Los Angeles price plus transportation costs. For this reason, we doubt whether there is actually a "U.S.-flag premium of \$5.46 per long ton on petroleum products shipped north from Los Angeles."

Likewise, U.S. buyers seeking an Alaska product whose principal outlet is a foreign country must meet the Alaska export price and, in addition, bear whatever additional transport cost is involved. This situation probably applies to occasional shipments of Southeast Alaska logs or lumber to the Lower 48; thus the SH&E report may be in error when it attributes a \$3.41-per-ton Jones Act penalty on Southbound exports of Alaska lumber. The same situation likely applies to shipments of fresh and frozen king and chum salmon from the Bristol Bay area -- their prices are most likely determined by the offers of Japanese fish-buyers; Lower-48 buyers are price-tankers and must absorb whatever the transportation costs to the Lower 48 may be.

The fact that few shippers now seem to take advantage of either (1) their ability to bypass the Jones Act with purchases in Canada or (2) the exception for through shipments over Canadian railroads (and particularly the failure of a British Columbia to Whittier rail-barge service) leads us to a rebuttable presumption that the effective burden of the Jones Act on the railbelt's general-merchandise imports is not great.

ALASKA CRUDE-OIL ECONOMICS:
THE JONES ACT AND THE EXPORT BAN

The greatest Alaska impact of the Jones Act undoubtedly comes from its influence on the wellhead value of crude oil produced in the state.

The wellhead value of Alaska crude oil is a "netback" value, determined by subtracting transportation costs from the market value of the oil at the receiving refinery. In the world at large, therefore, Alaska-produced crude oil is a price-taker, and higher transportation costs between the field and the refinery are deducted almost penny-for-penny from the wellhead price.

SH&E estimate the reduction in the value of Alaska crude resulting from the Jones Act at about \$225 million per year, based upon present levels of production in Alaska and the recent destinations of Prudhoe Bay crude oil. They obtained this figure by a straight comparison between required freight rates (RFRs) on U.S.-flag and foreign-flag tankers on the Valdez-Los Angeles, Valdez-Panama, and Panama-Gulf Coast routes.

SH&E's figure of \$225 million is valid only as an hypothesis about the past or the future. It is an estimate of how much higher Alaska wellhead revenues would now be if the Jones Act had not been in effect when the companies made their transportation investments or, alternatively, how much higher they would be after the end of the present Jones Act tanker fleet's economic life, if the Jones Act were repealed or waived today. For the latter purpose, however, SH&E's estimate of the Jones Act premium on the basis of comparing U.S.-flag and foreign-flag RFR's is probably an understatement. These assumptions about the market for Alaska crude oil reasonably approximate the market's past operation, but they are unsuitable for projecting future prices.

In the emerging one-price system, only the transportation cost between the Alaska and the U.S. Gulf will affect the wellhead price of Alaska crude oil. Because the Jones Act penalty is greater on this longer route, therefore, its depressing effect on Alaska wellhead revenues will be considerably greater than estimated by SH&E. Using Jones Act and foreign-flag tanker RFRs on the Alaska-Panama and Panama-Gulf routes to determine the netback value of all Alaska crude oil would double the estimated Jones Act penalty, from \$225 million to \$450 million. If we also take the world tanker surplus into account, and compare Jones Act RFRs with foreign-flag running costs rather than foreign-flag RFR's, the estimated Jones Act penalty incurred

by Alaska crude-oil rises from \$310 million per year to \$630 million.

The state's direct share of additions or reductions in wellhead prices is now about 28 percent, including royalties, production taxes, and state income taxes on profits from crude-oil production and TAPS operations. Thus, depending upon the additional assumptions adopted, the state's direct revenue loss from the Jones Act ranges from \$65 million to \$176 million annually.

Summary. If both the Jones Act and the ban on exporting Alaska oil remain in place, the wellhead value of all Alaska oil will ultimately be the world market price at the US. Gulf less pipeline and Jones Act shipping costs between Alaska and the Gulf. If both restrictions are waived, the wellhead value of all Alaska oil will ultimately be the world market price in Japan less pipeline and foreign-flag shipping costs between Alaska and Japan. If exports are permitted and the Jones Act remains unchanged, the wellhead value of Alaska oil will still rise to the world market price in Japan less pipeline and foreign-flag shipping costs between Alaska and Japan, because producers would not be willing to sell Alaska oil into U.S. West Coast markets unless they got at least as much for it there as they would get by exporting it.

The federal government will capture more than 60 percent of any incremental revenues from Alaska crude-oil production, by means of the "windfall profits tax" and the corporate income tax.

Long-term impacts: shifting the economic margin. The most far-reaching impact of the cabotage and export-licensing laws on Alaska's petroleum economy will be their influence on company decisions whether and where to explore new acreage; whether, when, and how to develop new discoveries; and whether, when, how to invest in enhancing or prolonging the output from producing fields. The minimum wellhead prices needed to justify exploring or developing different oil prospects and discoveries in Alaska are certain to cover a wide range of values; and minimum economic prices measured at an Alaska tanker terminal will reflect the minimum wellhead price plus transportation to the terminal, and will therefore vary even more widely.

Four generalizations stand out about this menu of prospects and discoveries:

- (1) Only the largest, most prolific, and/or most favorably located oil discoveries in Alaska will prove to be commercial.

- (2) The high cost of transportation within and from Alaska means that, in most places, a field must have a finding and development cost at the wellhead in the \$0 to \$20 range, even if constant-dollar world oil prices remain at their recent high levels.
- (3) Because the wellhead value of Alaska crude oil is determined by subtracting transportation costs from market prices elsewhere, a small percentage change in the world price, or a transportation cost disadvantage that seems small relative to the refinery value of crude oil has a greatly magnified effect on wellhead values. If today's \$30 world price nets back to a seemingly adequate wellhead price of \$8 per barrel for some remote Arctic prospect, a 13-percent fall in the world price to \$26 would reduce the actual wellhead price by half.

Under the same conditions, a \$4 difference in the Alaska netback price of oil shipped to Japan in foreign-flag vessels, and the Alaska netback price of oil shipped to Louisiana (or anywhere in the U.S., for that matter, because the West Coast price will probably be determined in Louisiana) would be 50 percent of the expected wellhead price. And the lower an oil prospect's minimum economic price at the wellhead, the more sensitive its development-feasibility will be to the crude-oil's destination prices and transportation costs.

- (4) The economic-feasibility thresholds for Alaska's crude-oil discoveries and prospects are certain to occupy a wide and nearly continuous spectrum of prices. Any event or institution that adversely affects netback values -- even by "only a dollar or so" per barrel -- carries the risk of bumping some Alaska oilfield out of the "commercial" into the "non-commercial" category. The depressing effect of the Jones Act and the export prohibition on wellhead prices is sure sooner or later, to prevent development of some major discovery in Alaska.

Granted, the course of world oil prices and industry's expectations regarding world oil prices are just as crucial as transport costs to the economics of petroleum development in Alaska. At any plausible world oil-price level, nevertheless, there is bound to be some oil in Alaska that is worth developing if it can be exported in foreign-flag tankers, but which will be uneconomic to develop for shipment to the U.S. Gulf or East coasts in Jones Act Tankers. Different expectations about world oil prices will change the names of those borderline prospects, but some Alaska oil will always be on the economic margin.

CHANGES IN MARINE SERVICE BETWEEN ALASKA AND OTHER STATES

In the three years since Simat, Helliesen & Eichner, Inc., (SH&E) completed their report, Alaska has seen significant changes in the marine movement of goods and commodities to and from Alaska. In general, competition has increased due to new entrants into the shipping business and greater availability of tankers in the crude oil trade.

The SH&E report analyzed the movement of consumer goods between Pudget Sound and the railbelt ports of Anchorage and Whittier. This trade is currently extremely competitive. A new entrant has started service to a third railbelt port, Seward, using barges that carry highway vehicles (roll-on/roll-off service). In addition, a carrier providing rail-car barge service to Whittier has added a second deck to these barges and can now carry roll-on/roll-off vehicles too. The two carriers providing direct service to Anchorage have maintained their service levels in response to this competitive pressure, thus leading to an overall increase in service levels to the railbelt. The only potential decline in service may be due to the exit from the trade of barge carriers which formerly provided service to Anchorage from the Pacific Northwest.

The dominant impact on shipping costs of the Jones Act, according to studies prepared for the Alaska Statehood Commission, is on the shipment of crude oil from Valdez to refineries in the lower 48 states. The higher tariffs charged by Jones Act tankers lower the well-head price of North Slope crude. A lower well-head price decreases revenues to both the state and federal governments. In its analysis of the SH&E report, Arlon R. Tussing and Associates, Inc., estimated that the impact on state revenues, given certain assumptions, could be as high as \$176 million per year.

Shipping patterns in the movement of North Slope crude to market are shifting in favor of more movements by large, more efficient tankers. This shift is prompted by many factors, including a large number of unused tankers in the international market, the retirement of older tankers due to age, the requirements of the Port and Tanker Safety Act of 1978, and the completion of an oil transport pipeline across the Isthmus of Panama in late 1982. Surprisingly, a small portion of North Slope production does already move to market on foreign-flag tankers. Shipments of crude to refineries in the Virgin Islands are not required to move on the Jones Act fleet.

The most recent change in the crude oil trade south from Valdez is the expected entry of several large, modern tankers built under the Construction Differential Subsidy

(CDS) program. In a final rule adopted this spring, the U.S. Department of Transportation (DOT) allowed U.S. tankers originally built to serve the overseas trade to enter the domestic trade if their owners pay back the outstanding balance of construction differential subsidy. The CDS program was established to compensate vessel owners for the higher cost of building vessels in U.S. shipyards. Once built, these vessels were expected to be deployed in trade between the United States and other countries. The U.S. DOT rule allows these tankers, among the largest the most modern in the U.S. fleet, to enter the domestic (Jones Act) trade. This means that these tankers can transport North Slope crude from the oil terminal at Valdez to lower 48 ports and the Panama pipeline if their owners repay the outstanding subsidy.

Although the costs of using CDS-built tankers will still exceed the cost of using foreign-flag tankers, the entry of CDS tankers into the Alaska trade is expected to drive down the total cost of transporting North Slope crude to market. The major impact is that greater amounts of North Slope crude will be carried on large tankers with capacities in excess of 100,000 dead weight tons. The Department of Revenue estimates that the entry of CDS tankers into the trade will increase state revenues by \$38 million next year.

For revenue and other reasons, the Sheffield Administration strongly supported the revised CDS tanker rules described above. (See attachments.) In addition, representatives of the Administration expressed opposition to legislation introduced in Congress to block or significantly restrict these rules. The measure ultimately enacted permits the entry into the Alaska trade of several new and efficient CDS tankers.

BILL SHEFFIELD
GOVERNOR



STATE OF ALASKA

OFFICE OF THE GOVERNOR
WASHINGTON, D.C.

STATE OF ALASKA - POSITION ON JONES ACT

The Merchant Marine Act (Jones Act), which was adopted by Congress in 1920, prevents the transportation of goods between U.S. ports on foreign-built vessels unless there is an intermediary stop at a foreign port. The State of Alaska favors an amendment to the Jones Act which would allow foreign-built ships into the U.S. coast cargo and passenger trade, provided that they meet American safety standards, and are U.S. owned, registered, manned, and repaired.

The intent of the Jones Act was to protect American ship builders and operators from free market competition by foreign ships which have lower construction and operating costs. The concern was that otherwise the United States would not have a sufficient merchant marine fleet for wartime demands. If, however, under the State's proposal, foreign-built vessels were still U.S. registered and operated, then they would be available during wartime or other periods of national emergency.

As a result of the Jones Act protection, freight rates are very high in the U.S. coast trade. In fact, where competition exists from land-based transportation service (rail and truck), the Jones Act merchant marine fleet has declined dramatically in the past twenty years. Because Alaska, Hawaii, and the noncontiguous territories (except the Virgin Islands) have no significant alternative to the Jones Act fleet, they bear the penalty of higher freight rates. The Alaska trade alone supports nearly one-third of the entire Jones Act fleet.

The Jones Act penalizes the U.S. and Alaska in several ways:

- 1) It reduces federal and state oil revenues by effectively imposing higher tanker transportation charges which are tax deductible. (This will be ameliorated by proposed C.D.S. regulations by the Federal Department of Transportation).
- 2) It limits U.S. markets for Alaskan products (fish, coal, minerals and timber) by contributing to higher destination costs as compared with export to the Pacific Rim nations.

3) It raises the cost of all domestic freight coming into the State, thereby contributing to a higher cost of living and depressing economic development.

4) It depresses the tourism industry in the Pacific Northwest and Alaska by raising the cost of tourist passage from Seattle to Alaska and limiting the flexibility of cruise ship itineraries.

In the future, these penalties will become more severe. As U.S. ships are constructed to replace existing ships, the cost differential between U.S. and foreign ship construction will increase. In a subsidized environment, Alaska and the domestic purchasers of Alaska products will have no choice but to pay higher freight rates.

Our proposal would eliminate the most expensive and burdensome aspect of the Jones Act while ameliorating impacts on the maritime industry. We expect that a future increase in the construction of U.S. naval vessels will help offset business lost as a result of foreign competition for cargo vessel construction. Further, it is anticipated that lower marine freight rates will increase shipping business, thereby creating a need for more U.S. maritime and service-related employees.

It should be recognized that the high cost of American shipbuilding has in fact inhibited the growth and development of U.S. maritime commerce. Foreign-built cruise ships utilizing Canadian ports because of Jones Act restrictions still encounter significant limitations on their operations when they bring their passengers into Alaskan ports. Presently, the Alaska Marine Highway system must turn away thousands of tourist users and passengers because of lack of space. Yet foreign-built ferry vessels, which could be used to expand Alaska's ferry service for everyone's benefit, are available at lower cost.

June 30, 1983



STATE OF ALASKA
OFFICE OF THE GOVERNOR
WASHINGTON, D.C.

July 6, 1983

(The following letter was sent to the Chairman and Ranking Minority Member of the House Committee on Merchant Marine and Fisheries, its Merchant Marine subcommittee, and the Senate Committee on Commerce, Science and Transportation.)

Dear Senator/Congressman:

I have enclosed the State of Alaska's position paper on the Merchant Marine Act (the Jones Act) for use in the Merchant Marine and Fisheries Committee's deliberations on the various bills relating to the issue. The State favors amending the Jones Act to allow the use of ships built in foreign countries in the Alaska coast cargo and passenger trade, if they meet American standards and are U.S. owned, registered, manned and repaired.

Alaska is extremely dependent on water-borne commerce. While we favor the goals of the Jones Act, its strict application limits the number of ships available for commerce, resulting in unfairly high freight rates and an inflexible transportation system. We believe that our proposal will meet the primary goals of existing law while allowing entities such as cruise ships and the Alaska Marine Highway to better serve their users. In the long run, we believe our proposal will revitalize the shipping industry by enabling it to compete more effectively with alternate modes of transport.

I appreciate this opportunity to express the State's position on this important matter. If we can be of further assistance in your deliberations on the Jones Act, please contact us.

Sincerely,

/s/

Bill Sheffield
Governor

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JEROME

June 7, 1983

The Honorable Mario Biaggi
Chairman, Merchant Marine Subcommittee
Committee on Merchant Marine and Fisheries
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Biaggi:

Thank you for the opportunity to express the State of Alaska's position regarding H.R. 1076. This legislation, sponsored by Congressman Bonker, would repeal a section of the Jones Act (known as the 3rd proviso) which allows an exception to that Act for merchandise that is transported between points within the continental United States over routes recognized by the Interstate Commerce Commission which include a Canadian rail connection. This exemption was passed by Congress in 1958 as part of the legislation incorporating the Alaska Statehood Act extending to Alaska the same exception to the Jones Act available to a number of Great Lakes states.

The principal current use for this provision is trainship service from Prince Rupert, British Columbia, to Whittier, Alaska, and barge service from the Mackenzie River in Canada to the North Slope of Alaska in support of oil and gas activities at Prudhoe Bay. A trainship service is also under consideration from Vancouver to Seward. This new proposed service by Alaska Navigation Company has prompted an initiative to repeal the 3rd proviso as a means of protecting Seattle-based marine freight businesses from additional competition.

While the State of Alaska recognizes its primary dependence on the Seattle-based shippers, I do not agree that the utilization of the 3rd proviso, which has been in existence since statehood, poses a dire threat to these companies. In fact, they have flourished, while the 3rd proviso operations comprise a relatively small percentage of the Alaska marine freight business. Continued competition from 3rd proviso carriers is good for Alaska in that it maintains a greater diversity of cargo service and, perhaps, moderates the high cost of freight shipments to Alaska.

The Honorable Mario Biaggi

-2-

June 7, 1983

To the extent that elimination of the 3rd proviso would result in higher freight rates, I believe that H.R. 1076 weakens rather than strengthens domestic waterborne commerce. It is beneficial for Alaska to have the lowest possible freight rates and the greatest possible diversity of service to encourage its economic development. Ultimately, this will allow the shipping business to expand its business as partners in Alaska's growth. Less competition will produce the opposite effect.

Therefore, I cannot support H.R. 1076 in its present form since it would serve to increase the cost of goods to consumers in Alaska and would restrict our present means of maritime transportation.

- I appreciate your consideration of this issue of great importance to Alaska and to our nation's seaborne commerce.

Sincerely,


Bill Sheffield
Governor

STATE OF ALASKA

DEPARTMENT OF TRANSPORTATION AND PUBLIC FACILITIES

OFFICE OF THE COMMISSIONER

JUL 10

ATTACHMENT 4

BILL SHEPPARD, GOVERNOR

POUCH 2
JUNEAU, ALASKA 99811
TELEX 45 3281
465-3900

Mr. Ed Gable
Chief, Carrier Rulings Board
U.S. Customs Service
Department of the Treasury
Washington, DC 20229

Dear Mr. Gable:

RE: Boeing Jetfoil
Demonstrations in Alaska

The State of Alaska recently completed a summer public demonstration and winter test of a Boeing Jetfoil to establish the feasibility of using a craft of this type for regularly scheduled passenger and freight service in southeast Alaska.

While the vessel demonstrated it can satisfactorily operate in the waters of Southeast Alaska, an analysis of the test results indicates to us that there is no credible method of estimating traffic volumes without a long term trial under actual operating conditions. Unfortunately, because of the restrictions of Title 46, U.S.C. (The Jones Act) now in effect, the only vessel suitable for continuation of a revenue analysis cannot be utilized. The Jetfoil in question, the ARIES, lost its privilege to engage in the coastwise trade because, although it was manufactured in the United States, it was sold to a foreign corporation and put in service under foreign registry for a period of approximately one year. Because of a default by the purchaser, the vessel has been returned to Boeing and is now home ported in Seattle.

The Alaska Legislature has made funding available to continue the trial operation of the Boeing Jetfoil. Therefore, we are, at this time, requesting an administrative waiver of the provisions of Title 46 U.S.C. to use the Boeing Jetfoil ARIES during the period from March 1, 1984 through March 1, 1985. If the State decides to initiate regular Jetfoil service, as a result of the trial operation, we would require the necessary vessels be built by U.S. manufacturers and be coastwise qualified.

The waiver requested, and the trials to be conducted, have implications far beyond passenger or freight service in Alaska. Both the National Security and High Technology impacts would be substantial. The enclosed copy of a letter from the manufacturer discusses these items in detail.

Your favorable consideration of this request will be appreciated. To enable us to make the commitments necessary to implement trial Jetfoil service in a timely manner, your decision in this matter by year end would be appreciated.

Sincerely,


Daniel A. Casey
Commissioner

Enclosure

cc: Ben Harding, Special Assistant to the Governor, Governor's Office
Jonathan W. Scribner, Acting Deputy Commissioner, Southeast Region, DOT&PF
Honorable Ted Stevens, U.S. Senate
Honorable Frank Murkowski, U.S. Senate
Honorable Don Young, U.S. House of Representatives
Robert E. Bateman, Boeing Marine Systems

DAC/RM/mjm



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

NOV - 9 1983

Dear Mr. Young:

Thank you for the letter of October 5, 1983, sent by you and other Senators and Representatives concerning the request of the State of Alaska for a Waiver of 46 U.S.C. 883 to permit the use of a once foreign-registered Boeing hydrofoil for one year in the waters of southeast Alaska to test the feasibility of such a craft for passenger and freight service there.

It is my pleasure to inform you that Alaska's request for a waiver has been approved.

Thank you for your interest in this matter.

Sincerely,

John M. Walker, Jr.
Assistant Secretary
(Enforcement and Operations)

The Honorable
Don Young
House of Representatives
Washington, D.C. 20515

WILL SHEFFIELD
GOVERNOR



State of Alaska
OFFICE OF THE GOVERNOR
WASHINGTON, D.C.

December 31, 1984

MEMORANDUM

TO: DISTRIBUTION LIST

FROM: *JWK* JOHN W. KATZ, Director of State/Federal Relations
and Special Counsel to the Governor

SUBJECT: LEGISLATIVE ISSUES IN THE 99th CONGRESS

This memorandum outlines the components of the legislative program which Governor Sheffield has requested this office to pursue in the 99th Congress. The program is based on our analysis of federal issues of concern to Alaska, and on discussions with State officials, local governments, and interested groups. A number of related executive branch issues are also addressed. Not dealt with are legislative and administrative matters of a more mundane nature, which this office handles on a day-to-day basis. Budget and appropriation issues are covered in separate memoranda which have also been prepared.

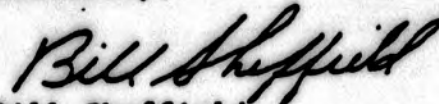
To facilitate your review, this memorandum is divided into three sections. The first part concerns legislation which was not enacted during the 98th Congress but which will likely be reintroduced next year. In most instances, we will advocate a State position based on our efforts in the past. The second section of the memorandum addresses legislation which will likely be introduced for the first time in the next Congress. Again, we have indicated the State Administration's position. The final section includes a selective listing of some of the nearly 700 public laws and administrative reports that will be considered by the Congress in the next two years. Except with respect to matters mentioned in the first two parts of the memorandum, items listed in the third section will probably require a lower level of attention by this office.

Page 2

Tax policy and the federal budget are two related issues currently receiving wide discussion in the nation's capital. Because of your likely interest in these subjects, I am enclosing our analyses of the Treasury Department's tax reform proposal and the President's proposed budget reductions for your information. A letter I sent last year to Senator Mathias' Subcommittee on International Economic Policy expressing the State's position on unitary taxation and my recent letter to President Reagan on Japanese trade issues may also be of interest to you.

If we can be of assistance in your work on federal issues, please do not hesitate to contact John W. Katz, director of my Washington, D.C. office, at (202) 624-5858, 444 North Capitol Street, N.W., Suite 518, Washington, D.C. 20001.

Sincerely,

A handwritten signature in cursive script that reads "Bill Sheffield".

Bill Sheffield
Governor



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

January 14, 1985

Dear Legislator:

I am writing to acquaint you with the current work of my Washington, D.C. office, and to offer its services to you.

As many of you know, the office provides a focal point for Alaska's relations with the U.S. Congress and various agencies. It also conducts policy analysis, monitoring, and advocacy activities on specific state-federal issues. These presently include natural resources and energy, transportation, telecommunications, fisheries, taxation, education, health and human services, and environmental protection. Office efforts often entail the preparation of issue analyses, position papers, and communications to federal decision-makers.

As in the past, some of these efforts could be of assistance to legislative committees and individual legislators. Among other things, we would be glad to monitor issues of interest, prepare issue papers, and assist in scheduling trips to Washington for legislators and staff. The Washington office currently responds to requests from individual Legislative Informations Offices and is distributing some information on a regular basis.

I have enclosed two memoranda that will help provide an overview of the office's projected work on federal issues likely to affect Alaska during 1985. The first, entitled "Legislative Issues in the 99th Congress," outlines key issues before the Congress and the federal agencies, while the second, entitled "Federal Budget Priorities," explains the appropriation items of greatest interest to the State. A listing of my Washington, D.C. staff by area of responsibility is also included for your use.

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If you have any questions or comments regarding the issues addressed below, please let me know.

I. LEGISLATIVE ISSUES PENDING FROM THE 98th CONGRESS

A. OCS Oil and Gas Leasing Issues

1. OCS Revenue Sharing - In the 98th Congress, House-Senate conferees agreed upon legislation to share a small portion of OCS oil and gas receipts with all coastal states. The legislation was then passed by the full House of Representatives. However, Reagan Administration opposition prevented Senate consideration of the conference report. We anticipate that similar legislation will be introduced in the 99th Congress and that the State will advocate its passage. Alaska has been designated the lead state on this issue by the Western Governors' Conference.
2. 8(g) Revenue Sharing - Although further discussions between affected governors and Secretary Clark may occur, the issue of how to share Section 8(g) revenues will likely be decided in court. Congressman Breaux introduced a bill late in the 98th Congress to require a 50-50 split of all 8(g) revenues. His bill, which we believe the State should support, may receive a hearing. However, this legislation is unlikely to move in view of the fate of the more broadly-based, but financially-limited, general OCS revenue sharing legislation.
3. Coastal Zone Consistency Amendment - Legislation to rectify the U.S. Supreme Court opinion that excluded OCS lease sales from state coastal zone management review was favorably reported by the Senate Commerce Committee and was the subject of hearings in the House Merchant Marine and Fisheries Committee. Legislation similar to that which the State has supported previously will be considered in the 99th Congress, probably as part of the reauthorization process of the Coastal Zone Management Act (see New Legislative Issues).
4. OCS Lease Sale Schedule - The five-year OCS Schedule is due to be updated and presented to Congress for review during the 99th Congress. Barring any surprises, the key lease sale that might result in Congressional action, including funding moratoriums, is the proposed North Aleutian Shelf Sale now scheduled for December, 1985.

- B. Clean Water Act Reauthorization - With the failure of the Clean Water Act amendments in the 98th Congress, another attempt will undoubtedly be made in the 99th Congress. We anticipate four potential issues of interest to the State:
1. Legislation related to the pulp mills' request for a variance from effluent guideline standards - The State has previously advocated this approach.
 2. Changes to Section 301(h) which would restrict coastal communities' ability to discharge municipal wastes into certain marine waters - The State has previously opposed this change from existing law.
 3. Extension of Best Available Technology (BAT) requirements deadline to 1987 - Depending on final legislative language, the State will likely support this provision, in part due to its beneficial impact on the pace of needed investment by the placer miners.
 4. Changes to Section 404 regarding regulation of dredge and fill materials - We recommend monitoring and advocacy, if appropriate, of amendments developed by the State in the 98th Congress.
- C. Fish Marketing - Senator Stevens will most likely again press for the establishment of a National Fisheries Marketing Council to coordinate and expand the use of American fish products. Legislation accomplishing this end passed the Senate in the 98th Congress but was not acted on by the House. The State supports the measure.
- D. Fisheries Development - Two major efforts at promoting fisheries development will probably reappear in the 99th Congress. Senator Stevens' Capital Construction Fund, which would grant certain tax advantages to shore-based processors, and Representative Breaux's U.S. Fisheries Development Corporation, which would have broad responsibilities for fish-related loans, investments, and research. In addition, specific private sector fishery development proposals occasionally require advocacy at the D.C. level or with the Congress.

- E. Fish Management - Problems of State-federal fish management are dealt with in every Congress. They arise either from species specific multi-state conflicts, such as the precipitous decline of East Coast striped bass, or from conflicts between State-federal management regimes, such as those in Alaska over management of crab stocks. We will monitor these issues and assist in developing State positions as appropriate. (See Magnuson Act reauthorization in New Legislative Issues.)
- F. High Seas Salmon Interception - Japanese interception on the high seas of Alaska spawned salmon continues to be a serious problem. Bi-lateral negotiations with Japan will be necessary to correct the problem. We are advocating the initiation of such talks at this time.
- G. Glacier Bay Fishing - The wording of ANILCA and the Wilderness Act arguably could make commercial fishing in Glacier Bay illegal. Solutions to the problem have been considered, such as exempting the bay from the Wilderness Act, or exchanging the best commercial fishing wilderness waters for waters not now in wilderness. Eventually a legislative solution must be found or fishing in the bay could cease.
- H. Clean Air Act Reauthorization - Work will continue on efforts to reauthorize and amend the Clean Air Act. Acid rain continues to dominate this discussion. We will monitor this legislation and assist, as necessary, in the development of State positions.
- I. Oil Spill Superfund - Legislation which would provide a comprehensive nationwide system of limited liability and compensation for oil spills in federal waters passed the House but was not approved by the Senate. The House bill would affect state tax-based cleanup funds; since Alaska's fund is not tax-based, we are not adversely affected if the legislation remains in its current form.
- J. Exclusive Economic Zone - With the failure of the U.S. to sign the Law of the Sea Treaty, efforts have begun in Congress to assess future U.S. ocean policy and/or to implement an exclusive economic zone out to the 200 mile limit. These efforts will continue in the 99th Congress. The Governor has previously submitted a statement in support of the establishment of an EEZ.

- K. Teshepuk/Utukok National Wildlife Refuge - We anticipate that Congressman Dingell will reintroduce his bill to convert the NPR-A into a wildlife refuge. If so, we recommend that the State assess the results of BLM management of the area to date and devise a position accordingly. In the past, the State has informally opposed the Dingell bill, although the lack of Congressional action mooted the need to take a formal position.
- L. Universal Telephone Service - The FCC announced in December the implementation of a \$1 or \$2 per month access charge for residential subscribers for long distance service. It starts at \$1 per month in mid-1985 and increases to \$2 per month in mid-1986. This will generate substantial controversy due to its impact on consumers, especially those in rural areas. The House passed legislation last year blocking access charges and may make a similar effort this year. If remedial legislation is considered, the State should pursue specific Alaska amendments relating to reasonable telephone rates in bush Alaska and long distance service. Further, this office will work with the State's telecommunications counsel on administrative matters pending before the FCC, including rate integration and the existing supplemental.
- M. Industrial Development Bonds - The small issue IDB program sunsets December 31, 1986, except for bonds used to finance manufacturing facilities. This office will participate in a small issue coalition effort to extend the sunset past 1986. All activity will be coordinated with AIDA and the Commissioner of Commerce and Economic Development. Alaska has been designated the lead State on this issue by the Western Governor's Conference.
- N. Aleut Compensation - Congress failed to act on the Aleut compensation provisions in the House and Senate bills that resulted from recommendations made by the Commission on Wartime Relocation and Internment of Civilians. Our office actively supported the bills, and the Governor offered testimony at the Anchorage hearing. The primary reason the bill was not enacted was lack of consensus on the amount of compensation for Japanese Americans who were also covered under the bill. We expect a new effort in the next Congressional session.

- O. Federal Quiet Title Act Amendment - A U.S. Supreme Court decision in Block v. North Dakota held that states were subject to the 12 year statute of limitations in quiet title suits against the United States. A House Judiciary subcommittee held hearings in the 98th Congress on a bill which would exempt states from the provisions of the 12 year statute of limitations, but the committee took no further action. As was the case this year, our office will coordinate its efforts in the next congress with the Western Governors Association to secure a state exemption.
- P. Federal Tax Proposals - The Department of the Treasury issued a report which recommends to the President various tax reform measures. This includes a modified flat tax proposal which restricts deductions for state taxes and eliminates tax exempt private purpose bonds. There will be numerous tax simplification bills which, although they are intended to be revenue neutral, will affect certain classes of taxpayers. Proposals of particular interest include bills dealing with severance tax limitations, oil excise taxes, oil import fees, unitary tax, tax exempt bonds, deductibility of state or local taxes, federal corporate income tax, and limitations on state property taxes on interstate natural gas pipelines. Our office will monitor these initiatives and will advocate the State's interest where necessary.
- Q. Highway Funding Formulas and Related Issues - Legislation containing modifications to various highway funding programs, as well as approval of the Interstate Cost Estimate, stalled in conference in the 98th Congress. The State supported the Senate legislation and opposed the House bill. A variety of highway funding issues of interest to the State will be considered again in the 99th Congress, in particular formulas for allocation of construction and repair funds. In 1986, the entire Surface Transportation Assistance Act will require reauthorization.
- R. Jones Act Modifications - Legislation to eliminate the Third Proviso of the Jones Act, which allows foreign carriers to transport U.S. goods to Alaska via Canada, passed the House in 1983 despite strong opposition by the State. The Senate never acted on the measure. The legislation is likely to be reoffered again next year, with similar results. As a result of the approval of the initiative repealing the Alaska Transportation Commission, the State must lobby Congress for repeal of

the Jones Act, which requires goods being transported between points in the U.S. to be carried on U.S.-built, -owned, and -operated ships. Although we laid the basis for such activity in the past Congress, the chances for accomplishing anything in this area are not bright, as evidenced by the outcome of the proposal for a vastly more limited exemption for Alaska oil exports. Congress will also consider other maritime legislation of interest to the State, such as cargo preference proposals (which we have opposed in the past).

- S. Temporary (Transit) Visas - A provision was included in the controversial Simpson-Mazzoli immigration bill to allow travellers from certain countries to visit the U.S. without first obtaining a visa overseas. Although that provision was non-controversial, the bill's sponsors do not want it considered independently of the larger immigration bill, which stalled in conference, and will likely be considered again next year. We will seek separate consideration of the measure if the immigration bill appears stalled.
- T. National Park Protection - Legislation creating "buffer zones" around national parks was passed overwhelmingly by the House in 1983, but was not acted on in the Senate. However, such legislation is a top priority of some Senate members and of the environmental community, and will likely be taken up next year. Because of the size of Alaska parks, and the fact that the legislation addresses "lower 48" problems, we will oppose any bill which does not include an Alaska exemption, as we did in the last Congress. We will take a similar position on related legislation which would allow the imposition of admission fees in national wildlife refuges.
- U. 90-10 Revenue Sharing Formula for Alaska Wildlife Refuges - In 1983, Congressman Breaux offered an amendment in committee to repeal the provision of the Statehood Act which grants the State 90% of wildlife refuge mineral lease revenues. He proposed to replace it with the standard nationwide provision, which grants 75% of such revenues to the federal government for wetlands protection and 25% to the local county. Although he later withdrew the amendment, Congressman Breaux may offer it again. We would vigorously oppose it, as we did in 1983.
- V. Submerged Lands Statute of Limitations and Acreage Chargeability - The State, along with Native Corporations and the Department of the Interior, is

seeking legislation to require that the State and Native Corporations be charged for acreage conveyed to them by the Federal Government according to the standard rules of survey. This legislation would also repeal the statute of limitations for navigability challenges initiated by the State [Section 901(a) of ANILCA]. Although no bill was introduced to accomplish this in the 98th Congress (despite a request from the Governor for such legislation), the Interior Department's practice was successfully modified, and all key Congressional participants in the issue were thoroughly briefed and prepared for legislative action next year.

- W. Infrastructure Funding - In late 1984, House Public Works Committee leaders introduced legislation to provide funding to the states for infrastructure repair and construction. Such legislation will likely be a major issue in Congress next year. The State will be interested in how funding is allocated among the states.
- X. Oil Export/Export Administration Act Reauthorization - In the 98th Congress, a major effort to modify the North Slope oil export restrictions of the EAA foundered in the face of maritime industry opposition. Because the necessary reauthorization of the EAA was not passed by Congress, the issue could arise next year; a study of the oil export question by federal agencies is mandated by this legislation, if it passes. We will continue to advocate major modification of the current oil export restriction.
- Y. Food Stamps - During the last session of Congress, the House passed a food stamp bill, but the Senate failed to act. We expect food stamp legislation to be considered in the 99th Congress. The State obtained the inclusion of an Alaska-specific pilot program for a rural nutrition block grant. A food stamp block grant program as an option open to all states may be one of the alternatives discussed next year.
- Z. Indian Health Care Amendments - The Congress passed a reauthorization of the Indian Health Care Improvement Act last year, but the bill was not approved by the President based primarily on White House objection to a Montana pilot project and proposed IHS organizational changes. Alaska has special interest in the hepatitis-B provision, the Bethel IHS hospital provision, and the IHS contractor demonstration

DRAFT

February 20, 1985

The Honorable William von Raab
Commissioner
United States Customs Service
Room 3136
1301 Constitution Avenue, N.W.
Washington, D.C. 20229

Dear Commissioner von Raab:

I am writing in strong support of your proposed rule-making concerning the transportation of passengers on foreign vessels (FR 1060, January 9, 1985). We also commented favorably on the advance notice published in the April 25, 1984 Federal Register. The State favors actions such as this which beneficially affect the tourism industry in Alaska, because of the vital contribution it makes to our economy.

Existing U.S. Customs Service regulations (19 CFR 4.80(a)) limit the number and duration of U.S. stops by most cruise ships. Enabling ship operators to stop for longer periods of time and in a wider variety of locations would benefit Alaska and the nation in several ways. A number of Alaska communities which currently do not receive regular tour ship visits offer a great deal to the potential visitor and would welcome being included on tour ship itineraries. The proposed rule would enable cruise ships to make new stops at these ports, thereby boosting and diversifying those local economies.

Enhanced flexibility would also allow cruise ship operators to create a wider variety of tour offerings, including land/sea programs which would allow cruise passengers to visit major attractions in interior Alaska. In general, this flexibility would likely allow greater numbers of passengers to visit Alaska, since operators can better design schedules to attract potential visitors. The proposal would also benefit the nation by reducing the U.S. balance-of-payments deficit as a result of increasing visits to U.S. ports in lieu of foreign stops.

DRAFT

DRAFT

The Honorable William von Raab -2- February 20, 1985

For the reasons stated above, we urge you to formally adopt the proposed rule as soon as possible.

Sincerely,

Bill Sheffield
Governor

cc: The Honorable Ted Stevens, U.S. Senate
The Honorable Frank Murkowski, U.S. Senate
The Honorable Don Young, U.S. Congress
Regulations Control Branch
Ed Gable, Director, Carriers, Drawback & Bond Division

BILL SHEPFIELD
GOVERNOR



State of Alaska
OFFICE OF THE GOVERNOR
WASHINGTON, D.C.

February 14, 1985

MEMORANDUM

TO: THE HONORABLE TED STEVENS, U.S. Senate
THE HONORABLE FRANK MURKOWSKI, U.S. Senate
THE HONORABLE DON YOUNG, U.S. House of Reps.

FROM: *JWK* JOHN W. KATZ, Director of State/Federal Relations
and Special Counsel to the Governor

SUBJECT: GOVERNOR'S SCHEDULE

For your information, I have listed below a series of meetings involving the Governor and various federal officials during the former's upcoming trip to Washington, D.C. in late February. Topics to be discussed at one or more of these meetings include oil exports, transportation of Prudhoe Bay natural gas, section 8(g) of the OCS Lands Act, the State's Pacific Rim trade conference, and the North Aleutian Shelf lease sale.

With one or two exceptions, the date and time of each meeting has been finalized. Per your offer, I will let you know if any scheduling difficulties are encountered. In addition, there has been some discussion about the possibility of delegation members attending certain meetings.

Please let me know if you have any questions or comments regarding the proposed schedule.

Tuesday, February 26, 1985

1:00 pm

Dr. Alton Keel, Associate
Director, Office of Management
and Budget for National
Security and International
Affairs

Page 2

Wednesday, February 27, 1985

11:30 am - 12:00 noon

Allen Wallis, Undersecretary
of State of Economic Affairs.

11:30 am - 2:00 pm

John S. Herrington, Secretary,
Department of Energy.

3:00 pm - 3:30 pm

Donald Hodel, Secretary,
Department of the Interior.

Thursday, February 28, 1985

10:00 am - 10:30 am

Malcom Baldrige, Secretary
Department of Commerce.

1:30 pm - 2:00 pm

Erich Block, Director,
National Science Foundation.

NOTE: We are also seeking meetings with Raymond J. O'Connor, Chairman, Federal Energy Regulatory Commission and George Schultz, Secretary of State. In addition, coastal governors will be meeting with Secretary Hodel at some point to discuss issues arising under section 8(g) of the OCS Lands Act.

cc: John Shively, Chief of Staff

Meeting with Secretary Baldrige

Department of Commerce

Pacific Rim Conference

- Top level federal participation in the conference is essential for attracting the key policy-makers and business people from Japan, Korea, and China.
- Federal participation will enhance U.S. relations with invited conferees and stress national importance of relations with the invited countries.

Oil Exports

- Reagan Administration support is essential to Congressional action on the issue - Leadership needs to be displayed.
- A limited amount of export, on Jones Act tankers, would do little, if any, harm to maritime industry and would accomplish much in improving Japanese-U.S. relations. It would also have beneficial effects on the future products of Alaska oil - important for marginal field development.
- The increased wellhead value of Alaska oil, resulting from reduced transportation costs, would result in several hundred million dollars a year in additional federal Windfall Profit tax collections.

Natural Gas Export

- Export of North Slope natural gas is the only market possibility for that resource at this time. If the results of the Japanese-Arco pre-feasibility study are favorable, Congressional action may be necessary.

Timber Exports

- Alaska is actively pursuing possibility of marketing additional timber exports to mainland China. A brief description of your trip to China and subsequent events should follow.

Meeting with Undersecretary Wallis

Department of State

Pacific Rim Conference

- Top level federal participation in the conference is essential for attracting the key policy-makers and business people from Japan, Korea, and China.
- Federal participation will enhance U.S. relations with invited conferees and stress national importance of relations with the invited countries.

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Natural Gas Export

- Export of North Slope natural gas is the only market possibility for that resource at this time. If the results of the Japanese-Arco pre-feasibility study are favorable, Congressional action may be necessary to authorize project.

Dr. Alton Keel

Office of Management and Budget

Oil Exports

- Reagan Administration support is essential to Congressional action on the issue - Leadership needs to be displayed.
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NOTE: See attached letter to David Stockman for further information.

Meetings with Secretary Hodel

Department of the Interior

North Aleutian Shelf Lease Sale

- The State has requested that the sale be delayed for a period of ten years or at least until 1994. The area contains unequalled natural resources, such as the Bristol Bay salmon fishery, marine mammals, and migratory birds. Delay will allow adequate time to fill data gaps identified by the State and give industry time to develop cleanup technology in case of an accident. Previous reductions in size of sale area and short term delays have not addressed these issues.

Oil Exports

- Reagan Administration support is essential to Congressional action on the issue - Leadership needs to be displayed.
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Pacific Rim Conference

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- Federal participation will enhance U.S. relations with invited conferees and stress national importance of relations with the invited countries.

Section 8(g) of the OCS Lands Act (if necessary in aftermath of Monday meeting).



STATE OF ALASKA
OFFICE OF THE GOVERNOR

Identical letters hand delivered to Senator Stevens and
Senator Murkowski on February 22, 1985.

February 21, 1985

The Honorable Don Young
U.S. House of Representatives
2331 Rayburn House Office Bldg.
Washington, D.C. 20515

Dear Congressman Young:

As you know, on November 6, 1984 Alaska voters approved a ballot measure (Initiative No. 83-02) which directed me to "seek repeal of federal statutes (the Jones Act) which require the use of United States vessels to ship goods between United States ports." I am writing to ask for your assistance in seeking this result.

The application of the Jones Act to Alaska has both increased the costs of all domestic freight shipped to and from Alaska and prevented the utilization of the most efficient available transportation options. By imposing higher transportation costs on domestic commerce, the Jones Act also discourages the development of new petroleum and mineral deposits in Alaska.

According to the Alaska Statehood Commission, the federal government loses from \$100-400 million dollars per year in oil revenues as a result of the higher transportation charges the Jones Act imposes on the movement of Alaska crude oil. The revenue loss occurs because transportation charges are deducted from the value of Alaska oil prior to the calculation of taxes. By reducing this value, the higher transportation charges also impede the development of marginal oil fields on Alaska's high cost North Slope.

Another serious problem with the application of the Jones Act to Alaska arises from the fact that it results in the strict separation of domestic and foreign waterborne commerce. Alaska could be economically served by vessels travelling from the U.S. Pacific Coast to the Orient. Western Alaska communities, with their severe employment

The Honorable Don Young -2-

February 21, 1985

problems, would particularly benefit from the ability to combine their domestic trade with this foreign service. However, the vessels currently providing international service are prohibited from stopping in Alaska by the Jones Act. Promising fishing ventures have been hampered by these restrictions.

Studies of the cost of the Jones Act to Alaska consumers have determined that approximately \$40 million dollars a year are added to the building materials, business supplies, and consumer goods shipped to Alaska. Given the existing high costs of living and working in Alaska, this additional burden is especially difficult for Alaskans to endure.

We understand the importance of the United States' cabotage laws and the necessity for a strong domestic merchant marine industry. However, Alaska is unfairly shouldering this goal by supporting about one-third of the entire Jones Act fleet, with the attendant effects of reduced resource development and higher costs. Nor has the Jones Act proved effective in stemming the decline of the U.S. merchant marine industry, which by relying on protectionism has lost business to other transportation modes and more efficient foreign ships and operators.

We realize that in the past Congress has shown no inclination to repeal the Jones Act. While recognizing the current situation, we would like to work closely with you in pursuing the objectives of the initiative. Toward this end, I will be in Washington, D.C. in late February and would like to discuss possible strategies with you at that time.

Thank you for your consideration of this important matter.

Sincerely,



Bill Sheffield
Governor

August 2, 1985

STATE OF ALASKA POSITION ON JONES ACT

BRIEFING POINTS

On November 6, 1984, Alaska voters approved a ballot measure (Initiative No. 83-02) which directed the Governor and the State of Alaska to "seek repeal of federal statutes (the Jones Act) which require the use of United States vessels to ship goods between U.S. ports."

1) The Jones Act reduces federal and state oil revenues by effectively imposing higher tanker transportation charges which are tax deductible.

2) According to the Alaska Statehood Commission, the federal government loses from \$100 to \$400 million dollars per year in oil revenues as a result of the higher transportation charges the Jones Act imposes on the movement of Alaska crude oil.

3) The Jones Act raises the cost of all domestic freight coming into the State, thereby contributing to a higher cost of living and depressing economic development in Alaska.

4) Studies of the cost of the Jones Act to Alaska consumers have determined that approximately \$40 million a year are added to the building materials, business supplies, and consumer goods shipped to Alaska.

5) The Jones Act limits U.S. markets for Alaskan products (fish, coal, minerals, and timber) by contributing to higher destination costs as compared with export to the Pacific Rim nations.

6) Alaska is unfairly shouldering this burden by supporting about one-third of the entire U.S. Jones Act fleet, with the attendant effects of reduced resource development and higher costs.

7) The Jones Act has not proved effective in stemming the decline of the U.S. merchant marine industry, which, by relying on protectionism, has lost business to other transportation modes and more efficient foreign ships and operators.

BFH



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

December 26, 1984

The President
The White House
Washington, D.C.

Mr. President:

Because you will soon be meeting with Prime Minister Nakasone of Japan, I thought it would be helpful to provide you with recent information on Alaska's efforts to expand our trade with Japan. I would also like to discuss the implementation of the Joint Statement on Japan-U.S. Energy Cooperation issued by Prime Minister Nakasone and you on November 11, 1983.

Oil Exports

The Joint Statement provided that "the U.S. will continue to keep under review the removal of restrictions on exports of domestic crude oil." Your administration has completed several analyses on the subject, including a report recently released by the Federal Trade Commission. To our knowledge, all of these investigations concluded that easing existing restrictions on the export of Alaska North Slope crude oil would result in significant national benefits, including greater federal tax revenues, a reduced trade deficit with Japan, and the production of more Alaska oil at lower prices.

The reauthorization of the Export Administration Act is still pending in Congress. I respectfully urge you to follow through on the results of your Administration's studies of oil exports and actively assist our efforts to ease existing restrictions on the export of Alaska oil. To do so would be entirely consistent with your Administration's support for free trade and U.S. energy development. I believe that it would be timely for you to do this during the 99th Congress, since Congress has expressed an interest in obtaining your views on the matter.

On September 30, 1983 I wrote to let you know of our willingness to offer a portion of the State's royalty oil for export to Japan. From our discussions with interested

parties in Japan, I believe that the quantity of royalty oil available - 50,000 barrels a day - is an appropriate amount to consider at this time. You may also wish to discuss the issue with Prime Minister Nakasone in order to judge its current importance to Japan.

Natural Gas Exports

Progress has been made in assessing the viability of marketing Alaska's enormous North Slope natural gas reserves in the Pacific Rim. As proposed in the Joint Statement, study teams have been organized in the U.S. and Japan, thanks in part to the leadership provided by the Department of State. I offer you the full cooperation of the State of Alaska for any aspect of the study where we might be of assistance. Further, we believe that the study should be expedited as much as possible so that the results can be utilized in future decision-making regarding the export of North Slope natural gas, which our analyses indicates would be of significant benefit to Alaska and the Nation.

Coal Exports

I am also encouraged by the long-term coal contract that the Usibelli mine in Healy, Alaska recently signed with the Korean Electric Power Company. The Beluga and Matanuska fields contain substantial steam coal reserves that are easily accessible and have potential interest to Japan. Accordingly, we are hopeful that future U.S.-Japanese discussions will focus on the economic and other benefits which would accrue from increased trade in Alaska coal.

Fisheries

Currently, approximately five percent of our Nation's trade deficit is related to seafood products. Much of this is attributable to a trade imbalance with Pacific Rim countries, particularly Japan. To counteract this, the State has been working diligently to accomplish import substitutions by establishing a larger domestic market for Alaskan seafood. We are also endeavoring to domesticate as quickly as feasible the harvesting and processing of those species, such as groundfish, which have traditionally been utilized by foreign nations and then exported back to the U.S.

An annual meeting is held between representatives of the U.S. and Japanese fishing industries to discuss business relations, in particular with respect to groundfish. At this year's recently concluded meeting, an agreement was

reached for the 1985 fishing season which will increase the volume of product delivered by U.S. fishermen to Japanese processors in "over-the-side" joint venture operations. Even more importantly, the agreement also provides for the importation by Japan of approximately 7,000 and 20,000 metric tons of finished product which will be manufactured by U.S./Alaskan processors in 1985 and 1986, respectively. This sale of finished product to Japan, most likely surimi, will help stimulate a primary and secondary processing industry that will ultimately employ several thousand Americans.

Critical to the successful implementation of this agreement will be the ability of Japanese companies to import U.S. produced groundfish products. Current Japanese import quotas greatly restrict U.S. imports, while Japanese surimi exports to the U.S. are continuing to dramatically expand. Your insistence that the Government of Japan relax its fish-related tariff and import barriers would be useful in assuring the success of this industry-to-industry agreement which will have a beneficial impact on the U.S. balance of trade.

On another fish-related problem, recent studies have demonstrated that continued Japanese high-sea harvest of Alaska spawned salmon is seriously affecting the national harvest and management of this resource by Americans. We will be working through Alaska's Congressional delegation to encourage the U.S. State Department to initiate bilateral discussions with the Japanese which will be necessary to stop this deleterious practice.

Timber Exports

The timber industry in Alaska is geared to trade with Japan and the Pacific Rim. As a result, the Alaska industry is increasing its promotional activity in Japan. The State is working through its Alaska Asia Office in Tokyo to assist in the promotion of Alaska forest products and products made from Alaska timber in Japan.

To date, Alaska's spruce round logs and cants are selling well in Japan. However, there is a need to improve hemlock sales to Japan, as sales of hemlock products are currently reduced from previous years' totals. In another troubling area, South Africa, which has lower environmental standards and dramatically cheaper labor costs than Alaska, has captured an increasingly larger share of Japan's dissolving sulfite pulp markets from the United States, particularly

The President

-4-

December 26, 1984

Alaska. Any assistance which your Administration could provide to enhance Alaska's market share of hemlock, as well as to restore the U.S. and Alaska's share of the dissolving sulfite pulp market would be appreciated.

The State and industry are also working to formulate a plan to make attractive foreign investment in the development of Alaska's Interior timber resources. We will advise your Administration on the details of this plan when it is completed.

We very much support your efforts to expand trade with Japan and stand willing to help in any way. If you would like any additional information on our own efforts to increase trade with Japan, we would be pleased to provide it.

Thank you for your consideration of our views.

Sincerely,



Bill Sheffield
Governor

cc: The Honorable Ted Stevens, U.S. Senate
The Honorable Frank Murkowski, U.S. Senate
The Honorable Don Young, U.S. House of Representatives
The Honorable George Schultz Secretary, U.S. Department
of State
The Honorable Malcolm Baldrige, Secretary, U.S.
Department of Commerce
The Honorable William Clark, Secretary, U.S. Department
of the Interior
The Honorable Don Hodel, Secretary, U.S. Department of
Energy
William Brock, U.S. Trade Representative
David Stockman, OMB Director

DRAFT

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DRAFT

DRAFT

January 29, 1985

Mr. David A. Stockman
Director
Office of Management and Budget
Old Executive Office Building
Room 252
Washington, D.C. 20503

Dear Mr. Stockman:

I am writing to ask for your assistance in amending existing federal restrictions on the export of Alaska North Slope crude oil. Recent estimates by the Federal Trade Commission of the additional Windfall Profits Tax revenues accruing to the federal government as a result of lifting the ban range from 200 million to one billion dollars per year. I believe that any measure offering revenues of such magnitude deserves serious scrutiny by the President and Congress.

The enhancement in federal tax revenues from the export of Alaska oil results from reduced transportation costs. Half of North Slope production -- 800,000 barrels a day -- must undergo an expensive and inefficient journey to the U.S. Gulf and East Coasts, due to the surplus of supply on the West Coast. Reducing the transportation costs increases the wellhead value of the oil, on which taxes are based. This increase in value would also provide the oil industry with a greater incentive to develop currently marginal fields on the high-cost North Slope and to explore for additional oil and gas in northern Alaska.

Eliminating or easing Alaska oil export restrictions would also have other important national and international benefits. The existing trade deficit with Japan would be reduced while the U.S. would gain a bargaining tool to use on other trade issues. Opportunities for financially troubled countries, such as Venezuela and Mexico, to sell oil to the United States would be expanded by displacing Alaska oil from the Gulf and East Coasts. Finally, national security interests would be enhanced by diversifying the energy supply of key U.S. allies away from OPEC and the Soviet Union.

Mr. David A. Stockman

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January 29, 1985

For the reasons stated above, groups as diverse as The Heritage Foundation, The Boston Globe, and The New York Times have endorsed the easing of restrictions on Alaska oil exports. However, the Administration has not conveyed a position on the issue to Congress. Your leadership in this matter is essential to ensuring that it receives proper consideration. In this regard, we have been advised by several members of Congress that the views of the Administration would be very important in their reexamination of the Export Administration Act provisions relating to Alaska oil.

I would like to meet with you to further discuss these issues in late February when I am in D.C. In the interim, please let me know if you have any questions. Thank you for your consideration of our views.

Sincerely,

Bill Sheffield
Governor

cc: The Honorable Ted Stevens, U.S. Senate
The Honorable Frank Murkowski, U.S. Senate
The Honorable Don Young, U.S. House of Representatives
Lee Verstandig, Assistant to the President

bcc: Attorney General Norman Gorsuch
Commissioner Esther Wunnicke, DNR
Commissioner Loren Lounsbury, DCED
Lennie Boston, Special Assistant
Ben Harding, Special Assistant
John W. Katz, Director, Washington, D.C. Office
John Greely, Press Secretary

July 12

July 12

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DISTRIBUTION.

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ry of Commerce, after or an agency hearing on / of not to exceed \$10,000 any regulation, order, or r in addition to or in lieu hich may be imposed."

SEC. 136. ALASKAN OIL STUDY.

(a) REVIEW OF ALASKAN OIL POLICY.—

(1) IN GENERAL.—The President shall undertake a comprehensive review of the issues and related data concerning possible changes in the existing incentives to produce crude oil from the North Slope of Alaska (including changes in Federal and State taxation, pipeline tariffs, and Federal leasing policies) and possible changes in the existing distribution of crude oil from the North Slope of Alaska (including changes in export restrictions which would permit exports at free market levels and at levels of 50,000 barrels per day, 100,000 barrels per day, 200,000 barrels per day, and 500,000 barrels per day), as well as the appropriateness of continuing existing controls. Such review shall include, but not be limited to, a study of—

(A) the effect of such changes on the energy and national security of the United States and its allies;

(B) the role of such changes in United States foreign policymaking, including international energy policy-making;

(C) the impact of such changes on employment levels in the maritime industry, the oil industry, and other industries;

(D) the impact of such changes on the refiners and on consumers;

(E) the impact of such changes on the revenues and expenditures of the Federal Government and the government of Alaska;

(F) the effect of such changes on incentives for oil and gas exploration and development in the United States; and

(G) the effect of such changes on the overall trade deficit of the United States, and the trade deficit of the United States with respect to particular countries, including the effect of such changes on trade barriers of other countries.

(2) FINDINGS, OPTIONS, AND RECOMMENDATIONS.—The President shall develop, after consulting with appropriate State and Federal officials and other persons, findings, options, and recommendations regarding the production and distribution of crude oil from the North Slope of Alaska.

(b) CONSULTATION AND REPORT.—In carrying out subsection (a), the President shall consult with the Committees on Foreign Affairs and Energy and Commerce of the House of Representatives and the appropriate committees of the Senate. Not later than 9 months after the date of the enactment of this Act, the President shall transmit to each of those committees a report which contains the results of the review under subsection (a)(1), and the findings, options, and recommendations developed under subsection (a)(2).

TITLE II—EXPORT PROMOTION PROGRAMS

SEC. 301. REQUIREMENT OF PRIOR AUTHORIZATION.

(a) GENERAL RULE.—Notwithstanding any other provision of law, money appropriated to the Department of Commerce for expenses to carry out any export promotion program may be obligated or expended only if—

Employment
and
unemployment.

Commerce and
trade.

President of U.S.

President of U.S.
Report.

15 USC 4051.

THE EXPORT OF OIL TO JAPAN - STATE REVENUE IMPACTS

Recent trade negotiations between the U.S. and Japan have suggested a reexamination of the desirability of lifting the current ban on the exportation of Alaska North Slope (ANS) crude oil. Many issues are raised by such a proposal, most of which are political rather than economic, although there would be major financial impacts on all parties currently involved in the Alaska oil trade.

The export ban was enacted by Congress at a time of a growing realization, fueled by the Arab oil boycott, of U.S. dependence on foreign sources for crude oil. The perceived need for domestic oil spurred Congress to overcome the staunch environmental opposition to the permitting for construction of the Trans Alaska Pipeline System. The ban on exports of ANS was an important compromise hastening the passage of enabling legislation to build TAPS.

The current and continuing controversy over exports of ANS reflects opposing views on the benefits and costs of such a move. Briefly, the rationale in favor of export is essentially that Alaska oil could be sold to Japan and any additional imports into the U.S. would be supplied from sources closer to the U.S. Gulf than Alaska, like Venezuela or Mexico. The primary benefits would derive from the increased revenues to the Federal Government, oil producers, and the State of Alaska because of a higher wellhead price for North slope production, due to the much lower cost of shipping oil from Valdez to Japan than from Valdez to the U.S. Gulf. Additional economic benefit would result from the positive effect on the U.S. foreign trade account.

Opponents to allowing exportation of ANS claim it is counter to the national security since the Alaska oil trade supports virtually the entire domestic tanker fleet. They believe that removal of this maritime industry protection will not only deprive the U.S. of a strong domestic fleet but will result in massive financial disruption due to loan default, and will penalize shippers who have made large investments in transportation infrastructure from Alaska to the U.S. Gulf.

To date, the State of Alaska has refrained from taking a strong advocacy position on this issue since it is a very political one in which the State is an easily identifiable beneficiary of removal of the export ban. Interestingly, consumers would not be directly affected by the legislation, although economic theory suggests that free trade would result in the consumer ultimately sharing in the resulting cost saving due to the increase in market efficiency ANS export would engender.

In any event, the purpose of this brief discussion is to examine the revenue implications for the State of Alaska and no attempt is made to evaluate the benefits, costs and redistributive consequences of removal of the export ban.

In order to estimate the State revenue impact of ANS export, the three following basic questions are addressed:

1. What transportation cost savings would be realized?
2. How much oil would be shipped?
3. What price would ANS sell for in Japan?

Transportation Cost Savings

To start with, it is not certain whether exported ANS would be shipped in foreign or American Flag tankers. If either some, or all, oil is shipped in American flag or "Jones Act" tankers, cost savings will be less owing to the higher operating costs of these tankers. Allowing export also raises questions about the impacts on the domestic tanker market.

The number of domestic tankers needed naturally depends both on the conditions of export and on the amount shipped. The export of ANS would require, in aggregate, fewer ton miles of transportation service to move Alaska crude to market since the route to Japan is much shorter than to the Gulf Coast of the United States. This will tend to reduce tanker demand domestically. As a result, newly idled tankers would presumably increase the competition for carriage of domestic oil, thus tending to lower rates to all markets, including the Gulf. It should be mentioned at this point that it is also not clear what impact, if any, the opening up of the Japanese market would have on the domestic oil market. In particular, West coast refiners would in a sense be bidding against the Japanese for ANS. The magnitude of the effect on price would depend on the cost of alternative imported crude oils. Owing to the lack of empirical evidence on the relevant supply and demand elasticities, no attempt is made to incorporate these "pecuniary externalities" into the cost savings estimates or higher wellhead values due to impacts on domestic crude oil prices.

Finally, from the oil producers point of view there will be major up front costs to ship to the Japanese market, including the renegotiation of transportation commitments to serve the new market. Company marketing flexibility is also somewhat limited owing to current long term commitments to the Trans Panama pipeline and existing tanker chartering agreements. These costs are not considered explicitly in the analysis but hopefully are reflected in export volume scenarios.

How Much Would Be Shipped

This is not an easy question to answer since it will depend on a number of factors already alluded to. Simply stated, it will depend on the price the Japanese are willing to pay, which in turn depends on the price of alternative world crude oils, the amount the companies are willing to sell, and whether Alaska would opt to sell its in-kind royalty oil to Japan.

Given the domestic tax environment (particularly the Windfall Profits Tax) and the generally high price of imported crude oil, it could be expected that integrated producer refiners on the West Coast would desire to export

only those amounts of ANS in excess of their current refining needs. Gulf refiner-producers of ANS would presumably just as soon swap and sell to Japan any ANS surplus to West Coast needs, saving the transportation cost to the Gulf. The State of Alaska currently receives royalty income from North Slope production, roughly 200 thousand bbls/day, some of which could readily be available for sale in the Japanese market. Political considerations with respect to in state use would be the main facet of this potential source of export.

Currently, prices of internationally traded crude oil are somewhat higher than the average delivered West Coast and Gulf price of ANS crude oil. Short of a major international price war, or the implementation of an import fee on foreign crude entering the U.S., domestic U.S. crude oil prices should bear a close resemblance to world crude oil prices since the U.S. is the major international "free world" market. Hence, it is unlikely that in order to sell to Japan at a competitive price the transportation cost savings would be negated as a result of Japanese price far lower than the U.S. delivered price.

ANS Sale Price in Japan

To answer this question we would need to know the ability of the Japanese refinery sector to process ANS and the current requirements of Japan for crude oil vis-a-vis existing contracts with other crude oil exporting countries. Most likely Japan would not mind dropping recent contracts with Iran, given the high costs of dealing with that particular country. Whether there would be substantial quality discounts for ANS compared to say Iranian or other international sources of crude oil, is again related to Japan's refining industry configuration.

REVENUE SENSITIVITY ANALYSIS

In order to examine potential State revenue impacts, three basic scenarios for State royalty oil are examined. The first calculation examines the impacts of Alaskan in-kind royalty sales alone. The second estimates the incremental impact on in-value royalties and severance tax collections resulting from producer sales. The third scenario of royalty disposition calculates revenue impacts for in-kind sales of 100 thousand bbls/day and further sales by ANS producers resulting in additional in-value royalty payments and severance tax collections.

The revenue impacts for each scenario are determined by further assumption about transportation cost savings and the sales price of ANS in the Japanese market.

Calculation of Transportation Cost Savings

In order to make this calculation, assumptions must be made about the cost of shipping crude oil from Valdez to Japan. This cost can then be compared to the cost of current shipments from Valdez to the U.S. Gulf.

Table A
Representative Tanker Cost
Valdez to Yokohama/U.S. Gulf

	<u>Valdez to Yokohama</u>	<u>Valdez to U.S. Gulf</u>	<u>Tanker Cost Savings Japan vs. U.S. Gulf</u>
Foreign Tanker	\$.62/bbl ¹	----	\$3.89/bbl
Jones Act Tanker	\$1.95/bbl ²	\$4.52/bbl ³	\$2.57/bbl
50% Jones Act Tanker	\$1.29/bbl	----	\$3.23/bbl

Increase in Wellhead Value ANS

In order to calculate the revenue impact of the export of ANS to Japan assumptions must be not only about transportation cost savings but also about the selling price of ANS in Japan. Three alternatives are assumed:

- A. ANS price = delivered price Iran Heavy
at Japan light to Japan
= \$28.25/bbl (March 1983)
- B. ANS price = ANS price
at Japan at U.S. Gulf
= \$27.00/bbl (March 1983)
- C. ANS price = ANS price
at Japan at U.S. Gulf less \$1.00/bbl

For reference, price A represents a premium case, the price B represents a neutral case, price C represents a discount case which could be interpreted as reflecting the imposition of an import fee on crude oil into the U.S.

-
- ¹ Foreign Tanker rate is for Long Range 2 tankers July 1982 World Scale and September 1982 AFRA index for Kenai to Yokohama (export of LNG Alaska to Japan.)
 - ² American Flag Tanker rate Valdez to Yokohama.
 - ³ Average reported transportation cost to U.S. Gulf by producers of Alaska North Slope crude for State severance tax purposes.

Table B illustrates the net increase in ANS wellhead price combining the tanker cost savings shown in Table A with the price assumptions made about the selling price of ANS in Japan.

Table B

Net Increase Value ANS Wellhead (\$/bbl)

<u>Tanker Alternative</u>	<u>Price Premium</u>	<u>Price Neutral</u>	<u>Price Discount</u>
Foreign	\$5.14/bbl	\$3.89/bbl	\$2.89/bbl
Jones Act	3.82/bbl	2.57/bbl	1.57/bbl
50% Jones Act	4.48/bbl	3.23/bbl	2.23/bbl

Case 1 - State Revenue from Sale of State In-Kind Royalty Crude Oil to Japan.

A key assumption from the standpoint of State of Alaska revenue impact is whether the State takes an active role in marketing its royalty share to Japan. The following table illustrates the revenue impacts if the State sold varying amounts of its current 200 thousand bbls/day production share of ANS to Japan.

Table C

State Revenue From the Sale of Alaska Royalty
Crude Oil to Japan (Millions \$/year)

	<u>Tanker Alternative</u>	<u>Volume Sold</u>	
		<u>100 Mb/d</u>	<u>200 Mb/d</u>
Price Premium:	Foreign Flag	\$187.61	\$375.22
	Jones Act	139.43	278.86
	50% Jones Act	163.52	327.04
Price Neutral:	Foreign Flag	\$141.99	\$283.98
	Jones Act	93.81	187.62
	50% Jones Act	117.90	235.80
Price Discount:	Foreign Flag	\$105.49	\$210.98
	Jones Act	57.31	114.62
	50% Jones Act	81.40	162.80

Case 2 - State revenue From In-Value Royalties & Severance Tax Assuming Producer Sales to Japan.

An alternative case would presume that the State sells none of its royalty directly to Japan but the producing companies do sell and the State collects increased in-value royalties and severance taxes. This case is illustrated in Table D.

Table D
State Revenue Impact From Producer
Sales of Crude Oil to Japan (Millions \$/year)

	<u>Tanker Alternative</u>	<u>Volume Sold</u>		
		<u>100 Mb/d</u>	<u>200 Mb/d</u>	<u>500 Mb/d</u>
Price Premium:	Foreign Flag	\$ 47.83	\$ 95.66	\$239.14
	Jones Act	35.55	71.09	177.75
	50% Jones Act	41.69	83.37	208.44
Price Neutral:	Foreign Flag	\$ 36.20	\$ 72.40	\$181.00
	Jones Act	23.91	47.82	119.55
	50% Jones Act	30.06	60.12	150.30
Price Discount:	Foreign Flag	\$ 26.89	\$ 53.78	\$134.45
	Jones Act	14.61	29.22	73.05
	50% Jones Act	20.75	41.50	103.75

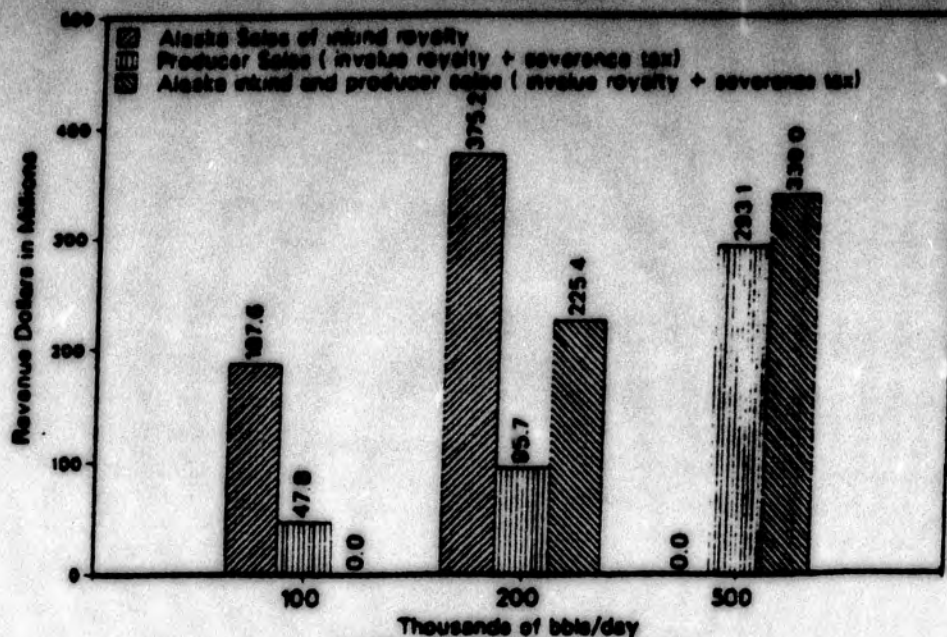
Case 3 - State Revenue From 100 Thousand bbls/day In-Kind Sales and Additional Producer Sales to Japan.

The final case illustrated involves both sales of 100 thousand bbls/day of Alaska royalty crude directly to Japan and sales of company owned crude.

Table E
State Revenue Impact from Sales of
Both Royalty In-Kind (100 Mb/d) and Company
Owned Crude Oil to Japan

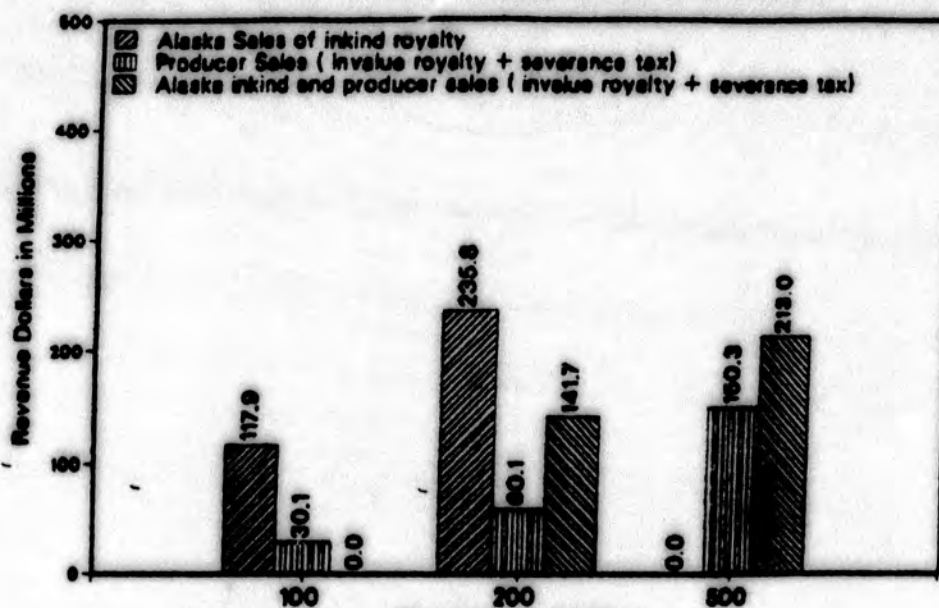
	<u>Tanker Alternative</u>	<u>Total Volume Sold</u>	
		<u>100 Mb/d</u>	<u>200 Mb/d</u>
Price Premium:	Foreign Flag	\$225.45	\$338.97
	Jones Act	167.55	251.92
	50% Jones Act	196.50	295.44
Price Neutral:	Foreign Flag	\$170.62	\$256.54
	Jones Act	112.72	169.48
	50% Jones Act	141.67	213.01
Price Discount:	Foreign Flag	\$126.76	\$190.59
	Jones Act	68.86	103.54
	50% Jones Act	97.81	147.06

The following bar charts illustrate in summary form the information contained in the previous tables. The Low Revenue Case assumes that ANS is shipped to Japan in Jones Act Tankers and sells for a \$1.00/bbl discount in Japan relative to what it would sell for at the U.S. Gulf. The Medium Revenue Case assumes that ANS is shipped to Japan 50% in Jones Act tankers and 50% in foreign tankers and sells for the same price it would fetch in the U.S. Gulf. The High Revenue Case assumes ANS is shipped to Japan in foreign tankers and sells at the same price as delivered Iranian Heavy (currently a \$1.00/bbl premium over U.S. Gulf price).



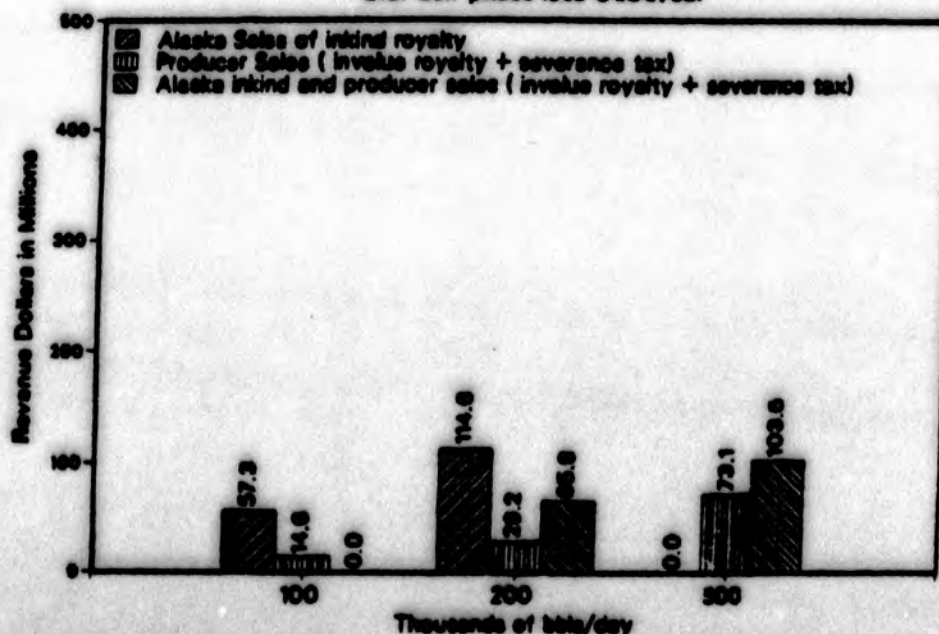
MEDIUM REVENUE CASE

50% Jones act tankers, ANS price = U.S. Gulf price



LOW REVENUE CASE

Jones act tankers, ANS price = March 1983
U.S. Gulf prices less \$1.00/bbl



Summary and Conclusions

The foregoing analysis suggest that under a wide range of assumptions the State of Alaska would enjoy revenue increases should the current ban on exports of ANS be removed. Though the impact illustrated ranges between \$10 and \$500 million per year, given the current market situation, the current commitments of the companies to the Trans Panama pipeline and currently uncommitted Alaska royalty crude, the best guess revenue impact would probably be about \$50 to \$100 million per year.

The export of ANS would offer the following benefits:

1. It improves our balance of trade.
2. It helps balance the federal budget by dipping into Japanese pockets rather than the U.S. citizen's pockets.
3. It improves revenues to North Slope producers and makes increased North Slope development even more attractive.
4. It increases State of Alaska revenues.
5. It puts increased pressure on OPEC to lower their prices.

However, the parties negatively impacted by such a change in national policy are probably politically powerful enough to block any move to allow export of ANS crude oil.

Gregg Erickson

THE EXPORT OF ALASKA CRUDE OIL
ITS SIGNIFICANCE FOR
PACIFIC BASIN PETROLEUM TRADE

by
Samuel A. Van Vactor and Arlon R. Tussing

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**Prepared for the
International Association of Energy Economists
Annual Meeting
Tokyo, 4-6 June 1986**

Introduction

The collapse of world oil prices is a catastrophic blow to crude-oil producers, but it will be a boon to international trade. Lower prices will have two distinct effects. Firstly, substantially lower petroleum product prices will stimulate energy demand. In turn, most energy-demand growth will be met by imported oil, which will be the least costly fuel at the margin for most applications in most markets. Refineries in oil-exporting countries will finally become profitable and will intensify global competition in petroleum-product markets.

Secondly, lower prices and abatement of fears concerning future energy shortages will enhance the incentives for oil-consuming nations to relax trade barriers for crude oil and petroleum products. The result will be a reduction in both transport and processing costs and a gain in economic efficiency. With lower prices, the waste entailed by oil-export restrictions in the United States and Canada will be economically, and hence politically, intolerable. The shift in North American policies will have an impact on petroleum trade throughout the Pacific Basin.

If the United States allows Alaska crude oil to be exported, higher West Coast prices will provide an incentive to export Alberta crude to the state of Washington. Light low-sulfur import crudes from Indonesia and other Pacific Rim countries will find a viable market in California.

Trade in petroleum products will increase. The U.S. will increase its export of high-sulfur fuel oil and increase imports of gasoline and other light fuels.

Significance of World Oil-Market Conditions

Fundamental supply-demand conditions in the world oil market are consistent with price swings as low as \$5 per barrel and as high as \$25 (in 1986 U.S. dollars) over the next decade. But it is Saudi Arabia's market share that will determine whether average prices will settle toward the high or low end of this scale. If the demand for Saudi oil is low relative to the Kingdom's revenue needs, the Saudis will be forced to compete with other oil suppliers rather than with suppliers of other fuels. The world's oil producers may find themselves in a similar situation to U.S. natural-gas producers who, in the last few years, have been faced with "gas-to-gas" competition because their product has been abundant enough to drive rival energy forms (chiefly heavy fuel oil) from ready fuel-switching markets. Under certain conditions, "oil-on-oil" competition could last for a decade. Sooner or later, however, because Middle Eastern oil has a lower marginal development and delivery cost than almost any other energy source (including oil produced elsewhere), the Saudis will regain their position as swing producer.

When there is significant demand for its crude oil, Saudi Arabia will set its price by focusing on the B-fuels market¹, where gas, oil and

1. We use the term B-fuels market as short for those uses that are variously tagged as "bulk-fuels", "boiler-fuels", or "black fuels". It refers to fuels uses in which the object of demand is calories as such, and in which residual and other heavy fuel oils actively compete with coal, natural gas, and other energy sources. In the United States, these markets are most often referred to as boiler-fuel markets, although the uses in question comprise extend much further than the raising of steam for electrical generation and other industrial purpose, to include distillation of a host of substances, melting and drying of bulk materials, metallurgy and other large-scale industrial process heat. A decade ago in Europe, it was fashionable to call these uses the black fuels markets, but supplies are no longer confined to coal and heavy fuel oil, but include natural gas, uranium, municipal waste, and vegetation. For those who prefer to use whole words, bulk fuels is probably the most accurate term.

coal compete. Put another way, the marginal supplier of energy to the world will base its price on the marginal uses of energy and the marginal development costs of fuels competing in that market. The Saudis have almost no economic incentive to limit production or restrain development of their fields, because their oil will never be worth much more than the value of substitute B-fuels.

As late as 1972, the major oil companies forecast Saudi crude oil production of 20 million barrels per day. Such an output is still possible, and the investment required to arrive at that level of production is an order of magnitude less than the cost to consuming nations of providing a similar increment in primary-energy supply from other resources. It is a good bet that the Saudis now realize that higher levels of capacity should have been installed in the mid-1970s, in order to prevent the price runups of 1979 and 1980 (which they themselves wittingly or unwittingly engineered by holding back on production). In short, Saudi Arabia has both the incentive and the ability to meet the world's incremental energy demand through the rest of this century.

Saudi Arabia will price its energy just below the costs of its closest competitors. In the short-run the competition is other sources of oil, plus natural gas in North America and Europe, where the long-distance transmission infrastructure is more than adequate to meet current demand. In the longer-run the competition is from coal and new natural gas supplies (including the substantial cost of adding new transport capacity).

In our view, oil prices are most likely to range between \$10 to \$15 through the early 1990s. It is important to note, however, that as long as the crude market is driven by netback sales arrangements, crude-oil prices are going to fluctuate sufficiently that periodic excursions below \$10 or above \$15 should not be surprising. In other words, seasonal demand swings and the moods of traders and speculators will have a more profound influence on crude-oil pricing patterns than in the past. This volatility in itself will promote trade, as brokers, importers and refiners adjust inventories to take advantage of seasonally and randomly cycling prices.

The West Coast Oil Surplus

The Prudhoe Bay oilfield was discovered in 1968. Its 9.6-billion barrels of proved reserves were a dramatic addition to the U.S. total. Until that time, West Coast oil reserves were only about 15 percent of the national inventory; with the determination that Prudhoe Bay was a commercial discovery, they came to account for 40 percent.

In subsequent years, the delay in completing the Trans-Alaska Pipeline System (TAPS) kept West Coast reserves from declining at the same proportionate rate as those East of the Rockies. In addition, the development of other giant crude-oil fields in Arctic Alaska (for example, the Kuparuk, Lisburne, and Endicott), the discovery of the offshore Santa Maria field near Santa Barbara, and the progress in thermally enhanced oil recovery (TEOR) for heavy California crudes has focused national attention on West Coast oil resources. One major oil company estimates that three-quarters of all the reserves yet to be developed in the United States will be in California and Alaska.

In short, the development of West Coast oil supplies has strategic implications. This has an important bearing on the regulatory environment likely to be faced by California and Alaska oil producers, since investments in future production are now threatened by the collapse in prices.

Since January 1981, when the U.S. system of oil-price controls was terminated, most oil markets have developed a structure in which crude-oil price differentials are a rational function of quality and transportation costs. The most glaring remaining anomaly in North America stems from the U.S. federal prohibition on crude-oil exports. While this regulation affects every domestic oil producer, it is only on the West Coast that it has an important economic impact.

The discovery at Prudhoe Bay stirred a vehement debate over how and where the oil should be shipped. The industry experimented with icebreaking tankers, but finally concluded that overland pipelines were the only practical transport means. Congress had to authorize construction of the pipeline since it crossed federal lands and required a wider right-of-way than permitted under existing law. West Coast

conservationists, concerned about environmental damage from marine crude-oil spills, wanted to prevent tanker movements along their shores, while Congressmen from the Midwest wanted a pipeline to go through Canada into the Chicago area. All parties acknowledged that such an overland pipeline would have lower unit transport costs in the long run, but its initial capital cost would have been considerably higher, and the industry balked. The North Slope producers preferred to ship the oil to a deepwater port on the south coast of Alaska, where it could be sent by tanker to Puget Sound, California and other markets.

Some members of Congress feared that the export of Alaska oil to Japan, Korea and other Asian countries would disadvantage U.S. refineries and its Merchant Marine. Spite from midwesterners deprived of their own pipeline link and from conservationists resentful of legislation that bypassed the newly enacted National Environmental Policy Act, joined with the protectionist interests to enact a prohibition of such exports in the Trans-Alaska Pipeline Authorization Act of 1973. Congress extended the prohibition to all domestically produced crude oil in 1979 amendments to the Export Administration Act.

The impact of this federal legislation is clearly evident in U.S. supply and distribution statistics as well as in the pricing of Alaska and California crude oil. Since TAPS was completed in 1977, the West Coast has had surplus crude-oil production. This situation is illustrated in Figure 1. Until then, there was net flow of petroleum products from other regions. Following the attachment of Alaska North Slope crude oil (ANS), however, the flow reversed and region became a net shipper of crude oil and petroleum products to other states.

The impact of this surplus on the pricing of California and Alaska crude oil is best illustrated using posted prices from California. The pricing of Alaska crude oil is complex, since each producer has a different methodology and only average prices are publicly available. However, there is good reason to believe that ANS sold on the West Coast fetches prices of up to \$5 less than the same crude oil sold in the Gulf Coast. California crude-oil prices are also about \$5 less than their counterparts in Texas and Louisiana.

Thousands of
Barrels per Day

Figure 1
The West Coast Oil Surplus

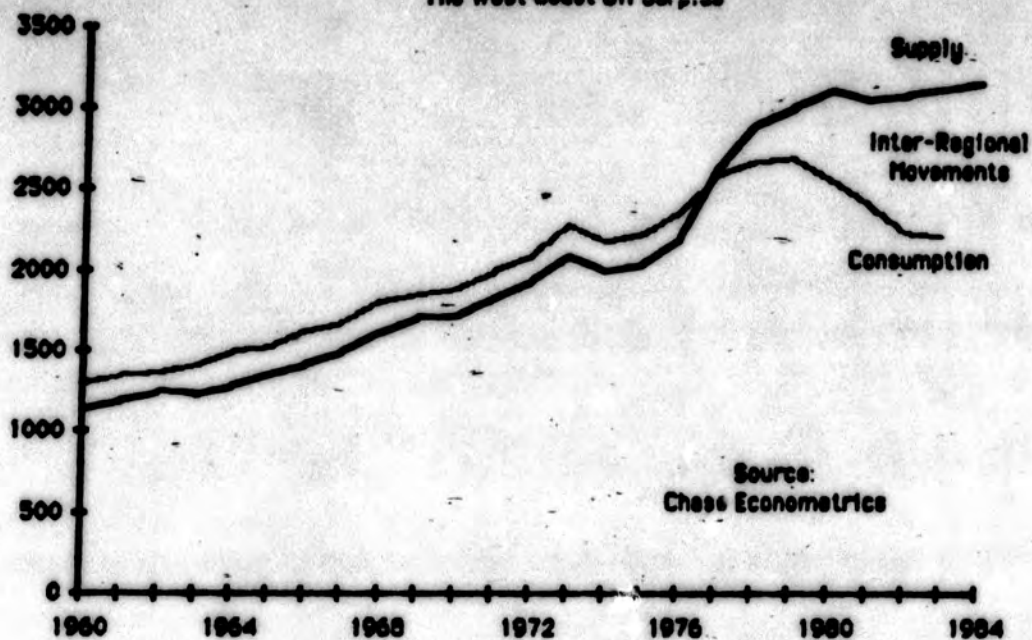
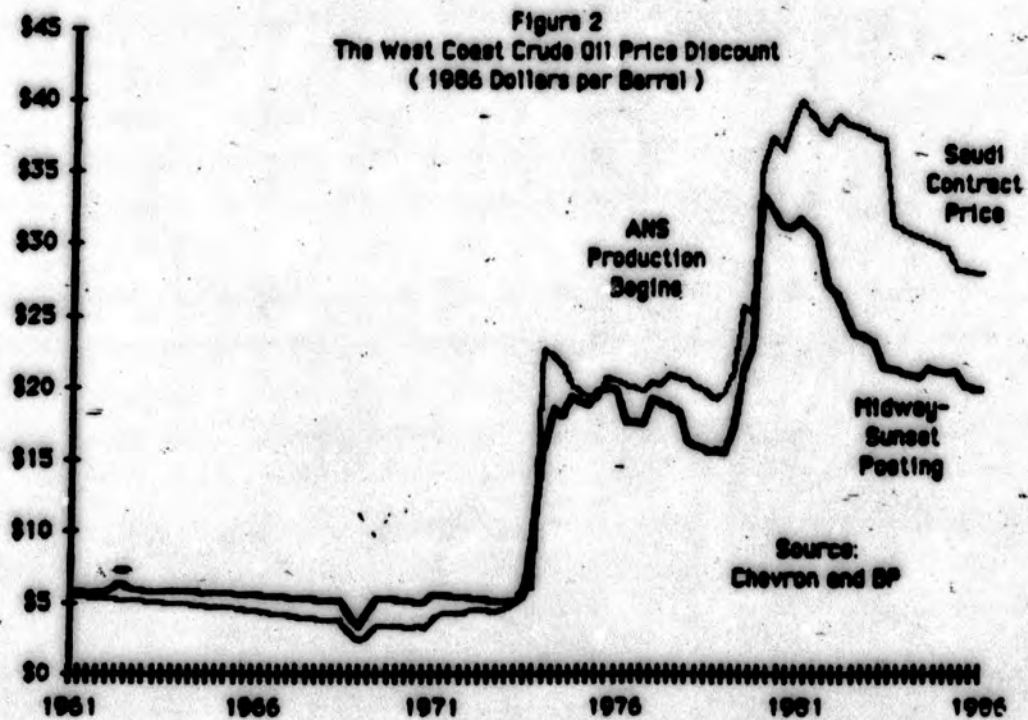


Figure 2
The West Coast Crude Oil Price Discount
(1986 Dollars per Barrel)



The West Coast "discount" is illustrated in Figure 2, where a heavy crude oil from the Midway-Sunset field in California's San Joaquin valley is compared to the official price of Arab Light. Three distinct periods are evident in the chart. From 1961 to 1972, the Mandatory Oil Import Program (MOIP) stabilized domestic prices above the world level. During the period from 1972 to 1976 price controls were in effect for domestic crude-oil production. The prices illustrated here are for the small volumes of uncontrolled production, however, and their movements closely track those of Arab Light. After 1976, however, the prices diverge: Uncontrolled California crude-oil prices are severely depressed. This shift reflects a combination of two influences --- the impact of surplus ANS and the weak market for heavy crude oil that prevailed during much of that period.

The Impact of \$10 to \$15 Crude Oil

The recent drop in crude-oil prices is going to have its most significant volumetric impact in the U.S. West Coast market. The Federal ban on exports requires Alaska and California producers to sell into the depressed West Coast market or ship their crude to the Gulf or East Coast of the U.S., using high-cost domestic tankers.

When world market levels were on the \$30 per barrel, West Coast producers and governments (qua landowners and tax-collectors) were willing to tolerate depressed prices and high transport costs, relative to other producing regions. But at the new price level, much of California's heavy crude-oil production will be uneconomic, and further investment in Arctic Alaska is unlikely. Unless the regulations are changed, therefore, by 1990 crude oil production in Alaska and California is likely to be on the order of one million barrels per day less than they otherwise would have been.

Shrinking production will have an impact on Congress in a way that no lobby, including the ones funded by the U.S. Merchant Marine, can offset. The concern flows from the rapid decline that is in prospect for established Alaska and California production absent new investment; the TEOR projects in the San Joaquin basin, offshore production at Santa Maria crudes, and further development of several giant fields

on the North Slope of Alaska; depend on the maintenance of netback prices substantially exceeding three or four dollars per barrel.

Heavy crude-oil production, particularly from mature fields, is expensive. It requires fuel to generate steam and electricity to pump crude oil, as well as a constant infusion of cash for cleaning and mechanical maintenance. If light crude oil settles between \$10 to \$15 per barrel in Texas, prices for heavy California crudes might range between \$2 and \$7, as long as the West Coast crude market remains in surplus. These prices are well below the average costs incurred by most California TEOR producers. Wells will be shut in rather than maintained, and crude oil production will decline. California production is likely to decline about 10 percent per year, dropping one-half million barrel per day within five years.

The Santa Maria basin offshore California contains the largest U.S. oil find of the past decade. Industry anticipated that this and other California offshore fields could produce up to one-half million barrels per day by the end of this decade. The crude, however, is "heavy" and "sour" --- low gravity and high sulfur --- and hence of low refining value. It is also very expensive to develop. As long as there is a West Coast price discount and world oil prices are less than \$15 per barrel, the planned development is unlikely to proceed.

Crude oil from Alaska's North Slope is even more disadvantaged than California production. The TAPS tariff for shipment across Alaska is now about \$6 per barrel. Then, the crude must be shipped from Valdez at a charge of \$1 to \$2 per barrel to the West Coast or Japan and \$5 or more to the U.S. Gulf Coast. Since export to East Asia is prohibited and the West Coast market is depressed, a North Slope investor (other than one already holding unutilized capacity on TAPS) faces a transport outlay of at least \$11 to move his crude to a viable market. As long as world oil prices fluctuate between \$10 and \$15, therefore, no company will take the risk of such an investment.

Abundant resources of crude oil have been identified on the North Slope, which can be developed for less than \$10 per barrel, net of transport costs, but at current prices such development is uneconomic. The Prudhoe Bay field will begin to decline in 1987, and by the early 1990s

there will be considerable space on the TAPS pipeline. Enhancement of crude-oil from Prudhoe Bay, stepout and infill development of Kuparuk and Milne Point, the opening of production in the Lisburne and Endicott formations, discoveries at Point Thomson and Seal Island, and the prodigious heavy cretaceous deposits at West Sak and Ugnu, are likely to be developed, only if their product can be moved to market at a cost substantially lower than refinery value. This result is unattainable without a relaxation of the export ban, and perhaps further reductions in TAPS transport tolls.

Without a shift in U.S. regulations, further development of Alaska's North Slope must await substantial increases in real oil prices that are not now in prospect. After 1987, production will begin to decline, dropping almost one-half million barrels per day by the mid-1990s.

Implications of Declining West Coast Supplies

Almost one-half of U.S. oil reserves are located in California and Alaska. Compared to production elsewhere, however, West Coast reserves are expensive to produce or transport and expensive to develop. When wellhead prices were more than \$20 per barrel, inefficient federal regulations hardly mattered: a \$5-per-barrel discount would be unlikely to prevent investment. Now, however, \$5 makes a great deal of difference and it is likely that the federal policy will change.

The Reagan administration's avowed policy is to reduce trade barriers and, particularly, to shrink regulation in the energy industries; there has already been considerable progress in this direction. In 1983, the Department of Commerce revised its regulations to allow the export of petroleum products. Since then there has been lively trade in heavy fuel oil from the West Coast to East-Asian markets. In late 1985, federal regulations were again revised concerning the export of Cook Inlet crude oil from Alaska, and a dribble of such exports began in January, 1986.

President Reagan can permit ANS exports by regulation, but either house of Congress can block such a move. The expiration of the Export Administration Act might have eased Congressional restrictions, but it was renewed in 1985. Thus, the export of ANS has a substantial hurdle to overcome.

When Alaska oil was selling at delivered prices of \$34 per barrel, as it was in 1981, or even at its mid-1985 price of nearly of \$27, it was impossible to arouse much public or Congressional concern over a transfer which, after all, affected some of the "deepest pockets" in the nation. Even after deducting the inflated transportation costs of (say) \$11 per barrel, the amounts left to be divided among the beneficiaries --- principally the North Slope producers, the State of Alaska, and the federal treasury --- were stupendous. So long as oil prices remained near all-time highs, therefore, it is hardly conceivable that economic-efficiency arguments for freer trade would make much way against the combination of xenophobia, spite, and generous campaign contributions by U.S. shipbuilders, shipowners, and maritime unions.

Congress will, however, respond to the concerns of Western states and the petroleum industry when oil production begins to decline. It will be forced to respond for the simple reason that the decline has a substantial impact on federal revenue. While a variety of measures, such as crude-oil tariffs and gasoline taxes, are under consideration the least complicated way to enhance federal revenues from the energy industries is to liberalize trade. Every other measure has a major impact on consumers and creates a host of technical problems.

The Impact on Pacific Basin Trade

Canada now has a crude-oil surplus and a nearly empty crude oil pipeline from Edmonton to Puget Sound. Exports were choked off in the mid-1970s because Ottawa feared long-term shortages in the Eastern provinces if Canada's Western reserves were not dedicated solely to domestic use. Alberta crude oil flowing to the state of Washington was replaced by ANS and OPEC crudes. Despite the fact that restrictions on export have been eased, Alberta crude cannot compete with Alaska oil because of the West Coast discount. On the other hand, if ANS is exported, its price to Puget Sound refineries will rise, Alberta crude will become competitive and Canadian crude-oil exports will increase.

Similar adjustments are likely in the California refinery sector. The drop in crude oil prices has made heavy fuel oil once again competitive with gas as electric-utility and industrial fuel. California, how-

ever, prohibits the burning of high-sulfur fuel oil, and there is almost no California or Alaska crude that yields a low-sulfur residuum. The best source of such feedstocks in the Pacific Basin is thus Indonesia.

If the West Coast price discount is eliminated, Indonesian and other low-sulfur imports (including Alberta crudes) will be competitive and can be used in California refineries. This development, in turn, will provide real competition to natural gas at the burner tip, and help rationalize all energy markets in the region.

Conclusion.

The ban on the export of Alaska crude oil is the most crucial impediment to Pacific Basin petroleum trade. It creates an inefficient pricing structure on the West Coast of North America, which distorts prices in surrounding petroleum markets. This prohibition remained in place for more than a decade because high oil prices obscured the inefficiencies it created. Over the coming year, however, the distortions and waste entailed by this policy will become more apparent, and as they come to light, the policy is likely to change.

Once the inhibition on exports of Alaska crude oil is removed, there will be a cascade of reactions that will substantially increase crude-oil and petroleum-product trade throughout the Pacific Basin.

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Shipping - stores and seal

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A Special Report to
The President and
The Congress

Shipping, Shipyards and Sealift:

Issues of National Security
and Federal Support 1985

National
Advisory
Committee on
Oceans and
Atmosphere

July 1985



**NATIONAL ADVISORY COMMITTEE
ON
OCEANS AND ATMOSPHERE**
3300 Whitehaven Street, N.W.
Washington, D.C. 20235

SEP 08 1986

To the President and the Members of the Congress:

As Chairman of the National Advisory Committee on Oceans and Atmosphere (NACOA), I am pleased to forward to you a copy of our report, "Shipping, Shipyards and Sealift: Issues of National Security and Federal Support." The conclusions reached and the recommendations made support current trends unlinking shipping from shipbuilding and advance several approaches for strengthening our Nation's sealift capability in the interests of national security.

Respectfully,

John E. Flipse
Chairman

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EXECUTIVE SUMMARY

Defining the Problem

The Nation's maritime policy, embodied in the Merchant Marine Acts of 1920 and 1936, as amended, has for over half a century provided Federal supports to the maritime industries to preserve in peacetime sufficient capacity to respond to a national defense emergency. It is increasingly clear that our maritime policy, and the package of protections derived from it—tax credits, loan guarantees, ship construction and operating subsidies, limited cargo preference, protected domestic trade (cabotage) and build-U.S. requirements—have had limited success in preserving a viable U.S.-flag fleet and merchant marine. The decline in the shipping and shipbuilding industries despite substantial government supports suggests the need to examine and define the national security requirements for each.

The United States has for some time been the world's largest trading nation with a dramatic increase from 130 million long tons of foreign trade in 1950 to 630 million in 1983. Carriage of foreign trade in U.S.-flag vessels has fallen from over half (by weight) at the end of World War II to less than 6 percent in 1983, but the declining role of U.S. shipping has not impeded the overall growth of the U.S. economy or our foreign trade. Indeed it can be argued that the decline of the high-cost, U.S.-flag fleet, and its supporting shipbuilding base, has had a net beneficial effect on the overall national economy. The economic arguments for Federal support of the maritime industries are thus less than conclusive, and the arguments have focussed increasingly on the national defense needs for U.S. shipping and shipyards.

The primary national requirements for the U.S. maritime industries are the national defense needs, during a conflict, for naval combatant ships to wage war at sea; adequate merchant sealift capacity to project military equipment and supplies overseas and concurrently provide critical shipping to support our economy; and sufficient shipyard capacity to support both. Sealift needs fall into three categories: floating prepositioned storage of supplies; rapid initial overseas deployment of forces, their equipment and supplies (large sealift); and long-term resupply of overseas forces (sustaining sealift). In addition, shipping assets would be needed for import of critical materials and some ordinary trade and for domestic waterborne

transport of critical materials, such as transport of strategic petroleum reserve oil to refineries.

Many experts are concerned that, in time of conflict, the Nation will need many more ships for combat and sealift—and more shipyards to activate, repair and replace them—than present natural economic forces will maintain in peacetime. NACOA has therefore defined the issues, for the purposes of this study on shipbuilding and sealift in the national defense context, as follows:

- What is the most effective and least costly way to ensure that adequate sealift capacity will be available in the timeframe required for a major modern conflict?
- What level of shipbuilding capacity would ensure an adequate base for mobilization and new ship construction and repair in a major conflict?
- To the extent that shipping and shipbuilding capacity is required, what level and type of Federal support are needed or appropriate?

The Scenario

Until recently, national sealift requirements were based on the scenario of a NATO/Warsaw Pact conflict requiring movement of U.S. troops and supplies across the North Atlantic to Europe. The changing balance of world economic and political forces resulting from the late 1960s discovery of massive oil reserves in the Middle East prompted U.S. military planners to begin focussing more attention on the Indian Ocean and the Southwest Asia region (the Middle East and Persian Gulf area). The current defense planning scenario, established by the Joint Chiefs of Staff, assumes that a major global conflict could begin in Southwest Asia, and spread to Europe, Northeast Asia (especially Korea) and three oceans. It is a worst-case scenario in terms of the requirements it generates—a prolonged (3-year), non-nuclear, global conflict, waged in three theatres, with two major periods of sea battle.

Military strategists conclude that a modern global conflict would have to be fought with Naval and sealift vessels already built during peacetime; NACOA concurs with this conclusion. Unlike the beginnings of World War II, where the United Kingdom held off the aggressor for several years while the United States prepared for war, a modern global conflict would almost

certainly mean immediate U.S. involvement, and the increased distance required for sealift of supplies adds severe time constraints. These considerations have prompted serious reappraisal of the status of, and requirements for, the Nation's sealift assets.

Maritime Industry Status

The continued decline in both the shipping and shipbuilding industries in this country has raised increasing national defense concerns.

Although the United States has one of the largest shipbuilding industries in the world, devoted almost solely to naval programs at this time, it ranks only 10th among commercial shipbuilding nations worldwide with less than two percent of the world's commercial ship orderbook. Largely because of differences in national standards of living, the world shipbuilding market, as with other heavy industry, is moving generally from the United States and Europe to the Orient, and from developed to developing nations. The U.S. shipbuilding industry has long been unable to compete with foreign yards. Virtually all of the merchant vessels built in U.S. yards in the past decade have been built either with Federal subsidy or for protected domestic trades, but recent changes in Federal maritime support programs and depressed economic conditions have all but halted this commercial ship construction. Three major shipyards have closed since 1982, and General Dynamics Corporation recently announced that its Quincy Shipbuilding Division, a major shipyard that has been in business for 101 years, will close in the spring or summer of 1986.

There are currently only 6 major U.S. shipping lines, carrying container cargo, down from 19 in 1970, and they are heavily dependent on government cargo reserved for U.S. ships. Almost all U.S.-flag bulk vessels operate in the domestic trades that are reserved for U.S. ships. In the domestic trades, however, trucks, railroads, pipelines, and tug/barges are replacing oceangoing, self-propelled cargo vessels. These developments threaten the viability of the domestic fleet, an important source of militarily useful tonnage and trained U.S. crews for meeting sealift demands in a national emergency.

There are currently less than 500 oceangoing vessels greater than 1,000 gross tons in the U.S.-flag fleet, and 105 U.S. shipyards capable of building or repairing vessels of this size. Except for the tremendous World War II peak, the U.S. shipyard employment base has risen fairly steadily over six decades despite the continued decline in the U.S.-flag fleet. Our longstanding national maritime policy appears to have done a better job of preserving our shipyard base than our U.S.-flag fleet.

Defense Requirements for Ships

The primary national defense requirement for the U.S. shipping and shipbuilding industries, beyond the peacetime carriage of government cargoes and peacetime building and repair of military vessels, is to provide increased sealift and Naval combatant capacity in case of national emergency. Sealift requirements would be similar for a global conflict and for a major U.S. action in Southwest Asia, because lift requirements for other areas would be provided by our allies. Sealift and shipyard requirements to support a major deployment to Southwest Asia have thus received great attention in recent years.

Since 1981, the Department of Defense has completed a comprehensive series of studies quantifying requirements for: prepositioning of supplies, airlift and sealift, delivery of liquid products, shipping needs at home during a global conflict, shipyard capacity for early mobilization (e.g., activating reserve ships) and shipyard capacity for wartime shipbuilding. These studies are all classified either "Secret" or "For Official Use Only;" NACOA has reviewed the entire series.

The 1981 "Congressionally Mandated Mobility Study" (CMMS) concludes that the United States requires an additional airlift capacity of about 20 million ton-miles per day, and recommends that this be supplemented by additional prepositioned supplies and more and faster sealift. The "DOD Sealift Study," completed in March 1984, concludes that the sealift capacity necessary to meet dry-bulk lift requirements for Southwest Asia is about 4.6 million deadweight tons of shipping capacity during the initial surge and about 3.3 million deadweight tons for sustaining resupply. Every militarily useful U.S.-flag private cargo vessel would be needed for sealift in a major overseas deployment, and projections of the future size of the fleet indicate a growing shortfall in U.S.-flag, dry-bulk sealift tonnage. Most of the U.S.-owned vessels under foreign flag are not now considered militarily useful. A companion study, called the "DOD Sealift Tanker Study," now nearing completion, will document a shortfall in militarily useful wet-bulk tonnage for sealift under U.S. ownership (U.S. and foreign flag).

The "Economic Security Shipping Study," recently completed by the Maritime Administration, addresses the shipping requirements for import and domestic transport of critical materials during wartime. The study concludes that there is no shortfall in container or breakbulk ship capacity, because most scheduled general cargo is nonessential in wartime. No shortfall in dry-bulk capacity is expected, since most critical bulk materials are required in small enough quantities to be taken from strategic stockpiles or imported by air. A shortfall is projected, however, in tanker capacity for domestic carriage of refined petroleum prod-

ucts, because the U.S.-flag tanker fleet would be required to support U.S. forces overseas.

Responding to the rapid decline of the U.S.-flag fleet, and increased readiness requirements imposed by the long-distance sealift routes in the new scenario, the Navy is rapidly improving the Nation's sealift capacity. More than \$1 billion a year for 5 years is planned for strategic sealift expenditures, more each year than was spent during all the years since World War II combined. The shortfall in dry cargo sealift is being addressed by increases in government-owned sealift vessels and increased funding for modifying commercial cargo vessels. The shortfall in wet-bulk sealift will probably be addressed by purchase of tankers for the Ready Reserve Force and further examination of alternatives such as foreign petroleum supply. The only projected shortfall in domestic shipping needs during a conflict is in tanker capacity for domestic petroleum carriage, but this could be alleviated by allowing foreign tank vessels (owned by U.S. citizens) to enter the protected Jones Act trade during a conflict. The cumulative effect of these approaches is greatly enhanced sealift capacity that is substantially more "ready."

Defense Requirements for Shipyards

The U.S. shipbuilding base must have sufficient "surge capacity" during early mobilization to activate the reserve combatant and sealift vessels and to convert active merchant vessels for sealift, and must expend quickly for battle damage repair of merchant and combatant ships and for new construction to replace vessels lost during a prolonged conflict.

Two joint studies by the Department of Defense and the Maritime Administration examine the shipyard capacity requirements. The "Shipyard Mobilization Base Study" (SYMBA) reviews the adequacy of the October 1982 shipbuilding base for a 3-year global conflict. The "National Defense Shipyard Study" (NADES) examines the adequacy, for the early mobilization stage of a conflict, of a much smaller shipyard base that is expected to survive the current decline and remain available in 1988-1990. The SYMBA Study concludes that an absolute minimum of facilities needed for the first year of conflict is 51 building positions, 41 graving docks and 56 floating drydocks; that shipyard facilities existing in October 1982 were more than adequate for a major mobilization; and that there might be temporary shortfalls in the number of skilled shipyard workers during early mobilization and later during wartime ship construction. The NADES Study uses different, and NACOA believes more realistic, assumptions about early mobilization and reflects the increased sealift readiness now planned by the Department of Defense. The NADES Study found that early mobilization would require initial availability of 142,000 skilled shipyard workers, peaking to 157,000

in the eighth month. The Department of the Navy concludes that peacetime employment, even in the smaller shipyard base projected for 1990, would be roughly adequate for early mobilization and facilities would be more than adequate for mobilization tasks.

An independent NACOA survey of shipyard surge capacity in the major defense contract yards suggests they are currently operating at only about half their full peacetime capacity in workers and steel fabrication, and only about a third of their capacity to finish new vessels. Our estimate of their wartime maximum capacity suggests a possible increase in ship production of 4 to 6 times greater than in today's underutilized shipbuilding base, without expansion of facilities.

Surge requirements for U.S. shipyards for a major mobilization have been lowered through several government initiatives: by increasing the amount of prepositioned military supplies, thus reducing the number of sealift ships needed; by building and converting a number of vessels under government control for sealift; by increasing the readiness of our reserve fleets, and thus reducing the shipyard work needed for activation; by relying more on conversion of existing commercial vessels than on wartime newbuilding of sealift vessels; and by planning more pre-mobilization work on commercial vessels in the active U.S.-flag fleet. NACOA concurs with the Department of Defense that a substantially reduced private U.S. shipbuilding base would be adequate to meet early mobilization needs required by the present scenario.

Alternatives

The range of solutions offered by public and private interests for solving the Nation's sealift problems fall into three broad categories:

- Preserving excess shipbuilding capacity through increased support for U.S. shipyards in peacetime, so that warships and sealift vessels can be activated, repaired and built during a major conflict.
- Increasing the government-controlled merchant fleet to have immediate and direct control of needed sealift assets during a major mobilization.
- Increasing the number and military readiness of privately owned sealift assets through measures to aid U.S. ship operators.

Our positions on several major proposals are as follows. We oppose a Federal shipbuilding program for new merchant vessels to be chartered or laid up in reserve fleets. We oppose a cargo preference scheme that would reserve a percentage of commercial cargos in U.S. foreign trade to U.S.-flag, U.S.-built vessels. We oppose a federally supported "Maritime Redevelopment Bank," that would use Federal funds to encourage financing for ship construction. We oppose any increased Federal supports to the U.S. shipbuilding industry, because the industry has overcapacity for the commercial market it serves, and the present

shipyard base is substantially in excess of the capacity needed for defense mobilization. We support more concerted efforts to increase the military usefulness of private merchant vessels and to increase the shipping tonnage in the active commercial U.S.-flag fleet. We favor increased use of private vessels as sealift assets rather than preserving excess shipbuilding capacity or increasing government control of sealift assets.

For the most part, NACOA opposes the range of proposals initiated largely in the Congress to preserve excess shipbuilding capacity; opposes further growth in the government-controlled active and reserve sealift fleets without fully exploring other alternatives; and supports a range of proposals from various sources, including our own deliberations, to increase the number and military usefulness of private vessels under U.S. control.

Conclusions and Recommendations

NACOA concludes the following:

- Sealift requirements for the initial stages of a modern major conflict depend more on the sufficiency of existing U.S.-controlled shipping and trained U.S. crews than on shipbuilding capacity. National efforts should therefore emphasize developing a viable Federal and commercial sealift fleet in peacetime.
- The United States now has a very large shipbuilding capacity, and the yards expected to survive the current decline will still have sufficient surge capacity to satisfy wartime needs as defined by current defense scenarios.
- Requirements to build in U.S. shipyards have impaired the competitiveness of U.S. operators of oceangoing, self-propelled cargo vessels, have contributed to the decline in the U.S.-flag fleet, and have failed in recent years to create substantial commercial work in U.S. shipyards.
- Most recent proposals to aid the U.S. shipbuilding industry—such as a federally funded merchant shipbuilding program, renewed construction subsidies, a federally backed maritime bank, and expanded cargo preference—are too small in scope to be of significant impact or would create larger problems.

NACOA recommends the following:

1. **OPPOSITION TO PROPOSALS FOR A FEDERAL SHIPBUILDING PROGRAM FOR COMMERCIAL SEALIFT VESSELS—OR ANY OTHER PROGRAM REQUIRING MAJOR FEDERAL FUNDING—DESIGNED TO PRESERVE THE PRESENT EXCESS CAPACITY IN THE SHIPBUILDING BASE.**

NACOA believes that all additional surge capacity required for mobilization currently exists within the yards doing Navy peacetime construction, and Navy and commercial repair work, and that this work will preserve an "irreducible minimum" shipbuilding base that will be adequate in future mobilization. This smaller shipbuilding base might initially be inadequate for wartime construction, but shipyard expansion would begin immediately and would continue as needed throughout the conflict. The Department of Defense studies allow virtually no geographic movement of skilled shipyard workers during mobilization, and we believe this is an unrealistic constraint. The major constraint on expansion of wartime shipbuilding would not be shipyard capacity, but delayed availability of major components, e.g., propulsion plants for Navy and merchant vessels, and complex weapons systems for combatant vessels; increases or decreases in the shipbuilding base would not affect this problem.

2. **DECREASED DEPENDENCE ON A GOVERNMENT-OWNED AND MAINTAINED READY RESERVE FORCE, AND REDUCED SIZE AND INCREASED READINESS OF THE RESERVE SEALIFT FLEETS.**

NACOA supports the approach of adapting modern, active commercial vessels to military purposes, because maintenance costs are borne by the operator in trade, the vessel provides training for U.S. crew, and the ship would have a ready crew if it were called up for service. In the long run, we believe this is a more efficient and less costly alternative than Federal building, acquiring or serving of an outmoded reserve fleet.

3. **CONTINUED EMPHASIS ON METHODS OF ADAPTING COMMERCIAL EFFICIENT VESSELS FOR MILITARY PURPOSES.**

Continued research is needed to develop cost-effective ways of adapting modern commercial vessels to military sealift needs. In addition, funding should be provided to do such conversion and activation work on U.S.-flag commercial ships during peacetime to enhance their readiness, reduce the shipyard conversion time required at mobilization, decrease the shipyard base required and decrease the need for expanded government-controlled sealift fleets.

4. **INCREASED EMPHASIS ON ENSURING THE AVAILABILITY, TRAINING AND READINESS OF U.S. CREWS NEEDED FOR MOBILIZATION OF RESERVE AND FOREIGN-FLAG SEALIFT VESSELS.**

Requirements for increased numbers of ready crews are being generated by the expanding size of the Ready Reserve Force, and increased reliance on U.S.-owned, foreign-flagged vessels. In addition, the greater readiness requirements for sealift vessels require better training and more rapid availability of crews to staff them.

**6. CONTINUED UNLINKING OF NATIONAL SHIP-
PING AND SHIPBUILDING POLICIES BY ELI-
MINATING ALL REQUIREMENTS FOR U.S.-
FLAG OPERATORS RECEIVING GOVERNMENT
SUPPORTS TO BUILD VESSELS IN U.S. SHIP-
YARDS.**

Specifically, we recommend that operators be allowed to use foreign-built vessels in the U.S. foreign trades and still be eligible for Capital Construction Fund tax deferral, Title XI Federal Ship Loan Guarantees, immediate access to government-impelled cargos and operating subsidy, preferably a new form of operating incentives we propose. (See recommendation #6.)

We believe the half century of requirements to build new vessels in high-cost U.S. shipyards has increased the capital and operating costs of the U.S. shipping industry, has discouraged modernization and expansion of the U.S.-flag fleet; and has contributed to the long-term decline of domestic and foreign waterborne trading opportunities for the U.S. fleet. We support permanent authority for U.S. shipowners to operate foreign-built vessels in the foreign trades while receiving Federal supports, to improve the competitive position, and thus the size and sealift capacity, of the U.S.-flag fleet.

**7. AMENDMENT OF CURRENT MARITIME STAT-
UTES THAT IMPAIR THE COMPETITIVENESS
OF U.S. VESSELS IN FOREIGN TRADE.**

Specifically, we recommend establishment of a new form of operating incentives linked to reductions in crew size and related operating costs; amendment of shipboard manning laws and regulations that prevent reductions in U.S. vessel crew size; and exemption of oceangoing cargo ships from paying duty on foreign

shipyard repairs. Federal supports must be designed to encourage decreases in U.S. operating costs. Crew size and other operating costs must be reduced if the U.S. fleet is to become competitive in the world market and grow to provide increased sealift assets under private control.

**8. INCREASED EMPHASIS ON INCENTIVES TO
ATTRACT FOREIGN-REGISTERED VESSELS—
UNDER U.S. OR FOREIGN OWNERSHIP—TO
THE U.S. FLAG.**

We propose a number of measures to encourage reflagging to the U.S. registry of vessels now under foreign registry. Even a small-scale reflagging would be desirable from a national defense standpoint, because these ships would provide work and training for U.S. crews, would be available for pre-mobilization installation of Sealift Enhancement Features, and would thus increase the sealift readiness of the U.S.-flag fleet.

**9. AMENDMENT OF THE JONES ACT TO ALLOW
SOME FOREIGN BUILDING OF NEW COMMER-
CIAL CARGO SHIPS FOR THE JONES ACT
DOMESTIC TRADE.**

We recommend a 10-year "coproduction" period, requiring building in U.S. shipyards in order to earn transferable credits for building in foreign yards. We suggest that these provisions be applicable only to large, oceangoing self-propelled, cargo-carrying ships that are capable of contributing to the Nation's sealift needs in case of a national emergency. This approach might stimulate a limited increase in commercial shipbuilding orders in U.S. yards, without Federal funding, and would expand and modernize the U.S.-flag, sealift capable cargo fleet.

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INTRODUCTION

In its January 1983 report, "Marine Transportation in the United States: Constraints and Opportunities," the National Advisory Committee on Oceans and Atmosphere (NACOA) presented a number of findings and recommendations concerning the U.S. shipbuilding industry. NACOA found that:

Congress and the Administration have continuously stressed that a U.S.-flag marine transportation system, with its supporting industrial base, is essential to our Nation's national security in peace and in times of emergency. Given this policy, NACOA concludes that the present levels of U.S.-flag participation in our trade and the supporting shipbuilding base are critically below that required to meet U.S. needs.

The Committee recommended prompt aid to U.S. shipyards and suggested government-backed low financing to attract foreign orders to U.S. yards, tax incentives for the yards to invest in productivity improvements, and government-assisted worker training programs. The report recommended that tax advantages for U.S. ship operators should continue to apply only for U.S.-built vessels and should not be expanded to encourage U.S. owners to build new vessels in foreign shipyards.

Of the many areas addressed in the 1983 NACOA report, the U.S. shipbuilding base appeared to have the most critical and immediate problems. A number of shipyards were reported to be facing imminent closure, and NACOA believed the situation was serious enough to warrant a follow-on study focussing on the problems of the shipbuilding industry and the possible national security implications. This study was begun in May of 1983.

For half a century, since passage of the Merchant Marine Act of 1936, the major justification for Federal supports for the shipping and shipbuilding industries has been their national defense utility. Consequently, we have reviewed the present Department of Defense (DOD) conflict scenario, mobilization plans, sealift needs and wartime economic shipping needs, available and projected sealift assets, ship activation requirements, wartime ship construction and repair needs, the consequent shipyard mobilization base required, and projections of decline in the shipyard base. The major classified documents on these subjects were made available to NACOA for review, and the Committee

held three classified sessions with officials of the intelligence community, the Department of Defense and the Maritime Administration. We also have considered the substantial recent changes in the Defense Department's assets for and approach to sealift and mobilization. At the same time, we considered numerous proposals designed to improve the Nation's sealift assets or to preserve its shipbuilding base or both. Based upon this expanded review, we have reaffirmed some conclusions from our earlier report on marine transportation, but we also have changed some of our previous recommendations.

Understanding the Scenario

Because of our Nation's geographic location—flanked by oceans on two sides and by the Gulf of Mexico to the south—virtually all of our allies are "overseas." This, coupled with a "forward" defense strategy based on keeping a conflict as far away as possible from our own borders, requires overseas projection of forces and their support by airlift and sealift.

Until recently, national sealift requirements were based on the scenario of a North Atlantic Treaty Organization (NATO)/Warsaw Pact conflict requiring movement of U.S. troops and supplies across the North Atlantic Ocean to Europe. No shortfalls in sealift capacity were foreseen for this scenario for several reasons despite a shrinking U.S.-flag fleet. Many troops and supplies are positioned in Europe. NATO allies have committed 400 merchant vessels to support a U.S. deployment in Europe. U.S.-owned, foreign-flagged vessels are considered to be available, and most (80 percent) carry NATO-nation officers and are largely crewed by foreign nationals from countries that have strong defense relationships with the United States—the Republic of South Korea, the Philippines and Taiwan (Yourch, 1985). Airlift, not sealift, had received primary attention and funding.

During the mid-1960s, the Soviet Union began to change its overall strategy from one of developing and defending its continental territory to one of aggressively extending its economic, political and military presence worldwide (Office of the Chief of Naval Operations, 1985). The discovery of massive oil resources in the Middle East in the late 1960s, and its

consequent effects on the balance of economic and political forces in the region and the world, prompted U.S. military planners to begin focussing more attention on the Indian Ocean and the Southwest Asia region.*

For several years, the U.S. Secretary of Defense, the Joint Chiefs of Staff and the military services have cooperated in studies called Strategic Mobility Requirements and Program (SMRP). The fiscal year 1982 SMRP focussed on the airlift and sealift requirements of a worldwide conflict centered in Europe between NATO and Warsaw Pact nations. SMRP-83 added an analysis of lift requirements for a unilateral U.S. military action in Southwest Asia. The Secretary of Defense directed that SMRP-84 planning be based on the possibility of a worldwide conflict centered in Southwest Asia as well as in the NATO/Warsaw Pact region (Office of the Chief of Naval Operations, 1985).

The Department of Defense quickly realized there would be difficulties responding to a military emergency in Southwest Asia: the distance for projection of forces is great; NATO support would not necessarily be forthcoming for limited U.S. actions; there are few defensible locations for land-based prepositioned supplies; and poor local infrastructure (ports, airstrips, roads) would require sealift of even more equipment for improvements. A Rapid Deployment Force (RDF) was established in 1981 in case of a crisis in this region, and its deployment needs focussed increased attention on the limits of available sealift. For a deployment to Southwest Asia, 95 percent of the supporting equipment and 99 percent of the fuel would go by sea. Yet, as late as fiscal year 1983, 97 percent of the mobility funding went to airlift and only 3 percent to sealift—almost a reverse proportion to the amount of lift each would be required to accomplish in a major mobilization of this kind (Congressional Budget Office, 1984).

What has emerged is a significantly changed approach to defense planning for a major conflict, with a new planning scenario established by the Joint Chiefs of Staff. It is a worst-case scenario in terms of the requirements it generates—a prolonged (3-year), non-nuclear, global conflict, waged in three theatres, with two major periods of sea battle. Continued emphasis is being placed on the requirements for an action in Southwest Asia, because lift requirements in the other two theatres are expected to be largely provided by our allies (U.S. Department of Defense, 1984). Because of this assumption, sealift requirements would be similar for a global conflict and for a unilateral major U.S. involvement in Southwest Asia.

A series of recently completed defense planning studies have addressed requirements for this same scenario; requirements have been quantified for troops, equipment and supplies, airlift, sealift and shipyard capacity. The studies dealing with sealift needs are discussed in Chapter 2 of this report, and those addressing requirements for a shipyard mobilization base—both for early mobilization and for a prolonged conflict—are examined in Chapter 3.

Defining the Problem

Since the founding of our Nation, the United States has, to some degree, protected our shipping and shipbuilding industries from foreign competition. An 1817 cabotage act reserved U.S. coastwise trade to U.S. vessels. Cabotage is generally understood as the trade or transport of merchandise by sea between two ports within the same country; it has also come to mean the practice of restricting such trade to ships registered within that country. Unlike many other maritime nations, the United States requires that vessels in the cabotage trade be not only registered, but built, in this country. The Merchant Marine Act of 1920, commonly known as the "Jones Act," reaffirmed this domestic trade reservation and has since remained basically unchanged. The pre-World War II Roosevelt Administration and the 1936 Merchant Marine Act stressed national defense arguments for protecting our maritime industries. During the five decades since, our national maritime policy has continued to support a strong U.S. fleet—U.S.-owned, built, manned and repaired. These requirements for U.S. ownership, construction in U.S. shipyards, and U.S. crews apply not only to vessels in our inland waterways and coastwise "Jones Act" trade but also to operation and construction subsidies established in the 1936 Merchant Marine Act for U.S. vessels in foreign trade, and for almost all subsequent loan guarantees and tax benefits that have been legislated for the maritime industries. Thus, U.S. ship operators and shipyards have long been linked, and the rationale for supporting both has largely been based on national security needs.

U.S. commercial ship construction costs have become two to three times higher than those reported in foreign yards and delivery times considerably longer. Questions have been raised in recent years about whether the many requirements to build in U.S. shipyards may not be imposing an unnecessary or unfair burden on the already ailing U.S. shipping industry by requiring U.S. shipowners, in effect, to support U.S. shipyards for the national interest.

The decline of both industries—despite substantial government subsidy, protection, tax advantages and other supports—suggests the need to examine and define the national security requirements for each.

* "Southwest Asia" is a geographic descriptor recently adopted by the Department of Defense to describe the Middle East and Persian Gulf area.

National security in this context is often understood to include two aspects. The first involves the overall economic health of the Nation, including such indicators as volume of foreign trade, trade deficit, gross national product, and the like. The second encompasses the Nation's defense needs; in the case of the maritime industries, these include shipping assets to carry military equipment and supplies overseas and to carry wartime imports of critical materials, and a shipbuilding base to activate and replace the sealift shipping, and to repair and build warships, as needed during a conflict.

In examining the economic impact of the shipbuilding industry, we find that the U.S. private shipbuilding and ship repair industry employs about 170,000, with gross industry revenues annually of about \$11 billion, representing less than 0.2 percent of the Nation's labor force, and in 1982 accounting for about 0.25 percent of the Nation's gross national product.* For comparison, the shipbuilding employment level represents about 70 percent as many workers as the motor vehicles industry and about 15 percent of the revenues of that industry (U.S. Department of Commerce, 1982). The U.S. shipping and shipbuilding industries are both capital and labor intensive, and largely unable to compete with lower foreign wage rates and major government supports provided in other shipbuilding nations. Import and export costs for U.S. business as a whole have been lowered through lower foreign-flag shipping costs. U.S. foreign trade has grown steadily and impressively since World War II, and the United States is now the major trading nation in the world. At the same time, however, there has been a precipitous decline in the percentage of this trade carried in U.S. vessels. Indeed, it can be argued that the decline of the high cost U.S.-flag fleet, and its supporting shipbuilding base, has had a net beneficial

* This employment figure excludes 78,500 workers in the Nation's nine public shipyards owned by the Navy and the Coast Guard; within the private sector it includes all workers employed in shipbuilding-related fields, including unskilled and administrative workers within the shipyards and also including related work such as ship design, consulting, etc. As such it is an economic indicator and not strictly representative of the emergency shipbuilding capacity available for a major conflict.

effect on the overall national economy. The economic arguments for Federal support of the maritime industries are thus less than conclusive, and the arguments have focussed increasingly on the national defense needs for U.S. shipping and shipyards.

The major national defense role for U.S. merchant ships is to provide national sealift capacity. With 40 of our 42 allies (Holloway, 1983) and about one-fourth of our land combat troops overseas (Tarpgaard, 1984), sealift capacity is an essential part of U.S. defense readiness. U.S. merchant vessels would be needed in a major or minor conflict to deliver military equipment and supplies overseas and to ensure the continuing import of critical materials to U.S. ports. These sealift vessels must be "in being," that is, already constructed before mobilization. And the U.S. shipbuilding base must have sufficient "surge capacity" to activate and convert available ships very quickly at the onset of a conflict—both reserve naval ships and reserve and commercial merchant ships for sealift. The shipbuilding base also must be sufficient to expand quickly enough to handle battle damage repair to merchant and combatant ships and to begin new construction to replace vessels lost during a prolonged conflict.

Many experts believe the Nation will need, in time of conflict, more ships for sealift and more shipyards to activate, repair and replace them than present natural economic forces will maintain in peacetime. Consequent proposals for Federal supports to the maritime industries abound. Because the national defense argument is so frequently used—but often not defined or quantified by those who use it—NACOA sought to review carefully the national defense needs for sealift and shipyard mobilization base.

NACOA has thus defined the issues, for the purposes of this study on shipbuilding and sealift in the national defense context, as follows:

- What is the most effective and least costly way to ensure that adequate sealift capacity will be available in the timeframe required for a major modern conflict?
- What level of shipbuilding capacity would ensure an adequate base for mobilization and new ship construction and repair in a major conflict?
- To the extent that shipping and shipbuilding capacity is required, what level and type of Federal support are needed or appropriate?

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CHAPTER 5

Summary, Conclusions and Recommendations

Summary

The Merchant Marine Act of 1936 clearly states that protecting U.S. shipping interests and preserving U.S. shipyards are national defense requirements. It is increasingly clear, however, that this national policy, and the package of protections derived from it—tax credits, loan guarantees, government-impelled cargo preference, cabotage, and build-U.S. requirements—have had limited success in preserving a viable U.S.-flag fleet and merchant marine. Increased ship size and faster turnaround times in port have preserved the carrying capacity of some parts of the U.S. fleet, particularly the containerships carrying "liner" cargo on scheduled trade routes, but the carriage of dry-bulk commodities in U.S. ships has almost disappeared, and the overall percentage of U.S. foreign trade carried today in U.S.-flag vessels has declined to only 6 percent. Owing to competitive costs from other modes of freight transportation, including oceangoing tug and barge, and especially owing to the cost of vessel replacement in U.S. yards, our domestic Jones Act fleet of ships is aging and shrinking.

Three major shipyards have closed in the past two years (Maryland Shipbuilding, American/Lorain and Savannah). In addition, General Dynamics Corporation has announced it will close its Quincy Shipyard in the spring or summer of 1986, and the Shipbuilders Council of America reports that several more major private shipyards are on the verge of closing. Despite many build-U.S. requirements dictated by law, no commercial oceangoing vessel orders were placed in U.S. shipyards in 1983, only five such ships were ordered in 1984, and no orders have been placed so far in 1985. The shipbuilding industry, at least as far as the major shipyards are concerned, is approaching a "monopsony," a situation where there is only one buyer in the market. The U.S. Navy generated almost 90 percent of the work in the major U.S. private shipyards in 1984. The "system" of laws and Federal programs related to marine transportation is not working. National defense arguments are increasingly used to justify retaining present Federal supports, which the Administration wishes to terminate, or for expanding Federal supports—especially for the U.S. shipbuilding industry.

In peacetime, the national defense need for the maritime shipbuilding industries is carriage of government cargos and building and repair of military vessels. In case of national emergency, the primary national defense requirement for the U.S. shipping and shipbuilding industries is to provide combatant and sealift shipping capacity, and the shipyard capacity to activate, convert, repair or replace the ships. During a conflict or national emergency, sealift ships would be needed for the rapid delivery of military equipment and supplies overseas and for sustained resupply, and additional shipping assets would be needed to carry critical imports to this country and to sustain critical domestic trade. A shipbuilding base would be needed to the extent that naval and merchant vessels would require rapid activation or conversion at the beginning of a conflict, regularly scheduled maintenance, battle damage repair and new construction for replacement of vessels lost during a prolonged conflict. How much sealift capacity is needed depends on how the military chooses to deploy its forces and its equipment. How many sealift ships and how much of a supporting shipyard mobilization base are needed depend a great deal on how the Nation chooses to solve its sealift problems.

Defense mobilization planners are currently working with a conflict scenario developed by the Joint Chiefs of Staff—basically a protracted (3-year), non-nuclear, three-theatre, global conflict that begins in Southwest Asia and spreads to Northeast Asia, Europe and three oceans. A series of Department of Defense studies, completed from 1981 to 1984, examined the cost effectiveness and timeliness of airlift, prepositioning of supplies and sealift for delivery of military equipment and supplies to a distant conflict area, especially to one in Southwest Asia. The studies proposed a coordinated mix of the three approaches and concluded that the United States had shortfalls in all three. A companion study also found a marginally adequate shipyard capacity to support sealift needs. The military's response has been to design programs to remedy the shortfalls in airlift, prepositioning and sealift, and to reduce the amount of ship activation work required to mobilize sealift ships. If these programs are fully funded, DOD projects no shortfall in shipyard capacity for the early stages of mobilization,