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Cover Page Footnote

The author wishes to thank two former students, Shari Ganahl and Ashley Walcher for their assistance in the research for this paper.

THE JONES ACT: IT IS TIME FOR REFORM

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The Jones Act was passed in 1920 as an amendment to the Merchant Marine Act. Its initial purpose was to protect a rail monopoly operating between the state of Washington and the territory of Alaska. It restricted transportation between U.S. ports to U.S. built, owned, registered and crewed vessels. Over the past 77 years it has become very controversial. This paper examines its costs and benefits and concludes that the Jones Act is indeed in need of major reform.

INTRODUCTION

The Jones Act of 1920 set aside domestic trade for US-built, US-flagged and U.S. crewed ships. The primary purpose of the Jones Act was to ensure the United States would have an adequate merchant marine fleet available during national emergencies. Over the past 77 years there have been many significant changes affecting U.S. defense sealift needs and capabilities.

Today, there is serious debate in Washington as well as several state capitals regarding the current benefits and costs of the Jones Act. The two primary debate topics focus on the increased costs of goods in Hawaii, Alaska, Guam and Puerto Rico and the current national defense benefits of the Jones Act. The purpose of this paper is to examine these two primary issues to determine if it is time to reform or eliminate the Jones Act. To address this central question the paper reviews the background of the Jones Act, then analyses the impact the Jones Act has had on military sealift capability and finally examines the economic effects of the Jones Act.

HISTORICAL BACKGROUND

According to Wood and Johnson (1996) cabotage is a set of laws which restrict commerce between a nation's port to carriers of that nation. It is one of the primary ways in which a nation can protect domestic transportation industries.

Cabotage was officially established in the United States under the Jones Act of the Merchant Marine Act of 1920. Its beginning, however, can be traced back to the eighteenth century.

In the late 1700's, the government of the United States began protecting US coastal trade indirectly. Acts passed in 1789 and 1790 levied discriminatory duties and port tonnage taxes on foreign-built ships engaged in U.S. coastal trades. In 1817, these acts were replaced by legislation that preserved US coastal shipping for domestically-flagged ships only. As new trade routes were developed to U.S. possessions and territories such as Puerto Rico, Hawaii, Alaska, and the Philippines, they were included under this rule. During World War II, U.S. cabotage restrictions were temporarily lifted as

the merchant marine became fully engaged in wartime missions.

The major piece of legislation that formally stated the U.S. position on coastal trade protection was the Jones Act of the Merchant Marine Act of 1920. It stated in part:

That no merchandise shall be transported by water, or by land and water on penalty of forfeiture thereof, between points in the United States, included Districts, Territories, and possessions thereof embraced within the coastwise laws, either directly or via a foreign port, or for any part of the transportation, in any other vessel than a vessel *built in and documented under the laws of the United States* (Whitehurst, 1985).

Over the years, there have been some exceptions to the Jones Act. The Philippines and the Virgin Islands were both given exemptions. This became irrelevant for the Philippines when they gained independence in 1946. However, the Virgin Islands exemption still stands today. The original exemptions allowed goods to be transported by foreign-flagged ships if that was necessary to ensure adequate shipping service. In 1936, an amendment to the Jones Act was passed which granted the U.S. Virgin Islands complete exemption from U.S. cabotage laws unless decided otherwise by the President of the United States.

Section 27 of the Jones Act provides for other exemptions. The primary one is that, "vessels of foreign registry may transport between US ports empty cargo vans, shipping tanks, or barges designed for carriage aboard ship and associated equipment used in the vessel's foreign trade" (Whitehurst, 1985). Section 27 also provides for the transfer of goods from one non-self-propelled barge to another, in the contiguous states. In addition, ships built with construction differential subsidies are not allowed to compete in the coastal trades. Occasionally, waivers

have been granted when no Jones Act ship was available. These waivers have almost entirely been for the transport of crude oil from Alaska to the lower forty-eight states.

Although some argue that the Jones Act has been effective and continues to be necessary for our national defense, not everyone agrees. A coalition for Jones Act Reform has been formed in Washington, DC. This reform group proposes significant changes to this long-standing law. The next section reviews the impact of the Jones Act on American labor, ships, and shipbuilding relative to defense needs and economic soundness.

LABOR

Over the years, the protection provided by the Jones Act and earlier laws allowed the wages of the American sailors to rise much more rapidly than those of foreign crews. The effect of these high labor costs on jobs is one area under fire in the debate over Jones Act reform.

The Jones Act, according to industry analyst Alan Abrams, has helped save jobs for American workers in the shipping industry (1991). In 1983, there were approximately 160,000 workers in private US shipyards. Of those, 10,000 workers could directly attribute their jobs to the protectionism provided by the Jones Act. Unfortunately, the jobs saved by the Jones Act may have cost others their jobs in the U.S. shipping industry. By the end of 1995 more than 60 US shipyards had been shut down eliminating an estimated 200,000 U.S. jobs. In addition, 40,000 merchant marines and 40,000 U.S. longshoremen have lost their jobs, despite Jones Act "protection" (Collins, 1996). Today, there is a notable lack of US-flag, US-crewed vessels engaged in carrying U.S. trade. A large part of this is due to the enormous discrepancies in wages and working conditions between US ships and foreign-flag vessels registered in countries with fewer regulations. Vessels from countries like Bangladesh, the Philippines, and Eastern Europe have comparatively lower crew costs because they pay much lower wages and few, if any, benefits. A 1983 study conducted by

the U.S. Congressional Budget Office found that U.S. crew costs were on average, 2.5 times higher than those of European crews and over six times higher than those of Third World Countries (Whitehurst, 1985). Primarily because of these very high crew costs, U.S. ship owners have increasingly registered their ships in so called flag of convenience nations like Panama, Liberia, Honduras and the Marshall Islands so they can use much cheaper foreign crews. In addition, the U.S. International Trade Commission recently concluded that the Jones Act has cost thousands of jobs across agriculture, metals, forestry, manufacturing and petroleum sectors of the U.S. economy (Collins, 1996).

In testimony to the House subcommittee on Transportation and Infrastructure in June 1996, the President of the U.S. Steel Manufacturers Association, James Collins, argued for reform of the Jones Act. According to his testimony, the Jones Act restrictions are putting U.S. steel makers at a distinct disadvantage with respect to their foreign competitors who are free to use the full range of transportation options. Included in his testimony are the following specific examples:

- ◆ it's more expensive to ship scrap metal from the Port of New York-New Jersey (NYNJ) to the U.S. Gulf Coast than it is to ship it from NY-NJ to any Asian port.
- ◆ Venezuela has become the leading supplier of steel products in Puerto Rico because of the excessively high cost of shipping steel under the Jones Act.
- ◆ Some U.S. steel producers can not ship to potential domestic markets at any price because the Jones Act ships are not available (1996).

SHIPS

The preamble to the Merchant Marine Act of 1920 states in part:

That it is necessary for the national defense and for the proper growth of its foreign and domestic commerce that the United States shall have a merchant marine of the best equipped and most suitable types of vessels sufficient to carry the greater portion of its commerce and serve as a naval or military auxiliary in time of war or national emergency, ultimately to be owned and operated by citizens of the United States (Whitehurst, 1985)

The question that has been raised is whether or not the Jones Act has been effective in its goal of sustaining such a fleet.

Long-time maritime journalist Robert Quartel claims the Jones Act is actually responsible for driving most U.S. ships out of business. Although the U.S. has an extensive system of deep water and inland ports, it has almost no ships. While not a single coastal freighter operates on its nearly 2,000 mile-long East-Coast, thousands of coastal freighters ply the waters of Europe and the Pacific Rim (Quartel, 1991). In 1830, American vessels carried 90 percent of the nation's trade; by 1980, they carried less than 10 percent and this number continues to decrease (Whitehurst, 1985). After World War II, there were approximately 2,500 privately owned vessels of more than 100 tons displacement. According to the trade journal *Feedstuffs*, currently there are only 128 and of those, only 33 carry dry bulk cargo (1995). The rest are liquid carriers. There are no US-flag bulkers at all operating on the Great Lakes. The number of US-flag ships are declining and the military usefulness of the ones that remain are questionable.

In 1984, the Jones Act fleet included 198 active merchant vessels. However, according to Whitehurst, a senior transportation research fellow at the Strom Thurmond Institute,

In 1985 the US-flag merchant marine was only marginally capable of supporting US forces in Europe if war

should come to that continent and could not simultaneously support a NATO effort and one or more contingencies in other parts of the world (1985).

This was evidenced in the Persian Gulf War in 1991 where only 10 percent of the ships specifically subsidized for the national defense actually entered the war zone (Shorrock, 1993). In fact, the Jones Act had to be temporarily suspended during the Persian Gulf war because it was impeding the transportation of fuel products to the Gulf.

SHIPBUILDING

The preamble to the Merchant Marine Act of 1920 also states that it is the policy of the United States to do whatever may be necessary to develop and ensure the maintenance of citizen-owned and operated merchant marine. It is debatable whether the Jones Act has achieved its goal of being able to maintain this fleet and if this objective is being pursued in the most effective manner.

In the past, Jones Act ships have been responsible for keeping a number of U.S. shipyards from going out of business (Feedstuffs, 1995). In the 30 years from 1953 to 1983, over 300 vessels were constructed for the Jones Act trades (Whitehurst, 1985). From 1970 through 1985, Jones Act ships accounted for 100% of the commercial ships built in American shipyards. This represents a notable investment in American shipping. The major justification for the extensive federal investment in U.S. shipyards has been to provide the construction and maintenance capability necessary to build, modify and maintain both naval warships and U.S. flag cargo ships. There's little doubt this capability is essential to the foreign policy of the U.S. In 1984 and 1985, this investment totaled almost one billion dollars (Whitehurst, 1985). In the past, the Jones Act had a significant influence on keeping American shipyards alive and able to serve national defense needs. Military shipbuilding alone could not have accomplished this. However, as pointed out in the previous section, the Jones Act has not been

effective at stopping the significant decline in U.S. shipyard jobs or U.S. merchant seamen jobs. More recently, the Maritime Security Act of 1996 has eliminated an old requirement (dating from 1936) that ships receiving operating subsidies must be US-built.

While it is clear that shipyards must be maintained for the national defense, how many shipyards are actually needed and whether a sufficient defense base could be maintained without the Jones Act are questions now being debated. While Section 27 of the Jones Act granted a monopoly to the shipyards on construction of ships for domestic trade, it left construction for the international trade open to foreign competition. Since the cost of building a merchant ship in the U.S. is about three times that of building in Japan or Korea, domestic construction for foreign-trade merchant fleets has been virtually non-existent for the past 30 years. However, the Alabama Shipyard (a subsidiary of Atlantic Marine Corporation) recently announced it will build four 1,432-TEU containerships in the U.S. for the China Ocean Shipping Co. It should be noted this exception was based on a 1994 rule change making Title XI loan guarantees from the U.S. Marine Administration available to non-U.S. companies (COSCO, 1997). Title XI of the Merchant Marine Act of 1936 established government-backed loans to encourage U.S. companies to build their ships in U.S. shipyards just prior to the outbreak of WWII. This provision while initially very effective has not stimulated ship operators to build foreign-trade ships in U.S. shipyards for several years.

According to a report in the March issue of the *American Shipper* (1997), this \$157 million deal was financed by a \$138 million Title XI loan guarantee backed by the U.S. government. Whether this signals a long-term commitment to promote U.S. shipyards or a one-time political decision remains to be seen. The question remains then, if U.S. shipyards are unable to compete on the international market, are we taking the most effective or efficient route to maintaining our shipyards for national defense?

THE COST OF THE JONES ACT TO AMERICAN CONSUMERS

The US Built Requirement

Since 1920, the Jones Act has greatly affected millions of American consumers and hundreds of American businesses. In 1990, the International Trade Commission studied the costs of the Jones Act to American consumers and found that the Act costs consumers an additional \$10.4 billion per year (Quartel, 1991). This cost estimate is derived from the high prices that must be paid to transport goods on U.S. ships relative to the average prices paid for foreign-flag shipping. The Jones Act requires that the ships used in domestic trade be crewed by US citizens and be built in US shipyards. Many feel that the Jones Act is a barrier to competition and that U.S. Flag domestic carriers pay too much for vessels, because they must operate in a restricted market with restricted resale capacity.

Today, the U.S. is 26th in the world in merchant shipbuilding, with a mere 0.2% of the world's gross tonnage. Between 1980 and 1987, despite the Jones Act's so called protection, 60 US shipyards closed! The last order for a major Jones Act vessel was in 1987 for the *R.J. Pfeiffer*, built for Matson Navigation. The ship was estimated to cost over \$150 million, or nearly 2.5 times the world price. (The Jones Act, 1996).

Supporter's Views

There are some people who feel very differently about the Jones Act. An article entitled, "Dismantle the Jones Act", by Joey Farrell (1991), President of American Waterway Operators, argues that the Jones Act provides the U.S. with working shipyards and crews to man their ships. The author believes the Jones Act's survival is crucial to the survival of the U.S. economy. However, Farrell overlooks the cost issue and says that U.S. shipyard jobs are more important than the high consumer prices. He is not the only supporter of the Jones Act.

The maritime unions that man the ships and supply labor to the shipyards are also strong supporters of the act. Farrell feels that The Jones Act is the only U.S. maritime promotional statute that has worked. He feels that if we didn't have the Act we would have foreign vessels crewed by foreign nationals taking over the domestic trade of the United States. However, opponents to the Act have proposed reforms that would help to preserve U.S. jobs and shipyards.

National Defense

Following the Persian Gulf War, the Clinton Administration studied the effectiveness of the Jones Act in providing ships for national defense. A commission headed by Vice-President Gore found that only 10% of the US-flag ships "specifically subsidized for the purposes of national defense" entered the war zone during the Persian Gulf war (Shorrock, 1995). Quartel maintains that only one Jones Act ship was part of the Persian Gulf deployment, and it was a roll-on, roll-off vessel. He and many other respected maritime observers believe that the Jones Act fleet was simply not of the right type for use in the rapid sealift deployment required in Operation Desert Storm (Quartel, 1991). It seems clear that the main objective of the Jones Act is not being achieved. This certainly supports the view that the Jones Act is outdated and should be reformed.

Alaska and Hawaii

Alaska's and Hawaii's consumers must bear significantly higher costs for goods than their mainland counterparts as a result of the Jones Act.

Studies have estimated the cost of the Jones Act to Alaskans to range from \$269 million to as high as \$674 million per year. This equates to an annual penalty on every Alaskan household of between \$1921 and \$4821 (The Jones Act, 1996).

These are very high costs that captive consumers must bear. Alaska and Hawaii have been fighting the Jones Act reform battle for years by trying to get a waiver to the Jones Act. The costs imposed on consumers in Alaska may be even higher than the above figures show. The Governor of Alaska reported that independent consultants have estimated the costs to Alaskans imposed by the Act to be as high as \$800 million annually. It is evident that Alaska and Hawaii must pay higher costs because of the Jones Act. There is little doubt that consumer goods of all kinds would be cheaper in these states if shippers were free to use foreign-flag as well as US-flag vessels. This reason has led supporters of the Jones Act reform to form a special interest group called the Jones Act Reform coalition.

THE JONES ACT REFORM COALITION AND THE COASTAL SHIPPING COMPETITION ACT

The Jones Act Reform Coalition, according to its Internet web site (www.lexitech.com/jarc), is an 860,000 member group of diverse private and public sector organizations. These organizations include chemical fertilizer and steel manufacturers, agriculture, livestock, and forestry companies, ports, independent vessel owners and operators as well as consumer and other advocacy groups. The president is the former maritime journalist, Robert Quartel.

The Coalition, founded in 1995, has been successful in lobbying Congress to introduce Jones Act reform legislation. The Bill, known as the Coastal Shipping Competition Act, would remove (among other things) the Jones Act restriction that U.S. deepwater domestic shipping (U.S. domestic coastal trade would be redefined to include all waters accessible by ocean-going vessels, including the Great Lakes and the St. Lawrence Seaway) be limited to U.S.-built, owned, flagged and crewed vessels (Martell, 1997).

Passage of this bill would significantly change the regulatory controls enacted 77 years ago and undoubtedly change the transportation industry.

It's difficult to say what specific changes might occur, but there's a strong chance U.S. coastal shipping would reemerge as a transportation industry segment and a competitor of rail transportation.

The Jones Act Reform Coalition predicts that this new legislation would improve U.S. national security by increasing the number of vessels and deepwater-qualified seamen available to the Department of Defense in time of national emergencies. The bill is currently being discussed in both the Senate and the House of Representatives.

CONCLUSION

Based on the foregoing analysis, it appears that the Jones Act has outlived its purpose. Its contribution to military sealift is now minimal and it artificially inflates the cost of goods for millions of American consumers. The 77-year-old law protects very few U.S. flag carriers from foreign-flag competition while distorting domestic waterborne transportation markets. It has also undermined the world-wide competitiveness of some important U.S. industries, most notably the steel industry. In short, the overall negative impact the Jones Act continues to make on the U.S. economy appears to be much greater than the small benefits it may still provide. It is time to reform the Jones Act as Congress is currently considering.

For years, the U.S. Steel Manufacturers Association, Alaska, Hawaii, the Jones Act Reform Coalition, and many independent organizations have been fighting to gain enough support to reform the Act. There have been many concrete reform proposals. The proposed Coastal Shipping Competition Act would eliminate the U.S. ownership requirements in exchange for a requirement that foreign-flag ships conform with U.S. environmental regulations, immigration laws, and work force health and safety regulations. The Bill also would require foreign-flagged ships to be registered as U.S. corporations, and pay U.S. taxes.

Supporters of the reform movement claim with reform would come more jobs for American merchant seamen because the amount of intracoastal shipping would increase if cheaper foreign-built ships were permitted to compete. They believe ships would start competing with trucking and rail and this would in turn reduce shipment costs and bolster the U.S. seafaring mobility base. This assessment is based on a reform bill provision which requires domestic trade ships to be manned by Americans or green card holders. Of course, not everyone agrees with this scenario.

Several key congressmen, including Senate majority leader Lott, and Admiral Herberger, chief of the U.S. Maritime Administration,

believe U.S. national defense would be weakened if the Jones Act were reformed. While they don't dispute the view that shipment costs would decrease, Senator Lott and Admiral Herberger believe U.S. seafaring jobs would be lost to foreign-flag shipping.

The debate now being waged in Congress seems to focus on the issue of the value of the Jones Act to U.S. national defense. While it is understandable that military officials would rather have complete control of all resources that might be needed in a national emergency, the facts suggest there is a more cost effective way to accomplish this purpose. It is time to reform the Jones Act by enacting the Coastal Shipping Competition Bill.

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