SHIPPING INSIGHTS

Can the US Restore Its Once Great Maritime Tradition?

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Late last year, a key piece of legislation was proposed in Washington that will, if ratified, alter the course of US shipping interests for generations to come. Once a formidable maritime power, the US has given up considerable ground since peaking in the latter decades of the twentieth century. While the US Navy has continued to modernize and maintain large fleet, the US Merchant Fleet has shrunk considerably losing critical ground to developing nations like China. With just 80 ships under US Flag trading internationally, Congress has been warned going as far back as the mid 80's that unless something is done to address the US Flag fleet, the United States will not have the necessary equipment to support a large-scale mobilization if required. SHIPS for America, or the Shipbuilding and Harbor Infrastructure for Prosperity and Security (SHIPS) for America Act, looks to put in place comprehensive legislation focused specifically on revitalizing the US's shipbuilding and commercial maritime industries and reduce the US's dependency on foreign vessels.

SHIPS would not be the first time that legislation was put in place to advance US shipping interests. The Jones Act, also known as the Merchant Marine Act of 1920, was put in place following the first world war to advance US shipping interests that were decimated by German U-boats during the war and paved the way for the sell off a massive government-controlled fleet that had been built to support the war effort. Today the Jones Act is most associated with protecting domestic shipments within the US and its territories from foreign competition, however this aspect of the law predates even the Jones Act dating back to the US Constitution.

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Early on in industrialization, the US effectively leveraged its growing naval and merchant power to advance US interests around the globe. The US's naval and merchant fleets swelled during the Second World War, and the US accelerated into the postwar era with a large merchant fleet, deep water ports to support the growing manufacturing base, and large-scale shipbuilding facilities up and down the coasts. With the advent of globalization, the US's ability to compete in the construction ships became increasingly difficult in favor of the developing world. Low labor costs and favorable currency exchanges placed increased pressure on crewing and manning, again favoring foreign built and manned vessels. Like so many US industries, the jobs went offshore.

Outside of government contracting for the Navy and to a lesser degree the Coast Guard, the US does not directly subsidize shipbuilding and so the free market determines the supply, demand and cost. This has directly resulted in the rationalization of most of the US shipbuilding capacity. There are subsidy programs available like the Title XI which was initiated during the Great Depression Era to promote the growth and modernization of the U.S. Merchant Marine and U.S. shipyards, however this has done relatively little to sustain the US's position as a maritime leader.

Today domestic US shipping is experiencing a bit of a renaissance in terms of the market, despite coming under scrutiny from pundits in Washington that have argued the high cost is the direct cause for the decline in US maritime power. The unusually cold winter is placing constraints on already tight capacity resulting in high utilization and very firm charter rates. The fundamentals point to a continued tight market for the foreseeable future due to the lack of yard space and virtually no orderbook. However, we do not have to go back very far to when earnings under the Jones Act were weak following a very capital-intensive fleet renewal program in the 2010's and generally low demand. Despite being a protected trade, the Jones Act tends to be subjected to either the highest of the highs or lowest of the lows. The high capital cost for construction can be as much as four times what the same ship costs to build foreign. Furthermore, the

finite number of yards means that ships cannot always be built when needed. Operating Expenses (OPEX) are also substantially higher than competing foreign vessels. As of today, it is cost prohibitive to build new ships under the Jones Act without a long-term commitment from end users and even then, there is a lead time of four to five years. Even with these perceived market tailwinds and legal protection, the threat of low-cost imports nearly always looms just over the horizon.

The right shoring of US Shipping interest is critical to national and economic security. It also provides a great opportunity to create skilled jobs for Americans from the construction of infrastructure, shipbuilding, crewing and manning, and the advancement of US maritime interests around the globe. It will however take much more than simple tax credits and subsidies to have a sustainable and lasting impact on the fleet.

It should be noted, vessels do not have to be built in the US to trade under the US flag, however legislators must on the experiences of the Jones Act to understand the hurdles they will face making US shipping interests relevant once again. With all eyes turned to Washington and the second inauguration of Donald Trump, markets around the globe are waiting to see how the policies of the administration will take shape. The SHIPS legislation is a bi-partisan bill, and the objectives align well with the narrative Trump promoted in his previous tenure as President and recent campaign. It remains to be seen if this new legislation designed at making America's maritime industries great again, will come to fruition.

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