# Opulence vs. security

Vincent Smith

December 6, 2019

Surprise, surprise! Among economists who have been writing throughout the last three centuries, Adam Smith is perhaps the last man standing who you think would support cargo preference measures to protect a domestic shipping industry, but he did. In *The Wealth of Nations*, Smith made a defense of the realm case for the Navigation Acts. The Acts created a monopoly on trade between England and the British colonies and a cargo preference mandate requiring that British ships carry all British exports to protect the British shipping industry. In 1776, Britain was embroiled in the American Revolutionary war, had recently been involved in a series of conflicts with European powers, and expected to face further engagements with those countries in which naval power would be critically important. Thus, Adam Smith argued, "… [D]efense,… is of much more importance than opulence" (*TWN*, IV.ii.30), fully recognizing that the Navigation Acts would waste resources, and adversely affect the British economy.

Today, many modern defenders of the Jones Act are more than happy to invoke Smith's opulence versus defense tradeoff as a rationale for cargo preference policies that protect US shipping. The Jones Act restricts domestic trade between US ports to ships that are US owned, crewed and built at a substantial cost to other sectors of the US economy, ostensibly for national defense purposes. Today almost all economists recognize that the Jones Act restrictions are detrimental to economic growth, just as Adam Smith drew similar conclusions about the impacts of the Navigation Acts for Britain in 1776. However, in contrast to Smith's assessment that those Acts substantially improved the relative superiority of the British fleet for the defense of the realm, a new study from the Cato Institute provides credible evidence that the Jones Act does not make the contributions to national defense claimed by the legislation's proponents. There is no quid pro quo; just costs.

The Cato study explicitly identifies the shortcomings of the Jones Act as a vehicle for providing a domestic merchant marine service and domestic shipbuilding industry that the armed forces can rely on in time of war. Instead, the study provides compelling evidence that the needs of the military have little or no relationship to those of US shipping companies, that this has been the case for at least four decades, that the capacity of the US merchant marine service to provide useful resources for the armed services is extremely modest, and that the Jones Act has had no measurable impact on that capacity.

The Jones Act gives US shipping companies the sole right to carry goods between US ports on vessels produced by US shipyards, and crewed by mostly US citizens, ostensibly to ensure the

US military has access to mercantile marine services and shipbuilding capacity in times of war. However, for quick mobilization, the military needs roll on/ roll off (Ro/Ros) carriers for tanks and material. These are not the vessels that US shipping companies use for Jones Act cargoes. US shipping needs, and therefore US shipyards construct, container ships and bulk carriers that are of limited or no use for rapid response mobilization purposes.

As a result, to maintain a viable Ready Reserve Fleet (RRF), the US navy increasingly has to purchase foreign built Ro/Ros. The good news for taxpayers and the federal defense budget is that those vessels cost the government much less than similar vessels produced in the United States. In fact, despite, and in important ways because of the Jones Act, in 2019, only four US companies could build large oceangoing vessels, in contrast to over 64 US companies who operated such shipyards after World War II (Colton, 2002). In addition, as the US shipping industry has atrophied, the number of mariners potentially available to sail the navy's RRF ships has fallen sharply and, for decades, has been insufficient for the needs of the Armed Forces.

The maritime industry's decline is informed by returning to Adam Smith's assessment of the Navigation Acts. Many Jones Act supporters simply don't realize that Smith's support for the Navigation Acts was largely based on the fact that their purpose was to adversely affect the size of the Dutch fleet, not to increase the size of the British fleet. Smith argued that "National animosity at that particular time aimed at … the diminution of the naval power of Holland, the only naval power which could endanger the security of England" (*TWN*, IV.ii.29). Smith's support was contingent on the Navigation Acts targeting the Dutch fleet's carrying trade, and he fully recognized that, and described how the Navigation Acts could distort and even harm British shipping.

According to Smith, the monopoly on carrying goods between the colonies and England created artificially high profits in that trade that would divert shipping and capital from trade with Europe. Smith noted that "The mercantile capital of Great Britain, though very great, yet not being infinite; and though greatly increased since the act of navigation, yet not being increased in the same proportion as the colony trade, that trade could not possibly be carried on without withdrawing some part of that capital from other branches of trade, not consequently without some decay of those other branches" (*TWN*, IV.vii.c.22). Smith argued that the heavy focus on colonial trade, by reducing the range of markets served by British shipping, made the English mercantile fleet's "more precarious and less secure" (*TWN*, IV.vii.c.46). Drawing a connection between high mercantile profits and efficiency, Smith notes that high profits seem "scarce to have been sufficient to keep up the capitals upon which they were made" (*TWN*, IV.vii.c.61). Taken together, a less diversified business portfolio chasing high profits in protected industries would, in Smith's view, corrode those industries. The Cato Study, reflecting Smith's insights, shows that the US domestic shipping industry has been steadily shrinking. Further, in contrast to Britain's situation in 1776, today US domestic shipping also faces strong intermodal competition from trucking and rail, which claim much of the business that, absent the Jones Act, would shift back to merchant marine companies and, conceivably, increase the number of US mariners (*TWN*, II.v.30).

The damage from cargo preference mandates, as Smith pointed out, is not limited to a country's shipping industry. Just like the Navigation Acts the Jones Act serves as an economic burden on domestic producers and consumers as well as industries in territories subject to its regulation. Producers face higher transportation costs which leads to less output and higher prices for consumers (*TWN*, IV.vii.c.67). Some studies even suggest that, by affecting incentives for technology adoption and innovation, legislation of this type has adverse consequences for economic growth (Porteous, 2019). As has been widely noted, the populations most egregiously affected by the Jones Act are the residents of territories like Puerto Rico and states like Hawaii, and Alaska (*TWN*, IV.vii.c56).

Clearly, the tradeoff between opulence and defense has tilted against the Jones Act. The Cato study effectively proposes simply ending the Jones Act cargo preference mandate than bans foreign companies from providing any transportation services for shipments of goods by water between US ports, effectively a 100 percent import quota. That may not be politically viable. An alternative approach would be to replace that ban by a tariff, perhaps initially set at a relatively high level. Then, following the long-standing tariffication process for manufactured goods introduced in the late 1940s under the General Agreement on Tariffs and Trade (since 1994 referred to as the World Trade Organization), the tariff could be lowered over a reasonably short period of time. Moreover, switching from a ban to a tariff has several policy benefits. A tariff provides revenue (as long as it is not set at a prohibitively high level), and is transparent in its effects on consumers and prices. In addition, a gradual reduction in the tariff rate allows domestic shipping companies access to a less draconian adjustment path, perhaps moderating interest group pressures against policy reform. As Smith argues, a "moderate and gradual" relaxation of restrictions may be critical for allowing firms in the protected market to survive or adjust to the change in the regulatory environment (*TWN*, IV.vii.c.44).