

American Shipper

Commentary: Cato Criticism Misses The Mark

Colin Grabow

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Editor's note: Colin Grabow is a trade policy analyst at the Cato Institute's Herbert A. Stiefel Center for Trade Policy Studies. Michael Hansen is the president of the Hawaii Shippers Council. The opinions expressed in the first commentary by Grabow and the second one by Hansen are theirs and not the views of American Shipper or FreightWaves.

Shaking up the status quo is certain to attract opposition. The Cato Institute is no stranger to this. Our recent efforts to highlight the failures of the nearly 100-year-old Jones Act, a law that has impeded the development of what could be a vibrant U.S. maritime industry, is a case in point.

On this subject, John McCown, a former CEO of Trailer Bridge Inc., recently assailed us for alleged “analytical gobbledygook.” While McCown’s opposition is not entirely unsurprising given his Jones Act industry background, less expected are the distortions, misdirection and obfuscations employed in his critique.

First, some background. On April 30, the Cato Institute hosted a panel discussion of the Jones Act’s impact on Puerto Rico. The event was moderated by renowned economist Anne Krueger. One of the panelists, John Dunham, presented the findings of a recent paper he authored that found significant increased shipping costs to Puerto Rico resulting from the Jones Act.

McCown took to *American Shipper* to make clear that he is no fan of the report, believing it to suffer from numerous methodological flaws. Dissent and disagreement are normal, expected and even welcome. Public policy discussions benefit from rigorous debate and questioning of assumptions (something too often lacking in discussions around the Jones Act).

Not acceptable, however, are deliberate mischaracterizations. Rather than take up his grievances with the report’s author, McCown assigns blame to — and impugns the alleged motives of — the Cato Institute. In doing so he violates one of the cardinal rules of taking others to task for alleged sloppiness: McCown failed to make sure he had his own facts in order.

Not a Cato study

The Cato Institute did not author, publish or provide financial sponsorship for the study in question, nor did it “promote” the study or bill its findings as the event’s “highlight,” which McCown claims. In fact, the event’s webpage makes no mention of the study, and no copies were distributed at the event. These facts are not made apparent in McCown’s piece, which curiously did not include a link to the study or provide its title or author despite it being his argument’s centerpiece. Regardless, Cato hosted an event, as most think tanks do, to discuss and debate new research.

An attendee at this event, McCown claims that a question he asked of the study was edited out of the event's archived video because it "didn't fit with [Cato's] agenda." In fact, his question was omitted because it was nearly a five-minute speech and he interrupted the panelist trying to respond. A previous question asked by McCown in which he did observe decorum is included in the event's video and can be readily found in its transcript. While we never shy from hosting a lively debate, we do want to ensure that those who present their research here are treated with respect.

Moreover, Cato always makes an effort to engage people with whom we disagree. As McCown notes, he has had numerous correspondences with the "Cato Institute" (over 20 email exchanges, all but one of which were with me alone). Sadly, however, even these exchanges are subject to mischaracterizations and inaccuracies, such as the claim that I said "costs don't matter" in relation to shipping rates. That, of course, would be an absurd position. In fact, what happened is that in response to McCown's theorizing about a mere 12% cost premium resulting from the Jones Act, I pointed out that data from the Federal Reserve Bank of New York suggests a much more significant impact.

Dubious claims

Furthermore, after devoting paragraph after paragraph to allegations that the Cato Institute is playing loose with the facts, McCown proceeds to introduce some dubious claims of his own.

Despite repeatedly downplaying the premium of Jones Act carriers versus their foreign-flagged counterparts, which he places at 12% but claims could be further reduced after foreign carriers are forced to comply with U.S. laws and regulations, McCown writes that Jones Act repeal would "likely result in an immediate shift in the Puerto Rico market to one served exclusively by foreign carriers." But why would this happen if rate differences between Jones Act carriers and foreign carriers are relatively minor, particularly given that shippers also take factors such as service frequency and reliability into question? One can only conclude that McCown does not truly believe his own claims that Jones Act carriers command only a small rate premium.

McCown then asserts that this predicted shift to foreign carriers, more specifically those from South America, would result in shippers seeing their \$300-per-FEU rates turned into \$3,000 rates — an astonishing tenfold increase that can exceed the cost of shipping from Yokohama to Los Angeles. Ignored in his scenario is the fact that companies such as Tropical Shipping, a subsidiary of the U.S. firm Saltchuk, already operate in the Caribbean despite competition from South American carriers. Furthermore, \$3,000 rates for a journey to the U.S. mainland of only a few days would be a clear signal for other carriers to enter the market, which would boost competition and lower prices.

That McCown would author a piece replete with misinformation and rhetorical sleights of hand is perhaps explained by his concluding endorsement of the Jones Act as a law that has "served our country well." I was puzzled to read this given that in my initial exchanges with McCown he characterized himself as an impartial observer who simply wanted to see the best analysis put forward. (Indeed, at our April event he prefaced one of his questions by stressing that he has "no dog in this fight.") In light of this stated commitment to solid analysis along with his impressive industry experience, I had continued to correspond with him and was happy to see his attendance at our event.

From reading McCown's column, it is unfortunately apparent that he is not interested in a fact-based debate. In my experience working on the Cato Institute's Project for Jones Act Reform, questioning the motives of reform advocates and the deliberate mischaracterization of our arguments has sadly become a recurring theme. Despite this, the Cato Institute will continue to offer fact-based analyses of the Jones Act and promote discussion of this matter of national consequence. We invite you to visit our website, read our research and offer your thoughts.

Colin Grabow is a trade policy analyst at the Cato Institute's Herbert A. Stiefel Center for Trade Policy Studies.

Editor's note: American Shipper also received the following commentary from Michael Hansen, president of the Hawaii Shippers Council.

Jones Act op-ed misleading

By Michael Hansen

American Shipper on July 23 published an op-ed, "Cato's Jones Act numbers wrong," critiquing a report that attempted to estimate the Jones Act's impact on Puerto Rico. The op-ed by John McCown calls the report "gobbledygook" and misleadingly implies it was the product of the Cato Institute.

The report McCown critiqued is "The Jones Act: A Legacy of Economic Ruin for Puerto Rico" by John Dunham & Associates (JDA) of Brooklyn, N.Y.

The JDA study and another report on the domestic Puerto Rico trade were published in February and commissioned by the Puerto Rico Chamber of Food Marketing, Industry & Distribution, known locally as Camara de Mercadeo, Industria y Distribucion de Alimentos and commonly referred to as MIDA.

Both reports were highlighted at a public forum, "Unnatural Disaster: Assessing the Jones Act's Impact on Puerto Rico," hosted by the Cato Institute on April 30 at its Washington, D.C., headquarters. McCown states he attended the forum but only refers to Dunham's report and largely attributes it to Cato.

However, Cato did not author either study, financially support them or arrange for their publication.

McCown's characterization of Dunham's report as "gobbledygook" relates to JDA's derivation of an 88.9% rate differential applicable to container cargo in the domestic Puerto Rico common carrier trade. That defines the quantitative difference between probable international freight rates in the complete absence of the Jones Act and estimated current Jones Act ocean freight rates between Puerto Rico and the Contiguous United States (CONUS). Accurately establishing this differential is key to estimating the Jones Act's economic impact on domestic coastwise trades such as that with Puerto Rico.

There are several problems inherent with accomplishing the task of quantitatively establishing a countermodel and base case for Jones Act trades generally and the Puerto Rico trade lane specifically. Because there is no existing foreign ocean shipping between CONUS and Puerto Rico, which is prohibited by the Jones Act, probable international freight rates for the countermodel must be extrapolated from other comparable international trade lanes.

Current Jones Act rates for the base case must be estimated from anecdotal evidence provided by shippers (i.e., merchant cargo owners). This is due to the nature of the domestic ocean common carriers' rate-setting process, which does not make their effective contract rates public. These methodologies, if not handled properly, can introduce a great deal of uncertainty into the process.

The Dunham report

Regarding Dunham's appearance at the Cato forum, McCown states, "The highlight was a presentation by a consultant on the findings of his just-published 40-page study. Its key conclusion was that container rates to Puerto Rico would decline 88.9% if there were no Jones Act." Although McCown's statement can only be a reference to the Dunham report, he doesn't identify the consultant by name nor Dunham's contractual relationship with MIDA as opposed to Cato.

However, McCown correctly points out what Dunham unreasonably asserted, that a foreign ocean carrier, in the absence of Jones Act restrictions, could transport container cargo between CONUS and Puerto Rico for approximately one-tenth the current freight rates charged under the Jones Act. Or, conversely, the differential attributable to the Jones Act in the Puerto Rico liner trade is approximately 90%. This can't possibly be true, hence McCown's gobbledygook characterization.

McCown's only other reference to the Dunham report being the product of someone else besides Cato was this oblique statement: "In my event follow-up communication to Cato, I expressed surprise that it linked itself to such an erroneous and misleading study." Obviously McCown felt justified in characterizing the Dunham report as a Cato product because of the "link" purportedly established by Cato hosting a forum at which Dunham presented his report's findings.

McCown identifies the issues relative to quantitatively establishing the countermodel and addresses what he perceives are Dunham's shortcomings in these regards. McCown correctly notes when extrapolating data from international trades to construct a countermodel for a Jones Act trade, it should be based upon international trade lanes with economies of scale comparable to that of the base case.

As McCown noted, the parameters of comparability would include: total cargo volume moving in the trade; the relative capacity of ships (in this instance twenty-foot equivalent units); trade imbalances (the ratio between inbound and outbound cargo volumes); transit distances (the distance over which the cargo is transported by sea); directional rates (the difference between headhaul and backhaul rates); and the proportion of ship-related costs (those liner shipping service expenses attributable to the ship's registry as opposed to costs any service would face regardless of their ships' registries). McCown makes a convincing argument that Dunham's report didn't stick closely enough to these principles of comparability and thus the improbable 90% differential resulted.

After adjusting for the various comparability parameters, McCown states Dunham's "methodology would result in a 9.1% decline. In other words, the study Cato promoted at its April 30 event was off by a factor of 10 when it was adjusted for clear math and logic errors."

McCown states his analysis of the Dunham report and his own independent analysis of the Puerto Rico trade were made available in spreadsheet form to Cato. To that end, he wrote, "My own analysis shows a total repeal of the Jones Act would likely result in a 12% decline in rates in

the Puerto Rico container trade. That assumes the current gap between foreign and domestic crewing and building costs doesn't change." As McCown has not made his spreadsheet analyses public, it's not possible to further evaluate his reported findings.

McCown made a further qualification: "That gap [between international and domestic ship costs] could narrow from both existing laws and regulations that would apply to foreign ships involved in domestic commerce as well as new laws and regulations that may come with any repeal." This is a reference to the existing trade restrictions formally known as "behind the boarder barriers" imposed by the U.S. domestic regulatory system, which McCown accurately notes is a real modeling issue not addressed by Dunham.

Dire prediction

McCown ironically states, "The repeal of the Jones Act will likely result in an immediate shift in the Puerto Rico market to one served exclusively by foreign carriers." Although downplaying the impact of the Jones Act throughout his piece, he assumes in its absence the domestic Puerto Rico trade would immediately convert to international carriers. This dire prediction can only mean that McCown understands the Jones Act has a significant economic impact on shipping services, and once removed, their customers (i.e., shippers) would quickly seek non-Jones Act alternatives.

He further writes, "South American carriers stopping en route to Brazil and Argentina will quickly dominate the [Puerto Rico] market [with repeal of the Jones Act]." This is a canard and ignores existing reality and his own advice to use comparable trades to construct a countermodel.

Both of the main Jones Act carriers in the Puerto Rico trade operate extensive foreign flag services between CONUS, Caribbean and Central American ports obviating any role Brazil and Argentina services might play with respect to Puerto Rico in a post-Jones Act scenario. Crowley Maritime operates foreign containerships through its Liner Shipping Services Division and Saltchuk Inc. / TOTE Inc. through their foreign carrier operation, Tropical Shipping. In response to removal of the Jones Act from Puerto Rico, these carriers would immediately slot in their own foreign containerships contemporaneously operating in the Caribbean.

Adding to the despair of his South American story, McCown foretells, "With this change [of removing the Jones Act], the mostly empty northbound leg in the current [Puerto Rico] shuttle services and the very low rates resulting from that disappear. Large employers like Bacardi and Goya [in Puerto Rico] that send their products to the mainland could see rates going from \$300 per 40-foot container to more than \$3,000 to match the rates South American shippers now pay [northbound to CONUS]. The worse case would be if this tenfold rate increase led any Puerto Rico rum makers to reallocate production to other Caribbean islands as what had been a shipping benefit was now a shipping detriment."

As McCown characterized Dunham's 88.9% differential to be "nonsensical" while attributing it to Cato, his preceding statement can only be labeled as such. The international South American ocean carriers would not enter the CONUS / Puerto Rico trade upon removal of the Jones Act. The international ocean carriers operating in the CONUS / Caribbean market would call at Puerto Rico and offer backhaul rates commensurate with their lower costs as they do now for northbound cargo shipped from other Caribbean ports. They face competitive pressures to do so

under the current market conditions and would face those same pressures if allowed to enter the domestic Puerto Rico trade.

In his concluding sentence, McCown wrote, “This is too important an issue to have anything but the most credible numbers and facts put on the table for policymakers.” I agree and entreat McCown to take his own advice.

Michael N. “Mike” Hansen’s maritime career began in the early 1970s and included hands-on experience working in a shipyard and at Hawaiian Tug & Barge in several trade and supervisory positions. He ran his own ship agency in Honolulu from the late 1970s through the 1990s. He also was involved in ship chartering and founded a container shipping company that operated a direct liner service from Honolulu to the South Pacific for more than five years. He currently is active in consulting and commercial shipbroking. Since the late 1990s, Mike has been president of the Hawaii Shippers Council, incorporated in 1997 to support the efforts of the national Jones Act Reform Coalition.