

BRIEF

by

Petroleum Industry Research Foundation, Inc.
New York 17, New York

to

The Director,
Office of Emergency Planning
Washington 25, D. C.

SUBJECT:

Comments on the Petitions filed by The American Maritime Association
and the Committee of American Tanker Owners

June 28, 1962

INTRODUCTION

The Petroleum Industry Research Foundation, Inc. is engaged in economic research and the dissemination of information concerning the oil industry. Our Board of Directors consists of independent East Coast oil marketers and our work frequently reflects the interests and problems of the oil marketers and consumers on the U. S. East Coast.

Since the great bulk of U. S. oil imports is delivered and consumed at the East Coast, much of our work has always been concerned with the problem of oil imports. We have testified on this subject before Governmental Agencies and Congressional Committees and have also submitted briefs to your agency.

At this time we would like to comment on two petitions recently submitted to your office by the American Maritime Association and by the Committee of American Tanker Owners. Both of these petitions request that a certain share of U. S. oil imports be transported in American - flag tankers. In order to avoid repetition, we have limited our comments primarily to the petition by the American Maritime Association (AMA), whose proposal is the less extreme of the two. However, all our arguments apply equally to the petition submitted by the Committee of American Tanker Owners (CATO).

The Petroleum Industry Research Foundation believes that the petitions by the AMA and CATO should be denied, since (a) they would add still further to the burden of the oil imports' restrictions which East Coast refiners, marketers and consumers must now bear, (b) the domestic tanker fleet does not need the special protection requested in the petitions, and (c) the national security is more likely to be harmed than helped by the recommendations in the two petitions.

THE COST OF THE AMA PROPOSALS

Under the AMA proposals 50% of all crude and unfinished oil imported east of California by companies with import quotas of at least 10,000 barrels daily would have to be delivered by tankers registered under the U. S. flag and having coastwise privileges. In the first half of 1962 the eighteen companies in this category imported 533,215 barrels daily, or 76% of all licensed crude oil imports delivered east of California. Virtually none of these imports were brought in by U. S. flag tankers. To comply with the AMA's proposal would therefore mean a transfer of about 265,000 barrels daily of imports from foreign flag to U. S. flag tankers. The AMA brief estimates that this transfer would add 16¢ per barrel to the delivered cost of the affected imported crude oil. On the basis of this estimate, the direct annual cost of the AMA's proposal would be about 15.5 million dollars.

However, this figure represents only a small part of the additional cost. In 1961 U. S. flag tankers delivered a total of 727.8 million barrels of domestic crude oil and products to the U. S. East Coast. The AMA proposal would require these tankers to carry an additional 265,000 barrels daily, or 96.7 million barrels annually, of foreign crude oil in 1962. This would cause a sudden increase in the demand for U. S. - flag bottoms of 13.3%, assuming all of the affected foreign crude to be of Caribbean origin. There can be no doubt that such an increase in demand would raise the entire freight rate schedule of domestic flag tankers. While the resulting increase is of course not subject to exact determination at this time, it is a fact that tanker rates tend to fluctuate widely in response to relatively small changes in demand. Thus between January 1st and June 15th, 1962 spot tanker rates for cargo from the Gulf Coast to

New York have ranged from a low of ATRS minus 30% (28.6¢ per barrel) to a high of ATRS plus 20% (48.9¢ per barrel).

An increase in tanker demand of the magnitude proposed by the AMA would certainly be expected to bring the rate at least up to ATRS plus 10%, or 44.7¢ per barrel, which was reached and exceeded on several occasions in the past 12 months when demand was slightly more brisk than normal.* For the transport of the 96.7 million barrels of foreign crude from the Caribbean area to the U. S. East Coast would require the equivalent of 26T-2 tankers, or a total volume of about 440,000 deadweight tons. This would be equal to three-quarters of the total inactive domestic tanker tonnage, as of March 31, 1962 (See table Page 5), or virtually all the readily available inactive tanker tonnage. The utilization of this much additional tonnage would certainly raise the average domestic tanker rate to the level assumed herein but probably even higher.

Since the average domestic tanker spot rate during the first 5½ months of 1962 (and also during 1958-1960) was about 34.1¢ per barrel (equal to ATRS minus 19%), the assumed higher rate would mean a 10.6¢ per barrel increase for all domestic oil shipment by tanker to the U. S. East Coast, as is shown in the following computations

TANKER SPOT RATES U. S. GULF COAST - EAST COAST

Average rate January 1-June 15, 1962--ATRS minus 19%..	34.1¢ per barrel
Assumed rate under AMA proposal-----ATRS plus 10%..	44.7¢ per barrel
Indicated increase.....	10.6¢ per barrel

*During the cold spell of January-February 1961, the domestic tanker rate ranged from ATRS plus 12.5% to ATRS plus 42.5%.

Based on last year's tanker shipments of 727.8 million barrels of domestic oil to the East Coast the annual cost of this increase would run to about 77 million dollars. Thus the gross cost of the proposed allocation of U. S. - flag tankers for import shipments would be as follows:

Increase due to higher tanker rates of domestic oil shipments.....	\$77.0 million
Increase due to carrying imports at current U. S.-tanker rates.... (as per AMA estimate)	\$15.5 million
	\$92.5 million

Actually the increase due to carrying imports in U. S. -flag ships would be more than the \$15.5 million assumed above, since these reflect only the current differential between U. S. and foreign tanker rates but not the differential resulting from the presumed rise in the domestic tanker rate. However, this additional cost might be offset by a slight decline in foreign-flag tanker rates due to the shift from foreign to U. S. flag ships.

It should be noted that the figure of \$92.5 million is equal to 6 times the maximum cost computed by the AMA in its petition. The difference lies in the fact that the AMA's computation takes account only of the existing differential between foreign and domestic tanker rates but ignores that the proposed increase in the employment of U. S. -flag tankers would inevitably cause a significant rise in these rates.

Of course, if the higher tanker employment should lead to a higher level of U. S. tanker construction the domestic freight rate may eventually drop back to its present level. But even under the most favorable circumstances this would not happen for several years. During these years, oil importers, refiners and marketers on the East

Coast and, in the final analysis, also consumers would have to bear the full burden of the additional transportation costs.

SIZE AND OPERATING CONDITIONS OF THE U. S. - FLAG TANKER FLEET

According to official statistics the deadweight tonnage of privately owned U. S. tankers has not declined in the last 5 years but has, on the contrary, exhibited a regular annual growth. As the table below shows, this growth has occurred principally among actively employed tankers. The tonnage of temporarily inactive and laid-up vessels is currently lower than at any time in the last five years, and so is the ratio of inactive to total vessels.

Employment of Privately-owned U. S. - Flag Tankers
(Plus inactive Nat'l Defense Reserve)
In thousands of deadweight tons

<u>As of:</u>	<u>3/31/62</u>	<u>3/31/61</u>	<u>3/31/60</u>	<u>3/31/59</u>	<u>3/31/58</u>
Active Vessels	6,422	6,044	5,701	5,474	5,181
Inactive Vessels	598	796	961	765	642
Inactive Vessels as % of total private capacity	9.3%	13.2%	16.9%	14.0%	12.4%
(National Defense Reserve	1,011	1,038	1,015	899	684)

SOURCE: Maritime Administration, U. S. Dept. of Commerce

As the preceding figures show, for the five year period since the Suez crisis the statistical evidence does not suggest that the domestic tanker fleet has suffered due to competition from foreign-flag tankers or from any other cause.

In fact, oil transportation by domestic tanker has consistently expanded during the last several years according to the data shown below. This is due principally to the federal restrictions on oil imports imposed in March 1959. Under these restrictions imports of crude and refined oil (other than the residual fuel oil) are held to a fixed ratio of U. S. oil demands.

TOTAL TANKER SHIPMENTS OF DOMESTIC CRUDE OIL AND PRODUCTS TO THE U.S.
EAST COAST
(thousands of bbls.)

	<u>1961</u>	<u>1960</u>	<u>1959</u>	<u>1958</u>
	727,821	706,521	682,450	669,676

SOURCE: U.S. Bureau of Mines

Inasmuch as U. S. Maritime legislation prohibits the employment of non - U. S. -flag tankers in domestic oil transportation, U. S. -flag tankers reap the full benefit of the oil import restrictions, while being kept completely insulated from the pressure of foreign-flag competition.

It may be added that though residual fuel oil imports are not held to a fixed ratio to domestic demand, such imports do not affect domestic tanker shipments of this product, since domestic residual fuel oil is strictly a by-product which falls off accidentally in the course of refining crude oil into such products as gasoline and distillate oil. Hence the domestic production of residual fuel oil does not depend on the demand for or the price of this product. Consequently, imported residual oil does not displace the domestic product which would be shipped to the East Coast in available quantities regardless of the level of imports.

THE AMA PROPOSAL AND THE NATIONAL SECURITY

A. The Need for Spare Capacity

If the AMA proposal were put into effect it would have a negative impact on the national security, both domestically and internationally. The figures quoted on page 5 indicate that the total inactive U. S. tanker tonnage (privately owned ships and national defense reserve) currently equals only about 20% of the total U. S. - flag tanker capacity. This percentage, which is approximately in line with the spare capacity of many U. S. industries, provides a reasonable - although by no means excessive - margin for emergency expansion. However, if this margin were cut in half, as would be the case if the AMA proposals were adopted, the ability of the U. S. -flag tanker fleet to respond to National emergencies would be greatly reduced.

B. The Effect on Soviet Tanker Chartering

As previously stated, the AMA proposal would cause unemployment for about 440,000 deadweight tons of foreign-flag tankers, assuming that all substitution of foreign flag by U. S. - flag vessels would occur in the Caribbean - U. S. run. The companies primarily affected by this development would be the independent foreign-flag tanker owners who account for about 70% of all free-world tankers outside the U. S. These companies who chart their vessels to oil shippers at prevailing rates have for some years now operated at extremely low freight rates. In fact a number of their tankers is currently being operated at a deficit and is kept active only because the cost of dry docking the tankers is often higher than the loss sustained in operating them at prevailing depressed rates. Any additional unemployment would of course cause a further deterioration of this

situation.

Soviet oil exports have greatly benefited from this world-wide slump in tanker rates which has caused a number of independent free-world tanker operators to charter their vessels to the USSR. The importance of the availability of these free-world vessels to the Soviet oil export trust can be gauged from the fact that while Soviet oil exports currently account for about 6% of total international oil shipments, the Soviet tanker fleet accounts for only 2.2% of the world's tanker fleet engaged in International trade. The USSR is therefore largely insufficient in tanker carrying capacity. According to a Bureau of Mines paper this insufficiency is likely to continue beyond 1965.*

Hence Soviet oil export ability is inversely related to the utilization of the independent foreign-flag tanker fleet by free-world nations. The cut-back in foreign-flag tanker utilization proposed by the AMA would therefore benefit Soviet oil export by making additional free-world vessels at still lower rates available for carrying Soviet shipments to other nations. Presumably, this would not be in the best interest of our national security.

CONCLUSION

The Office of Emergency Planning's predecessor organization, the Office of Civil and Defense Mobilization, has rejected on December 29, 1960 proposals very similar to those recently submitted by the AMA and CATO.** In our view, nothing has occurred since then to justify a change in the government's position adopted at that time.

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* Development and Characteristics of the Soviet Tanker Fleet, statement by Donald J. Frendzel, East European specialist, Bureau of Mines, October 13, 1961.

**Since the proposal by CATO goes much further than the AMA's, the cost and national security risk of the CATO proposal would be correspondingly higher..