

REPEAL THE JONES ACT

The Jones Act is bad for American energy producers and consumers and should be repealed—if not entirely, at least for shipments of oil and liquefied natural gas.

The 1920 Jones Act requires that shipments between two U.S. ports be on U.S.-built, U.S.-manned vessels.¹ Of course, there is no such requirement when a shipment goes from a U.S. port to a foreign port or vice versa—any ship can make that trip. As a result, when there is a spike in demand for sea transport, there is often a shortage of U.S.-built ships to move products from U.S. sellers to buyers in a U.S. port, and it can be much cheaper to simply ship U.S. products to foreign buyers in foreign ports.

This problem is particularly acute in rapidly shifting energy markets: as a result of the recent U.S. oil boom it now cost three times as much to ship oil from Texas to refineries on the U.S. East Coast as it costs to ship oil further to refineries in Canada.² In the coming decades, North American energy markets will keep shifting more and more rapidly as a result of new technologies and increasing international trade in energy. The Jones Act will prevent American companies from adapting to these shifts because it takes years to build new ships and train new workers. So while the rest of the world will be able to respond to changing markets, U.S. energy producers will be held back.

The Jones Act Holds Back Domestic Energy Production & Increases Our Reliance on Foreign Oil

The Jones Act impedes U.S. companies trying to adapt to increasingly rapid change in global oil and gas markets. Directional drilling and hydraulic fracturing have transformed oil markets by dramatically increasing U.S. production of oil and gas from shale, creating intense demand for new transport by pipeline, rail, and ship. But this “fracking” boom is not a one-time shift—instead fracking will make U.S. oil production more and more volatile. Fractured wells produce far more oil and gas initially and then tail off much more rapidly than conventional wells.³ As a result, shale drillers get an increasingly large proportion of their ultimate recovery in the first year or two of well operation.⁴ This is good for the companies because they get a quicker return on investment and it

¹ Merchant Marine Act of 1920, §27, P.L. 66-26.

² Cong. Res. Serv., Shipping U.S. Crude Oil by Water: Vessel Flag Requirements and Safety Issues 9 (July 2014) <http://www.fas.org/sgp/crs/misc/R43653.pdf>; National Energy Board of Canada, Market Snapshot: Record high crude oil imports from the U.S. push Canadian oil imports to a three year high (March 2016) (describing increased marine transport of oil from Texas to refineries in Quebec and New Brunswick) <https://www.neb-one.gc.ca/nrg/ntgrtd/mrkt/snpsht/2016/03-01hghcrdlmprt-eng.html>.

³ John Kemp, *Why the Shale Revolution is Not About to End*, REUTERS, Aug. 29, 2014, <http://www.reuters.com/article/shale-usa-drilling-kemp-idUSL5N0QZ3U720140829>.

⁴ LEONARDO MAUGERI, THE SHALE OIL BOOM, A U.S. PHENOMENON, HARVARD BELFER CENTER (2013) <http://www.belfercenter.org/sites/default/files/legacy/files/USShaleOilReport.pdf/>.

is good for the country because it means U.S. oil markets react more quickly to changes in oil prices, ramping up production when high prices induce new drilling and letting production fall off when low prices discourage new drilling. In other words, steady conventional wells generally keep pumping no matter how low the price gets but rapid shale decline curves help the U.S. tailor production to prices.

But U.S. producers can only benefit from their new ability to quickly ramp up production if oil transport markets are sufficiently liquid to allow them to connect these new sources of production with demand centers. And the principal demand for fracked oil comes from refineries searching for light oil. Unfortunately, the refineries closest to the oil boom are in the Midwest and the Gulf Coast and many of them have recently upgraded to handle heavy oil from Canada, Mexico, and Venezuela, so the most obvious destination for light fracked oil would be refineries on the U.S. east coast that currently import light oil from the U.K., Norway, and the Middle East.⁵

Unfortunately, because of the Jones Act, it costs three times as much to ship oil from Texas to refineries on the U.S. East Coast as it costs to ship oil Canada.⁶ Similarly, northeastern U.S. refineries pay more than three times as much to ship oil from Texas rather than from West Africa or Saudi Arabia.⁷ As a result, the northeastern U.S. is more likely to rely on foreign sources of crude oil,⁸ while, with the ban on U.S. oil exports now ended, U.S. oil is shipped longer distances abroad.

The same problems may arise in U.S. liquefied natural gas (LNG) markets. New LNG facilities on the Gulf Coast are exporting cargoes across the Pacific Ocean to Japan⁹ while the Massachusetts import facilities take in gas from Trinidad & Tobago.¹⁰ But these shipping routes can never be rationalized because there are no U.S. flagged liquefied natural gas tankers to carry LNG between

⁵ U.S. Energy Information Administration, *Regional Refinery Trends Evolve to Accommodate Increased Domestic Crude Oil Production*, Jan. 15, 2015, <http://www.eia.gov/todayinenergy/detail.php?id=19591>.

⁶ Cong. Res. Serv., *Shipping U.S. Crude Oil by Water: Vessel Flag Requirements and Safety Issues 9* (July 2014) <http://www.fas.org/sgp/crs/misc/R43653.pdf>.

⁷ *Id.* at 10.

⁸ Or take U.S. oil shipped by more dangerous rail transport. *See, e.g.*, United States State Department, *Final Supplemental Environmental Impact Statement* (Jan. 2014) ES-35 (estimating that denying the Keystone XL pipeline permit would increase transport by rail and thus “result in an estimated 49 additional injuries and six additional fatalities ... on an annual basis”).

⁹ U.S. Energy Information Administration, *U.S. Natural Gas Exports and Re-Exports by Country*, https://www.eia.gov/dnav/ng/ng_move_expc_s1_a.htm.

¹⁰ U.S. Energy Information Administration, *U.S. Natural Gas Imports by Point of Entry*, https://www.eia.gov/dnav/ng/NG_MOVE_POE1_A_EPG0_IML_MMCF_M.htm; Thomas Overton, *Everett LNG Terminal at the Crossroads*, *POWER*, July 2, 2013, <http://www.powermag.com/everett-lng-terminal-at-the-crossroads/?pagenum=2>.

U.S. ports.¹¹

There Are Few Public-Spirited Justifications for the Jones Act

Given the costs that the Jones Act imposes on domestic energy producers and consumers, it is not surprising that it has begun to attract scrutiny. There are relatively recent reports detailing the cost of the Jones Act from the U.S. Energy Information Administration,¹² the Congressional Research Service,¹³ and the Heritage Foundation.¹⁴

By contrast, the Jones Act has attracted few public defenses other than occasional opinion pieces by representatives of U.S. shipping companies. The most careful extended defense is a law review article by Samuel Giberga, the executive officer of “Hornbeck Offshore Services, Inc., the owner and operator of one of the largest fleet of Jones Act qualified offshore service vessel.”¹⁵ Mr. Giberga argues that the Jones Act is justified by three ways that it enables our national defense. First, he says that it “keeps our coastal regions in the hands of people that we can count on the most to be loyal to the United States: U.S. citizens.”¹⁶ Second, he says that, by encouraging domestic flagged shipping, it “provide[s] a ready reserve of mariners capable of operating vessels” in case of military conflict.¹⁷ Third, he argues that “it ensures our ability to transport military cargos and personnel.”¹⁸

These are not unreasonable aims but the Jones Act is poorly tailored to achieve them in shifting energy markets. First, it does not ensure that only U.S. flagged vessels operate in U.S. ports because the majority of oil tankers and all LNG tankers will continue to be foreign-flagged.

As to the second and third points: if the goal is to support U.S. sailors and ship-building, the Jones Act is a very poor means, at least for rapidly shifting energy transport. No one would build a

¹¹ Greg LaRose, *Report Chills Idea to Link LNG Exports to U.S.-Built Ships*, THE TIMES PICAYUNE, Dec. 4, 2015, http://www.nola.com/business/index.ssf/2015/12/report_chills_idea_to_link_lng.html.

¹² Additional Information on Jones Act Vessels’ Potential Role in Northeast Refinery Closures, May 11, 2012, <http://www.eia.gov/analysis/petroleum/nerefining/update/pdf/add051112.pdf>.

¹³ Cong. Res. Serv., *Shipping U.S. Crude Oil by Water: Vessel Flag Requirements and Safety Issues* 9 (July 2014) <http://www.fas.org/sgp/crs/misc/R43653.pdf>.

¹⁴ The Heritage Foundation, *Sink the Jones Act: Restoring America’s Competitive Advantage in Maritime-Related Industries*, May 22, 2014, <http://www.heritage.org/government-regulation/report/sink-the-jones-act-restoring-americas-competitive-advantage-maritime>.

¹⁵ Samuel A. Giberga & John Henry Tab Thompson, *We and Mr. Jones: How the Misunderstood Jones Act Enhances Our Security and Economy*, 46 J. OF MARITIME LAW & COMMERCE 493, 493 (2015) available at <http://www.offshoremarine.org/articles/how-the-misunderstood-jones-act-enhances-our-security-and-our-economy>.

¹⁶ *Id.* at 502.

¹⁷ *Id.* at 503.

¹⁸ *Id.*

quarter-of-a-billion LNG tanker¹⁹ that would be economically justified only for a single U.S.-port-to-U.S.-port trade route.²⁰ And even if more oil tankers can be built, they will take years to build²¹ during which time, U.S. producers will be sending oil abroad and U.S. consumers will be taking in foreign oil.

Furthermore, the Jones Act's incentives to build U.S. shipping bear little relation to the strategic needs of the United States. Given increased production of domestic oil and gas, if a world conflict shut down international trade, the continued reliability of oil and gas markets would be one of the least worrying areas. And fundamentally, a complete ban on foreign-flagged ships is an extremely inefficient means of subsidizing U.S. flagged ships. Given that rental costs for U.S. flagged ships are approximately four-times those for foreign-flagged ships,²² there would be plenty of room to apply a strategic tax to foreign-flagged ships to provide a subsidy for domestic shipping, while leaving all parties better off.

The Jones Act Illustrates How Useless Regulations Hold Back the Energy Sector

Finally, the Jones Act is a particularly promising target for repeal or modification because it could be a confidence-building measure toward freer trade, less costly regulation, and less government interference in energy markets. Admittedly, the Jones Act is not the most wide-reaching or the most costly distortion in energy markets. But small success stories can catalyze wider changes in government regulation: For years, groups that favor stronger environmental regulations have relied on just a few stories of successful regulations to justify myriad new requirements.²³ Similarly, given the widespread consensus on the costs of the Jones Act, and the very few public-spirited arguments in its favor, repealing the Jones Act for energy transport may be a stepping stone toward less costly government intrusion in the energy sector.

¹⁹ Xun Yao Chen, *A guide to liquefied natural gas carriers and key shipping costs*, MARKET REALIST, May 23, 2014, <http://marketrealist.com/2014/05/expensive-lng-carriers-results-in-dividends/>.

²⁰ U.S. Government Accountability Office, *Implications of Using U.S. Liquefied- Natural-Gas Carriers for Exports* (Dec. 2015) <http://www.gao.gov/assets/680/673976.pdf>.

²¹ Sandy Fielden, *Ship To Wreck - Can The Jones Act Tanker Market Keep Growing?*, RBN ENERGY, Oct. 25, 2015, <https://rbnenergy.com/ship-to-wreck-can-the-jones-act-tanker-market-keep-growing>.

²² *Id.*

²³ Jonathan H. Adler, *Fables of the Cuyahoga: Reconstructing a History of Environmental Protection*, 14 FORDHAM ENVTL. L.J. 89 (2002) (describing how widespread, but mistaken, belief that there are photos of a 1969 river fire in Cleveland motivated environmental regulation for decades).