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THE WHITE HOUSE

WASHINGTON

July 12, 1976

MR PRESIDENT:

The Administration's "Third-Flag" Bill

In late May you decided to propose our own "third-flag" legislation as an alternative to a Federal Maritime Commission draft bill and another bill already under discussion in the House (H.R. 7940). Your decision was based on information contained in a decision memorandum from OMB plus staffing comments from your senior advisors. (See TAB B for back-up)

Jim Cannon now strongly recommends that you reconsider this decision for the following reasons:

1. While OMB recommended against supporting any legislation, the decision memorandum suggested that some kind of Congressional action on a third-flag bill was likely and that an Administration bill might be a preferable alternative to other bills. However, it would now appear that Congressional action is unlikely this year. Representative Pete McCloskey, the ranking Republican on the House Marine Sub-committee reports that no has made a good case for a bill and that he is determined to stop any bill. He argues that the chance of any action this session "are slim" and that the best Administration strategy is to "cool it, and wait to help him resist a bill, if necessary.
2. The decision memorandum failed to emphasize sufficiently that any increased economic regulatory authority for the FMC would be wholly inconsistent with the President's efforts to reduce economic regulation and to emphasize increased competition as a preferable alternative.

If you approve Jim Cannon's recommendation to reconsider your decision on the above subject, an appropriate decision memorandum will be prepared outlining your options.

Approve \_\_\_\_\_

Disapprove \_\_\_\_\_

Jim Connor



THE WHITE HOUSE

WASHINGTON

May 22, 1976

ADMINISTRATIVELY CONFIDENTIAL

MEMORANDUM FOR: JAMES T. LYNN

FROM: JAMES E. CONNOR *jec*

SUBJECT: Federal Maritime Commission's  
Successor Bill to "Third-Flag"  
Legislation

The President has reviewed your memorandum of May 14 on the above subject and has approved Option #3 -- Support a bill of significantly more limited proportions than the FMC draft bill. The President also added the following notation:

"No compromise beyond what we decide as to provisions."

Please follow-up with the appropriate action.

cc: Dick Cheney

THE PRESIDENT HAS SEEN....

THE WHITE HOUSE

WASHINGTON

May 21, 1976

MR PRESIDENT:

Federal Maritime Commission's  
Successor Bill to "Third-Flag"  
Legislation

Staffing of the attached memorandum prepared by  
Jim Lynn resulted in the following recommendations:

Option 1 - Oppose the FMC draft bill and request FMC  
to use its current authorities to deal with any  
problem.

Supported by Messrs. Seidman, Buchen  
and Cannon.

Option 3 - Support a bill of significantly more limited  
proportions than the FMC draft bill.

Supported by Messrs. Marsh, Friedersdorf  
and Scowcroft.

General Scowcroft (NSC) offered some additional  
comments supporting their recommendation. See TAB A.

Tim Austin had not comments on this subject.

OMB informs us that your decision is needed on this  
matter before you leave Washington.

Jim Connor



EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

MAY 14 1976

MEMORANDUM FOR: THE PRESIDENT  
FROM: James T. Lynn *Ohene*  
SUBJECT: Federal Maritime Commission's Successor  
Bill to "Third-Flag" Legislation

ISSUE

What position should the Administration take regarding a Federal Maritime Commission (FMC) draft bill entitled the "Ocean Shipping Act of 1976"?

BACKGROUND

FMC is requesting Administration clearance of a draft bill entitled the "Ocean Shipping Act of 1976," a successor bill to previous so-called "third-flag" bills which were active last session of Congress. These bills are commonly seen as a way to deal with Soviet-flag shipping competition in the U.S. foreign trades. Proponents of these bills--namely U.S. ship operators, maritime labor unions, and the FMC--claim that state-owned or state-controlled carriers, like the Soviet carriers, are not necessarily operated on a profit basis. It is alleged that these carriers unfairly underprice their services to gain larger shares of international shipping markets. European ship operators have made similar complaints against the Soviets.

The proposed FMC bill provides the FMC with new powers in the regulation of state-controlled ocean carriers. The basic provisions of the proposed bill are as follows:

- "Controlled carriers", for purposes of additional FMC regulation, include all carriers whose assets are owned primarily by, or whose operations are directed by, governments whose vessels are not accorded most-favored-nation treatment.
- Increased FMC regulation of controlled carrier rates does not apply to trades between the U.S. and the foreign country which owns or operates the controlled carrier. Rather, it only applies to "third-flag" carriage (e.g., Soviet-flag carriage between the U.S. and Japan).

- FMC is empowered to disapprove controlled carrier rates which are below levels which are "just and reasonable." FMC is provided with wide discretionary powers in making determinations of "reasonableness."
- The burden of proof is on controlled carriers to demonstrate that their rates are "just and reasonable."
- FMC is authorized to suspend controlled carrier rates for a total period not exceeding 14 months, pending investigation (currently FMC has no rate suspension powers). Furthermore, controlled carriers are required to file statements of justification for rate decreases.
- Controlled carriers are required to designate and retain a registered agent in the U.S. who shall maintain complete business records.
- FMC is provided with a \$2 million appropriation authorization for additional staffing to handle increased workload brought about by the above provisions.

U.S. exporters and importers opposed the "third-flag" bills last session because they felt that FMC would use its new authorities to restrict competition by third-flag carriers by subjecting them to minimum rate controls, the results of which would be to increase ocean freight rates to the U.S. and to strengthen the cartel-like ocean shipping conference system. The Administration (DOT) also opposed the third-flag bills last session because: (a) such legislation was contrary to the purposes of regulatory reform and tended to discriminate against third-flag carriers; and (b) FMC was believed to have sufficient authority to deal with alleged Soviet-flag rate-cutting.

#### CURRENT STATUS

Third-flag legislation was considered in both the House Merchant Marine and Fisheries Committee and the Senate Commerce Committee last year. However, because of importer/exporter and Administration opposition, it never reached the House or Senate floor.

The House Committee, however, is anxious to reconsider the legislation and has asked Chairman Bakke of the FMC to testify on May 26. The Committee has indicated that it wants the bill at least ten days before the hearing (May 16) to distribute to other parties who wish to testify. We anticipate that the bill will receive a favorable House hearing. The Senate Committee is expected to await House action before considering the bill.

## OPTIONS

1. Oppose the FMC draft bill. Request the FMC to use its current authorities to deal with any unreasonably low rates which may be filed by the Soviets.
2. Support the FMC draft bill with some modifications agreed to by FMC.
3. Support a bill of significantly more limited proportions than the FMC draft bill.

## DISCUSSION OF THE SOVIET-FLAG PROBLEM

Neither the FMC nor the maritime industry have made much of an effort to demonstrate that a Soviet-flag shipping problem exists. Unanswered questions are as follows:

- To what degree are Soviet-flag carriers competing in the U.S. foreign trades?
- Is there evidence that the rates under which they are competing are lower than other non-conference carriers and/or are in any way predatory?
- If the FMC believes that rates filed by Soviet-flag carriers are predatory, why hasn't it taken action under its existing statutory authorities to deal with the problem?

Available information indicates the following:

### Soviet-Flag Competition

The most recent statistics available from the FMC (the first 9 months of 1974) indicate that the Soviets carry a relatively modest 4% of U.S. exports and 3% of imports in trades served by scheduled carriers (liners). About half of Soviet carriage occurs in the U.S. Pacific Coast--Far East market, where the Soviets carry 6% of exports and 7% of imports.

Shipowners claim that they are not so much concerned by the relatively small percentage of trade now carried by the Soviets as they are about the future, which could increase that percentage into the teens and beyond. However, data provided by the FMC indicate that the Soviet liner fleet is anticipated to expand in tonnage capacity by only 2% from 1976 to 1981. Although the competitive capabilities of the Soviet fleet will be upgraded in that period by the replacement of old breakbulk vessels with more efficient containerships, there does

not appear to be reason for alarm that the Soviets will suddenly emerge as a dominant merchant maritime power. This finding has been confirmed by a 1975 CIA report which indicates that: (a) a number of long-standing deficiencies place the Soviet merchant fleet behind Western fleets in maritime technology (e.g., the average size of Soviet merchant ships is less than half the world average); and (b) although the Soviet fleet will be improving in the next five years, it will still lag behind Western maritime powers.

#### Soviet-Flag Freight Rates

U.S. and European ship operators deeply mistrust Soviet intentions and allege that the Soviets are charging rates which are commercially non-compensatory. To support the contention, the ship operators normally quote specific rates filed by the Soviets which are substantially below comparable ocean shipping conference rates.

FMC has provided data on freight rates for selected major commodities moving in the U.S.-Europe and U.S.-Far East trades. In comparing the Soviet rates with other rates filed by U.S.-flag and foreign-flag non-conference operators, it appears that the Soviets peg their rates very closely to the rates of other non-conference carriers (which can be as much as 20-50% lower than conference rates.) This finding is confirmed by a 1975 FMC staff report which indicates that although the Soviets have established rate levels substantially below conference rates, they "have endeavored...to avoid the position of being the lowest non-conference carrier."

On the other hand, we agree that a potential problem exists in that the Soviets, unlike other ship operators, could choose to operate their ships for other than profit motives--for example, to earn hard currency or for political/military reasons.

#### FMC Authority to Deal with Low Rates

Section 18(b)(5) of the 1916 Shipping Act authorizes FMC to "disapprove any rate or charge filed by a common carrier of the U.S....which, after hearing, it finds to be so unreasonably high or low as to be detrimental to the commerce of the U.S." FMC contends that this authority is insufficient for the following reasons:

- The burden of proof is on the FMC or complainant to show that the rate is unreasonably low;
- Formal proceedings are by necessity lengthy (one to two years), and FMC does not have rate suspension powers pending the outcome of the proceedings;

- Unduly low rates can only be dealt with on a rate-by-rate basis; and
- In the case of foreign flag lines, necessary financial data are usually located overseas where the FMC cannot enforce its subpoena powers to produce the necessary documents.

On the other hand, DOT, in a March 11 study on FMC's Section 18(b)(5) authorities concluded that:

"Section 18(b)(5)...provides enough authority for the FMC to promptly and adequately address the problem of unreasonably low rates charged by non-national or third-flag ocean carriers in the foreign commerce of the U.S. The duration of past Section 18(b)(5) cases was not the result of any shortcomings in the law, but rather the result of the administration of the law which led to unnecessarily long delayed reports of decisions. Revisions of FMC rules of practice may be needed, but amendment of Section 18(b)(5) is not required."

In short, there is a basic difference of opinion as to the sufficiency of Section 18(b)(5) to deal with unreasonably low rates. Despite the fact that FMC believes 18(b)(5) is insufficient, it is difficult to understand why FMC has not tried to take any regulatory action against low Soviet rates if it believes that these rates are so low as to be predatory. If it tried and failed, FMC's case for the need for additional legislation would be a great deal stronger than it currently appears to be.

#### AGENCY POSITIONS AND SHIPPER VIEWS

Nine agencies have provided views on the FMC draft bill. DOT, Justice, Treasury, CEA, and CIEP oppose the bill for similar reasons, as cited below:

- The FMC has not demonstrated that a Soviet-flag problem clearly exists; nor, if it does exist, why it cannot use existing authorities to deal with it.
- Insofar as the bill strengthens FMC authorities over a segment of the ocean liner industry, it runs counter to the trend to reduce transportation regulatory activities.

- The bill would tend to restrict competition by state-controlled carriers by subjecting them to minimum rate controls to which other carriers would not be subject. The likely result of such regulation would be to strengthen ocean shipping conferences and thereby increase ocean freight rates (although to an unknown degree).

State reports that it would not oppose new legislation, if properly drafted, which would prevent predatory rate practices in the U.S. foreign trades, but that the FMC bill presents significant foreign policy and economic problems. Principally, under the FMC bill, the test of state ownership or control of a vessel is not limited to the country under whose flag the vessel is registered. Rather, it encompasses the government which has ultimate control of the vessel (e.g., a Soviet vessel registered under a "flag of convenience," such as Liberia). State indicates that under international law, it is the state of a vessel's registry alone which determines the legal status of a vessel. Allowing the FMC to go "behind the flag" would be in violation of treaty commitments. Additionally, State objects to: (a) the bookkeeping requirement imposed by the bill because it is unnecessary and could engender similar practices in other countries; and (b) the burden of proof and rate suspension provisions proposed by FMC because these provisions may be overly restrictive.

Office of the Special Representative for Trade Negotiations reports that it favors the general intent of the Legislation but that it defers on the technical aspects of the bill.

Commerce defers to the views of FMC and Labor defers to other agencies more directly concerned.

Most exporters and importers that opposed last year's bills indicate that they do not intend to oppose the FMC proposal because it limits increased FMC regulation to a much smaller range of third-flag carriers--state controlled carriers. Although they would prefer that no bill be enacted, they would rather accept the FMC bill than have to continue to fight against potentially more harmful legislation. However, exporters and importers in the Great Lakes region will continue to oppose the bill because, in many instances, the Soviets are the only carriers providing shipping services to the region.

#### DISCUSSION OF OPTIONS

Option #1 -- Oppose the FMC draft bill and request the FMC to use existing authorities to deal with any unreasonably low Soviet rates.

Reasons for this option have been cited above by the various agencies, namely: (a) there is a lack of showing of need for a bill; (b) the bill is contrary to the purposes of regulatory reform; (c) the bill may have an adverse impact on freight rates; and (d) the bill has negative foreign policy impacts.

Option #2 -- Support the FMC draft bill with some modifications agreed to by the FMC. Reasons for supporting the bill include: (a) the Soviets have the capability of charging non-compensatory rates, whether or not they are actually doing so now; and (b) the perception of a threat by U.S. operators tends to discourage investment and create instability. Changes agreed to by the FMC include the following:

- Alternative language to avoid violations of treaty and international law;
- Softening of the provision which would shift the burden of proof regarding low rates onto the controlled carriers; and
- Deletion of the \$2 million appropriation authorization for FMC.

Option #3 -- Support a bill of significantly more limited proportions than the FMC draft bill. In addition to several of the modifications included in option #2, such a bill would further restrain expansion of FMC's authorities in the following way:

- Burden of proof regarding rate reasonableness would be clearly retained with the FMC, rather than shifted onto controlled carriers;
- Variable costs would be established as the sole standard for determining whether rates are reasonable;
- FMC would only be permitted to suspend controlled carrier rates if they were: (a) lower than those charged by any non-controlled carrier in the trade; and (b) more than 15% below shipping conference rates;
- Although controlled carriers would be required to submit data needed by FMC, they would not need to retain a registered business agent in the U.S.; and

- The President would be given authority to postpone, discontinue or suspend any FMC action for foreign policy or national defense reasons.

#### CONCLUSION AND OMB RECOMMENDATION

Most of the agencies primarily concerned with the legislation--notably DOT, Justice, Treasury and CEA--have indicated a preference for option #1 (to oppose the FMC draft bill). However, they feel that some progress has been made in "watering down" the original FMC draft bill, per option #2, and they believe that option #3 (to support a bill of significantly more limited proportions) goes a long way in meeting their objections to the FMC draft bill. State believes that some type of limited legislation is desirable, and supports a bill along the lines of option #3.

On merit alone, OMB recommends option #1. Like the other agencies, we believe that the FMC has made a poor case for the need for this legislation and has failed to make a "good faith effort" to use its existing authorities if it believes the Soviets are charging unreasonably low rates.

On the other hand, option #3 has some value in the following respects:

- Without shipper opposition to the bill, there is a strong chance that both House and Senate Committees will report out a bill; and
- If a bill is enacted by Congress (and unless you should decide to veto it), it would be preferable to try to work in provisions which minimize the potential negative aspects of the bill.

#### DECISION

\_\_\_\_\_ Option #1. Oppose the FMC draft bill and request FMC to use its current authorities to deal with any problem.

\_\_\_\_\_ Option #2. Support the FMC draft bill with some modifications agreed to by FMC.

RA 7 Option #3. Support a bill of significantly more limited proportions than the FMC draft bill.

*No compromise beyond what we decide as to provisions.*



## NATIONAL SECURITY COUNCIL

ACTION

May 19, 1976

MEMORANDUM FOR: JAMES CONNOR  
FROM: JEANNE W. DAVIS   
SUBJECT: Federal Maritime Commission's  
"Third Flag" Bill

You asked for our views on Jim Lynn's memorandum to the President concerning the Federal Maritime Commission's (FMC) draft "Third Flag" legislation.

The entry of state-owned and state-controlled carriers into traditional shipping markets has posed a threat to established firms in the U.S. and West Europe. The U.S. maritime industry and its supporters in Congress bemoan the demise of the U.S. merchant marine and note with alarm the growth of state-owned merchant fleets, some of which have cut rates indiscriminately to garner a larger market share.

We must, therefore, take some action to put the state-owned shippers on notice that we cannot and will not condone predatory pricing practices. Thus some "third flag" legislation is probably necessary and desirable at this time. However, this legislation should be drafted in such a manner which takes into account domestic and international economic considerations as well as specific treaty obligations. The FMC draft fails on this score. The bill would allow the FMC to "look behind" the vessels' registry to determine which government has ultimate control of the ship. Such a provision would not be consistent with current international law and practice. There are a number of other objectionable features in the draft bill which are covered adequately in the OMB memorandum.

Therefore, we favor Option 3 under which the Administration would support a significantly limited version of the FMC draft bill. In our view the Administration should not oppose the FMC draft outright (Option 1), as some agencies have recommended, even though the Commission has not adequately justified the need for such legislation.

We fear that unless the Administration is able to offer a reasonable alternative to the FMC draft or to the numerous other "third flag" bills introduced last session, Congress may pass a bill which would be overly restrictive and inconsistent with our international obligations.

RECOMMENDATION:

That the President approve Option 3.

STAFFING

THE WHITE HOUSE

ACTION MEMORANDUM

WASHINGTON

LOG NO.:

Date: July 12, 1976

Time:

FOR ACTION:

cc (for information):

Jim Lynn  
✓ Jack Marsh / *Friedersdorf*  
✓ Brent Scowcroft  
FROM THE STAFF SECRETARY

DUE: Date: July 13, 1976 - Tuesday

Time: 2 P.M.

SUBJECT:

Jim Connor's memorandum regarding  
Jim Cannon's request for President's  
Reconsideration of his decision on the  
Administration's "Third-Flag" Bill

ACTION REQUESTED:

- For Necessary Action
- For Your Recommendations .
- Prepare Agenda and Brief
- Draft Reply
- For Your Comments
- Draft Remarks

REMARKS:

*Marsh / Friedersdorf - Concur with Cannon  
Recommendation  
Scowcroft - see comments*

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate  
delay in submitting the required material, please  
telephone the Staff Secretary immediately.

Jim Connor  
For the President

THE WHITE HOUSE

WASHINGTON

June 22, 1976

MEMORANDUM FOR: DICK CHENEY  
FROM: JIM CANNON *for Jim Cannon*  
SUBJECT: The Administration's "Third-Flag" Bill



In late May the President decided to propose our own "third-flag" legislation as an alternative to a Federal Maritime Commission ("FMC") draft bill and another bill already under discussion in the House (H.R. 7940). Each of the three bills would give the FMC substantial new authority to deal with state-controlled ocean shipping firms -- primarily Soviet-Flag -- which are allegedly "unfairly" competing with other profit-making shipping firms. The Administration bill, which would be a watered down version of the FMC draft bill, is now being drafted.

This decision was based on information contained in a decision memorandum from OMB and staff comments collected by Jim Connor.

I would strongly recommend that the President reconsider this decision for two reasons:

1. While OMB recommended against supporting any legislation, the decision memorandum suggested that some kind of Congressional action on a third-flag bill was likely and that an Administration bill might be a preferable alternative to other bills. However, it would now appear that Congressional action is unlikely this year. Representative Pete McCloskey, the ranking Republican on the House Merchant Marine Subcommittee, reports that no one has made a good case for a bill and that he is determined to stop any bill. He argues that the chance of any action this session "are slim" and that the best Administration strategy is to "cool it" and wait to help him resist a bill, if necessary.
2. The decision memorandum failed to emphasize sufficiently that any increased economic regulatory authority for the FMC would be wholly inconsistent with the President's efforts to reduce economic regulation and to emphasize increased competition as a preferable alternative.

If you agree with my recommendation that the President reconsider this issue, we will be happy to work with OMB in drafting the appropriate decision memorandum for the President.

cc: Paul O'Neill

June 8, 1976

THE WHITE HOUSE  
WASHINGTON

TO: JIM CANNON

FROM: PAUL LEACH

*Paul  
(kb)*

I have discussed this with Art Quern and Ed Schmults and would like to chat with you about it.

THE WHITE HOUSE

WASHINGTON

June 8, 1976

MEMORANDUM FOR: JIM CANNON  
FROM: PAUL LEACH *PL*  
SUBJECT: Third-Flag Legislation

Background

For the past year there has been some discussion in Congress about the need for legislation (a "third-flag" bill) giving the Federal Maritime Commission ("FMC") authority to deal with state-owned or state-controlled ocean shipping firms --- primarily Soviet-flag --- which are "unfairly" competing with other profit-making shipping firms.

In late May, FMC Chairman Bakke was scheduled to testify at hearings before the House Merchant Marine Subcommittee. Prior to his testimony, Bakke requested Administration approval of the FMC's draft "Ocean Shipping Act of 1976" which he wanted to present as an alternative to the original bill (H.R. 7940) which the Subcommittee had been discussing.

This issue reached the President in late May and he decided to support another bill ("the Proposed Administration Bill") which would be "of significantly more limited proportions than the FMC draft bill." This decision was based on the information contained in a decision memorandum from OMB (see Tab A) and staff comments (collected by Jim Connor).

Issues

On the basis of information which I have gathered since the President's decision, I would suggest that the President may want to reconsider his decision.

Furthermore, if the decision is not reversed, I would also suggest that the exact provisions of the Proposed Administration Bill deserve more detailed attention and discussion than they were afforded in the decision memorandum at Tab A.

#### Reasons For Reconsideration

Congressional Situation. In the decision memorandum, it was stated that some kind of Congressional action on the third-flag problem was likely. It was argued that "without shipper opposition to the bill, there is a strong chance that both House and Senate committees will report out a bill." However, when Chairman Bakke appeared on May 26, some members of the House Merchant Marine Subcommittee were hostile. In particular, Representative Pete McCloskey---the ranking Republican---attacked Bakke's arguments with enthusiasm, as did Representative Ruppe (and other Great Lakes representatives).

Subsequently, I talked with McCloskey about the prospects for a "third-flag" bill and he reported that chances were about "10 percent." He reported that no one had made a good case for any bill and that he was determined to stop any bill. (This is a change in his position since he co-sponsored the original bill last year.) Interestingly, he questioned how the President could favor any kind of "third-flag" bill since it would inevitably provide the FMC with greatly expanded economic regulatory powers --- which McCloskey argued would be inconsistent with the President's regulatory reform programs. McCloskey's advice was for the Administration to "cool it" and wait to see if a bill began to move (at which time he would call for our help).

Congressman McCloskey followed up our conversation with a "status report" which reviews the situation and concludes that chances of House action on any bill this year "are slim because of the time constraints caused by the upcoming Congressional and Presidential election." This is at Tab B.

Conflict With Regulatory Reform. In addition to this different assessment of the likelihood for Congressional action, the decision memorandum, in presenting agency views on Option 3 ("Support a bill of significantly more limited proportions"), fails to emphasize the intensity of agency distaste for this regulation. Specifically, the memorandum says that DOT, Justice, Treasury and CEA "feel that some progress has been made in 'watering down' the original FMC draft bill ... and they believe that Option 3 ... goes a long way in meeting their objections to the FMC draft bill." On the contrary, I think that most or all of these agencies are totally opposed to any bill. The reasons are quite simple: No case has been made for the need for legislation in any form and increased economic regulatory authority for the FMC would be wholly inconsistent with the President's regulatory reform efforts.

#### The Proposed Administration Bill

If, upon reconsideration, it is decided that an Administration bill is necessary, I hope that careful consideration can be given to a number of issues which are not adequately discussed in the broad outline of the bill contained in the decision memorandum (at Tab A on pages 7 and 8). Specifically, some examples include:

- Is the controlled-carrier's burden of "submitting data needed by the FMC" equivalent to bearing the burden of proof? If so, how can this be reconciled with the burden of proof resting with FMC?
- Who can challenge a proposed "controlled-carrier rate"? Shippers who pay it? Competing carriers? FMC?
- What rate and operating cost data will be required to be filed by conference and independent carriers in order to make this new scheme of regulation effective? Is this expanded FMC interference desirable?
- When should the FMC consult with the President (or the State and Defense Departments) to assess foreign

policy and national defense considerations of a rate examination? Before initiating investigation? During? After?

- Once a controlled carrier rate is filed, should it be open to challenge indefinitely?
- For how long should a proposed rate be suspended by the FMC?
- Who bears the burden of proving that a proposed rate is "(a) lower than those charged by any non-controlled carrier in the trade; and (b) more than 15% below shipping conference rates" and thus subject to suspension by the FMC?

#### Conclusion

I would argue that Congressional action on a "third-flag" bill is unlikely this year, that any bill is irreconcilably contrary to the Administration's regulatory reform policies and that a workable bill is going to be close to impossible to draft. Thus, I would hope that this issue can be re-examined quickly, before the Administration paints itself into a corner (see, e.g., Tab C for recent Journal of Commerce article on this situation) from whence it will not be able to escape.

cc: Jim Lynn  
Bill Seidman  
Ed Schmults





EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

MAY 14 1975

MEMORANDUM FOR: THE PRESIDENT  
FROM: James T. Lynn *OLynn*  
SUBJECT: Federal Maritime Commission's Successor  
Bill to "Third-Flag" Legislation

ISSUE

What position should the Administration take regarding a Federal Maritime Commission (FMC) draft bill entitled the "Ocean Shipping Act of 1976"?

BACKGROUND

FMC is requesting Administration clearance of a draft bill entitled the "Ocean Shipping Act of 1976," a successor bill to previous so-called "third-flag" bills which were active last session of Congress. These bills are commonly seen as a way to deal with Soviet-flag shipping competition in the U.S. foreign trades. Proponents of these bills--namely U.S. ship operators, maritime labor unions, and the FMC--claim that state-owned or state-controlled carriers, like the Soviet carriers, are not necessarily operated on a profit basis. It is alleged that these carriers unfairly underprice their services to gain larger shares of international shipping markets. European ship operators have made similar complaints against the Soviets.

The proposed FMC bill provides the FMC with new powers in the regulation of state-controlled ocean carriers. The basic provisions of the proposed bill are as follows:

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- FMC is empowered to disapprove controlled carrier rates which are below levels which are "just and reasonable." FMC is provided with wide discretionary powers in making determinations of "reasonableness."
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#### CURRENT STATUS

Third-flag legislation was considered in both the House Merchant Marine and Fisheries Committee and the Senate Commerce Committee last year. However, because of importer/exporter and Administration opposition, it never reached the House or Senate floor.

The House Committee, however, is anxious to reconsider the legislation and has asked Chairman Bakke of the FMC to testify on May 26. The Committee has indicated that it wants the bill at least ten days before the hearing (May 16) to distribute to other parties who wish to testify. We anticipate that the bill will receive a favorable House hearing. The Senate Committee is expected to await House action before considering the bill.

## OPTIONS

1. Oppose the FMC draft bill. Request the FMC to use its current authorities to deal with any unreasonably low rates which may be filed by the Soviets.
2. Support the FMC draft bill with some modifications agreed to by FMC.
3. Support a bill of significantly more limited proportions than the FMC draft bill.

## DISCUSSION OF THE SOVIET-FLAG PROBLEM

Neither the FMC nor the maritime industry have made much of an effort to demonstrate that a Soviet-flag shipping problem exists. Unanswered questions are as follows:

- To what degree are Soviet-flag carriers competing in the U.S. foreign trades?
- Is there evidence that the rates under which they are competing are lower than other non-conference carriers and/or are in any way predatory?
- If the FMC believes that rates filed by Soviet-flag carriers are predatory, why hasn't it taken action under its existing statutory authorities to deal with the problem?

Available information indicates the following:

### Soviet-Flag Competition

The most recent statistics available from the FMC (the first 9 months of 1974) indicate that the Soviets carry a relatively modest 4% of U.S. exports and 3% of imports in trades served by scheduled carriers (liners). About half of Soviet carriage occurs in the U.S. Pacific Coast--Far East market, where the Soviets carry 6% of exports and 7% of imports.

Shipowners claim that they are not so much concerned by the relatively small percentage of trade now carried by the Soviets as they are about the future, which could increase that percentage into the teens and beyond. However, data provided by the FMC indicate that the Soviet liner fleet is anticipated to expand in tonnage capacity by only 2% from 1975 to 1981. Although the competitive capabilities of the Soviet fleet will be upgraded in that period by the replacement of old breakbulk vessels with more efficient containerships, there does

not appear to be reason for alarm that the Soviets will suddenly emerge as a dominant merchant maritime power. This finding has been confirmed by a 1975 CIA report which indicates that: (a) a number of long-standing deficiencies place the Soviet merchant fleet behind Western fleets in maritime technology (e.g., the average size of Soviet merchant ships is less than half the world average); and (b) although the Soviet fleet will be improving in the next five years, it will still lag behind Western maritime powers.

#### Soviet-Flag Freight Rates

U.S. and European ship operators deeply mistrust Soviet intentions and allege that the Soviets are charging rates which are commercially non-compensatory. To support the contention, the ship operators normally quote specific rates filed by the Soviets which are substantially below comparable ocean shipping conference rates.

FMC has provided data on freight rates for selected major commodities moving in the U.S.-Europe and U.S.-Far East trades. In comparing the Soviet rates with other rates filed by U.S.-flag and foreign-flag non-conference operators, it appears that the Soviets peg their rates very closely to the rates of other non-conference carriers (which can be as much as 20-50% lower than conference rates.) This finding is confirmed by a 1975 FMC staff report which indicates that although the Soviets have established rate levels substantially below conference rates, they "have endeavored...to avoid the position of being the lowest non-conference carrier."

On the other hand, we agree that a potential problem exists in that the Soviets, unlike other ship operators, could choose to operate their ships for other than profit motives--for example, to earn hard currency or for political/military reasons.

#### FMC Authority to Deal with Low Rates

Section 18(b)(5) of the 1916 Shipping Act authorizes FMC to "disapprove any rate or charge filed by a common carrier of the U.S....which, after hearing, it finds to be so unreasonably high or low as to be detrimental to the commerce of the U.S." FMC contends that this authority is insufficient for the following reasons:

- The burden of proof is on the FMC or complainant to show that the rate is unreasonably low;
- Formal proceedings are by necessity lengthy (one to two years), and FMC does not have rate suspension powers pending the outcome of the proceedings;

- Unduly low rates can only be dealt with on a rate-by-rate basis; and
- In the case of foreign flag lines, necessary financial data are usually located overseas where the FMC cannot enforce its subpoena powers to produce the necessary documents.

On the other hand, DOT, in a March 11 study on FMC's Section 18(b)(5) authorities concluded that:

"Section 18(b)(5)...provides enough authority for the FMC to promptly and adequately address the problem of unreasonably low rates charged by non-national or third-flag ocean carriers in the foreign commerce of the U.S. The duration of past Section 18(b)(5) cases was not the result of any shortcomings in the law, but rather the result of the administration of the law which led to unnecessarily long delayed reports of decisions. Revisions of FMC rules of practice may be needed, but amendment of Section 18(b)(5) is not required."

In short, there is a basic difference of opinion as to the sufficiency of Section 18(b)(5) to deal with unreasonably low rates. Despite the fact that FMC believes 18(b)(5) is insufficient, it is difficult to understand why FMC has not tried to take any regulatory action against low Soviet rates if it believes that these rates are so low as to be predatory. If it tried and failed, FMC's case for the need for additional legislation would be a great deal stronger than it currently appears to be.

#### AGENCY POSITIONS AND SHIPPER VIEWS

Nine agencies have provided views on the FMC draft bill. DOT, Justice, Treasury, CEA, and CIEP oppose the bill for similar reasons, as cited below:

- The FMC has not demonstrated that a Soviet-flag problem clearly exists; nor, if it does exist, why it cannot use existing authorities to deal with it.
- Insofar as the bill strengthens FMC authorities over a segment of the ocean liner industry, it runs counter to the trend to reduce transportation regulatory activities.

- The bill would tend to restrict competition by state-controlled carriers by subjecting them to minimum rate controls to which other carriers would not be subject. The likely result of such regulation would be to strengthen ocean shipping conferences and thereby increase ocean freight rates (although to an unknown degree).

State reports that it would not oppose new legislation, if properly drafted, which would prevent predatory rate practices in the U.S. foreign trades, but that the FMC bill presents significant foreign policy and economic problems. Principally, under the FMC bill, the test of state ownership or control of a vessel is not limited to the country under whose flag the vessel is registered. Rather, it encompasses the government which has ultimate control of the vessel (e.g., a Soviet vessel registered under a "flag of convenience," such as Liberia). State indicates that under international law, it is the state of a vessel's registry alone which determines the legal status of a vessel. Allowing the FMC to go "behind the flag" would be in violation of treaty commitments. Additionally, State objects to: (a) the bookkeeping requirement imposed by the bill because it is unnecessary and could engender similar practices in other countries; and (b) the burden of proof and rate suspension provisions proposed by FMC because these provisions may be overly restrictive.

Office of the Special Representative for Trade Negotiations reports that it favors the general intent of the legislation but that it defers on the technical aspects of the bill.

Commerce defers to the views of FMC and Labor defers to other agencies more directly concerned.

Most exporters and importers that opposed last year's bills indicate that they do not intend to oppose the FMC proposal because it limits increased FMC regulation to a much smaller range of third-flag carriers--state controlled carriers. Although they would prefer that no bill be enacted, they would rather accept the FMC bill than have to continue to fight against potentially more harmful legislation. However, exporters and importers in the Great Lakes region will continue to oppose the bill because, in many instances, the Soviets are the only carriers providing shipping services to the region.

#### DISCUSSION OF OPTIONS

- Option #1 -- Oppose the FMC draft bill and request the FMC to use existing authorities to deal with any unreasonably low Soviet rates.

Reasons for this option have been cited above by the various agencies, namely: (a) there is a lack of showing of need for a bill; (b) the bill is contrary to the purposes of regulatory reform; (c) the bill may have an adverse impact on freight rates; and (d) the bill has negative foreign policy impacts.

Option #2 -- Support the FMC draft bill with some modifications agreed to by the FMC. Reasons for supporting the bill include: (a) the Soviets have the capability of charging non-compensatory rates, whether or not they are actually doing so now; and (b) the perception of a threat by U.S. operators tends to discourage investment and create instability. Changes agreed to by the FMC include the following:

- Alternative language to avoid violations of treaty and international law;
- Softening of the provision which would shift the burden of proof regarding low rates onto the controlled carriers; and
- Deletion of the \$2 million appropriation authorization for FMC.

Option #3 -- Support a bill of significantly more limited proportions than the FMC draft bill. In addition to several of the modifications included in option #2, such a bill would further restrain expansion of FMC's authorities in the following way:

- Burden of proof regarding rate reasonableness would be clearly retained with the FMC, rather than shifted onto controlled carriers;
- Variable costs would be established as the sole standard for determining whether rates are reasonable;
- FMC would only be permitted to suspend controlled carrier rates if they were: (a) lower than those charged by any non-controlled carrier in the trade; and (b) more than 15% below shipping conference rates;
- Although controlled carriers would be required to submit data needed by FMC, they would not need to retain a registered business agent in the U.S.; and

- The President would be given authority to postpone, discontinue or suspend any FMC action for foreign policy or national defense reasons.

#### CONCLUSION AND OMB RECOMMENDATION

Most of the agencies primarily concerned with the legislation--notably DOT, Justice, Treasury and CEA--have indicated a preference for option #1 (to oppose the FMC draft bill). However, they feel that some progress has been made in "watering down" the original FMC draft bill, per option #2, and they believe that option #3 (to support a bill of significantly more limited proportions) goes a long way in meeting their objections to the FMC draft bill. State believes that some type of limited legislation is desirable, and supports a bill along the lines of option #3.

On merit alone, OMB recommends option #1. Like the other agencies, we believe that the FMC has made a poor case for the need for this legislation and has failed to make a "good faith effort" to use its existing authorities if it believes the Soviets are charging unreasonably low rates.

On the other hand, option #3 has some value in the following respects:

- Without shipper opposition to the bill, there is a strong chance that both House and Senate Committees will report out a bill; and
- If a bill is enacted by Congress (and unless you should decide to veto it), it would be preferable to try to work in provisions which minimize the potential negative aspects of the bill.

#### DECISION

- \_\_\_\_\_ Option #1. Oppose the FMC draft bill and request FMC to use its current authorities to deal with any problem.
- \_\_\_\_\_ Option #2. Support the FMC draft bill with some modifications agreed to by FMC.
- \_\_\_\_\_ Option #3. Support a bill of significantly more limited proportions than the FMC draft bill.

THE WHITE HOUSE  
WASHINGTON

Jim -

Jim Cannon has withdrawn his request  
that the President reconsider his  
decision on the Third Flag Legislation.

I assume we can just file??

A large, stylized handwritten signature, possibly reading 'Trudy', written in dark ink.

Trudy 7/16/76

*file May 22, 1976*

B

**Congress of the United States**  
**House of Representatives**  
Washington, D.C. 20515

June 3, 1976

Mr. Paul C. Leach  
Associate Director  
Domestic Council  
Room 218, Old Executive Office Building  
1600 Pennsylvania Avenue  
Washington, D. C. 20500

Dear Paul:

This is in response to your request for a status report on the so-called third flag legislation pending before the House Merchant Marine Subcommittee.

As you are aware, the original bill, H.R. 7940, introduced by the Chairman of the full Committee, Mrs. Sullivan, Mr. Downing, and myself last June, has gone through substantial revision. Briefly, H.R. 7940, as introduced, would have required all non-national carriers (a carrier who transports goods between two countries who is not registered in either one of those countries, but rather is registered in a third country) serving the foreign commerce of the United States charge rates which are "compensatory on a commercial cost basis." It would have placed the burden of proof on the non-national carrier to meet this standard and vested the Federal Maritime Commission (FMC) with authority to suspend and eventually reject rates if that burden was not met. The provisions of the bill would not have applied to chartered vessels or to bulk carriers, but to liner operators. The legislation was supported by U.S. maritime interests.

Last fall three days of hearings were held on H.R. 7940. Significant opposition surfaced at these hearings. The most objectionable feature was the potential for government intrusion into the rate-setting practices of privately-owned, non-national carriers serving the United States. In many instances, these carriers provide efficient, specialized, and low-cost service to U.S. exporters and importers; they are the only real competition to the steamship conferences which have anti-trust immunity to fix ocean freight rates. Moreover, to restrict the operations of vessels owned by our trading partners without providing comparable restrictions for U.S. vessels would have violated Treaties of Friendship, Commerce, and Navigation. The chief oppon-

ents were the Great Lakes interests, major U.S. exporters and importers, and Departments of State and Transportation, speaking for the Administration.

After considerable delay, the FMC drafted a revised bill (which did not receive Office of Management and Budget clearance, but was printed verbatim in the press) that attempted to alleviate most of the objections to H.R. 7940. The major provisions of this bill are --

- \* Scope restricted to "controlled carriers", which are defined as carriers owned or operated by a government with whom the U.S. does not have Treaties of Friendship, Commerce, and Navigation. (In essence then, it is limited to carriers of the Soviet Bloc countries.)
- \* Requires rates of controlled carriers to be "just and reasonable". Although the term is not defined, the bill lists several factors the FMC "may" take into account. They include whether the rates are: (a) fully compensatory, (b) assessed by other carriers in the same trade, or (c) required to assure movement of particular cargo in the trade.
- \* Places the burden of proof on controlled carriers whose rates are being challenged.
- \* Requires controlled carriers to establish a registered agent within the U.S. This agent is to maintain complete business records supporting the rates which are filed.
- \* Grants the FMC discretion to decide whether or not to order the rates of controlled carriers suspended while a hearing is in process. However, except for an initial 90-day period immediately after enactment, it gives the FMC authority to suspend rates only if it acts within 30 days after the rates are filed.
- \* Applies to controlled carriers that are "cross trading", i.e., serving the foreign trade of other countries. It does not apply if they serve the commerce between the U.S. and their own country.

On May 26, a further hearing was held ostensibly on H.R. 7940 at which FMC Chairman Bakke was the only witness. In reality, the hearing was on the FMC revised bill. Testimony at this hearing disclosed that the Soviet Bloc countries only carry about 4 percent of our liner exports and imports. The only area where they carry a significant percent of the liner cargo (about 22 percent) is in the Great Lakes which have not, until recently, been served by U.S.-flag carriers. Moreover, Chairman

Bakke, in response to questions by Great Lakes Congressmen, indicated that the FMC has no evidence of predatory practices by Soviet Bloc carriers on the Great Lakes.

In order to satisfy the Great Lakes interests, who remain opposed to the legislation, language is being drafted by Committee staff to limit the scope of the bill. Basically, two approaches are being explored. First, exempting from the bill controlled carriers who serve the Great Lakes unless the President declares that the "national interest" requires the provisions of the bill be applicable to such carriers. Secondly, limiting the parties who may challenge the rates of a controlled carrier to U.S.-flag carriers providing direct service to the area in question. At this time, the latter approach has more support among Committee staff. It is my understanding that Chairman Sullivan and Mr. Downing will introduce a clean bill next week, which will be the revised FMC bill, as modified by the second approach.

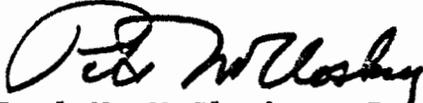
Finally, the State Department has recently submitted a letter to Mr. Downing, Chairman of the Merchant Marine Subcommittee, indicating that President Ford has reviewed H.R. 7940 and the revised FMC bill, and has found both of them lacking. Specifically, that Department states the President would agree to a proposal only if --

- \* Violations of treaty and international law be avoided.
- \* Burden of proof as to reasonableness of rates be retained with the FMC, rather than shifted to controlled carriers.
- \* Variable costs as the sole standard for determining whether rates are reasonable.
- \* FMC be permitted to suspend controlled carrier rates only if they are: (a) lower than those charged by any non-controlled carrier in the trade, and (b) more than 15 percent below steamship conference rates.
- \* Controlled carriers be required to submit data needed by FMC, but not required to retain a registered business agent in the U.S.
- \* The President be authorized to postpone, discontinue, or suspend any FMC action for foreign policy or national defense reasons.

My assessment is that the majority will try to push through the Subcommittee and the full Committee the revised FMC bill as modified. In this regard, I understand that Subcommittee Chairman Downing is attempting to schedule hearings in early July on that

bill. In my view, the prospects of passage of the legislation by the House in this Session of Congress, however, are slim because of the time constraints caused by the upcoming Congressional and Presidential elections.

Sincerely yours,



Paul N. McCloskey, Jr.

PNMcC/Mgl



Far Removed From What Ship Industries Want

LEADER PAGE

JUN 3 1976

# Ford Details Acceptable Limits On Third-Flag Ship Legislation

By ROBERT F. MORISON  
Journal of Commerce Staff

WASHINGTON — The administration has outlined the limits of legislation it will accept to cope with competition from so-called "third-flag" operators in the foreign trades of the United States, especially state-owned carriers of the Socialist bloc.

And, these limits are far removed from what traditionally the shipping industries here and abroad want and what Congress seems inclined to think is needed.

But, it does constitute the first inclination by the executive branch to support any sort of move in this direction since furor over the Russian and Polish merchant fleets began.

## Certain Principles Urged

The President, according to James T. Lynn, director of the Office of Management and Budget (OMB), has made it clear that certain principles must be included in any legislation which he could support. These principles include:

1. Third-flag carriers of countries with which this country has antidiscriminatory commercial treaties, in effect, would be exempt.

2. The Federal Maritime Commission (FMC) would continue to bear the burden of proof to show third-flag rates to be predatory or damaging to the carriers of a U. S. flag and those of its trading-partner countries.

3. Variable costs, far less than full costs, would be the standard for judging whether the challenged rates would be adequate.

4. FMC would be given authority to suspend for six months — plus a second six months if need be — where third-flag rates were found lower than those of non-state-controlled third-flag operators in the trade and more than 15 per cent below conference rates.

5. The President, much as he may with international air rates, would be given authority to postpone, discontinue or suspend any FMC actions in the area of state-controlled third-flag rates for foreign policy or national defense reasons.

Mr. Lynn relayed these principles to Secretary of State Henry A. Kissinger late last month. This is being, in turn, transmitted to Congress.

The State Department, through the office of Robert J. McCloskey, assistant secretary for congressional relations, has advised the House Merchant Marine and Fisheries Committee that it believes both the pending House bill (HR 7940) and the variation suggested by the FMC — and rejected recently by OMB — "seek to remedy the unfair and predatory practices of certain carriers by resorting to measures which we believe are too cumbersome and disruptive and which, in fact, would not solve the problem."

Further, it is noted that the administration is trying to reform regulatory processes and in doing so to reduce the intrusion of government in the economy. The pending bills are inconsistent with this intention and "we believe it is extremely important to avoid providing the FMC with authorities in excess of those it really needs to deal with existing or potential problems," Mr. McCloskey said.

The executive branch objects to the absence of any distinction between the possibly predatory state-controlled operators and the traditional, profit-guided, privately owned third flags. The latter have long pro-

vided competitive service in the U. S. trades, the absence of which could lead to higher shipping rates, and might also violate the many treaties of friendship, commerce and navigation. This country has to guarantee equal treatment to U. S. and foreign-flag ships and trade, he added.

By restricting a legislative approach to state-controlled carriers not affected by commercial treaties or other U. S. obligations to equal treatment "we acknowledge economic reality," and only those carriers "backed by the total resources of their respective governments, and hence immune from the normal play of market forces, would be subject to exceptional regulatory scrutiny," Mr. McCloskey said.

## Version of Rate Rules

The State Department has worked up a version of third-flag rate regulation legislation which will be submitted to Congress soon.

However, there are strong indications that at least the House merchant marine subcommittee has run out of patience with the executive branch and will go ahead, instead, with a bill along the lines suggested by FMC and unacceptable to the administration. (No further hearings are scheduled at this time.)

Generally, the FMC approach would require the state-controlled lines operating outside conferences and functioning as third-flag carriers to keep their rates above what amounts to full costs.

## FMC Authority

FMC would enjoy suspension authority for seven months with an additional seven months where the potentially offending carrier had not furnished the necessary data to complete FMC's investigation.

Such carriers would also be required to maintain agents within U. S. jurisdiction to facilitate access to data needed to substantiate costs. This, too, is opposed by the White House.

Mr. McCloskey said the legislation the administration has in mind "would respond to the problems at hand without violating the competitive status of privately owned independent carriers, provide protection to the U. S. merchant fleet, and retain for shippers their traditional and stable choice of carrier rates."

MEMORANDUM

NATIONAL SECURITY COUNCIL

4041

July 13, 1976

MEMORANDUM FOR: JAMES CONNOR

FROM: Jeanne W. Davis 

SUBJECT: Your Memo re Jim Cannon's  
Request for President's Reconsideration  
of His Decision re Administration's  
"Third-Flag Bill"

The NSC Staff has no objection to Jim Cannon's recommendation that the Administration not submit a "Third Flag" bill during this session.

THE WHITE HOUSE

ACTION MEMORANDUM

WASHINGTON

LOG NO.:

Date: July 12, 1976

Time:

FOR ACTION:

cc. (for information):

Jim Lynn  
Jack Marsh  
Brent Scowcroft  
FROM THE STAFF SECRETARY

DUE: Date: July 13, 1976 - Tuesday

Time: 2 P. M.

SUBJECT:

Jim Connor's memorandum regarding  
Jim Cannon's request for President's  
Reconsideration of his decision on the  
Administration's "Third-Flag" Bill

ACTION REQUESTED:

FROM: Max L. Friedersdorf

For Your Recommendations

Please handle ✓

Draft Reply

Please see me \_\_\_\_\_

Draft Remarks

For your information \_\_\_\_\_

Other *Connor  
with Cannon  
recommendation*

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a  
delay in submitting the required material, please

Jim Connor  
For the President

THE WHITE HOUSE

WASHINGTON

May 22, 1976

ADMINISTRATIVELY CONFIDENTIAL

MEMORANDUM FOR: JAMES T. LYNN -

FROM: JAMES E. CONNOR *jee*

SUBJECT: Federal Maritime Commission's  
Successor Bill to "Third-Flag"  
Legislation

The President has reviewed your memorandum of May 14 on the above subject and has approved Option #3 -- Support a bill of significantly more limited proportions than the FMC draft bill. The President also added the following notation:

"No compromise beyond what we decide as to provisions."

Please follow-up with the appropriate action.

cc: Dick Cheney

option 3  
approved  
5/22/76

May 21, 1976

MR PRESIDENT:

**Federal Maritime Commission's  
Successor Bill to "Third-Flag"  
Legislation**

Staffing of the attached memorandum prepared by Jim Lynn resulted in the following recommendations:

Option 1 - Oppose the FMC draft bill and request FMC to use its current authorities to deal with any problem.

Supported by Messrs. Seidman, Buchen and Cannon.

Option 3 - Support a bill of significantly more limited proportions than the FMC draft bill.

Supported by Messrs. Marsh, Friedersdorf and Scowcroft.

General Scowcroft (NSC) offered some additional comments supporting their recommendation. See TAB A.

Tim Austin had not comments ~~on~~ this subject.

OMB informs us that your decision is needed on this matter before you leave Washington.

Jim Connor



EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

MAY 14 1976

MEMORANDUM FOR: THE PRESIDENT  
FROM: James T. Lynn *Ohene*  
SUBJECT: Federal Maritime Commission's Successor  
Bill to "Third-Flag" Legislation

ISSUE

What position should the Administration take regarding a Federal Maritime Commission (FMC) draft bill entitled the "Ocean Shipping Act of 1976"?

BACKGROUND

FMC is requesting Administration clearance of a draft bill entitled the "Ocean Shipping Act of 1976," a successor bill to previous so-called "third-flag" bills which were active last session of Congress. These bills are commonly seen as a way to deal with Soviet-flag shipping competition in the U.S. foreign trades. Proponents of these bills--namely U.S. ship operators, maritime labor unions, and the FMC--claim that state-owned or state-controlled carriers, like the Soviet carriers, are not necessarily operated on a profit basis. It is alleged that these carriers unfairly underprice their services to gain larger shares of international shipping markets. European ship operators have made similar complaints against the Soviets.

The proposed FMC bill provides the FMC with new powers in the regulation of state-controlled ocean carriers. The basic provisions of the proposed bill are as follows:

- "Controlled carriers", for purposes of additional FMC regulation, include all carriers whose assets are owned primarily by, or whose operations are directed by, governments whose vessels are not accorded most-favored-nation treatment.
- Increased FMC regulation of controlled carrier rates does not apply to trades between the U.S. and the foreign country which owns or operates the controlled carrier. Rather, it only applies to "third-flag" carriage (e.g., Soviet-flag carriage between the U.S. and Japan).

- FMC is empowered to disapprove controlled carrier rates which are below levels which are "just and reasonable." FMC is provided with wide discretionary powers in making determinations of "reasonableness."
- The burden of proof is on controlled carriers to demonstrate that their rates are "just and reasonable."
- FMC is authorized to suspend controlled carrier rates for a total period not exceeding 14 months, pending investigation (currently FMC has no rate suspension powers). Furthermore, controlled carriers are required to file statements of justification for rate decreases.
- Controlled carriers are required to designate and retain a registered agent in the U.S. who shall maintain complete business records.
- FMC is provided with a \$2 million appropriation authorization for additional staffing to handle increased workload brought about by the above provisions.

U.S. exporters and importers opposed the "third-flag" bills last session because they felt that FMC would use its new authorities to restrict competition by third-flag carriers by subjecting them to minimum rate controls, the results of which would be to increase ocean freight rates to the U.S. and to strengthen the cartel-like ocean shipping conference system. The Administration (DOT) also opposed the third-flag bills last session because: (a) such legislation was contrary to the purposes of regulatory reform and tended to discriminate against third-flag carriers; and (b) FMC was believed to have sufficient authority to deal with alleged Soviet-flag rate-cutting.

#### CURRENT STATUS

Third-flag legislation was considered in both the House Merchant Marine and Fisheries Committee and the Senate Commerce Committee last year. However, because of importer/exporter and Administration opposition, it never reached the House or Senate floor.

The House Committee, however, is anxious to reconsider the legislation and has asked Chairman Bakke of the FMC to testify on May 26. The Committee has indicated that it wants the bill at least ten days before the hearing (May 16) to distribute to other parties who wish to testify. We anticipate that the bill will receive a favorable House hearing. The Senate Committee is expected to await House action before considering the bill.

OPTIONS

1. Oppose the FMC draft bill. Request the FMC to use its current authorities to deal with any unreasonably low rates which may be filed by the Soviets.
2. Support the FMC draft bill with some modifications agreed to by FMC.
3. Support a bill of significantly more limited proportions than the FMC draft bill.

DISCUSSION OF THE SOVIET-FLAG PROBLEM

Neither the FMC nor the maritime industry have made much of an effort to demonstrate that a Soviet-flag shipping problem exists. Unanswered questions are as follows:

- To what degree are Soviet-flag carriers competing in the U.S. foreign trades?
- Is there evidence that the rates under which they are competing are lower than other non-conference carriers and/or are in any way predatory?
- If the FMC believes that rates filed by Soviet-flag carriers are predatory, why hasn't it taken action under its existing statutory authorities to deal with the problem?

Available information indicates the following:

Soviet-Flag Competition

The most recent statistics available from the FMC (the first 9 months of 1974) indicate that the Soviets carry a relatively modest 4% of U.S. exports and 3% of imports in trades served by scheduled carriers (liners). About half of Soviet carriage occurs in the U.S. Pacific Coast--Far East market, where the Soviets carry 6% of exports and 7% of imports.

Shipowners claim that they are not so much concerned by the relatively small percentage of trade now carried by the Soviets as they are about the future, which could increase that percentage into the teens and beyond. However, data provided by the FMC indicate that the Soviet liner fleet is anticipated to expand in tonnage capacity by only .2% from 1976 to 1981. Although the competitive capabilities of the Soviet fleet will be upgraded in that period by the replacement of old breakbulk vessels with more efficient containerships, there does

not appear to be reason for alarm that the Soviets will suddenly emerge as a dominant merchant maritime power. This finding has been confirmed by a 1975 CIA report which indicates that: (a) a number of long-standing deficiencies place the Soviet merchant fleet behind Western fleets in maritime technology (e.g., the average size of Soviet merchant ships is less than half the world average); and (b) although the Soviet fleet will be improving in the next five years, it will still lag behind Western maritime powers.

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U.S. and European ship operators deeply mistrust Soviet intentions and allege that the Soviets are charging rates which are commercially non-compensatory. To support the contention, the ship operators normally quote specific rates filed by the Soviets which are substantially below comparable ocean shipping conference rates.

FMC has provided data on freight rates for selected major commodities moving in the U.S.-Europe and U.S.-Far East trades. In comparing the Soviet rates with other rates filed by U.S.-flag and foreign-flag non-conference operators, it appears that the Soviets peg their rates very closely to the rates of other non-conference carriers (which can be as much as 20-50% lower than conference rates.) This finding is confirmed by a 1975 FMC staff report which indicates that although the Soviets have established rate levels substantially below conference rates, they "have endeavored...to avoid the position of being the lowest non-conference carrier."

On the other hand, we agree that a potential problem exists in that the Soviets, unlike other ship operators, could choose to operate their ships for other than profit motives--for example, to earn hard currency or for political/military reasons.

### FMC Authority to Deal with Low Rates

Section 18(b)(5) of the 1916 Shipping Act authorizes FMC to "disapprove any rate or charge filed by a common carrier of the U.S....which, after hearing, it finds to be so unreasonably high or low as to be detrimental to the commerce of the U.S." FMC contends that this authority is insufficient for the following reasons:

- The burden of proof is on the FMC or complainant to show that the rate is unreasonably low;
- Formal proceedings are by necessity lengthy (one to two years), and FMC does not have rate suspension powers pending the outcome of the proceedings;

- Unduly low rates can only be dealt with on a rate-by-rate basis; and
- In the case of foreign flag lines, necessary financial data are usually located overseas where the FMC cannot enforce its subpoena powers to produce the necessary documents.

On the other hand, DOT, in a March 11 study on FMC's Section 18(b)(5) authorities concluded that:

"Section 18(b)(5)...provides enough authority for the FMC to promptly and adequately address the problem of unreasonably low rates charged by non-national or third-flag ocean carriers in the foreign commerce of the U.S. The duration of past Section 18(b)(5) cases was not the result of any shortcomings in the law, but rather the result of the administration of the law which led to unnecessarily long delayed reports of decisions. Revisions of FMC rules of practice may be needed, but amendment of Section 18(b)(5) is not required."

In short, there is a basic difference of opinion as to the sufficiency of Section 18(b)(5) to deal with unreasonably low rates. Despite the fact that FMC believes 18(b)(5) is insufficient, it is difficult to understand why FMC has not tried to take any regulatory action against low Soviet rates if it believes that these rates are so low as to be predatory. If it tried and failed, FMC's case for the need for additional legislation would be a great deal stronger than it currently appears to be.

#### AGENCY POSITIONS AND SHIPPER VIEWS

Nine agencies have provided views on the FMC draft bill. DOT, Justice, Treasury, CEA, and CIEP oppose the bill for similar reasons, as cited below:

- The FMC has not demonstrated that a Soviet-flag problem clearly exists; nor, if it does exist, why it cannot use existing authorities to deal with it.
- Insofar as the bill strengthens FMC authorities over a segment of the ocean liner industry, it runs counter to the trend to reduce transportation regulatory activities.

- The bill would tend to restrict competition by state-controlled carriers by subjecting them to minimum rate controls to which other carriers would not be subject. The likely result of such regulation would be to strengthen ocean shipping conferences and thereby increase ocean freight rates (although to an unknown degree).

State reports that it would not oppose new legislation, if properly drafted, which would prevent predatory rate practices in the U.S. foreign trades, but that the FMC bill presents significant foreign policy and economic problems. Principally, under the FMC bill, the test of state ownership or control of a vessel is not limited to the country under whose flag the vessel is registered. Rather, it encompasses the government which has ultimate control of the vessel (e.g., a Soviet vessel registered under a "flag of convenience," such as Liberia). State indicates that under international law, it is the state of a vessel's registry alone which determines the legal status of a vessel. Allowing the FMC to go "behind the flag" would be in violation of treaty commitments. Additionally, State objects to: (a) the bookkeeping requirement imposed by the bill because it is unnecessary and could engender similar practices in other countries; and (b) the burden of proof and rate suspension provisions proposed by FMC because these provisions may be overly restrictive.

Office of the Special Representative for Trade Negotiations reports that it favors the general intent of the legislation but that it defers on the technical aspects of the bill.

Commerce defers to the views of FMC and Labor defers to other agencies more directly concerned.

Most exporters and importers that opposed last year's bills indicate that they do not intend to oppose the FMC proposal because it limits increased FMC regulation to a much smaller range of third-flag carriers--state controlled carriers. Although they would prefer that no bill be enacted, they would rather accept the FMC bill than have to continue to fight against potentially more harmful legislation. However, exporters and importers in the Great Lakes region will continue to oppose the bill because, in many instances, the Soviets are the only carriers providing shipping services to the region.

#### DISCUSSION OF OPTIONS

Option #1 -- Oppose the FMC draft bill and request the FMC to use existing authorities to deal with any unreasonably low Soviet rates.

Reasons for this option have been cited above by the various agencies, namely: (a) there is a lack of showing of need for a bill; (b) the bill is contrary to the purposes of regulatory reform; (c) the bill may have an adverse impact on freight rates; and (d) the bill has negative foreign policy impacts.

Option #2 -- Support the FMC draft bill with some modifications agreed to by the FMC. Reasons for supporting the bill include: (a) the Soviets have the capability of charging non-compensatory rates, whether or not they are actually doing so now; and (b) the perception of a threat by U.S. operators tends to discourage investment and create instability. Changes agreed to by the FMC include the following:

- Alternative language to avoid violations of treaty and international law;
- Softening of the provision which would shift the burden of proof regarding low rates onto the controlled carriers; and
- Deletion of the \$2 million appropriation authorization for FMC.

Option #3 -- Support a bill of significantly more limited proportions than the FMC draft bill. In addition to several of the modifications included in option #2, such a bill would further restrain expansion of FMC's authorities in the following way:

- Burden of proof regarding rate reasonableness would be clearly retained with the FMC, rather than shifted onto controlled carriers;
- Variable costs would be established as the sole standard for determining whether rates are reasonable;
- FMC would only be permitted to suspend controlled carrier rates if they were: (a) lower than those charged by any non-controlled carrier in the trade; and (b) more than 15% below shipping conference rates;
- Although controlled carriers would be required to submit data needed by FMC, they would not need to retain a registered business agent in the U.S.; and

- The President would be given authority to postpone, discontinue or suspend any FMC action for foreign policy or national defense reasons.

#### CONCLUSION AND OMB RECOMMENDATION

Most of the agencies primarily concerned with the legislation--notably DOT, Justice, Treasury and CEA--have indicated a preference for option #1 (to oppose the FMC draft bill). However, they feel that some progress has been made in "watering down" the original FMC draft bill, per option #2, and they believe that option #3 (to support a bill of significantly more limited proportions) goes a long way in meeting their objections to the FMC draft bill. State believes that some type of limited legislation is desirable, and supports a bill along the lines of option #3.

On merit alone, OMB recommends option #1. Like the other agencies, we believe that the FMC has made a poor case for the need for this legislation and has failed to make a "good faith effort" to use its existing authorities if it believes the Soviets are charging unreasonably low rates.

On the other hand, option #3 has some value in the following respects:

- Without shipper opposition to the bill, there is a strong chance that both House and Senate Committees will report out a bill; and
- If a bill is enacted by Congress (and unless you should decide to veto it), it would be preferable to try to work in provisions which minimize the potential negative aspects of the bill.

#### DECISION

- \_\_\_\_\_ Option #1. Oppose the FMC draft bill and request FMC to use its current authorities to deal with any problem.
- \_\_\_\_\_ Option #2. Support the FMC draft bill with some modifications agreed to by FMC.
- \_\_\_\_\_ Option #3. Support a bill of significantly more limited proportions than the FMC draft bill.

STAFFING

THE WHITE HOUSE

ACTION MEMORANDUM

WASHINGTON

LOG NO.:

Date: May 14, 1976

Time:

FOR ACTION:

cc (for information):

- ✓ Phil Buchen
- Jim Cannon
- ✓ Max Friedersdorf
- ✓ Jack Marsh

- ✓ Brent Scowcroft
- ✓ Bill Seidman
- ✓ Tim Austin

FROM THE STAFF SECRETARY

DUE: Date: ~~Monday~~ Tuesday, May 18 Time: 12 Noon

SUBJECT:

James T. Lynn memo 5/14/76 re  
Federal Maritime Commission's Successor  
Bill to "Third-Flag" Legislation

ACTION REQUESTED:

- For Necessary Action
- For Your Recommendations
- Prepare Agenda and Brief
- Draft Reply
- For Your Comments
- Draft Remarks

REMARKS:

March - option 3  
 Seidman - option 1  
 Austin - no comments  
 Friedersdorf - option 3  
 Buchen - support OMB - option 1  
 Scowcroft (Davis) option 3 (plus comments)  
 Cannon (Caronaugh) option 1

original to Bob Linder 5/14

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate delay in submitting the required material, please telephone the Staff Secretary immediately.

Jim Connor  
 For the President

## NATIONAL SECURITY COUNCIL

ACTION

May 19, 1976

MEMORANDUM FOR: JAMES CONNOR  
FROM: JEANNE W. DAVIS   
SUBJECT: Federal Maritime Commission's  
"Third Flag" Bill

You asked for our views on Jim Lynn's memorandum to the President concerning the Federal Maritime Commission's (FMC) draft "Third Flag" legislation.

The entry of state-owned and state-controlled carriers into traditional shipping markets has posed a threat to established firms in the U.S. and West Europe. The U.S. maritime industry and its supporters in Congress bemoan the demise of the U.S. merchant marine and note with alarm the growth of state-owned merchant fleets, some of which have cut rates indiscriminately to garner a larger market share.

We must, therefore, take some action to put the state-owned shippers on notice that we cannot and will not condone predatory pricing practices. Thus some "third flag" legislation is probably necessary and desirable at this time. However, this legislation should be drafted in such a manner which takes into account domestic and international economic considerations as well as specific treaty obligations. The FMC draft fails on this score. The bill would allow the FMC to "look behind" the vessels' registry to determine which government has ultimate control of the ship. Such a provision would not be consistent with current international law and practice. There are a number of other objectionable features in the draft bill which are covered adequately in the OMB memorandum.

Therefore, we favor Option 3 under which the Administration would support a significantly limited version of the FMC draft bill. In our view the Administration should not oppose the FMC draft outright (Option 1), as some agencies have recommended, even though the Commission has not adequately justified the need for such legislation.

We fear that unless the Administration is able to offer a reasonable alternative to the FMC draft or to the numerous other "third flag" bills introduced last session, Congress may pass a bill which would be overly restrictive and inconsistent with our international obligations.

RECOMMENDATION:

That the President approve Option 3.

THE WHITE HOUSE  
WASHINGTON

5/14/76

TO: BOB LINDER

FROM: TRUDY FRY

The attached is sent to you for review before it is forwarded to the President.

I am presently staffing this memo.

A handwritten signature in black ink, appearing to be 'TRUDY FRY', written in a cursive style.

THE WHITE HOUSE

ACTION MEMORANDUM

WASHINGTON

LOG NO.:

Date: May 14, 1976

Time:

FOR ACTION:

cc (for information):

Phil Buchen

Brent Scowcroft

Jim Cannon

Bill Seidman

Max Friedersdorf

Tim Austin

Jack Marsh

FROM THE STAFF SECRETARY

DUE: Date:

Tuesday, May 18

Time:

12 Noon

SUBJECT:

James T. Lynn memo 5/14/76 re  
Federal Maritime Commission's Successor  
Bill to "Third-Flag" Legislation

ACTION REQUESTED:

For Necessary Action

For Your Recommendations

Prepare Agenda and Brief

Draft Reply

For Your Comments

Draft Remarks

REMARKS:

Support OMB's recommendation.

Edward C. Schmults

5/19/76



PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

Jim Connor  
For the President

THE WHITE HOUSE

ACTION MEMORANDUM

WASHINGTON

LOG NO.:

Date: May 14, 1976

Time:

FOR ACTION:

Phil Buchen  
Jim Cannon  
Max Friedersdorf  
Jack Marsh  
FROM THE STAFF SECRETARY

cc (for information):

Brent Scowcroft  
Bill Seidman  
Tim Austin

DUE: Date: Tuesday, May 18 Time: 12 Noon

SUBJECT:

James T. Lynn memo 5/14/76 re  
Federal Maritime Commission's Successor  
Bill to "Third-Flag" Legislation

ACTION REQUESTED:

- For Necessary Action
- For Your Recommendations
- Prepare Agenda and Brief
- Draft Reply
- For Your Comments
- Draft Remarks

REMARKS:

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

Jim Connor  
For the President

THE WHITE HOUSE  
WASHINGTON

Jim -

After checking with OMB found  
out that Dan Kearney X3120  
spoke to O'Neill and O'Neill spoke  
to Cannon and decided not to send  
this in --- have they spoken to you  
about it?

Trudy

THE WHITE HOUSE

WASHINGTON

May 18, 1976

MEMORANDUM FOR:

JIM CONNOR

FROM:

MAX FRIEDERSDORF *mf*

SUBJECT:

James Lynn memo 5/14/76 re  
Federal Maritime Commission's  
Successor Bill to "Third-Flag"  
Legislation

The Office of Legislative Affairs recommends Option No. 3.

THE WHITE HOUSE

ACTION MEMORANDUM

WASHINGTON

LOG NO.:

Date: May 14, 1976

Time:

FOR ACTION:

cc (for information):

Phil Buchen

Brent Scowcroft

Jim Cannon

Bill Seidman

Max Friedersdorf

Tim Austin

Jack Marsh

FROM THE STAFF SECRETARY

DUE: Date: Tuesday, May 18 Time: 12 Noon

SUBJECT:

James T. Lynn memo 5/14/76 re  
Federal Maritime Commission's Successor  
Bill to "Third-Flag" Legislation

ACTION REQUESTED:

For Necessary Action

For Your Recommendations

Prepare Agenda and Brief

Draft Reply

For Your Comments

Draft Remarks

REMARKS:

*5/20/76*  
*Support Option 1*  
*[Signature]*

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

Jim Connor  
For the President