



**Regulatory
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Project**
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Repeal the Jones Act for American Energy

Energy & Environment Working Group

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The views expressed are those of the author in his personal capacity and not in his official/professional capacity.

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Executive Summary

The antiquated Jones Act is preventing Americans from receiving energy produced by American innovation in oil and gas production. It places limits on shipping oil and gas to customers in U.S. ports, forcing American companies to send low-cost oil and gas to consumers abroad. The Jones Act raise prices for American consumers and American companies and should be repealed for shipments of oil and gas and energy equipment.

The Merchant Marine Act of 1920, colloquially known as the Jones Act, requires that shipments between two U.S. ports be on U.S.-built, U.S.-manned, and U.S. owned vessels.¹ 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 is much cheaper to simply ship U.S. products to foreign buyers in foreign ports.²

This problem is particularly acute in rapidly shifting energy markets: as a result of the recent U.S. oil boom, it now costs 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.³ 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.

I. 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 — colloquially known as “fracking” have transformed oil markets by dramatically increasing U.S. production of oil and gas from shale, creating intense demand for new energy transport by pipeline, rail, and ship.⁴ But this shale 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

¹ Merchant Marine Act of 1920, §27, P.L. 66-26 (The Act was sponsored by Senator Wesley L. Jones. (R-WA)). The Jones Act also has other provisions, creating benefits for sailors, that are not addressed or criticized here. *See* 46 U.S.C. § 30104.

² Waivers may be granted in the interest of national defense. 46 U.S.C. § 501.

³ John Frittelli, *Shipping U.S. Crude Oil by Water: Vessel Flag Requirements and Safety Issues*, CONG. RES. SERV., 9 (July 21, 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* (Mar. 2, 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/snpst/2016/03-01hghcrdlmpert-eng.html>.

⁴ James W. Coleman, *Importing Energy, Exporting Regulation*, 83 FORDHAM L. REV. 1357, 1363-67 (2014).

conventional wells.⁵ As a result, shale drillers get an increasingly large proportion of their ultimate recovery in the first year or two of well operation.⁶ This is good for oil companies because they get a quicker return on investment and it 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, while steady conventional wells around the world generally keep pumping no matter how low the price gets, U.S. shale wells can rapidly increase and decrease production to help the U.S. economy tailor production to prices.

But U.S. producers can only benefit from their new ability to quickly ramp up production if oil transport markets can shift quickly 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 United Kingdom, Norway, and the Middle East.⁷

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.⁸ There are simply not enough Jones Act compliant ships to carry Texas oil to the U.S. East Coast, so it must be shipped abroad. 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.⁹ As a result, the northeastern U.S. is more likely to rely on foreign sources of crude oil,¹⁰ while, with the ban on U.S. oil exports now ended, U.S. oil is shipped longer distances abroad, leaving American consumers behind.

United States liquefied natural gas (LNG) markets face the same problem. New LNG facilities on the Gulf Coast are exporting cargoes across the Pacific Ocean to Japan¹¹ while Massachusetts

⁵ 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>.

⁶ 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>.

⁷ 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>. Of course, vessels that comply with the Jones Act are competing in a different market, and government studies have been careful to note that there are differences between these vessels other than price. U.S. Government Accountability Office, *Puerto Rico: Characteristics of the Island's Maritime Trade and Potential Effects of Modifying the Jones Act* (Mar. 2013), <http://www.gao.gov/assets/660/653046.pdf> (“Foreign carriers operate in a different market with different characteristics and, as mentioned, generally have lower vessel operating costs compared to Jones Act carriers.”).

⁸ Fritelli, *supra* note 3 at 9.

⁹ *Id.* at 10.

¹⁰ Or take U.S. oil shipped by more dangerous rail transport. *See, e.g.*, United States Department of State Bureau of Oceans and International Environmental and Scientific Affairs, *Final Supplemental Environmental Impact Statement for the Keystone XL Project* (Jan. 2014), at 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”).

¹¹ 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.

import facilities take in gas from Trinidad & Tobago.¹² But these shipping routes can never be rationalized because there are no U.S. flagged liquefied natural gas tankers to carry LNG between U.S. ports.¹³

The Jones Act has also long imposed particularly heavy burdens on far-flung domestic ports like Hawaii, Alaska, and Puerto Rico, because they often import commodities from the United States. This problem is particularly salient in Puerto Rico, which just declared bankruptcy because it is \$74 billion in debt.¹⁴ Economists estimate that, just from 1970-2012, the Jones Act cost Puerto Rico's economy \$29 billion.¹⁵ Reforming the Jones Act could save consumers in Puerto Rico, Alaska, and Hawaii as much as \$15 billion per year.¹⁶

II. 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,¹⁷ the Congressional Research Service,¹⁸ the Mercatus Center,¹⁹ the Heritage Foundation,²⁰ and the U.S. Government Accountability Office.²¹

¹² 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_I_ML_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>.

¹³ 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.

¹⁴ Nathan Bomey, *Why You Can't Ignore Puerto Rico's Bankruptcy*, USA TODAY, May 4, 2017, <https://www.usatoday.com/story/money/2017/05/04/puerto-rico-bankruptcy/101284402/>.

¹⁵ Senate of Puerto Rico, Comm. on Civil Rights, Citizen Participation, and Social Economy, Final Report, Sen. Resolution No. 237 (Apr. 9, 2015), at 37, [https://www.finance.senate.gov/imo/media/doc/Puerto%20Rico%20Senate%20Committee%20on%20Civil%20Rights,%20Citizen%20Participation%20and%20Social%20Economy%20\(Attachment%201\).pdf](https://www.finance.senate.gov/imo/media/doc/Puerto%20Rico%20Senate%20Committee%20on%20Civil%20Rights,%20Citizen%20Participation%20and%20Social%20Economy%20(Attachment%201).pdf) (“According to Dr. Valentín, the economic impact that the Jones Act of 1920 has had on Puerto Rico from 1971 to 2012 equals twenty-nine point fifty-two billion dollars (\$29.052 [billion]).”). These stark figures have led to calls for Jones Act reform from sources as diverse as the New York Times and the International Monetary Fund. Editorial Board, *Puerto Rico Needs Debt Relief*, N.Y. TIMES, July 1, 2015, https://www.nytimes.com/2015/07/02/opinion/puerto-rico-needs-debt-relief.html?_r=0.

¹⁶ Russ Kashian, Jeff Pagel, & Ike Brannon, *The Jones Act in Perspective: A Survey of Costs and Effects of the 1920 Merchant Marine Act*, GRASSROOT INSTITUTE OF HAWAII (2017), at 11 <http://assets.grassrootinstitute.org/wp-content/uploads/2017/04/Jones-Act-Final-4-8-17.pdf>.

¹⁷ U.S. Energy Information Administration, *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>.

¹⁸ Fritelli, *supra* note 3 at 9.

¹⁹ Thomas Grennes, *An Economic Analysis of the Jones Act*, MERCATUS RESEARCH (2017), <https://www.mercatus.org/system/files/mercatus-grennes-jones-act-v1.pdf>.

²⁰ Nicolas Loris, Brian Slattery and Bryan Riley, *Sink the Jones Act: Restoring America's Competitive Advantage in Maritime-Related Industries*, THE HERITAGE FOUNDATION (May 22, 2014), <http://www.heritage.org/government-regulation/report/sink-the-jones-act-restoring-americas-competitive-advantage-maritime>.

²¹ *Puerto Rico: Characteristics*, *supra* note 7.

By contrast, the Jones Act has attracted few public defenses other than occasional opinion pieces by representatives of ship-building companies that benefit from the Jones Act's restrictions. The most extended defense of the Jones Act 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."²² 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."²³ 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.²⁴ Third, he argues that "it ensures our ability to transport military cargoes and personnel."²⁵

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 are foreign-flagged — naturally, companies choose to use foreign tankers and send their product abroad rather than pay twice or three times as much for Jones Act compliant tankers.

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 quarter-of-a-billion LNG tanker²⁶ that would be economically justified only for a single U.S.-port-to-U.S.-port trade route.²⁷ And even if more oil tankers can be built eventually, they will take years to build²⁸ 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 U.S. 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 the notion that the U.S. Navy would borrow oil and gas tankers to transport troops to distant battlefields is simply anachronistic in the modern military.

The bottom line is that the Jones Act's complete ban on foreign-flagged ships is an extremely inefficient means of subsidizing U.S. flagged ships. Given that charter costs for U.S. flagged ships

²² 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>.

²³ *Id.* at 502.

²⁴ *Id.* at 503.

²⁵ *Id.*

²⁶ 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/>.

²⁷ U.S. Government Accountability Office, *Maritime Transportation: Implications of Using U.S. Liquefied-Natural Gas Carriers for Exports* (Dec. 2015) <http://www.gao.gov/assets/680/673976.pdf>.

²⁸ 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>.

are approximately four-times those for foreign-flagged ships,²⁹ 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.

III. 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. The current moment also presents a unique opportunity because the new Administration, unlike any in recent memory, has not taken office with any stated maritime policy.³⁰ And the new administration has shown a willingness to listen to the concerns of the U.S. energy industry when it complains of expansive use of the antiquated Jones Act: On May 10, U.S. Customs and Border Protection withdrew a controversial proposal to extend the reach of the Jones Act that President Obama's had administration promulgated on January 18 of this year.³¹

The Jones Act may not be the widest-reaching or the costliest distortion in energy markets. But small success stories can catalyze wider changes in government regulation. Just as stories of successful regulations are used to justify new requirements, so too stories of successful deregulation can create momentum to find other anachronistic regulations hampering energy markets.³² 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.

²⁹ *Id.*

³⁰ Secretary Clinton, for example, pledged to support the Jones Act during her campaign for the presidency. Press Release, Seafarers International Union, *Clinton Thanks SIU, Pledges to Back Maritime* (Jan. 11, 2016), <http://seafarers.org/news/2016/Q1/HillaryClintonThanksSIU.htm> (“You and your members have my commitment to support the Jones Act and to fight to ensure that its application is permitted under international trade agreements.”).

³¹ U.S. Customs and Border Protection, 51 Customs Bull. 11 (May 20, 2017), 19 CFR 177, Withdrawal of Proposed Modification and Revocation of Ruling Letters Relating to Customs Application of The Jones Act to the Transportation of Certain Merchandise and Equipment Between Coastwise Points.

³² 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).