

6/28/77 [1]

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THE PRESIDENT'S SCHEDULE

Tuesday - June 28, 1977

8:15 Dr. Zbigniew Brzezinski - The Oval Office.

8:45 Mr. Frank Moore - The Oval Office.

9:00 Meeting with Congressman Dan Rostenkowski.
(15 min.) (Mr. Frank Moore) - The Oval Office.

9:30 Mr. Jody Powell - The Oval Office.

10:30 Arrival Ceremony for His Excellency Carlos
Andres Perez, President of the Republic of
Venezuela and Mrs. Perez - The South Grounds.

11:00 Meeting with President Carlos Andres Perez.
(60 min.) (Dr. Zbigniew Brzezinski) - The Oval Office
and the Cabinet Room.

12:30 Lunch with Mr. Henry Howell - The Oval Office.
(30 min.)

2:15 Meeting with Honorable George Meany,
(20 min.) Mr. Sol Chaiken et al. (Mr. Landon Butler).
The Cabinet Room.

7:30 State Dinner (Black Tie) Honoring President
and Mrs. Carlos Andres Perez.
The State Floor.

Perez visit 6-28-77

Open Democracy
Spokesman - L.A. - 3rd W.

Hum Rts - ARMS -
NON-PROLIF - LOS

1973 EMBARGO

→ DON ROMULO BETANCOURT

SIMON BOLIVAR
GREAT LIBERATOR

CONSERVATION/ENVIRON

ROS'S VISIT
SEÑOR PRESIDENTE,
ESTA ES SU CASA

BIRCH - MARVELLA

FRITZ - PETSEY

DALE - BETTY

JACK - CHARLOTTE (Jeb Kate)

NORM - MAY

DICK - JIM

JOE - -

CYNTHIA GREGORY

TED KIVITT

GISELLE

GRAND PAYS CLASIQUE

UNION COLLEGE

WHEATON COLLEGE

Colombia - Barco
SU-MIT - Mr Barco / Ros
stan

Lopez - Mickelson

Algeria - MAOII

(Boumedienn

LDC - oil/GAS -

Cultural agreement

Ambassador

Morocco - Benjelloun

175 year friendship

Mid E

Zaire

KING HASSAN

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for Preservation Purposes

THE WHITE HOUSE
WASHINGTON

June 28, 1977

Stu Eizenstat -

The attached was returned in
the President's outbox. It is
forwarded to you for appropriate
handling.

Rick Hutcheson

Re: Tax Reform

THE PRESIDENT HAS SEEN.

THE WHITE HOUSE

WASHINGTON

June 28, 1977

*Stu - Leave
These over. Leave
out Pechman, but
absorb his ideas in
a memo from your
staff. J.*

Mr. President:

Attached is the memorandum you requested on tax reform. I have prepared duplicate copies, one for Secretary Blumenthal and one for Assistant Secretary Woodworth. Rick has copies of the Pechman memoranda for attachment.

Stu

Stu Eizenstat

TWO SIGNATURES NEEDED

THE WHITE HOUSE

WASHINGTON

MEMORANDUM FOR:

SECRETARY BLUMENTHAL
ASSISTANT SECRETARY WOODWORTH

SUBJECT:

Tax Reform

Your presentations on tax reform have been very informative and helpful. I am pleased that you are reaching out broadly to obtain a wide range of views. Since our last session, I have considered many of the issues you have raised. As you continue to develop our program, I hope you will take into account the following general principles:

1. The program should be more progressive. Specifically:
 - (a) Greater tax reductions should be provided for middle income taxpayers so that the relative share of the overall tax burden borne by the middle class is reduced.
 - (b) The average taxes paid by individuals in the \$50,000 and over brackets should be maintained at about their present levels or reduced only slightly -- with the saving in revenues distributed to low and middle income taxpayers.
2. Please attempt to identify more tax preferences that we can eliminate.
3. Please make additional efforts to achieve simplicity for the average taxpayer. Consideration should be given to encouraging reduced use of itemized deductions either through a lower rate schedule for those who do not itemize or a reasonable floor on itemized deductions.

We must be able to prove this -

Attached are two memoranda recently prepared for me by ~~Joe Pechman~~, with whom I know you have discussed these matters. I think Pechman's package A or B, without integration, has substantial merit and hope you will give these

modify language

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THE WHITE HOUSE

WASHINGTON

June 28, 1977

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Stu Eizenstat

TWO SIGNATURES NEEDED

ideas careful consideration in developing our tax reform program.

I would like everyone involved in the tax reform effort to be very cautious in making public statements about our proposals, particularly those regarding any net revenue loss or rate reductions. I am concerned that continued discussion of these items will divert the attention of the public and Congress from the difficult issue of tax reform to the easy one of tax cuts and rate reductions.

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y _____

June 16, 1977

MEMORANDUM FOR THE PRESIDENT

FROM: Joe Pechman

SUBJECT: Tax Reform Options

The major objectives of tax reform should be to improve the equity of the tax system (both vertical and horizontal) and make it simple to understand. Both objectives can be achieved by moving toward a comprehensive tax base which would eliminate the major preferences, curb business expense account abuses, allow only essential personal deductions, consolidate the four tax rate schedules, and reduce the marginal income tax rates substantially in all brackets. The rates should be adjusted to make the income tax more progressive than it is today. Business taxes should also be reduced, but the form and the amount of the reductions should be as consistent as possible with the equity and simplification objectives and should also maximize the stimulus to business capital formation.

Building Blocks of Tax Reform

The building blocks for the construction of any tax reform package are as follows:

1. Capital gains. The capital gains provisions are complicated, distort economic behavior, and favor the wealthy taxpayer. Equity, simplicity, and tax neutrality would all be served if capital gains were treated as other income. This change alone would permit a substantial reduction in the higher bracket individual income tax rates.

2. Capital gains transferred by gift or at death. Today, such gains are not taxed until the assets are sold by the recipients of the gifts or bequest. This is inequitable because it benefits families who can hold on to their assets for long periods, and penalizes those who — for business or other reasons — must sell their assets. It also encourages families to hold on to their wealth without turning it over for generations to avoid paying the capital gains tax. This lock-in

effect would be aggravated if capital gains were treated as other income. Lawyers complain that the present provisions raise difficult tracing problems. For all these reasons, capital gains should be taxed when assets are transferred to others as well as when they are sold.

3. Business tax preferences. While some progress has been made in recent years to eliminate tax preferences, a number of costly preferences have remained or have recently been introduced. Elimination of these preferences might be accompanied by a reduction in the corporation income tax rate. The major business tax preferences are: (a) percentage depletion for small producers of oil and gas and for all minerals producers; (b) deferral of tax through the Domestic International Sales Corporation (DISC); (c) deferral of tax on income of foreign corporations controlled by U.S. shareholders; and (d) tax shelters (which remain despite the revisions in the 1976 Act).

4. Business expense accounts. The abuse of business expense accounts should be terminated. Consideration should be given to putting per diem and per meal limits on business expenses; denial of deductions for club dues, admissions to sports and theatrical events, and other lavish entertainment expenses; and a limit on deductions for air travel to coach fare.

5. Tax-exempt interest. The correct method of eliminating this inequity would be to tax interest in all future municipal issues, and to use the revenue to increase aid to states and local governments. However, the opposition would be fierce. As an alternative, the states and local governments should be given the option to issue taxable issues, with the interest to be subsidized by the federal government to the extent of 40 percent.

6. Other exclusions for property income. Aside from tax-exempt interest, property income receives preferential treatment in two respects: first, the interest earned on life insurance savings of individuals is not taxed; and second, the first \$100 of dividends (\$200 on joint returns) is excluded from income. At one time, it was felt that it would be difficult to tax the interest on life insurance savings, but the necessary accounting can be done for the individual on a modern computer. The dividend exclusion is a vestige of the

1954 Act (which gave dividend relief to individuals in the wrong way) and should be repealed regardless of the decision on integration of the corporation and individual income taxes (see item 13 below).

7. Personal deductions. The personal deductions under the individual income tax are much too generous. In 1975, 72 percent of the itemized deductions were reported on returns with income above \$15,000. Moreover, the personal deductions are a major cause of the complexity of the individual income tax return and of the difficulties of taxpayers in preparing their returns. Equity and simplicity would be served if the deductions were pruned to a minimum.

The only essential deductions are for extraordinary medical expenses and casualty losses (for example, more than 10 percent of income), charitable contributions above a reasonable minimum (for example, 2 or 3 percent of income), and interest paid up to the amount of property income reported on the tax return. The deduction for income taxes might be continued to encourage the use of state income taxes. If it is deemed necessary to subsidize homeowners, a deduction for the first \$3,000 of property taxes and an additional \$2,500-\$5,000 of interest (over and above the amount of property income) might be allowed.

If these possibilities are politically unacceptable, one alternative is to place a floor of, say, 10 percent on itemized deductions, but this approach was rejected by Congress in 1964. Another alternative is to design a special rate schedule with lower rates for taxpayers who do not itemize and waive the use of any special tax credits. This would permit the adoption of a simple tax return for the large majority of taxpayers.

8. Treatment of the elderly. The elderly receive excessively generous treatment. Those over 65 years of age receive an extra \$750 exemption and an extra tax credit of \$35, pay no tax on their social security benefits, and receive a 15 percent tax credit on the first \$2,500 of other income (less any social security or other exempt pension income) for single persons and \$3,750 for a couple. The credit is phased out for those with earnings above \$7,500 if single, and \$10,000 if married. Despite recent simplifications, the credit

complicates the tax return unnecessarily. The case for any special treatment of the elderly is weak; if some preference is considered necessary, the additional per capita exemption should be sufficient.

9. Transfer payments. Social security benefits, unemployment compensation, workmen's compensation, welfare benefits, and other transfer payments are tax-exempt. It would be better to tax all transfers and to raise the personal exemptions so that those with inadequate total incomes are exempt from tax. Since the social security system is financed in part by an employee payroll tax which is not deductible in computing taxable income, only half of social security income might be included in the tax base. Unemployment and workmen's compensation should be fully taxable. Other transfer payments might continue to be excluded because they are received by persons who would not be taxable in any case.

10. Treatment of the family unit. The present four rate schedules are the result of piecemeal legislation to differentiate between taxpayers in different marital statuses and with different family responsibilities. The complications are of major proportions, yet the result pleases no one. Single persons still believe they are overtaxed; married couples with two earners also believe they are overtaxed, even though they benefit from income splitting. The only solution is to adopt one rate schedule for all taxpayers and make allowances for family size through the personal exemption or tax credit. To avoid the penalty on marriage, a generous deduction should be allowed for two-earner couples (say, 10 percent of the earnings of the spouse with the lower earnings up to \$2,500).

Adoption of one rate schedule would lower the tax liabilities of single persons as compared with married couples. This seems reasonable, because there is no logical reason why the tax of high-income individuals should be reduced substantially (as is done today) when he or she marries a person with little or no income.

11. Personal exemptions, tax credits, and the standard deduction. Allowances for the taxpayer and his family are now provided by a per capita exemption of \$750 and a per capita tax credit of \$35. In addition, a flat standard deduction of \$2,200 for single persons and \$3,200 for married couples is allowed. The objective

of these provisions is to avoid taxing people who are officially classified as poor. The exemption and the credit serve the same purpose — they make allowances for family size — but the two together complicate the tax return. If rates are altered, the same average effective tax rates can be achieved for all income classes with an exemption or a credit. The difference between the two is that the credit increases the tax value of an additional dependent in the lower brackets and reduces it in the upper brackets. Middle-income taxpayers who are near the breaking point receive little or no benefit from the credit. The standard deduction should be adjusted upward periodically to keep pace with inflation.

12. Withholding on interest and dividends. Even though information forms are required for virtually all interest and dividend payments, the amount of underreporting of these items (particularly interest) is substantial. When it last considered the matter thirteen years ago, the Senate preferred to enforce the tax on interest and dividends through information returns rather than withholding. But it is now clear that the IRS will never be given sufficient resources to match the tens of millions of information forms with tax returns. The only solution is to add interest and dividends to the withholding system.

13. Business taxes. Business tax reduction is inevitably regressive and, therefore, should be moderate. Any form of integration of the corporation and individual income taxes would be costly and reduce progressivity. If integration were in the form of individual relief, great pressure would be put on corporations to increase dividend payouts and national saving (and investment) might be reduced. Faster depreciation, additional investment tax credits, and a reduced corporate rate should be considered as an alternative to integration. If integration is proposed, the tax rates should be adjusted to offset its regressive effect.

14. Tax rate reduction. Comprehensive tax reform requires rate reduction to prevent inordinately large tax increases for those who lose preferences. In addition, lower tax rates would improve economic incentives and reduce the tendency to seek tax shelters. The goals should be to reduce the tax rates from the present range of 14-70 percent to 10-50 percent, but this goal can be reached only with a tough tax reform package. The rates should be designed to give

significant tax reductions to middle- as well as to low-income taxpayers.

Illustrative Tax Reform Packages

The building blocks can be combined in many ways for purposes of tax reform. To illustrate the possibilities, three individual income tax packages are summarized in Table 1. (Business taxes are dealt with in the accompanying memorandum.)

Package A — the most ambitious package — would eliminate the capital gains and the other major preferences, set tough rules for business expense account deductions, remove the tax advantages of the elderly, tax half of social security benefits and all unemployment and workmen's compensation payments; slash the personal deductions, substitute one tax rate schedule for the present four schedules, use only the personal exemption (rather than an exemption and a credit), and withhold on interest and dividends. This package would be a tax reformer's dream, but it would be unacceptable to important groups in society.

Package B is designed to simplify, as well as reform, the income tax. It is the same as Package A, with the exception that the tax advantages of the elderly remain untouched and a lower rate schedule is provided for taxpayers who waive all personal deductions and tax credits. (The schedule is calculated to convert itemized deductions up to about 10 percent of income to rate reductions.) Package B, which I prefer, would permit all but a relatively few taxpayers to fill out a simple tax return form without any deductions or credits.

Package C is similar to Package A, with the exception that fewer itemized deductions are eliminated, business expense accounts are dealt with more leniently, and there is no change in the treatment of transferred capital gains, the present four rate schedules, and transfer payments. In addition, a \$200 per capita credit is substituted for the present exemption and per capita credit. Package C is virtually identical to the Treasury proposals. Because it does not tax transferred capital gains, it cannot be as progressive as Package B.

Moreover, conversion of the exemption to a credit reduces the amount of the tax reduction that can be given to middle income taxpayers.

TABLE 1

Illustrative Individual Income
Tax Reform Packages

Tax items	Revenue effect (billions of dollars)	Pack- age A	Pack- age B	Pack- age C
<u>Capital Gains</u>				
Tax capital gains as ordinary income	4.4	x	x	x
Tax capital gains transferred by gift or at death	7.3	x	x	x
<u>Business Preferences</u>				
Eliminate percentage depletion	1.3	x	x	x
Eliminate deferral through DISCs	1.2	x	x	x
Eliminate deferral of income through foreign controlled corporations	0.6	x	x	x
Eliminate remaining tax shelters	1.0	x	x	x
<u>Business Expense Accounts</u>				
Adopt per meal and per diem limits	a	x	x	
Eliminate deductions for club dues, yachts, and so forth	a	x	x	x
Eliminate deductions for sports and theatrical events	a	x	x	x
Limit air travel deductions to coach fares	a	x	x	
<u>Other Preferences</u>				
Adopt subsidized taxable bond option	-0.5	x	x	x
Tax interest on life insurance savings	1.7	x	x	x
Eliminate dividend exclusion	0.4	x	x	x

-continued-

TABLE 1 (continued)

Tax items	Revenue effect (billions of dollars)	Pack- age A	Pack- age B	Pack- age C
<u>Treatment of the Elderly</u>				
Eliminate elderly tax credit	0.5	x		
Eliminate special exemption for the aged and the blind	1.2	x		
<u>Transfer Payments</u>				
Tax one-half of social security benefits	1.8	x		
Tax unemployment and workmen's compensation payments	3.3	x	x	
<u>Personal Deductions</u>				
Eliminate all deductions for taxes except state-local income taxes	6.5	x		
Eliminate deduction for state sales taxes	1.5			x
Eliminate deduction for gasoline taxes	0.7		x	x
Introduce 2 percent floor for charitable contributions	2.0	x		
Allow deductions for medical expenses and casualty losses for amounts exceeding 10 percent of income	1.3	x		x
Limit interest deductions to property income plus \$2,500	0.5	x		
Limit interest deductions to property income plus \$10,000	0.1			x
Special lower rate schedule for non-itemizers	b		x	

-continued-

TABLE 1 (continued)

Tax items	Revenue effect (billions of dollars)	Pack- age A	Pack- age B	Pack- age C
<u>Treatment of Family Unit</u>				
Substitute one rate schedule for the present four schedules	b	x	x	
Deduction of 10 percent (up to \$2,500) of earnings of spouse with lower earnings	-3.0	x	x	
Deduction of 10 percent (up to \$600) of earnings of spouse with lower earnings	-1.7			x
<u>Exemptions, Tax Credits, and Standard Deduction</u>				
Convert the exemption and credit to an exemption of \$1,000	-2.5	x	x	
Convert the exemption and credit to a credit of \$200	6.5			x
Standard deduction of \$3,500 for married couples and \$2,500 for single persons	-2.0	x	x	
<u>Withholding</u>				
Withhold on interest and dividends	1.5	x	x	x
<u>Individual Income Tax Rates</u>				
Schedule A rates	c	x		
Schedule B rates	c		x	
Schedule C rates	c			x

-continued-

TABLE 1 (concluded)

NOTE: All packages assume elimination of the minimum tax and the maximum tax on earned income.

- a. Revenue effect is difficult to calculate. Total revenue gain from all the proposed revisions of business expense account deductions probably would raise more than \$1 billion a year.
- b. Rate schedule would be calculated to convert itemized deductions up to 10 percent of income to rate reductions.
- c. Rate schedule would be set to yield the desired revenue and progressivity objectives.

June 16, 1977

MEMORANDUM FOR THE PRESIDENT

FROM: Joe Pechman

SUBJECT: Integration of the Corporation and Individual
Income Taxes

I believe it would be unwise to include integration in the forthcoming tax reform package. Any form of integration will be costly and reduce progressivity. Integration will make equities more attractive, but it may reduce private capital formation, rather than stimulate it.

There are two types of integration—"full" integration and "partial" integration—and both have significant weaknesses. Under full integration, corporate earnings are taxed to shareholders and they receive a full tax credit for the corporate tax (which becomes merely a withholding tax). Under partial integration, shareholders include the corporate tax paid on their dividends in their income and they receive a tax credit for the amount of corporate tax so included. In effect, full integration eliminates the entire corporate tax; partial integration removes the corporate tax only to the extent earnings are paid out.

Partial Integration

Partial integration would put great pressure on corporations to increase dividends if the top individual income tax rate were brought down to the level of the corporate rate. Given such rates, a corporate manager who retained any part of the earnings of a corporation would be denying his shareholders (except those subject to the top rate) a tax credit for the retentions. In effect, the shareholder would be making a forced loan to the corporation for the credits he was denied.

I would expect that the pressure to distribute would be so great that corporations would increase dividend payouts and request

their stockholders to reinvest their dividends automatically through dividend reinvestment plans. The earnings that would be available for corporate reinvestment could be no higher than it is at present; it would be lower to the extent that the shareholders did not reinvest their dividends. The corporation could turn to the capital markets for additional funds; but, even if stocks became more attractive, it is uncertain whether the corporations would or could replace their lost retained earnings from outside sources. In these circumstances, the vulnerability of some businesses to financial market conditions would be increased and corporate investment might be reduced.

Another reason why investment might be reduced is that the integration proposals envisage denying the corporate tax preferences in calculating the corporate tax credit allowed to shareholders. The most important of the preferences is the investment credit, which now amounts to almost \$10 billion a year. Denial of the preferences is considered necessary to reduce the revenue loss from integration and also to avoid the criticism that the shareholder would otherwise be given a credit for a tax he did not pay. A pass-through of the investment credit to shareholders would treat them on a par with sole proprietorships and partnerships, but the criticism will be hard to respond to. Under the circumstances, the effectiveness of the investment credit as a stimulus would be undermined.

Full Integration

Full integration has the merit that it would provide tax credits for shareholders whether dividends were paid or not. Thus, there would be no pressure on corporations to increase their payouts. (In fact, the availability of the credits might justify reducing payouts.) Internal funds for investment purposes are therefore likely to be unimpaired and might even be increased.

The difficulty is that a pass-through of the investment credit is even less likely under full than under partial integration. Again, the greater attractiveness of corporate equities might offset the incentive lost by the effective repeal of the investment tax credit, but there is considerable danger that it would not.

Another problem with full integration is that it will be difficult to implement. Shareholders will be required to keep track of the corporate earnings on which they were taxed and therefore automatically reinvested. In addition, an arbitrary rule would be required to allocate earnings to part-year shareholders. These problems are not insuperable, but they make full integration less attractive.

Finally, under both integration schemes, tax exempt organizations would not be given any credit for the corporation tax paid on their shareholders. This is considered necessary to avoid the loss in revenue, which would be of the order of \$6-12 billion (depending upon which method was used). The denial of the benefits of integration to pension funds will be regarded as a discrimination against labor; and educational and other nonprofit organizations will argue that this back door method of taxing them should be removed when the burden of the corporation income tax is being lifted from nontaxable individuals.

Conclusion

I conclude that it would be unwise to give up a significant amount of revenue for integration and to link it with the forthcoming tax reform package. The issues in integration are serious enough to warrant additional study before a presidential recommendation is made. Moreover, if the objective is to stimulate capital formation, it would be more effective to provide direct incentives through such devices as more acceleration of depreciation and an improved or enlarged investment credit. A cut in the corporate tax rate, say, from 48 to 45 percent, would also be in order if individual income tax rates are reduced. To keep the regressive effect of business tax changes to moderate proportions, the net tax cut to corporate enterprises—after making adjustments to offset the revenues gained from the removal of preferences—might be limited to \$2-3 billion.

THE PRESIDENT HAS SEEN.

THE WHITE HOUSE

WASHINGTON

June 28, 1977

Q

Mr. President:

In response to your recent request attached are explanations of:

- a) Forestry oral bids (Tab A)
- b) Ice cream composition (Tab B - Humphrey letter re ice cream standards; FDA ice cream standards sheet)
- c) Strip mining surface rights (Tab C)

Stu

Stu Eizenstat

**Electrostatic Copy Made
for Preservation Purposes**

THE WHITE HOUSE
WASHINGTON

June 28, 1977

Stu Eizenstat -

The attached was returned in
the President's outbox. It is
forwarded to you for your
information.

Rick Hutcheson

Re: National Forest Timber
Bidding Practices

THE WHITE HOUSE
WASHINGTON

ACTION	FYI
	MONDALE
	COSTANZA
X	EIZENSTAT
	JORDAN
	LIPSHUTZ
	MOORE
	POWELL
	WATSON

	ENROLLED BILL
	AGENCY REPORT
	CAB DECISION
	EXECUTIVE ORDER
	Comments due to Carp/Huron within 48 hours; due to Staff Secretary next day

	FOR STAFFING
	FOR INFORMATION
X	FROM PRESIDENT'S OUTBOX
	LOG IN/TO PRESIDENT TODAY
	IMMEDIATE TURNAROUND

	ARAGON
	BOURNE
	BRZEZINSKI
	BUTLER
	CARP
	H. CARTER
	CLOUGH
	FALLOWS
	FIRST LADY
	GAMMILL
	HARDEN
	HOYT
	HUTCHESON
	JAGODA
	KING

	KRAFT
	LANCE
	LINDER
	MITCHELL
	POSTON
	PRESS
	B. RAINWATER
	SCHLESINGER
	SCHNEIDERS
	SCHULTZE
	SIEGEL
	SMITH
	STRAUSS
	WELLS
	VOORDE

THE PRESIDENT HAS SEEN.

NATIONAL FOREST TIMBER BIDDING
PRACTICES

To Stu
J.

There has been periodic concern over the opportunity for collusive bidding practices for national forest timber. There have been 5 cases investigated by Justice in recent years, only one of which has been prosecuted. The Forest Service feels that a sealed bid approach is preferable to oral bidding in guarding against collusion. They have periodically tried to implement such a policy but have been beaten down by timber interests whenever they have tried.

In passing the National Timber Management Act of 1976, the Congress instructed the Forest Service to give preference to the use of sealed bids. This provision was sponsored by Senator Talmadge and Congressman Krebs. Opposition to the sealed bid approach began building almost immediately. As a result, the Forest Service devised regulations that would permit 75% oral/25% sealed bids in those cases where local economies are heavily dependent on local timber processing firms successfully bidding for national forest timber. The Forest Service has identified 183 such communities. In all other cases, sealed bidding is to be used.

It is suspected that the strong objection to sealed bids arises out of a fear on the part of the large timber firms that they will leave more money on the table than would be required under an oral bidding approach.

Congress appears to be on the verge of reversing its decision of last year and returning to oral bidding.

Let me know
what we can do to
optimize bid levels -
J

THE WHITE HOUSE
WASHINGTON

June 28, 1977

Frank Moore -

The attached was returned in the
President's outbox and the original
is forwarded to you for arranging
delivery.

Rick Hutcheson

cc: Stu Eizenstat

Re: Ice Cream Standards

THE WHITE HOUSE
WASHINGTON

6-27-77

To Sen. Talmadge

I enjoyed having breakfast with you.

As you can see from this memo, FDA has kept open the subject of ice cream standards. I share your concern about imports of casein & probable increases in milk price support costs.

Jimmy

ICE CREAM STANDARDS

cc: Sen
Talmadge
J.C.

Under current standards of identity, ice cream must contain 20 percent total milk solids -- including 10 percent milkfat and 10 percent nonfat milk solids. Whey solids (a by-product of milk processing) may not exceed 25 percent of the nonfat solids requirement. The Food and Drug Administration (FDA) has proposed new standards that would replace the nonfat milk solids requirement with a minimum requirement for milk-derived protein. The new standards are expected to result in a substantial substitution of whey and, to a much lesser extent, casein for nonfat dry milk.

FDA argues that the new standards would (a) permit increased utilization of domestic whey -- much of which is now being produced and sold at below cost because of EPA regulations that restrict, or prohibit, former methods of effluent disposal -- and (b) provide greater flexibility in the manufacture of ice cream and thus possibly lower the consumer cost.

The National Milk Producers Federation has objected to the change on grounds that it would degrade the physical and nutritional characteristics of traditional ice cream. Secretary Bergland and several members of Congress have raised objections based on the budgetary effects of causing more nonfat dry milk to come under Federal ownership and because any increase in the use of casein would come from imports. They have requested that FDA hold a public hearing to receive evidence bearing on the issue. The longer-term (and more important) implication of the new standards would be to put increased pressure on the current dairy price support program and hasten the day it will have to be redesigned -- which eventually it will have to be. Secretary Bergland met with Commissioner Kennedy a few weeks ago to discuss the matter. A copy of Senator Humphrey's letter to the Commissioner is attached.

On the basis of fairly rough USDA estimates, the price advantage of cheaper ice cream to consumers might total about \$73 million annually (assuming retail price is lowered 2½% on average). On the other hand, the increased government stocks of nonfat dry milk would increase budget costs an estimated \$91 million the first year, rising to about \$183 million by the third year.

Given the several objections that have been raised regarding the new standards, FDA has agreed to issue a notice in the Federal Register staying the new standards and permitting the submission of additional data (over the next 60 days) bearing on whether to grant the requested hearing.

The FDA staff has informally told us that they do not expect sufficient information to be forthcoming to justify a hearing. Their evaluation will be based strictly on the physical and nutritional effects of the revised standards.

sk
J.C.

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ICE CREAM STANDARDS

Background. The present standard requires a minimum level of non fat milk solids (NFMS), of which no more than 25% may be derived from whole whey solids. Casein is now permitted but only after the minimum NFMS requirement has been met. Declaration of optional ingredients is not required.

The revised standard replaces the minimum NFMS requirement with a minimum requirement for milk-derived protein, having the same quality as whole milk protein. The milk-derived protein may come from caseinates or modified whey products. Optional ingredients must be declared.

Discussion. The National Milk Producers Federation (NMPF) has objected to the change in permitted source of milk protein, stating that this would degrade the physical and nutritional characteristics of traditional ice cream.

While we do not agree with these contentions, based on information available to us, we will issue a notice in the Federal Register: staying the new protein provisions for a reasonable time. This will permit the submission of additional data bearing on whether to grant the requested hearing. The effective date of other provisions will be confirmed. The notice permits a 60 day comment period.

The NMPF objections were directed to the alleged degradation of the physical and nutritional characteristics of ice cream. However we believe the real problem is economic and political in nature. For example, imported casein and/or domestically-produced modified whey products may replace some domestically-produced NFMS. (Currently there are no quotas on imported casein.) The NMPF perceives that this would cause serious problems in USDA milk-product price support programs.

It should be emphasized that the manufacturers of domestic whey and modified whey products as well as the ice cream industry have already expressed their support of the standard as revised. They contend that the revised standard would permit increased utilization of domestic whey, greater flexibility in manufacture and thus possibly lower costs to the consumers without degrading the characteristics of traditional ice cream.

If the information received in response to our Federal Register Notice justifies holding a hearing we will do so.

Prepared by H. Roberts
HFF-1/FDA Bureau of Foods
245-8850

THE PRESIDENT HAS SEEN.

SURFACE OWNER CONSENT - STRIP MINING SURFACE RIGHTS

Background

Much of the federally-owned coal in the West is overlain by privately-owned land which was settled under the various Homestead Acts retaining mineral rights to the U.S. government. The mineral rights were retained at a time when strip mining was not contemplated, and in fact were retained largely to encourage farm settlement instead of "dummy" homesteads by corporations seeking title to subsurface rights.

The Bill

The strip mine bill contains a provision to protect these specific surface owners (if they derive their living from the land) by giving them the right of "written consent" prior to leasing of their land for strip mining. The bill as vetoed during the last two years contained a provision which gave this right, subject to a limitation on compensation for consenting landowners. This limitation was developed after a lengthy conference committee in 1974 as a compromise among those concerned about "windfall profits" to surface owners, those who opposed any strip mining in this split ownership situation (the Mansfield amendment), and those who favored a simple written consent provision. The compensation limitation only applied to leasing of surface rights. Sale of surface rights was not similarly limited because of a constitutional problem.

This year, the House and Senate Committees removed the limitation on compensation and retained a simple written consent provision. This was done for two reasons: 1) During the last several years, most surface owners who are willing to sell out have already made deals with coal companies for surface rights; this provision is really directed to protect the remaining ranchers and farmers who genuinely want to stay; and 2) the anomaly of limiting leases but not sales seemed to make the limitation formula extraneous. The removal of this limitation caused Senator Bumpers and others who oppose granting a rancher the right to consent, to raise the issue on the Senate floor. They succeeded in passing a provision which allowed the unrestricted written consent procedure to operate normally but if the Secretary found it in the "national interest" to lease the coal anyway, a condemnation-like proceeding would be invoked. This would not provide any rancher certainty of tenure, and thus was unsatisfactory to the House and many in the Senate.

Administration Position

The Administration has supported through Committee and on the floor a firm right of written consent for the rancher or farmer who does not want to leave the land, but also supported the limitation on compensation in the vetoed bill.

Conference Committee Resolution

The Conference Committee took up this issue Thursday, June 23. The Senate receded to the House language, the simple written consent provision.

Senator Metcalf feels very strongly about this issue and will resist any effort by Senator Bumpers to bring it up again, so the issue appears to be resolved for the time being.

Although we favored a limitation on compensation, its absence does not really pose a practical problem. Given the enormous quantities of both surface and coal in the hands of coal interests at the present time, and given that market forces have served to define the parameters of surface right settlements, this situation will neither be a constraint on coal development nor a "windfall" of any magnitude.

THE WHITE HOUSE
WASHINGTON

6-24-77

Sta.

Explain to me

a) Forestry over bids

b) Ice cream composition

c) Strip mining surface rights

Verbally is o.k.

J C

THE WHITE HOUSE
WASHINGTON

June 28, 1977

Frank Moore -

The attached was returned in
the President's outbox. It is
forwarded to you for your
information.

Rick Hutcheson

Re/ Public Officials Ethics Bill
S. 555

THE PRESIDENT HAS SEEN.

THE WHITE HOUSE

WASHINGTON

June 28, 1977

MEMORANDUM TO FRANK MOORE

FROM BOB THOMSON

RE: PUBLIC OFFICIALS ETHICS BILL - S.555

Yesterday we were successful in beating back one major and several minor efforts to weaken the ethics bill on the Senate floor. However, on the last vote of the day, the Senate passed a very bad amendment mandating the appointment of a special prosecutor in the Korean investigation.

*Atty Gen
problem*

The major successful vote came on an attempt by Senator Javits to delete language of the bill imputing a spouse's income to the public official. Working closely with Senator Ribicoff and Stu's staff, we drafted compromise language that allows an exemption from disclosure and disqualification only where four conditions are met:

1. The official has no knowledge of a particular spousal or dependent interest;
2. The official has used all reasonable efforts to obtain the information;
3. The official derives no benefit from the interest; and
4. Such spousal or dependent interest was not derived directly or indirectly from interests or income of the reporting individual.

Good

Our language was accepted by a voice vote after the Javits language exempting spousal or dependent reporting entirely was defeated 36-47.

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The amendment on Korea requires the Attorney General to make a decision on prosecution of the Korean matter(s) within 90 days after enactment of the legislation. If after 90 days the Attorney General fails to make a decision or concludes that further investigation is warranted, he must seek appointment of a special prosecutor.

Obviously, the amendment will impede passage of the legislation in the House and embarrass House leadership. Moreover, it substantially impedes Judge Bell's flexibility in a case currently before the Grand Jury.

Quite frankly, I must shoulder much of the blame for this dog of an amendment. We had not contacted Judge Bell prior to introduction of the amendment, so I took no position initially. Hearing this, Ribicoff accepted the amendment by voice vote, while I was attempting to reach the Attorney General by telephone. Senator Byrd feels the amendment could have been defeated, had I taken a more decisive position initially.

THE PRESIDENT HAS SEEN.

THE WHITE HOUSE
WASHINGTON

June 28, 1977

MEMORANDUM FOR: THE PRESIDENT
FROM: STU EIZENSTAT *Stu*
SUBJECT: Adams Decision on Passive
Restraints in Cars

In your meeting with Secretary Adams regarding air bags and other passive restraints in automobiles, Adams explained that Congress could overrule his decision by passing a law prohibiting the imposition of air bags.

After the meeting with you, Adams asked us to mention that there exists another way for Congress to reverse the decision. Under the law, a period of sixty legislative days from the date the regulation is announced is provided, during which time Congress may veto the regulation. Both houses must veto the decision within that period in order to void the proposed regulation. If Senator Byrd adheres to his intention of adjourning by October 8, there are just over sixty legislative days remaining in this session.

Our Congressional liason people will be briefed on Adam's decision and a strategy will be developed for dealing with Congress.

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THE WHITE HOUSE

WASHINGTON

June 28, 1977

Secretary Blumenthal
The Vice President
Stu Eizenstat
Frank Moore
Jack Watson
Z. Brzezinski
Landon Butler
Bert Lance
Charlie Schultze
Robert Strauss

Re: Cargo Preference

The attached was returned in the President's
outbox and is forwarded to you for your information
and appropriate action.

Rick Hutcheson

cc: Ernie Preeg

THE WHITE HOUSE

WASHINGTON

June 28, 1977

Secretary Blumenthal
The Vice President
Stu Eizenstat
Frank Moore
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Rick Hutcheson

cc: Ernie Preeg

MEMORANDUM

THE PRESIDENT HAS SEEN.
THE WHITE HOUSE
WASHINGTON

*Shi -
see note
J*

ACTION

27 June 1977

TO:

THE PRESIDENT

FROM:

RICK HUTCHESON *Rick*

SUBJECT:

Cargo Preference

Attachments:

1. Eizenstat summary of the options, with recommendations. (As Stu as summarized Secretary Kreps' memo adequately, it is not attached.)
2. Strauss memo on political aspects of the decision.
3. EPG option paper from Secretary Blumenthal. (An appendix, spelling out the EPG pros and cons at greater length, was not attached.)
4. Carter campaign statements on cargo preference.
5. Eizenstat memo on the repatriation of American-owned foreign flag ships, as a possible alternate to cargo preference (at your request).

Other staff comments:

Butler, Moore and Lipshutz concur with Eizenstat's recommendations.

OMB reiterates its opposition to cargo preference on the grounds that it would: (a) invite retaliation; (b) be expensive; (c) be difficult to administer; and (d) would amount to protectionism for the U.S. merchant marine. OMB favors EPG Option #2, modified such that: (a) there is no explicit cap on the operating subsidy budget; and (b) the participation of foreign built ships would be limited to only oil tankers.

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for Preservation Purposes**

THE WHITE HOUSE

WASHINGTON

June 23, 1977

MEMORANDUM FOR: THE PRESIDENT

FROM: STU EIZENSTAT
BILL JOHNSTON

Stu

SUBJECT: Cargo Preference

BACKGROUND

At your instruction we have consulted extensively with industry and Congressional leaders trying to develop a mutually satisfactory strategy for rebuilding the American merchant marine. Unfortunately, our efforts to find a generally acceptable compromise to cargo preference have not been successful.

The maritime industry, and its many Congressional supporters, supported some of our alternative proposals. But every group we talked to felt that our proposals were not acceptable substitutes for cargo preference. They were willing to accept sharp cutbacks in percentages and timetables if we would agree to some form of cargo preference. But they rejected all other compromises citing their understanding of your campaign promise. Within the last week both Senator Long personally, and Congressman Murphy by letter, have emphatically restated this to me.

On the other side many members of our Administration, including Charlie Schultze, Mike Blumenthal and Dick Cooper, feel that no version of cargo preference is acceptable. They feel that the principles involved - our commitments to free trade and to the fight against inflation - cannot be breached. They argue that the economic costs of cargo preference outweigh its benefits. Moreover, they feel that even a modest cargo preference bill entails a dangerous precedent that may later be extended by Congress, or imitated by other nations.

OPTIONS

The attached decision memos from Secretaries Blumenthal and Kreps lay out two views of the alternatives. The EPG paper concludes that the options are:

- 1) Cargo preference with the reserved share cut to 25% and with foreign built ships eligible for 2/5 of this share.
- 2) A larger operating subsidy program for which all kinds of ships would be eligible, and for which the eligibility rules would be significantly relaxed.
- 3) Extension of the Jones Act to the Virgin Islands for oil.

Option 2 was developed by CEA, EPG, Treasury and OMB staffs after an EPG discussion in which many EPG members expressed dissatisfaction with both cargo preference and other options.

Secretary Kreps feels that Option 2 should be rejected because it is unlikely to benefit the U.S. merchant marine and is certain to be offensive to most of the industry. She doubts that Option 3 is viable either, because it involves relatively few ships and is almost certain to be enacted with or without our support. She believes that the real choices are:

- 1) Cargo preference as in 1 above.
- 2) A package of alternatives that would include:
 - a) The Jones Act extension as in Option 3.
 - b) Repeal of the U.S. income tax deferrals available to foreign subsidiaries of U.S. shipping companies. (Treasury opposes this)
 - c) A legislative initiative to expand our dry bulk fleet. (already drafted)
 - d) A commitment to seek additional bilateral shipping agreements on a case by case basis.

ANALYSIS

We agree with Secretary Kreps that from a political standpoint, Option 2 in the Blumenthal memo does not merit serious consideration. The proposed subsidy is a potentially expensive on-budget item with uncertain benefits. And because the proposal would tend to benefit the large oil companies, the maritime community would view it as an insult rather than as a substitute. As Secretary Kreps observes, a simple rejection of cargo preference is politically preferable to Option 2.

In our view the options boil down to accepting or rejecting cargo preference. If you reject it, a package of alternatives should be offered, even though these will not be considered acceptable by cargo preference proponents.

Accordingly we would modify the two Kreps options as follows:

1) Cargo Preference with severely reduced percentages:

*Less than
10%,
as Strauss
indicates*

We feel that the percentage of oil imports reserved for our ships should be cut to 8-12%, with half of this available to foreign built ships reregistered under the American flag. This proposal would substantially increase the current proportion of oil moving on American ships and create some sea going and shipyard jobs, at a minimal cost to the public (estimated at \$75-100 million). Both Congressman Murphy and Senator Long have indicated that a proposal along these lines would be satisfactory. It would, of course, still set the precedents considered to be undesirable.

Ambassador Strauss has worked closely with us in developing this alternative. At his instance we have met with a representative of the unions who has indicated that such a severely reduced percentage would be acceptable because it would, at least, recognize the concept of cargo preference.

Thus, we could accurately state that we have fulfilled our campaign commitment (see attached campaign statements) but at a reasonable cost.

As under the current version of H.R. 1037, our proposal for vastly reduced cargo preference percentages would not add to maritime subsidy costs, since preference ships would not be eligible for any subsidies.

2) A set of alternatives including a-d in the Kreps Option 2 above and:

e) Increased income taxes on both American and foreign owned foreign flag fleets. This would involve changing the definition of income sources so that half of the earnings from shipment into and out of the U.S. would be treated as U.S. earnings, (currently most of this income is treated as "earned on the high seas"). It would also involve ending the exemption from taxation that income earned by foreign flag shipping companies now enjoys. Recommendations along these lines have already been proposed by a Task Force of the House Ways and Means Committee.

RECOMMENDATION

While we feel that cargo preference is a flawed concept, it appears to be the only immediately available alternative that can significantly strengthen the maritime industry. In light of your commitment to the industry, and the likelihood that rejection of cargo preference will be seen as a broken promise, we support the limited cargo preference option outlined above.

oh - get
Strauss
minimum
J

THE SPECIAL REPRESENTATIVE FOR
TRADE NEGOTIATIONS
WASHINGTON
20506

June 24, 1977

MEMORANDUM FOR THE PRESIDENT

From: Ambassador Robert S. Strauss

Subject: Cargo Preference Legislation



Stu Eizenstat and I have met at length with Senator Long on this issue. I have taken indirect soundings of the leadership of the unions, and talked with others on the Hill. Blackwell of the Maritime Administration believes our labor soundings are accurate.

Politically, something in the way of a Cargo Preference is going to be very hard to resist. Other options don't serve or satisfy the political need, and might even be counterproductive. The unions certainly feel that the Administration is committed to a Cargo Preference Policy.

The Maritime unions claim that a Cargo Preference Act is essential to the future of the U.S. Merchant Fleet and the security of the United States. Other remedies such as those proposed in the several option papers which have been circulated, in their view, do not suit this purpose and are seen either as entirely insufficient or a policy action contrary to their interests. They believe that the Cargo Preference policy will protect seafaring jobs for U.S. sailors and provide substantial on-shore employment in shipyards around America. (They point to the substantial numbers of minority employment in today's shipyards as evidence that the jobs created on-shore would go where the need is greatest.)

What we have determined is that establishing the concept of Cargo Preferences is more important than the percentage. When Eizenstat and I met with Russell Long, we finally convinced him of this and left him in the political posture of "anything you fellows can satisfy Jesse Calhoun with, I will take and support." I believe we can successfully sell less than ten percent preferences stretched out over five or six years and try to get the Hill and the Union committed to this if you desire to go the Cargo Preference route. In short, what we have accomplished is determining that the concept is far more important than the percentage.

This memorandum is not an attempt to justify Cargo Preferences over other options. It is intended to provide you with a least possible option at an initial, relatively modest cost. There are other memoranda presently before you relating to inflationary and trade aspects. I would be glad to discuss these options with you personally if you desire. It is my personal opinion that we have a day or two "bad story" situation following any available option.



THE SECRETARY OF THE TREASURY
WASHINGTON 20220

June 17, 1977

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MEMORANDUM FOR THE PRESIDENT

FROM: W. MICHAEL BLUMENTHAL
CHAIRMAN, ECONOMIC POLICY GROUP

SUBJECT: OIL CARGO PREFERENCE

WMB

In March the EPG unanimously recommended that you oppose oil cargo preference legislation, and suggested we might explore alternative ways of assisting the maritime industry. You then directed Commerce and White House staff to consult further on the Hill and with industry groups.

These consultations indicate that while the maritime interests would support a modified version of the cargo preference bill (H.R. 1037), they consider alternative forms of assistance inadequate and would strongly oppose them as a substitute for cargo preference.

During the campaign you made several statements about the need for a viable U.S. maritime industry, which maritime interests understand as commitments to support cargo preference. It appears that your campaign commitment was to increase the number of seagoing jobs and not to assist the shipbuilding industry.

The House Subcommittee on Merchant Marine is pressing the Administration for a decision. There is also an intensive lobbying effort underway on behalf of cargo preference by a coalition of shipbuilders, ship operators and marine supportive industries.

The EPG has reviewed this issue again and presents three alternative proposals.

OPTION 1: Support a modified form of cargo preference, with a reduced preference percentage, a stretched out implementation timetable, and provision for limited foreign-built tanker participation. (Commerce and Labor support.)

Pro: This is acceptable to maritime interests. Impact on national security cuts both ways: Commerce believes U.S.-flag ships would be more reliable in emergencies; State and DOD do not see that as a benefit since foreign ports

might be closed to U.S.-flag ships. It would create 2100 to 4600 new seagoing jobs, a possible 13,500 transitional shipyard jobs after 1980, plus some near-term shipyard business for reconstruction of foreign-built tankers. The U.S. balance of payments could improve by \$95-\$150 million. Might improve tanker safety and pollution avoidance. Age limit would prevent use of obsolescent tankers in preference trade.

Con: Annual cost through higher oil prices is estimated at \$233-\$884 million depending on level of oil imports in 1985 and final form of the wellhead tax. If the wellhead tax exempts cargo preference oil, the annual cost per job created ranges from \$23,000 to \$111,000. CEA estimates the net impact on the economy as a whole would be a decrease in total employment and GNP. Would be contrary to London Summit pledge to reject protectionism, would reverse U.S. policy favoring free competition, could trigger emulation by others, and would violate U.S. treaties with more than 30 countries.

OPTION 2: Expanded use of operating subsidies. (Supported by State, CEA, NSC, DOD, DOT and the Special Assistant to the President for Energy; OMB supports without a cap on the subsidy. Treasury and FEA support option 2 or 3.)

Pro: By relaxing restrictions on eligibility for operating subsidies, and increasing operation subsidies from the current level of \$400 million per year to \$500 million per year, 5,000 additional seagoing jobs could be created at an annual cost per job of \$20,000. Would not increase the cost of oil and, therefore, would not have the inflationary impact of cargo preference. Would not have the adverse foreign policy repercussions of cargo preference.

Con: Is strongly opposed by maritime interests as an alternative to cargo preference. They argue that independent operators will not be attracted and that the major oil companies with their company unions will be the primary beneficiaries. Shipbuilders oppose since no new ship construction would be generated. Further consultation and staffing are needed if you choose this approach since it would mean basic changes in long standing subsidy programs, including a budgetary ceiling for the first time. A recent OMB attempt to cap existing subsidies was strongly opposed.

OPTION 3: Extend the Jones Act, which requires U.S. ships for domestic commerce, to the Virgin Islands for oil.

(Treasury and FEA support option 2 or 3. State supports option 3 in conjunction with option 2 if needed.)

Pro: Could create 2,000 seagoing jobs with the cost likely to be absorbed by the refiner thereby avoiding the inflationary impact of cargo preference. After years of resisting,

Amerada Hess, the only refinery in the Virgin Islands, is no longer opposing extension of the Jones Act since the oil import fee system will make it cheaper to use U.S.-flag ships.

Con: Maritime interests oppose this as a substitute for cargo preference because they believe the Congress will extend the Jones Act to their benefit in any event. There is also concern that it could serve as a precedent to complete extension of the Jones Act to the Virgin Islands which could impact negatively on tourism, the islands' major industry.

ADDITIONAL ISSUE: In-depth study of the maritime industry.
(Supported by State, Commerce, OMB, CEA, NSC, DOD, DOT, FEA, and the Special Assistant to the President for Energy. Treasury supports with option 3.) This would be a broad study of all aspects of the maritime industry including the various government support measures, regulation of shipping, and anti-competitive arrangements of foreign carriers. The study would seek to develop a long-run national maritime policy in preparation for dealing with future requests for assistance and to assure that U.S. maritime needs are met. Such an in-depth study might be a fourth option by itself, but since it would entail a substantial further delay, it would be opposed by maritime interests.

Background on the maritime industry and a detailed elaboration of the pros and cons of the foregoing options are attached. In view of the economic and political complexity of this issue, I recommend that you have a brief meeting with Cabinet members and advisers most concerned before you make a final decision.

RECOMMENDATION

That you convene a Cabinet-level meeting on this subject.

Approve _____ Disapprove _____

DECISION

OPTION 1: Modified Oil Cargo Preference

Approve _____ Disapprove _____

OPTION 2: Expanded Use of Operating Subsidies

Approve _____ Disapprove _____

OPTION 3: Extend the Jones Act to Virgin Islands for Oil

Approve _____ Disapprove _____

ADDITIONAL ISSUE: In-Depth Study of the Maritime Industry

Approve _____ Disapprove _____

PAST STATEMENTS BY PRESIDENT CARTER

In a discussion of Cargo Preference with leaders of the National Maritime Union at the time they endorsed him for President last spring, Mr. Carter said the following:

"Well one thing that I've learned as Governor and I believe that I can see clearly the prospect as President is that if it did cost two cents a gallon more or one cent a gallon more, I think that if I went to the American people and I would say, 'look it's going to cost us a million gallons of gasoline* to haul the fuel in our ships. I'd think it's gratifying to have the strength and that insurance which you need for a strong merchant marine. This is what I am recommending to the Congress and to the people.' I believe that the American people would say well you know that's reasonable. You might have to give this product or that product we have to have a nation that's bound together.

We've seen the American people misled so often that they kind of lost confidence in the Government. But I think that if you approach a problem head-on if in certain circumstances it does cost more to ship on American ships the best thing to do is tell the American people that it cost more on American ships because we pay our seamen adequate wages. You wouldn't want to do otherwise. And I think this is a good investment for the American people to make sure we have an adequate
....**"

* He must have misspoke here

** Next word garbled.

At another meeting involving senior representatives of maritime management and labor and the Congress, Mr. Carter said on June 30, 1976:

"I'll feel responsible for that as President. I know that the cost will be fairly large. Sometimes there may be a necessity for slightly higher charge to haul cargo. I recognize that, but I believe that if I, as President, would present this proposition to the Congress and the people and say it might cost a little more -- and I'll expect you to cooperate to hold that cost down -- it might cost a little more but it will provide for our nation's defense, I think the American people will respond."

In a letter of May 25, 1976, to the President, National Marine Engineers' Beneficial Association, Mr. Carter placed the following among the objectives for which he intended to work:

"Enact and develop a national cargo policy which would assure our U.S.-flag merchant marine a fair share of all types of cargo."

Finally, the 1976 Democratic Platform on Maritime Affairs includes as an objective:

"....the development of a national cargo policy which assures the U.S. fleet a fair participation in all U.S. trade."

ELIZABETH A. KELSO
PATRIATION OF US-OWNED
FOREIGN FLAG SHIPS

Supplemental Issue: Repatriation of American Owned Ships

You asked me to assess an earlier memorandum that suggested, as an alternative to cargo preference, a program to encourage repatriation of American owned foreign flag ships.

Such a program might involve two major elements:

- 1) Reform of the tax laws which grant exemptions and deferrals of taxation on foreign flag shipping. (Option 2 of my memo outlines these changes.)
 - 2) Reform of the laws which currently reserve operating and construction subsidies, and certain foreign aid and defense cargoes for companies that operate All-American fleets, i.e., exclusively American built, operated and repaired. (Option 2 of the EPG memo includes some of these changes)
- While I believe that the changes in the tax code may merit support, they will probably not, by themselves, be sufficient to encourage large numbers of ships to repatriate. The foreign flag companies argue that if their subsidies are ended they may simply divest themselves of their fleets, and utilize foreign charters, rather than repatriating.
 - As for the changes that would open the maritime subsidy programs to mixed fleets, I do not believe that such changes are warranted. One major impact of such changes would be to make the major oil companies, which now operate large foreign fleets, eligible for subsidies if they re-flagged their ships. This would generate a few new sea-going jobs, but would not, initially, generate any shipyard employment. The sea going jobs would go to members of the oil company unions, rather than to the maritime unions. The result would be bitter opposition from the maritime industry, and public criticism of the bonanza for the oil companies.
 - Finally, both the rule changes and the changes in the tax code could not pass without support from many key legislators who now favor cargo preference. (Notably Russell Long.) While I have not posed the question directly, I very much doubt that we could obtain this support if we opposed cargo preference.

One additional note: The repatriation memo implied that cargo preference would add to maritime subsidy costs. Under the current version of H.R. 1037, preference ships would not be eligible for any subsidies.

THE PRESIDENT HAS SEEN.

Sta-
Assess

J.C.

Cargo Preference Legislation (H.R. 1037)

Congressman Murphy (D.-N.Y.) has introduced a bill which would require that 20 percent of the oil imported by the U.S. be transported on U.S. flag ships. By 1980, the preference percentage would increase to 30 percent.

Cargo preference legislation passed Congress in the last session but was vetoed by the Ford Administration. It apparently has strong support in the committees having jurisdiction over maritime matters.

World-wide, there is a large surplus of tankers; the cargo preference legislation would create an artificial demand for construction of additional tankers in the U.S.

New ships built as a result of cargo preference legislation would balloon spending under the various subsidies that the maritime interests now enjoy--construction differential subsidies, operating subsidies, loan guarantees, and special tax shelter benefits. A ¹⁹⁵²~~1948~~ study by the Treasury Department reported that the cost to the Government in lost tax revenues from the special tax provisions was eight times the cost of the operating subsidies paid.

Comments on the four main arguments used in support of the legislation are as follows:

- o U.S. tankers are safer. Comment. Even if U.S. ships are safer than foreign ships, 70 percent of U.S. oil imports would still be transported on foreign ships.
- o U.S. tankers could be made available for military support. Comment. The tankers likely to be built for the cargo preference trade will be too large and cumbersome for effective military support in time of war.
- o U.S. tankers can be depended upon for civilian supply during crisis or war. Comment. It is not apparent that the U.S. needs control over tankers when it does not have control over foreign oil supplies. However, if U.S. flag ships are essential for this purpose, U.S. owned, foreign flag tankers could be repatriated.
- o A U.S. tanker construction program would create jobs. Comment. If warranted, jobs for U.S. seamen could be created by repatriating U.S. owned, foreign flag tankers. However, jobs created in the shipbuilding industry by H.R. 1037 would be a one-time surge leaving a problem for the future.

As drafted, H.R. 1037 would require construction of at least 100 tankers within the next few years despite a world-wide surplus. This could divert present shipyard capacity from the Navy's shipbuilding program to tanker construction. In

addition, H.R. 1037 would require a substantial increase in the Commerce Department's budget as present law authorizes the Government to subsidize up to 50 percent of the cost of each ship constructed. Federal ship mortgage guarantees would also increase significantly.

U.S. firms own or control over 200 foreign-built tankers, less than 15 years old. When added to our present fleet these ships could transport over 50 percent of U.S. oil imports. Moreover, most of these foreign-built ships are of a type which could be used for military support in wartime.

To repatriate these vessels U.S. restrictions in H.R. 1037 and existing merchant marine statutes impeding repatriation and restricting certain cargoes to U.S. built ships would have to be removed--at least until a sufficient number of ships have been repatriated.

As an alternative to cargo preference legislation, repatriation would:

- o Avoid the economic, budgetary and warship construction impact problems inherent in H.R. 1037.
- o Create jobs for U.S. seamen and increase U.S. control of oil imports transportation faster than any other method.
- o Assure a gradual increase in long term demand for the U.S. shipbuilding industry. Repatriated ships would be replaced by U.S. built ships.

What can we do?

- o Increase both short and long term demand for the U.S. ship repair industry. It's capacity is likely to be of more value in time of war than that of the shipbuilding industry.

THE WHITE HOUSE

WASHINGTON

28

Date: June 24, 1977

MEMORANDUM

FOR ACTION:

Jack Watson
 Bert Lance
 Jim Schlesinger - *FROR issue memo*
London - concult
Schulke - by phone

FOR INFORMATION:

The Vice President
 Bob Lipshutz *concul + comment*
 Frank Moore *concul*
 Z. Brzezinski

FROM: Rick Hutcheson, Staff Secretary

SUBJECT: Eizenstat/Johnston's memo 6/23/77 re Cargo Preference.

YOUR RESPONSE MUST BE DELIVERED
 TO THE STAFF SECRETARY BY:
 TIME: 10:00 AM
 DAY: Monday
 DATE: June 27, 1977

ACTION REQUESTED:

Your comments
 Other: _____

STAFF RESPONSE:

I concur. No comment.
 Please note other comments below:

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. (Telephone, 7052)

THE WHITE HOUSE.

WASHINGTON

June 23, 1977

MEMORANDUM FOR: THE PRESIDENT
FROM: STU EIZENSTAT *Stu*
BILL JOHNSTON
SUBJECT: Cargo Preference

BACKGROUND

At your instruction we have consulted extensively with industry and Congressional leaders trying to develop a mutually satisfactory strategy for rebuilding the American merchant marine. Unfortunately, our efforts to find a generally acceptable compromise to cargo preference have not been successful.

The maritime industry, and its many Congressional supporters, supported some of our alternative proposals. But every group we talked to felt that our proposals were not acceptable substitutes for cargo preference. They were willing to accept sharp cutbacks in percentages and timetables if we would agree to some form of cargo preference. But they rejected all other compromises citing their understanding of your campaign promise. Within the last week both Senator Long personally, and Congressman Murphy by letter, have emphatically restated this to me.

On the other side many members of our Administration, including Charlie Schultze, Mike Blumenthal and Dick Cooper, feel that no version of cargo preference is acceptable. They feel that the principles involved - our commitments to free trade and to the fight against inflation - cannot be breached. They argue that the economic costs of cargo preference outweigh its benefits. Moreover, they feel that even a modest cargo preference bill entails a dangerous precedent that may later be extended by Congress, or imitated by other nations.

OPTIONS

The attached decision memos from Secretaries Blumenthal and Kreps lay out two views of the alternatives. The EPG paper concludes that the options are:

- 1) Cargo preference with the reserved share cut to 25% and with foreign built ships eligible for 2/5 of this share.
- 2) A larger operating subsidy program for which all kinds of ships would be eligible, and for which the eligibility rules would be significantly relaxed.
- 3) Extension of the Jones Act to the Virgin Islands for oil.

Option 2 was developed by CEA, EPG, Treasury and OMB staffs after an EPG discussion in which many EPG members expressed dissatisfaction with both cargo preference and other options.

Secretary Kreps feels that Option 2 should be rejected because it is unlikely to benefit the U.S. merchant marine and is certain to be offensive to most of the industry. She doubts that Option 3 is viable either, because it involves relatively few ships and is almost certain to be enacted with or without our support. She believes that the real choices are:

- 1) Cargo preference as in 1 above.
- 2) A package of alternatives that would include:
 - a) The Jones Act extension as in Option 3.
 - b) Repeal of the U.S. income tax deferrals available to foreign subsidiaries of U.S. shipping companies.
(Treasury opposes this)
 - c) A legislative initiative to expand our dry bulk fleet. (already drafted)
 - d) A commitment to seek additional bilateral shipping agreements on a case by case basis.

ANALYSIS

We agree with Secretary Kreps that from a political standpoint, Option 2 in the Blumenthal memo does not merit serious consideration. The proposed subsidy is a potentially expensive on-budget item with uncertain benefits. And because the proposal would tend to benefit the large oil companies, the maritime community would view it as an insult rather than as a substitute. As Secretary Kreps observes, a simple rejection of cargo preference is politically preferable to Option 2.

In our view the options boil down to accepting or rejecting cargo preference. If you reject it, a package of alternatives should be offered, even though these will not be considered acceptable by cargo preference proponents.

Accordingly we would modify the two Kreps options as follows:

- 1) Cargo Preference with severely reduced percentages:
We feel that the percentage of oil imports reserved for our ships should be cut to 8-12%, with half of this available to foreign built ships reregistered under the American flag. This proposal would substantially increase the current proportion of oil moving on American ships and create some sea going and shipyard jobs, at a minimal cost to the public (estimated at \$75-100 million). Both Congressman Murphy and Senator Long have indicated that a proposal along these lines would be satisfactory. It would, of course, still set the precedents considered to be undesirable.

Ambassador Strauss has worked closely with us in developing this alternative. At his instance we have met with a representative of the unions who has indicated that such a severely reduced percentage would be acceptable because it would, at least, recognize the concept of cargo preference.

Thus, we could accurately state that we have fulfilled our campaign commitment (see attached campaign statements) but at a reasonable cost.

As under the current version of H.R. 1037, our proposal for vastly reduced cargo preference percentages would not add to maritime subsidy costs, since preference ships would not be eligible for any subsidies.

- 2) A set of alternatives including a-d in the Kreps Option 2 above and:
 - e) Increased income taxes on both American and foreign owned foreign flag fleets. This would involve changing the definition of income sources so that half of the earnings from shipment into and out of the U.S. would be treated as U.S. earnings, (currently most of this income is treated as "earned on the high seas"). It would also involve ending the exemption from taxation that income earned by foreign flag shipping companies now enjoys. Recommendations along these lines have already been proposed by a Task Force of the House Ways and Means Committee.

RECOMMENDATION

While we feel that cargo preference is a flawed concept, it appears to be the only immediately available alternative that can significantly strengthen the maritime industry. In light of your commitment to the industry, and the likelihood that rejection of cargo preference will be seen as a broken promise, we support the limited cargo preference option outlined above.

June 27, 1977

MEMORANDUM FOR: CHRISTINE DODSON
FROM: TIMOTHY DEAL *TD*
SUBJECT: Cargo Preferences

You asked for our comments/concurrence on the Eizenstat/Johnston memo regarding cargo preferences. We have already commented extensively on this issue and our views are recorded in Secretary Blumenthal's memo to the President on behalf of the EPG. The EPG memo outlined three options. We supported -- and continue to support -- option 2 which calls for increased operating subsidies without cargo preferences. We agree with State, CEA and Treasury that from an economic and foreign policy standpoint no version of cargo preferences is acceptable. Such measures are inflationary and protectionist.

We do not support the Eizenstat/Johnston recommendation for a more restricted cargo preference system. The fallback option is also unacceptable. The five alternative measures listed (including four from Secretary Kreps' memo) were carefully reviewed by an inter-agency group and rejected as unworkable, costly and ineffective.

We recommend, therefore, that the President choose option 2 in the Blumenthal memo. That position has the support of the vast majority of the agencies represented on the EPG.

60

THE WHITE HOUSE

WASHINGTON

Date: June 24, 1977

MEMORANDUM

FOR ACTION:

Jack Watson
Bert Lance
Jim Schlesinger

FOR INFORMATION:

The Vice President
Bob Lipshutz
Frank Moore
Z. Brzezinski

FROM: Rick Hutcheson, Staff Secretary

SUBJECT: Eizenstat/Johnston's memo 6/23/77 re Cargo Preference.

YOUR RESPONSE MUST BE DELIVERED TO THE STAFF SECRETARY BY:

TIME: 10:00 AM

DAY: Monday

DATE: June 27, 1977

ACTION REQUESTED:

Your comments

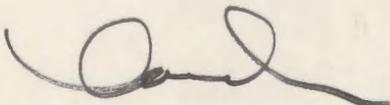
Other:

STAFF RESPONSE:

I concur.

No comment.

Please note other comments below:

Rick -
Stu's solution makes
the most of a very
difficult situation -
WR concur - 

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

THE WHITE HOUSE

WASHINGTON

Date: June 24, 1977

MEMORANDUM

FOR ACTION:

Jack Watson
Bert Lance
Jim Schlesinger

FOR INFORMATION:

The Vice President
Bob Lipshutz
Frank Moore
Z. Brzezinski

FROM: Rick Hutcheson, Staff Secretary

SUBJECT: Eizenstat/Johnston's memo 6/23/77 re Cargo Preference.

YOUR RESPONSE MUST BE DELIVERED TO THE STAFF SECRETARY BY:

TIME: 10:00 AM

DAY: Monday

DATE: June 27, 1977

ACTION REQUESTED:

Your comments

Other:

STAFF RESPONSE:

I concur.

No comment.

Please note other comments below:

I support the concept set out by Stu and Bill: Cargo preference with severely ~~limited~~ reduced percentages; and Income Tax Law changes to furnish an incentive for repatriation of American owned ships to our flag.

Further, if we validly can do so, I suggest taxing a portion of ^{all} foreign flag ships earnings relative to business done in the U.S.A.

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate...



EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

file

MEMORANDUM FOR: RICK HUTCHESON
FROM: DENNIS GREEN *DG*
SUBJECT: Oil Cargo Preference

This is in response to the Eizenstat/Johnston memorandum on cargo preference which you circulated to the Director on June 24.

We continue to believe that oil cargo preference legislation is highly objectionable and should be opposed. If compelled to support some form of action to support the maritime industry, then we would endorse option 2 of the Blumenthal memorandum, but without an explicit budget limitation on the operating subsidy program and with re-registration of U.S. owned foreign-flag ships limited to only oil tankers. The latter steps should be taken to reduce the offensiveness of this option to the maritime industry.

Our specific objections to the option contained in the memorandum from Eizenstat and Johnston--i.e., cargo preference with severely reduced percentages--are as follows:

- This would be basic protectionism for the U.S. merchant marine. It will be highly offensive to our trading partners, particularly NATO ally countries on whose fleets we can already rely in a national emergency;
- It will invite retaliation. It may encourage OPEC countries to reserve oil cargo for expanded tanker fleets of their own, and it may become a precedent for other countries to reserve all types of cargo for their merchant fleets;
- It will be expensive. Even at the reduced percentage level incorporated in this option (8-12%), the cost per permanent seafaring job created will be at least \$50,000 per year, or nearly twice the cost per job of option 2 of the Blumenthal memorandum; and

- It will be difficult to administer. The Commerce Department will be required to adopt and enforce regulations to ensure that a fixed percentage of all our oil imports are carried from source to destination aboard U.S. tankers.

Recommendation

We believe that cargo preference, in any form, would be unadvisable. If an option must be chosen to assist the maritime industry, then we would endorse Option 2, but with the revisions noted above, i.e., with no explicit cap on the operating subsidy budget and with the participation of foreign built ships limited to only oil tankers.

Finally, given the continued pressure for additional assistance to this industry, I feel that the Administration should undertake a complete review of Federal aids to the maritime industry, with the objective of ascertaining the necessary level of taxpayer support for the U.S. merchant marine.

THE WHITE HOUSE
WASHINGTON

Stu will
TELL
lines

Date: June 17, 1977

MEMORANDUM

FOR ACTION:
Stu Eizenstat — *attached*
Jack Watson
Bert Lance — *attached*
Jim Schlesinger *down*

FOR INFORMATION:
The Vice President
Bob Lipshutz
Frank Moore
Zbigniew Brzezinski *concur: w/DP+2*

FROM: Rick Hutcheson, Staff Secretary

SUBJECT: Chairman Blumenthal's memo 6/17/77 re Oil
Cargo Preference/Sec. Kreps' memo 6/17/77
re Modified Oil Cargo Preference and Other
Maritime Options.

Johnson
working on it

**YOUR RESPONSE MUST BE DELIVERED
TO THE STAFF SECRETARY BY:**
TIME: 10:00 AM
DAY: ~~Tuesday~~ *Wed*
DATE: June 21, 1977

*Jack/HF will concur
on rewrite*

ACTION REQUESTED:
 Your comments
Other: _____

STAFF RESPONSE:
 I concur. No comment.
Please note other comments below:

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. (Telephone, 7052)

THE WHITE HOUSE
WASHINGTON

*Due Mon
4 P*

ACTION	FYI
<input checked="" type="checkbox"/>	MONDALE
<input type="checkbox"/>	COSTANZA
<input checked="" type="checkbox"/>	EIZENSTAT
<input type="checkbox"/>	JORDAN
<input checked="" type="checkbox"/>	LIPSHUTZ
<input checked="" type="checkbox"/>	MOORE
<input type="checkbox"/>	POWELL
<input checked="" type="checkbox"/>	WATSON

<input type="checkbox"/>	ENROLLED BILL
<input type="checkbox"/>	AGENCY REPORT
<input type="checkbox"/>	CAB DECISION
<input type="checkbox"/>	EXECUTIVE ORDER

Comments due to
Carp/Huron within
48 hours; due to
Staff Secretary
next day

<input checked="" type="checkbox"/>	FOR STAFFING
<input type="checkbox"/>	FOR INFORMATION
<input type="checkbox"/>	FROM PRESIDENT'S OUTBOX
<input type="checkbox"/>	LOG IN/TO PRESIDENT TODAY
<input type="checkbox"/>	IMMEDIATE TURNAROUND

<input type="checkbox"/>	ARAGON
<input type="checkbox"/>	BOURNE
<input checked="" type="checkbox"/>	BRZEZINSKI
<input type="checkbox"/>	BUTLER
<input type="checkbox"/>	CARP
<input type="checkbox"/>	H. CARTER
<input type="checkbox"/>	CLOUGH
<input type="checkbox"/>	FALLOWS
<input type="checkbox"/>	FIRST LADY
<input type="checkbox"/>	GAMMILL
<input type="checkbox"/>	HARDEN
<input type="checkbox"/>	HOYT
<input type="checkbox"/>	HUTCHESON
<input type="checkbox"/>	JAGODA
<input type="checkbox"/>	KING

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<input type="checkbox"/>	MITCHELL
<input type="checkbox"/>	POSTON
<input type="checkbox"/>	PRESS
<input type="checkbox"/>	B. RAINWATER
<input checked="" type="checkbox"/>	SCHLESINGER
<input type="checkbox"/>	SCHNEIDERS
<input type="checkbox"/>	SCHULTZE
<input type="checkbox"/>	SIEGEL
<input type="checkbox"/>	SMITH
<input type="checkbox"/>	STRAUSS
<input type="checkbox"/>	WELLS
<input type="checkbox"/>	VOORDE



THE SECRETARY OF THE TREASURY
WASHINGTON 20220

June 17, 1977

1977 JUN 17 PM 4 25

MEMORANDUM FOR THE PRESIDENT

FROM: W. MICHAEL BLUMENTHAL
CHAIRMAN, ECONOMIC POLICY GROUP

SUBJECT: OIL CARGO PREFERENCE

WMB

In March the EPG unanimously recommended that you oppose oil cargo preference legislation, and suggested we might explore alternative ways of assisting the maritime industry. You then directed Commerce and White House staff to consult further on the Hill and with industry groups.

These consultations indicate that while the maritime interests would support a modified version of the cargo preference bill (H.R. 1037), they consider alternative forms of assistance inadequate and would strongly oppose them as a substitute for cargo preference.

During the campaign you made several statements about the need for a viable U.S. maritime industry, which maritime interests understand as commitments to support cargo preference. It appears that your campaign commitment was to increase the number of seagoing jobs and not to assist the shipbuilding industry.

The House Subcommittee on Merchant Marine is pressing the Administration for a decision. There is also an intensive lobbying effort underway on behalf of cargo preference by a coalition of shipbuilders, ship operators and marine supportive industries.

The EPG has reviewed this issue again and presents three alternative proposals.

OPTION 1: Support a modified form of cargo preference, with a reduced preference percentage, a stretched out implementation timetable, and provision for limited foreign-built tanker participation. (Commerce and Labor support.)

Pro: This is acceptable to maritime interests. Impact on national security cuts both ways: Commerce believes U.S.-flag ships would be more reliable in emergencies; State and DOD do not see that as a benefit since foreign ports

might be closed to U.S.-flag ships. It would create 2100 to 4600 new seagoing jobs, a possible 13,500 transitional shipyard jobs after 1980, plus some near-term shipyard business for reconstruction of foreign-built tankers. The U.S. balance of payments could improve by \$95-\$150 million. Might improve tanker safety and pollution avoidance. Age limit would prevent use of obsolescent tankers in preference trade.

Con: Annual cost through higher oil prices is estimated at \$233-\$884 million depending on level of oil imports in 1985 and final form of the wellhead tax. If the wellhead tax exempts cargo preference oil, the annual cost per job created ranges from \$23,000 to \$111,000. CEA estimates the net impact on the economy as a whole would be a decrease in total employment and GNP. Would be contrary to London Summit pledge to reject protectionism, would reverse U.S. policy favoring free competition, could trigger emulation by others, and would violate U.S. treaties with more than 30 countries.

OPTION 2: Expanded use of operating subsidies. (Supported by State, CEA, NSC, DOD, DOT and the Special Assistant to the President for Energy; OMB supports without a cap on the subsidy. Treasury and FEA support option 2 or 3.)

Pro: By relaxing restrictions on eligibility for operating subsidies, and increasing operation subsidies from the current level of \$400 million per year to \$500 million per year, 5,000 additional seagoing jobs could be created at an annual cost per job of \$20,000. Would not increase the cost of oil and, therefore, would not have the inflationary impact of cargo preference. Would not have the adverse foreign policy repercussions of cargo preference.

Con: Is strongly opposed by maritime interests as an alternative to cargo preference. They argue that independent operators will not be attracted and that the major oil companies with their company unions will be the primary beneficiaries. Shipbuilders oppose since no new ship construction would be generated. Further consultation and staffing are needed if you choose this approach since it would mean basic changes in long standing subsidy programs, including a budgetary ceiling for the first time. A recent OMB attempt to cap existing subsidies was strongly opposed.

OPTION 3: Extend the Jones Act, which requires U.S. ships for domestic commerce, to the Virgin Islands for oil.

(Treasury and FEA support option 2 or 3. State supports option 3 in conjunction with option 2 if needed.)

Pro: Could create 2,000 seagoing jobs with the cost likely to be absorbed by the refiner thereby avoiding the inflationary impact of cargo preference. After years of resisting,

Amerada Hess, the only refinery in the Virgin Islands, is no longer opposing extension of the Jones Act since the oil import fee system will make it cheaper to use U.S.-flag ships.

Con: Maritime interests oppose this as a substitute for cargo preference because they believe the Congress will extend the Jones Act to their benefit in any event. There is also concern that it could serve as a precedent to complete extension of the Jones Act to the Virgin Islands which could impact negatively on tourism, the islands' major industry.

ADDITIONAL ISSUE: In-depth study of the maritime industry. (Supported by State, Commerce, OMB, CEA, NSC, DOD, DOT, FEA, and the Special Assistant to the President for Energy. Treasury supports with option 3.) This would be a broad study of all aspects of the maritime industry including the various government support measures, regulation of shipping, and anti-competitive arrangements of foreign carriers. The study would seek to develop a long-run national maritime policy in preparation for dealing with future requests for assistance and to assure that U.S. maritime needs are met. Such an in-depth study might be a fourth option by itself, but since it would entail a substantial further delay, it would be opposed by maritime interests.

Background on the maritime industry and a detailed elaboration of the pros and cons of the foregoing options are attached. In view of the economic and political complexity of this issue, I recommend that you have a brief meeting with Cabinet members and advisers most concerned before you make a final decision.

RECOMMENDATION

That you convene a Cabinet-level meeting on this subject.

Approve _____ Disapprove _____

DECISION

OPTION 1: Modified Oil Cargo Preference

Approve _____ Disapprove _____

OPTION 2: Expanded Use of Operating Subsidies

Approve _____ Disapprove _____

OPTION 3: Extend the Jones Act to Virgin Islands for Oil

Approve _____ Disapprove _____

ADDITIONAL ISSUE: In-Depth Study of the Maritime Industry

Approve _____ Disapprove _____

PAST STATEMENTS BY PRESIDENT CARTER

In a discussion of Cargo Preference with leaders of the National Maritime Union at the time they endorsed him for President last spring, Mr. Carter said the following:

"Well one thing that I've learned as Governor and I believe that I can see clearly the prospect as President is that if it did cost two cents a gallon more or one cent a gallon more, I think that if I went to the American people and I would say, 'look it's going to cost us a million gallons of gasoline* to haul the fuel in our ships. I'd think it's gratifying to have the strength and that insurance which you need for a strong merchant marine. This is what I am recommending to the Congress and to the people.' I believe that the American people would say well you know that's reasonable. You might have to give this product or that product we have to have a nation that's bound together.

We've seen the American people misled so often that they kind of lost confidence in the Government. But I think that if you approach a problem head-on if in certain circumstances it does cost more to ship on American ships the best thing to do is tell the American people that it cost more on American ships because we pay our seamen adequate wages. You wouldn't want to do otherwise. And I think this is a good investment for the American people to make sure we have an adequate
.....**"

* He must have misspoke here

** Next word garbled.

At another meeting involving senior representatives of maritime management and labor and the Congress, Mr. Carter said on June 30, 1976:

"I'll feel responsible for that as President. I know that the cost will be fairly large. Sometimes there may be a necessity for slightly higher charge to haul cargo. I recognize that, but I believe that if I, as President, would present this proposition to the Congress and the people and say it might cost a little more -- and I'll expect you to cooperate to hold that cost down -- it might cost a little more but it will provide for our nation's defense, I think the American people will respond."

In a letter of May 25, 1976, to the President, National Marine Engineers' Beneficial Association, Mr. Carter placed the following among the objectives for which he intended to work:

"Enact and develop a national cargo policy which would assure our U.S.-flag merchant marine a fair share of all types of cargo."

Finally, the 1976 Democratic Platform on Maritime Affairs includes as an objective:

"....the development of a national cargo policy which assures the U.S. fleet a fair participation in all U.S. trade."

MEMORANDUM

NATIONAL SECURITY COUNCIL

3873

INFORMATION

June 21, 1977

MEMORANDUM FOR: RICK HUTCHESON
FROM: *Christine Dodson*
CHRISTINE DODSON *for*
SUBJECT: Oil Cargo Preferences

This is in response to your request of June 17 for our comments on Secretary Blumenthal's memorandum concerning oil cargo preferences.

The NSC staff concurs with Secretary Blumenthal's recommendation that the President discuss this issue with Cabinet members and key advisors. Regarding the proposed options, we support Option 2 (expanded use of operating subsidies) as well as an in-depth study of the maritime industry, which is listed as an additional issue.

THE WHITE HOUSE
WASHINGTON

344

xc Cargo Johnston

Date: June 17, 1977

MEMORANDUM

FOR ACTION:

Stu Eizenstat
Jack Watson
Bert Lance
Jim Schlesinger

FOR INFORMATION:

The Vice President
Bob Lipshutz
Frank Moore
Zbigniew Brzezinski

FROM: Rick Hutcheson, Staff Secretary

SUBJECT: Chairman Blumenthal's memo 6/17/77 re Oil
Cargo Preference/Sec. Kreps' memo 6/17/77
re Modified Oil Cargo Preference and Other
Maritime Options.

YOUR RESPONSE MUST BE DELIVERED
TO THE STAFF SECRETARY BY:

TIME: 10:00 AM

DAY: ~~Tuesday~~

DATE: June 21, 1977

Wed.

ACTION REQUESTED:

Your comments

Other:

STAFF RESPONSE:

I concur.

No comment.

Please note other comments below:

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.



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

JUN 21 1977

MEMORANDUM FOR: RICK HUTCHESON
FROM: DENNIS O. GREEN
SUBJECT: Oil Cargo Preference

This is in response to your memorandum of June 17, 1977, to Bert Lance, requesting comments on Chairman Blumenthal's memorandum to the President regarding oil cargo preference legislation and other maritime options.

We continue to believe that oil cargo preference legislation is highly objectionable and should be opposed. If compelled to support some form of action to support the maritime industry then we would endorse a modified option #2 which would expand the use of operating subsidies.

Our specific objections to option #1--modified oil cargo preference--and suggestions for modifying option #2 are as follows:

Option #1: Support a modified form of cargo preference...

- This would amount to a form of basic protectionism for the U.S. merchant marine. It will be highly offensive to our trading partners, particularly NATO ally countries on whose fleets we can already rely in a national emergency;
- It will invite retaliation. It may encourage OPEC countries to reserve oil cargo for expanded tanker fleets of their own, and it may become a precedent for other countries to reserve all types of cargo for their merchant fleets;
- It will be enormously expensive. The estimates show a cost per permanent job created of \$91,000 to \$111,000, depending on the level of U.S. oil imports. Only if temporary shipyard jobs are added would the average cost per job created fall to \$23,000 and then only while additional ships are being constructed. However, these figures understate the case since they are estimates of the situation in 1985, when the world tanker surplus is presumed to have ended and the current differential between U.S. and foreign tanker freight rates will have narrowed; and
- It will be difficult to administer. The Commerce Department will be required to adopt and enforce regulations to ensure that 25 percent of all our oil imports are carried from source to destination aboard U.S. tankers.

Option #2: Expand use of operating subsidies.

While an expanded operating differential subsidy program is opposed by maritime interests, in particular the maritime unions affiliated with the AFL-CIO who see it benefiting non-affiliated company unions, we believe the option could be modified in two respects which might increase its receptivity without seriously increasing the program's costs.

1. The budget limitation on the operating subsidy program could be removed.

The idea of controlling operating subsidies through the normal budget process is especially attractive from OMB's perspective. However, endorsement of this proposal is likely to expose the Administration to considerable criticism from maritime unions, shipbuilders, and congressional supporters of the maritime industry. The lifting of certain restrictions, as already proposed in this option, would expand the pool of applicants eligible to receive operating subsidies, and thereby potentially increase the costs of the program. However, other legal requirements of the Merchant Marine Act, relating to the adequacy of the U.S. fleet for the national defense and foreign commerce of the United States, would continue to apply. These would act to restrict the number of operators receiving subsidies.

2. Limit re-registration of U.S. owned foreign-flag ships under the U.S. flag to oil tankers only. This is to reduce the potential for objections from the shipbuilding industry. It is primarily tankers which are in oversupply in the world today and U.S. shipyards have the least probability of building them in the future. Extending eligibility for operating subsidies only to foreign built tankers will also help to limit the budget impact of this option.

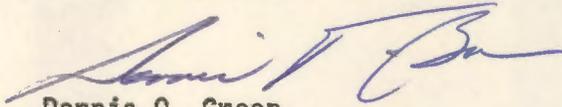
We cannot predict with certainty the number of ships which would be added to the current subsidy program under option two with these modifications. However, we anticipate the program could be administered to add approximately \$50 million to the cost of the subsidy program (\$100 million) as envisioned under Option 2 of the EPG paper.

Recommendation

In summary, we believe that cargo preference, in any form, would be unadvisable. If an option must be chosen to assist the maritime industry then we would endorse Option 2, but with the revisions noted above, i.e., with no

explicit cap on the operating subsidy budget and with the participation of foreign built ships limited to only oil tankers.

Finally, given the continued pressure for additional assistance to this industry, I feel that the Administration should undertake a complete review of Federal aids to the maritime industry, with the objective of ascertaining the necessary level of taxpayer support for the U.S. merchant marine.



Dennis O. Green
Associate Director for
Economics and Government

THE WHITE HOUSE

WASHINGTON

Date: June 17, 1977

MEMORANDUM

FOR ACTION:

Stu Eizenstat
Jack Watson
Bert Lance
Jim Schlesinger

FOR INFORMATION:

The Vice President
Bob Lipshutz
Frank Moore
Zbigniew Brzezinski

FROM: Rick Hutcheson, Staff Secretary

SUBJECT: Chairman Blumenthal's memo 6/17/77 re Oil
Cargo Preference/Sec. Kreps' memo 6/17/77
re Modified Oil Cargo Preference and Other
Maritime Options.

YOUR RESPONSE MUST BE DELIVERED
TO THE STAFF SECRETARY BY:

TIME: 10:00 AM

DAY: Tuesday

DATE: June 21, 1977

ACTION REQUESTED:

Your comments

Other:

Agree with statement of issues.

STAFF RESPONSE:

I concur.

No comment.

Please note other comments below:

JRS
JAMES R. SCHLESINGER

JUN 21 1977

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.



MEMORANDUM FOR THE PRESIDENT

Subject: Modified Oil Cargo Preference and Other Maritime Options

H.R. 1037 provides that 20 percent of U.S. oceanborne oil imports will be carried by U.S.-flag, U.S.-built tankers, with the preference percentage going to 25 in 1978 and to 30 in 1980.

In March, you indicated that you did not endorse H.R. 1037 as such, but that you favored some action to assist the maritime industry. At your direction, Commerce and White House spokesmen have since met with Congressional representatives to seek a mutually supportable course of action. Meetings have also been held with representatives of maritime labor and the shipbuilding and ship operating industries. Four options have been addressed.

1. Modified Oil Cargo Preference - Under the proposed new approach developed in Commerce the ultimate preference percentage would be reduced to 25 and the implementation timetable stretched to 1985. Foreign-built tankers under U.S. registry could carry 10 percent of our oil imports as preference cargo.

These modifications would reduce the annual cost as of 1985 from the \$705 million attributable to H.R. 1037 to \$350 million, assuming an import level of 10 million barrels/day, and would entail \$160 million/year at 6 million barrels/day. In terms of consumer impact, these new totals translate to 12 hundredths of a cent/gallon at 10 million barrels/day and to 7 hundredths at 6 million.

Although the proposed changes would not obviate possible adverse foreign policy effects, I believe that measures such as assuring shares of the trade to our treaty allies could mitigate those effects. This is the only one of the options that is acceptable to the maritime interests who think there is a Presidential commitment and to the Congressional advocates of cargo preference. On balance, I believe that its advantages outweigh its disadvantages.

2. Operating Subsidy for Foreign-Built Ships - This option would provide for \$100 million in operating differential subsidies for foreign-built ships transferred to U.S. registry, which would be permitted to operate without any of the restrictions that now apply to U.S. subsidized ships in foreign trade.

Substantively, it is doubtful that this option would cause any additions to the U.S.-flag fleet. Since it would not cover capital costs, it is highly unlikely that it would lead to the purchase of any foreign built ships. Although it might theoretically make the major oil companies with foreign flag fleets close to indifferent between U.S. and foreign-flag operation, it contains no incentive to change ship registries except possibly that of forestalling cargo preference.



U.S. shipbuilders, ship operators, and maritime unions, as well as the Congressional sponsors of cargo preference, find this option not merely unacceptable but highly offensive. They all view it as benefitting, if anyone, only the major oil companies. In this light, I believe it should be rejected. A simple turn-down of cargo preference would be preferable to this option.

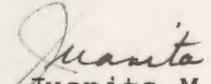
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Although they consider it desirable, the Congressional and industry representatives we have talked to do not see this as significant enough to be a valid alternative to cargo preference.

4. Alternative Initiatives -

- (a) Repeal U.S. Income Tax deferral provisions relating to shipping income received by foreign subsidiaries of U.S. corporations. This so-called "Subpart F" income exclusion constitutes a tax subsidy to U.S.-owned foreign flag shipping estimated at \$90 million to \$140 million/year.
- (b) Support legislative and regulatory initiatives to facilitate expansion of the U.S.-flag dry bulk carrier fleet. (There are currently only 16 active U.S.-flag dry bulkers.)
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These alternatives are considered generally desirable by the Congressional and industry groups we have consulted, but not as a substitute for some form of cargo preference - even in combination with option 3. However, if you decide that you cannot support modified cargo preference you may want to consider some combination of the option 4 alternatives, together with option 3, as a means of strengthening the merchant marine and/or removing impediments to its further development.


Juanita M. Kreps

ANNEX

BACKGROUND ON MARITIME INDUSTRY

A. World Tanker Fleet. At present, approximately 10 percent of the world tanker fleet is in lay-up and an additional 10 percent is underemployed. Tankers now under construction will more than offset future scrapping of tankers. This surplus tonnage in the world tanker market is expected to continue at least through 1981. The Department of Commerce estimates the tanker surplus will end in the early 1980's. OMB, CEA, State and CIA estimate the surplus could last through 1985. Of the 245 tankers in the U.S. fleet, 10 are currently idle. With the additional demand generated by the strategic petroleum reserve and Alaskan North Slope oil, U.S. tankers will be fully employed from the fourth quarter of 1977 at least through 1978.

B. Employment of U.S. Seamen/Shipyard Workers. Jobs for U.S. seamen have declined from about 56,000 in 1970 to about 44,000 today due to more efficient ships requiring smaller crews and the decline in the number of U.S.-flag ships. Carriage of Alaskan North Slope oil and the strategic petroleum reserve will increase U.S. seagoing employment by 700 jobs beginning in late 1977; by 1980 an additional 875 jobs will be created. Significant layoffs of shipyard workers will occur over the next year regardless of action on cargo preference. Cargo preference could shorten the duration of layoffs and permit employment to remain roughly at current levels through the early 1980's if oil imports are about 10 million barrels/day.

C. Federal Assistance to the U.S. Maritime Industries. Total Federal outlays for all subsidies to the maritime industry in FY 1977 are about \$786 million including: \$236 million for ship construction; \$388 million for ship operating costs; \$62 million in captive carriage of P.L. 480 grain shipments; and \$100 million tax subsidy through the Capital Construction Fund program. You added \$152 million in new budget authority to the Ford Administration's proposed FY 1978 budget for subsidies to the maritime industry.

Despite Federal support, the U.S.-flag tanker share of U.S. international trade was less than 4 percent in 1976. (Another 57 percent of 1976 U.S. oil imports was carried in U.S.-owned ships, most under flags of convenience.) Only one major oil company has participated in the direct subsidy programs since they were extended to tankers in 1970 because a number of legal and administrative restrictions are unacceptable to operators and the world tanker market has been depressed.

ALTERNATIVE RESPONSES TO THE CARGO PREFERENCE BILL
(H.R. 1037)

OPTION 1: Modified Oil Cargo Preference. (Supported by Commerce and Labor.) Modifications to H.R. 1037 to make cargo preference more acceptable would: (a) reduce the cargo preference percentage from 30 to 25 percent of U.S. oil imports; (b) stretch out complete implementation from 1980 to 1985; (c) permit acquisition of some foreign-built tankers to carry under U.S. flag 10 percent of U.S. oil imports as preference cargo; (d) require that reconstruction necessary to meet U.S. safety and anti-pollution standards on such foreign-built ships be done in the U.S.; (e) impose a 25-year age limit on tankers; and (f) provide an explicit mechanism to assure adequate capacity for Navy shipbuilding. These modifications reduce some of the negative economic effects of H.R. 1037 while retaining the support of industry and labor.

Commerce maintains that this option would enhance national security by increasing our capability to move essential wartime imports in U.S.-flag rather than less reliable foreign-flag ships. Defense believes that the essential national security problem is access to, not carriage of, oil, and does not support H.R. 1037 on national security grounds. State believes that, on balance, oil cargo preference would not be beneficial to national security. U.S. cargo preference, if emulated by others, would reduce U.S. flexibility in future supply disruptions should U.S.-flag tankers be banned from suppliers' ports. Furthermore, vessels of our allies would be available to meet our needs in time of emergency.

ADVANTAGES

- o It is acceptable to maritime interests as, in their view, fulfilling your campaign commitment, and assuring their economic well being.
- o Between 2,100 and 4,600 seagoing jobs would be generated depending on whether oil imports are 6 or 10 million barrels/day. At least 13,500 shipyard and supporting industry jobs would be created after 1980 at an oil import level of 10 million barrels/day, but no shipyard jobs at 6 million barrels/day.
- o Age limit would prevent the extended use of obsolescent, worn-out and inefficient tankers in the preference trade.

- o Could improve tanker safety and pollution avoidance to the extent that U.S. ship and crew standards are more stringent than foreign, although new Coast Guard standards will apply to all shipping in U.S. waters.
- o Could improve the U.S. balance of payments by \$95-\$150 million.
- o Reconstruction in the U.S. of foreign-built tankers would generate near term shipyard business/employment.

DISADVANTAGES

- o Commerce estimates the annual cost (excluding wellhead tax increase) of carrying preference cargo in 1985 from \$233 million to \$420 million depending on whether 1985 oil imports are 6 or 10 million barrels/day. Since cargo preference would increase the cost of imported oil, the proposed wellhead tax on domestic production would be increased. The CEA estimates total costs (including wellhead tax increase) in 1985 at the above import levels from \$644 million to \$884 million. Preference oil could be excluded from the wellhead tax computation, which would likely require an entitlements program. The price impact (excluding wellhead tax) would be about 0.1 cent/gallon spread over total oil consumption.
- o If 1985 oil imports are 6 million barrels/day, the cost per seagoing job would be \$111,000, excluding the wellhead tax increase. At the 10 million barrels/day import level, the cost per permanent seagoing job would be \$91,000, but the addition of temporary shipbuilding jobs would lower the average to \$23,000 while additional ships are constructed.
- o CEA estimates net impact on the economy as a whole would be a decrease in total employment and GNP.
- o Would be contrary to the London Summit pledge to reject protectionism.
- o Would probably trigger the adoption of similar or more stringent measures by other countries. Currently, cargo preference imposed by other countries applies to 5% of world oil trade.

- o Would be a reversal of U.S. policy which has favored free competition for commercial cargoes.
- o Would violate U.S. treaties with more than 30 countries.

OPTION 2: Expanded operating subsidy program. (Supported by State, CEA, NSC, DOD, DOT and the Special Assistant to the President for Energy. OMB supports without a cap on the subsidy. Treasury and FEA support option 2 or 3.)

This option would attempt to create 5000 additional seagoing jobs by a more flexible and generous operating subsidy program. It entails basic changes in longstanding subsidy programs, including a budgetary ceiling. Maritime interests strongly oppose this as an alternative to cargo preference arguing that independent operators will not be attracted and that the major oil companies with their company unions will be the primary beneficiaries. Shipbuilders oppose this option since no new ship construction would be generated. Union leaders claim they will maintain their traditional alliance with shipbuilders in opposing this option. A recent OMB attempt to put a cap on existing subsidies was strongly opposed.

U.S. ship operators are deterred from registering their ships under U.S. flag by legislative and Maritime Administration regulatory restrictions. Relaxation of restrictions such as permitting foreign-built vessels constructed prior to December 31, 1977, to qualify for subsidy, allowing operators receiving subsidy on their U.S. fleet also to operate a foreign fleet, and allowing repairs of subsidized vessels in foreign shipyards, should attract more ships to U.S. registry.

Since it is difficult to estimate the number of U.S.-owned vessels which would apply for subsidies under these relaxed conditions, an administrative budgetary limit of \$100 million should be placed on expenditures under the new program. Since operating subsidy appropriations for FY 78 will be about \$400 million, the total budget limitation for FY 78 should be about \$500 million.

Eligibility for participation would be open to all vessels (tankers, bulk carriers, and liners) to permit equal opportunity for subsidy to all U.S. ship owners and to avoid discrimination by type of cargo. There is no economic reason to limit the program to tankers.

It may be necessary to structure the subsidy in such a way as to provide additional incentives for independent operators to participate in the program in order to ensure an acceptable level of accession by independents. Most

foreign flag U.S.-owned ships that could switch to the U.S. flag under this program are owned by large multinational corporations.

ADVANTAGES

- o Would generate as many additional seagoing jobs (5,000) as cargo preference at a lower total cost (\$100 million vs. \$233-\$420 million) and at a lower cost per job (\$20,000 vs. \$91,000-\$111,000).
- o Would not increase refiners' acquisition cost of crude oil and, therefore, would not have attendant inflationary impact of cargo preference.
- o Would not have the adverse foreign policy repercussions of cargo preference.
- o Would put a limit on total operating subsidy which is now open-ended.

DISADVANTAGES

- o It is unacceptable to the advocates of cargo preference and would be attacked as benefiting the major oil companies.
- o Would add \$100 million to the budget cost of the maritime subsidy programs.
- o Would not generate additional temporary jobs in U.S. shipyards after 1980 as cargo preference would.
- o With a cap, there would be a budget limit to subsidies to the maritime industry for the first time.
- o It is not possible to predict the rate of participation by U.S.-owned foreign flag ships.

OPTION 3: Extend the Jones Act to the Virgin Islands for oil. (Treasury and FEA support option 2 or 3. State supports option 3 in conjunction with option 2 if needed.) The Jones Act, which requires U.S. ships for domestic trade, would be extended to the Virgin Islands for oil products only. This trade is currently open to foreign flag tankers. Reserving Virgin Islands oil trade to U.S. flag tankers would provide employment for about 2,000 U.S. seamen.

Amerada Hess, the firm which operates the only refinery in the Virgin Islands, receives a double benefit from current U.S. policies: it is treated as a domestic refiner

with respect to the oil entitlement program, but is treated as a foreign refiner with respect to the Jones Act. Since Hess is a small refiner, it is expected that he would absorb the added cost of using U.S.-flag ships. After years of resisting, Hess is no longer opposing extension of the Jones Act to the Virgin Islands. The oil import fee system will make it cheaper for him to use U.S.-flag ships in any event.

An independent refiner with plans to build a new refinery in the Virgin Islands claims it cannot do so if the Jones Act extension is implemented. This would result in the loss of 3,000 potential construction jobs. However, problems unrelated to the Jones Act such as the lack of crude and markets for refined products may preclude construction of the refinery. In any event, the Virgin Islands is a poor location for refining. Firms consider it only because of the exclusion from the Jones Act and the availability of tax assistance.

Executive Branch lawyers are trying to determine whether extension of the Jones Act can be accomplished by a Presidential proclamation or whether legislation is needed.

ADVANTAGES

- o Would provide approximately 2,000 seagoing jobs with the cost likely absorbed by the refiner.
- o Would not have the inflationary impact of oil cargo preference.
- o Would lead to a better allocation of refinery capacity.

DISADVANTAGES

- o Could serve as a precedent for complete extension of the Jones Act to the Virgin Islands which could impact negatively on tourism, the islands' major industry.
- o Maritime interests oppose as a substitute for cargo preference because they believe the Congress will extend the Jones Act to their benefit in any event.

ADDITIONAL ISSUE: IN-DEPTH STUDY OF THE MARITIME INDUSTRY.
(Supported by State, Commerce, OMB, CEA, NSC, DOD, DOT, FEA, and the Special Assistant to the President for Energy. Treasury supports with option 3.)

There was considerable support among EPG members for an in-depth study of the maritime industry. Such a study would examine the long-term prospects of the industry and the implications for U.S. interests. If it was determined that a promotional policy was appropriate, the study would evaluate the various methods including direct subsidies, tax deferments, loan guarantees, investment tax credits and cargo preference. The question of economic regulation would be addressed and the economic costs of various courses of action would be estimated. The study should also include an evaluation of the increasing reliance upon anti-competitive arrangements by some foreign governments and carriers.

If you chose option 1 which gives the maritime industry what it wants, announcement of the study could detract from this action. On the other hand, none of the three options is likely to solve the long-run problems of the maritime industry. It will only be a matter of time before the maritime industry seeks additional Federal assistance. We should, therefore, seek to develop a long-run national maritime policy in preparation for dealing with future requests for assistance and to assure that U.S. maritime needs are met.



MEMORANDUM FOR THE PRESIDENT

Subject: Modified Oil Cargo Preference and Other Maritime Options

H.R. 1037 provides that 20 percent of U.S. oceanborne oil imports will be carried by U.S.-flag, U.S.-built tankers, with the preference percentage going to 25 in 1978 and to 30 in 1980.

In March, you indicated that you did not endorse H.R. 1037 as such, but that you favored some action to assist the maritime industry. At your direction, Commerce and White House spokesmen have since met with Congressional representatives to seek a mutually supportable course of action. Meetings have also been held with representatives of maritime labor and the shipbuilding and ship operating industries. Four options have been addressed.

1. Modified Oil Cargo Preference - Under the proposed new approach developed in Commerce the ultimate preference percentage would be reduced to 25 and the implementation timetable stretched to 1985. Foreign-built tankers under U.S. registry could carry 10 percent of our oil imports as preference cargo.

These modifications would reduce the annual cost as of 1985 from the \$705 million attributable to H.R. 1037 to \$350 million, assuming an import level of 10 million barrels/day, and would entail \$160 million/year at 6 million barrels/day. In terms of consumer impact, these new totals translate to 12 hundredths of a cent/gallon at 10 million barrels/day and to 7 hundredths at 6 million.

Although the proposed changes would not obviate possible adverse foreign policy effects, I believe that measures such as assuring shares of the trade to our treaty allies could mitigate those effects. This is the only one of the options that is acceptable to the maritime interests who think there is a Presidential commitment and to the Congressional advocates of cargo preference. On balance, I believe that its advantages outweigh its disadvantages.

2. Operating Subsidy for Foreign-Built Ships - This option would provide for \$100 million in operating differential subsidies for foreign-built ships transferred to U.S. registry, which would be permitted to operate without any of the restrictions that now apply to U.S. subsidized ships in foreign trade.

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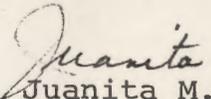
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If you chose option 1 which gives the maritime industry what it wants, announcement of the study could detract from this action. On the other hand, none of the three options is likely to solve the long-run problems of the maritime industry. It will only be a matter of time before the maritime industry seeks additional Federal assistance. We should, therefore, seek to develop a long-run national maritime policy in preparation for dealing with future requests for assistance and to assure that U.S. maritime needs are met.

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