The U.S. Harbor Maintenance Tax: The Great Whipping Buoy

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Introduction

The United States and Canada have worked under the NAFTA agreement for 18 years now. Trade flows between the two countries--- which are in world's largest trade relationship--- have increased as a result. Both countries have similar ocean container cargo screening processes in place, with manifest data being transmitted 24 hours in advance of port arrival. Trade impediments, however, still exist. Softwood lumber has been a sore spot and the border has "thickened" to a degree because of post 9-11 regulations **(Prokop 2004 and 2012)**. A new point of concern has emerged in terms of container imports destined for the U.S.

This paper will examine the structure and controversies surrounding the U.S. Harbor Maintenance Tax (HMT). While this tax is a non-tariff barrier (NTB) in the strictest sense--- and should be expected to distort trade flows--- concern over the possible diversion of cargo away from U.S. to Canadian ports has led some U.S. government officials to wonder what the cause might be. Oddly, the HMT is not explicitly mentioned as a cause and nor is the idea that it failed to live up to its purpose.

These subterfuges should be a cause for concern in Canada's maritime sector.

HMT Structure

The U.S. Congress enacted the Harbor Maintenance Tax (HMT), within the Water Resources Development Act of 1986, as a means to fund port dredging and maintenance of channels. It set up a trust fund to pay for the Army Corps of Engineers and other leaders in dredging. The rationale was to create a user fee instead of relying on general tax revenues to fund port infrastructure. Currently, about $3 billion is spent on dredging projects over a given year; and the fund is sitting at about a $6 billion surplus.[1] While $3 billion may sound like a lot of money, since 2000 only three deep dredging projects have been approved **(Prince 2012; p. 23)**. In other words, one must distinguish between port maintenance and improvement. The U.S. Department of Transportation's survey of 35 ports (out of the 85 members of the American Association of Port Authorities, AAPA) revealed an expenditure of $145 million on dredging in 2006, of which only 43.2% was devoted to improvement as opposed to maintenance **(USDOT 2009; p. 6)**.

The HMT was levied on all users of U.S. ports including importers and exporters though the U.S. Supreme Court (in U.S. Shoe Co. vs. United States) exempted exporters in a 1998 ruling noting that the U.S.

Constitution prohibits export taxation. The tax rate of 0.125% is based on the value of cargo[2] on a vessel entering a port. The tax on cargo value at exit was the part ruled unconstitutional. So apart from exporters the HMT is a user-based tax on benefits. Of course, since the tax is earmarked to port development, it does not account for any negative externalities which may occur because of port usage (e.g., pollution, road congestion due to drayage, etc.).

Currently, U.S. Customs and Border Protection (CBP) collects this tax on imports. At the same time the U.S. Court of Appeals for the Federal Circuit ruled in 2001 that the HMT is not a customs duty--- meaning that the HMT applies to U.S. imports entering foreign trade zones (FTZs). This ruling upheld an earlier decision by the U.S. Court of International Trade. It should also be noted that cargo bound for non-contiguous U.S. states and territories (i.e., Alaska, Hawaii, Guam and Puerto Rico) are exempt from the tax. Back to the U.S. Constitution--- while the federal government is supposed to collect taxes and customs duties in a consistent manner the U.S. Supreme Court has granted the government the latitude to account for geographical differences among the states. Apparently the rationale is that the HMT is too burdensome in these two states whose consumers are so heavily reliant on ocean transportation. At the same time, all Lower 48 ports must levy the tax--- whether or not dredging is an issue. In this way naturally deep-water ports such as Tacoma are cross-subsidizing the more problematic ones such as New Orleans (or even Tacoma's

competitor, Oakland, CA which needs more frequent dredging).

Since the tax also applies to wholly domestic trade it is a part of the equation making short-sea shipping cost prohibitive. The tax may be double levied on an import container: once at port of entry and a second time should the container be trans-shipped (in this case, short-sea shipped) to another port. Of course, if the trans-shipment were handled via road or rail, there would be no further HMT levied. Short-sea shipping interests have tried for an exemption to the HMT to no avail. An argument for a second levy is that short-sea shippers do, indeed, benefit from port usage and so should pay the tax. But an argument against it is the extent to which short-sea shippers use shallow-draft barges and other vessels and, therefore, receive no direct benefit from port dredging. Still, it is tough to tell how much revenue the U.S. Treasury would lose if the domestic short-sea coastal and river routes were exempt. Mark Yonge, managing member of the Short-Sea Shipping Cooperative (SCOOP) says: "There's really no accurate record-keeping anywhere of what domestic HMT is being collected… Customs doesn't have any capability of doing that. There's no manifest filed. It's almost a voluntary tax, because Customs doesn't board the vessels that go down the coast. It's almost an honor system." **(Edmonson 2005; p. 35)**. Nonetheless, SCOOP estimated that the HMT raised the cost of short-sea cargo anywhere from $50-$100 more than the equivalent haulage by road or rail **(Edmonson 2004; p. 40)**. Apart from these issues a

bigger cost issue is the requirement to buy and operate U.S. flagged vessels as part of the Jones Act.

HMT Distortionary Effects

Great Lakes shipping (or international short-sea shipping in this case) may be ill-affected. Canada-U.S. barge or ferry transport of containers or the trucks themselves via Lake Ontario and Lake Erie could avoid land border bottlenecks. Of course, several potential ports for such services (e.g., Hamilton and Nanticoke, ON; Oswego, NY and Erie, PA) would need to be furnished with proper customs and security facilities. Detroit-Windsor Truck Ferry ships trucks with hazmat across the Detroit River into Canada. However, the trucks prefer to return via the Ambassador Bridge trading off the time delay as against having to pay the HMT should they be hauled back to a U.S. port **(Edmonson 2005; p. 35).** Of course, another thing to keep in mind is the type of vessel to be used in trans-border short-sea shipping. If the vessel (i.e., ferry or barge) should be classified as a "ship" the 24-hour advance manifest rule applies. If not then the "vessel" could fall under the more generous regulations for trucks (i.e., a 1-hour advance manifest rule).

The latest iteration in the HMT saga is in a U.S.-Canada border dispute. As noted imported ocean cargo to the U.S. receives a HMT levy while subsequent trans-shipping via land does not. Of course, if the ocean cargo enters a Canadian port in the first leg, the HMT is avoided

all together. This activity has the ports of Los Angeles, Long Beach, Oakland, Portland, Seattle and Tacoma concerned about their comparative disadvantage. In the language of international trade, the HMT is a non-tariff trade barrier (NTB). Naturally, the ports of Vancouver and Prince Rupert, BC are the targets of this concern.

In addition to U.S. West Coast ports' concerns about diversion of cargo away from U.S. ports to Canada's, the chairman of the U.S. Federal Maritime Commission (FMC), Richard Lidinsky, has requested his organization look into whether or not the diversion is due to "artificial differences in container inspection, practices and costs, rail costs and infrastructure cost investments." **(Edmonson 2011; p. 14)**. He added: "The time has come for the FMC to examine the disparities that have pushed U.S.-bound ocean cargo from our ports to Canadian ports. Last year, 7 percent of U.S.-bound imports that entered through the West Coast came through a Canadian port instead of a U.S. port." **(Dupin 2011; p. 54)**. At this stage, the FMC is engaged in a study and there are no plans to recommend a countervailing duty on trans-shipments from Canada. For such a duty to have a chance for success in the NAFTA dispute settlement panel (DSP) or at the World Trade Organization (WTO) it would have to be on the basis that Canadian ports and intermodal operations (most specifically, CN rail shipments to the U.S.) are benefitting from government subsidies or protections of some sort. Absence of a Canadian version of the HMT this would not pass muster.

U.S. & Canada Port Activities

According to the American Association of Port Authorities the U.S. imported about 783 million metric tons of cargo via marine transport in 2010. Canada was only about one-tenth that size at about 72 million metric tons. Furthermore, container volume in the U.S. grew from 30 million TEUs in 2000 to 42 million in 2010--- or annual growth rate of 3.4%. Canada's annual growth rate over the same time period was higher at 5%; but the volume in 2010 was only about 5 million TEUs. So, in the wildest of senses, if all of Canada's maritime cargo resulted from diversion away from U.S. ports of entry, Canada could only account for 9% of U.S. tonnage (i.e., 72/783) and 12% of its TEUs (i.e., 5/42). Of course, the HMT cannot be made to take the blame for even a small fraction of those ratios. At any rate 2010 saw about 0.4 million TEU's worth of U.S. bound containers handled at Canadian ports--- or about 1% (i.e., 0.4/42).

Is all of this trade diversion[3]? Well, the Asia-West Coast great circle routes favor Canadian ports over L.A. and Long Beach in terms of in-transit times. And if infrastructure improvements at Canadian ports (e.g., Prince Rupert) are making these destinations more attractive, then this diversion is a natural market process. The HMT would be playing a very small role here.

Looking at this diversion issue from a market perspective shippers make their routing decisions based

on costs, service quality and delivery times. U.S. ports need to manage these in order to remain competitive with Canadian ports. While it is true that the HMT raises effective shipping costs, following through on the revenue earmark into dredging and port maintenance will help improve the service quality side of the equation. In the spirit of NAFTA the U.S. needs to re-examine how to attract and maintain cargo activity without resorting to protectionism--- especially given its fragile economy at this time.

Conclusion

Again, the United States and Canada have the world's largest bilateral trade relationship. Yet unilateral trade taxation policies can lead to unintended consequences. Worse, U.S. West Coast ports face a dilemma in that some container diversion is taking place while the very source of that diversion, the HMT, is not filtered back to them in the form of infrastructure improvement to allow them to compete with Canada's West Coast ports. It is unfortunate that the HMT--- a tax loved, it seems, only by Congress--- has failed in its original intent only to become just another NTB adding to the landed costs of U.S. consumer goods. And investigations by the FMC will hopefully not be used as a point of leverage in order to place trade sanctions on Canada.

Endnotes

[1] Congress has been reluctant over the years to spend the tax in the way intended. Using public sector accounting rules the surplus in the trust fund has been used, since 2000, to off-set annual federal deficit sizes.

[2] The 0.125% rate came into effect in 1990. The original rate was 0.04% on domestic and international cargo and on cruise ship tickets. Thus, all users were not exempt since the tax also applied to cruise ship passengers. While the rate is small the tax bill is not insignificant. If a container had $500,000 worth of fashion apparel or machine parts, etc., the levy would be $500,000(0.00125) = $625. The average tax on a 40-foot container (covering the average of all types of commodities) is about $80.

[3] Technically, this is not trade diversion as noted in the literature. Here trade is being diverted within a trade bloc in order to seek efficiencies. If the United States and Canada enhanced their free trade agreement in order to form a customs union, this diversion would recede.

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