



GLOBAL IMPACT



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Dear Friends:

Just about every action carries a degree of risk. But sometimes inaction carries more risk. Whether it's a new trade deal or security upgrades, it's important to arm yourself with as much information as possible.

The U.S. and five Central American countries are expected to sign the U.S.-Central American Free Trade Agreement. But a number of obstacles exist, including difficulties in Washington. What are the benefits of the accord and could it become a lightning rod? (p1-2).

The maritime industry is gearing up to meet important new security requirements. But how will they impact transportation flows and what costs are involved? This article provides details every shipper needs to know. (p3-4).

We hope you enjoy this issue and, as always, we welcome your comments.

Sincerely,

John A. Rowney
Division President
Ocean Marine Division

FREE TRADE WITH CENTRAL AMERICA

DISPELLING MYTHS AND MAKING THE U.S.-CENTRAL AMERICAN FREE TRADE AGREEMENT WORK

Almost one year ago, U.S. Trade Representative Robert Zoellick and ministers from Central America announced the launch of U.S.-Central American Free Trade Agreement (CAFTA) negotiations. The primary goal is to eliminate barriers to trade in goods, agriculture, services and investment between the United States and Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.

CAFTA is anticipated to give U.S. exporters and investors greater access to Central American markets, strengthen North-South ties, promote the rule of law in Central America and foster economic growth there by granting the five Central American countries preferential access to U.S. markets. But obtaining an agreement and Congressional approval in the short term may prove difficult.

STICKING POINTS AND A SENSITIVE U.S. POLITICAL ENVIRONMENT

In January 2003, when CAFTA negotiations began, it was estimated that an agreement could be reached by December 2003, with a vote in Congress soon afterward. Sticking points involving agriculture (especially sugar), textiles, telecom, insurance and intellectual property protection would prove to be difficult to remedy. Nevertheless, as of this writing, an agreement has been reached, with the exception of Costa Rica — which said it needs to undertake further consultations before finalizing its participation.

The greater difficulty, however, may take



place in Washington, D.C. Unless a vote on CAFTA occurs in early 2004, Congress is likely to postpone it until after the November 2004 elections. Why? Currently, free trade issues are receiving a great deal of negative attention in Washington and several Congressional districts. The most controversial issues stem from the loss of U.S. manufacturing jobs.

Although U.S. non-farm payroll employment rose by 126,000 in October, hopefully marking the end of the so-called "jobless" recovery, manufacturing jobs continue to disappear. For example, they fell from a high of 21 million in 1979 to 14.5 million in October 2003. And many blame the 24-year-long trend on international trade. But careful analysis reveals that trade is not the cause of the decline in the manufacturing sector.

Manufacturing production in the United States has rapidly increased — not decreased — over the past 50 years, according to the Federal Reserve. New technologies and innovation have tremendously accelerated

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productivity growth, enabling U.S. manufacturers to produce more goods with fewer workers. As a result, the manufacturing sector is following a path similar to the one taken by the U.S. agricultural sector. In 1940, 9.5 million U.S. workers were employed on farms. By 2002, this had dropped to less than 3.3 million. Yet, U.S. agricultural output can now feed the world.



Although skyrocketing productivity has resulted in fewer manufacturing jobs, it has provided enormous benefits. These include greater efficiency, increased wages and a higher standard of living. Additionally, more capital is freed up to be invested in new industries.

High productivity combined with the U.S. economic ability to produce new jobs are more than offsetting the losses. In fact, from 1970 through 2000, the U.S. economy produced huge numbers of jobs — 60 million. Plus, the Department of Labor projects a net increase of 22.2 million more this decade.

The majority of new jobs is expected to emerge in the service sector. Today, this industry is much more sophisticated and globally competitive than it was even five years ago, according to analysts. In turn, average hourly earnings for production workers in the service sector have already caught up to those in manufacturing.

Although many economists feel that free trade has become the scapegoat for many of our economic ills, the controversy surrounding it is very real. As a result, CAFTA is likely to become a lightning rod for those unhappy with economic conditions.

U.S.-CENTRAL AMERICAN TRADE

U.S. exports to the five Central American countries, which represent a combined population of 34 million, reached nearly \$10 billion in 2002. This is about the same as U.S. exports to Italy or the entire African continent. Key exports include machinery and equipment; chemicals and plastics; foodstuffs including apples, corn, wheat and rice; textiles and apparel; and paper. U.S. imports from the region reached almost \$12 billion in 2002. (Note: the administration may include the Dominican Republic in CAFTA, a country which imported \$4.3 billion in goods from the U.S. in 2002).

CAFTA WILL LEVEL THE PLAYING FIELD

Currently, more than 20 Central American trade agreements — without U.S. involvement — grant preferences to products from Mexico, Canada, Chile and several other nations. This has put U.S. exporters at a competitive disadvantage. For example, U.S. apple growers shipped nearly \$4 million of apples to Costa Rica in 2002. To the disadvantage of these U.S. exporters, Costa Rica applied a 15 percent import tariff, while Canadian apples imported by Costa Rica entered duty free. In addition, U.S. tariffs on Central American goods are already low, with 74 percent entering the U.S. duty-free.

By reducing tariffs on U.S. goods and services, CAFTA will level the playing field for U.S. firms and accelerate U.S. exports to the region. Plus, many U.S. policymakers hope CAFTA will act as a stepping stone to the creation of the Free Trade Area of the Americas.

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CENTRAL AMERICAN BENEFITS

Central America also will benefit in several ways. In addition to enhanced access to U.S. markets, CAFTA will strengthen and help stabilize the region. In turn, U.S. direct investment in Central America, which registered a cumulative amount of \$3 billion in 2002, is likely to rise, satisfying a strong demand for capital there. Plus, CAFTA will support democracy and economic reform — all factors that lead to higher standards of living.

MAKING CAFTA WORK FOR U.S. COMPANIES

Although U.S.-Central American trade is relatively small, CAFTA presents incremental benefits that can aid small and large companies alike.

For many small U.S. firms, for example, expanding into small Central American markets will provide the know-how to expand into larger markets. And in today's dynamic global environment, expanding globally is vital to achieving success in the 21st century. For more information on CAFTA, visit the United States Trade Representative's office (www.ustr.gov), the U.S. Department of Commerce (www.commerce.gov), the International Trade Administration (www.trade.gov) or obtain export assistance from the office nearest you (www.commerce.gov/statemap2.html). ■



FINAL SECURITY RULES REQUIRE BILLIONS IN INVESTMENT

PRIVATE FIRMS AND PUBLIC PORTS MUST ADOPT STRATEGIES TO ACCOMMODATE GREATER SECURITY COSTS

Security rules mandated by the Maritime Transportation Security Act (MTSA) will cost the industry billions of dollars over the next decade, even though federal grants required by the same law have covered only a fraction of the tab so far. The rules are vital to the homeland security of the U.S., which moves 95 percent of its overseas cargo by ship, but they also necessitate changes in the way companies of all sizes do business through U.S. ports.



With implementation deadlines fast approaching and the likelihood of new security measures, private firms and public ports alike must continue to adopt new strategies to mitigate risk and preserve revenues.

On November 22, 2003, final rules published by the Coast Guard replaced temporary interim rules and incorporated hundreds of industry comments received earlier in the year. The rules cover vessel and facility security, maritime area and offshore oil platform security, and the implementation of the Automatic Identification System (AIS) on certain vessels.

Owners and operators of vessels and facilities affected by the rules must designate security officers, develop security plans based on assessments, implement measures specific to operations, and comply with heightened maritime security levels. Affected companies must submit security plans to the Coast Guard by December 31, 2003, and vessels and facilities must implement those plans by July 1, 2004.

The rules also require the installation of the Automatic Identification System (AIS) on U.S. flag SOLAS (International Convention for the Safety of Life at Sea) commercial vessels and certain domestic commercial vessels operating in Vessel Traffic System areas. To ease the cost burden on industry, the Coast Guard has excluded certain small fishing vessels and small passenger vessels from the AIS requirement. The deadline for implementation on all vessels affected by the rule is December 31, 2004.

While broad, the security rules do provide many exceptions, such as small passenger vessels and public access facilities that serve small recreational vessels. Companies that may be affected by the rules should consult an attorney and read the full text of the rules, available at www.gpoaccess.gov

(search the *Federal Register* for “National Maritime Security Initiatives”). Managers may also call an information line about the new rules at (800) 842-8740, ext. 69270.

REAL COSTS TO BEAR

Public port agencies and private vessel and facility operators already have invested millions in increased security measures. In addition to expenditures already incurred, the new rules will cost the industry approximately \$1.5 billion in the first year, with present value total costs of \$7.3 billion over the next decade, the Coast Guard reports. Such outlays are certain to have a significant impact on the revenues of hundreds of small businesses in the industry.

According to the Coast Guard, the rules will affect owners of 10,300 U.S. flag SOLAS and domestic (non-SOLAS) vessels, who will have to purchase and install equipment, hire security officers, train personnel and prepare paperwork associated with the rules. Over 10 years, the estimated total cost of compliance is \$248 million for U.S. flag SOLAS vessels and \$1.1 billion for domestic (non-SOLAS) vessels. The final rules will affect about 5,000 facilities at an estimated total cost of \$5.4 billion over 10 years.

About 3,500 vessels will have to implement AIS for a total 10-year cost of \$50.4 million. The Coast Guard estimates the per-vessel cost of an AIS unit in the first year will be about \$9,300, with \$7,000 devoted to the technology and the balance to installation and training. Additional maintenance and replacement costs surely will follow.

For vessel operators affected by the rule, the market for AIS equipment is far from established, making the prediction of future costs difficult. Companies would be wise to make liberal cost projections and hope that increased competition among manufacturers of the technology will drive prices down.



FEDERAL HELP LIMITED AT BEST

While industry costs stretch into the billions, port security grants appropriated by Congress have totaled only \$513 million since September 11, 2001, according to the American Association of Port Authorities (AAPA). That includes \$125 million devoted to grants in the fiscal year 2004 budget, signed in October. For 2005, the AAPA is lobbying

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for \$400 million. "To ensure implementation of security measures, it is vital that the federal government continue and augment its financial help to ports, as it has done with airports," said AAPA President Kurt Nagle, referring to the \$3 billion in federal aid already granted to the air travel industry.

Companies and ports must continue to participate in the port security grant program, administered by the Transportation Security Administration (TSA), and apply whenever possible for federal assistance. The TSA most recently considered more than 1,000 grant requests totaling \$987 million, according to the AAPA.

But it is clear that counting on federal aid in the future is a dangerous strategy, since lawmakers and the Bush administration appear to assign different priorities to the program. The Senate, for example, had requested \$150 million in grants for fiscal year 2004, compared to \$100 million from the House and no such funds in the president's original budget.

For most companies and municipalities, the cost of compliance will mean revising financial priorities significantly over the next decade, including the decision of how much cost to pass along to the supply chain and, ultimately, to consumers.

PLANNING FOR A SECURITY CRACKDOWN

But the initial costs of implementing the final security rules are only part of the big picture. Will future security mandates, initiated suddenly, require additional surges in spending? Almost certainly. And companies have no choice but to plan for worst-case scenarios that result in costs almost too high to estimate.

For example, raising the Maritime Security (MARSEC) Level from Level 1 to Level 2 or 3, the highest level, would have significant repercussions in the industry. (The industry has operated at Level 1 since September 11, 2001.)

Elevating to Level 2 twice a year for a total of six weeks would cost vessel owners and operators an estimated total of \$235 million annually, and facility owners and operators an estimated \$424 million, according to a

Coast Guard study. The study did not attempt to quantify costs related to operational restrictions, such as the limiting of cargo operations to daylight hours or limited access to facilities or vessels. Such restrictions are almost certain to occur, meaning companies must have contingency plans in place to address the resulting delays and logjams.

The high costs of MARSEC Level 3, which would result in the temporary closure of ports and waterways, are virtually impossible to estimate, the Coast Guard says, but they could have such far-reaching consequences as delayed commerce, decreased productivity, price increases, increased unemployment, unstable financial markets worldwide and economic recession.

Last year's temporary shutdown of West Coast ports due to a labor dispute, for example, cost more than \$1 billion a day during the first five days, according to the AAPA. Managers at companies of all sizes must ask: If a security incident were to shut down ports for even longer, how would my business stay afloat? ■

Effective January 1, 2004, Cofr-Rite program capacity for vessels in the International P&I Clubs has been expanded to \$50 million.

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