Our View:
Seeking Profits from Opportunities Created by Regulatory Changes

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The powerful generally have their way. In the United States, the pharmaceutical companies have prevented consumers from availing themselves of low-cost prescriptions even if a drug has been around for years. Insulin, a product used by diabetics for decades and certainly off patent, provides an example, In the United States, monopolist suppliers have cornered the market. In other countries such as Canada, these monopolists have been blocked from charging excessive prices. Thus, insulin users that pay $320 per vial here can purchase insulin for $30 per vial in Canada.[1]

Economists describe the companies charging high prices in the United States as "rent seekers." Rent seeking occurs when a firm or group of firms uses its position to obtain government protection for its activity, thereby limiting or eliminating competition. The US pharmaceutical companies making one-thousand-percent margins on insulin do so only because our federal government prohibits the importation of low-priced product from Canada and elsewhere.

Refiners have often profited from rent seeking. Late in the 1990s, the United States issued rules requiring gasoline with lower sulfur content. Prices rose when refiners could not produce enough of the cleaner gasoline. Severin Borenstein, an economist at the University of California, called on the Environmental Protection Agency to introduce a penalty fee for gasoline with higher sulfur to moderate the impact of the new rule on consumer prices. Rent-seeking refiners such as Marathon and Valero successfully opposed the effort.

Today, refiners are rent seeking again. In the US, they and domestic crude producers have formed the Coalition for American Energy Security (CAES) to discourage backsliding by the Trump administration on IMO 2020 compliance should US diesel and gasoline process rise. Shipowners have done the same in forming the Trident Alliance.

The alliance, made up of shipowners favoring strict enforcement of the rule, recently expressed its outrage over Indonesia's decision to not enforce the IMO 2020 rule domestically. The group posted a strongly worded online attack on the country that began this way:

> The entry into force date of the new global sulphur cap is set in stone. From January 1st, 2020 the maximum sulphur content of fuel consumed on the high seas will be 0.50%, unless an exhaust gas cleaning system is used. Due to compliance cost, the Trident Alliance believes it is essential for authorities to

[1] Tyler Choi, "American caravan arrives in Canadian 'birthplace of insulin' for cheaper medicine," Reuters, June 29, 2019 [https://tinyurl.com/y4mkdpbq].

> fully and effectively enforce the regulations if fair competition is to be maintained, and to protect health and environmental interests.[2]

The Trident Alliance seems to comprise relatively well-financed shipowners. While shipping is a business where profits are not regular, the Alliance appears to be a cabal of companies that have found the funding needed to upgrade their ships. The goal of its members is to see other, less-well-financed shipowners forced into selling their ships for scrap, thereby creating a tighter market with higher rates, as well as higher sales prices for older ships. Shipowners in Indonesia seem the ideal target.

Indonesia's shipping industry is bordering on decrepit. One shipbroker, Albert Susilo, told *Manifold Times* that many of the ships may not be capable of using low-sulfur fuel:

> "Most of the domestic vessels in Indonesia are generally older tonnages between 15 to 30 years old and have been running on high sulphur fuel oil (HSFO) or gasoil all the time.
>
> "In some cases, various companies manufacturing engine and equipment used by these vessels have probably closed down; even if owners wanted to carry out a ship implementation plan for their vessels they will not know who to approach for technical assistance."[3]

The Trident Alliance's rent-seeking plans have run into a brick wall, however, because Indonesia also sees a chance to seek rents, in its case by means of the IMO regulation. Indonesia produces significant volumes of a light sweet crude that is an ideal feedstock for refining IMO-compliant fuels. However, one of the country's main refineries is configured such that it must produce substantial amounts of high-sulfur fuel. Indonesia apparently has addressed this problem by exporting its low-sulfur products while allowing its own shipping companies to use the high-sulfur fuel when moving goods and people back and forth among the nation's eighteen thousand islands. This strategy seems the perfect financial balm for a country whose economy has been bruised by the US/China trade war.

The Trident Alliance members are not pleased. When they learned of Indonesia's decision, they threatened to sue, warning Indonesia that "states party to Annex 6 can be held liable for non-enforcement by the other states that are party to it."

I can imagine the Indonesian officials chuckling at the Trident threat because other rent seekers have inflicted much worse damage on the country. In the late 1970s, an individual like the Trident Alliance chairman Roger Strevens crippled the Indonesian economy by arresting most of the tankers leased by the country's national oil company. The "colonizer" then was Bruce

[2] Trident Alliance, "Trident Alliance responds to Indonesian threats on IMO2020 low sulphur fuel policy," July 31, 2019 [https://tinyurl.com/y4op37fb].

[3] "Indonesia: Decision to allow domestic consumption of 3.5% marine fuel 'makes sense,'" *Manifold Times*, July 24, 2019 [https://tinyurl.com/y3hbdcq7].

Rappaport, a Swiss trader who was later caught up in the Iran-Contra affair and a longtime friend of William Casey, the former CIA head.[4]

A *New York Times* article reporting on Rappaport receiving immunity from a special prosecutor provided further details:

> Mr. Rappaport's shipping contracts with Pertamina, the Indonesian state-owned oil company, spawned a widely publicized legal dispute in the 1970's. Mr. Rappaport declared a victory when he settled his more than $1 billion in claims against Indonesia for several hundred million dollars.[5]

Once burned…. Indonesia will proceed with its plan, ignoring Trident's empty threats. The alliance's members, as well as refiners hoping to earn large rents from the IMO transition, should worry that other countries such as Vietnam, Thailand, and Malaysia, as well as some in the Caribbean, will follow Indonesia's example.

There is an old Wall Street saying that goes "hogs get fat while pigs get slaughtered." The rent-seeking refiners and shipowners hoping to see large profits risk financial slaughter at the hands of governments, like Indonesia's, that put the interests of their citizens and their companies ahead of those of the IMO.

[4] In the interest of full disclosure, the author notes that he worked for Rappaport on the matter that resulted in Rappaport being identified as a key party in the Iran/Contra affair.

[5] Jeff Garth with Stephen Engelberg, "Seeking Testimony in Pipeline Case: Immunity Given to a Secretive Swiss," *The New York Times*, March 6, 1988 [https://tinyurl.com/y4929py7].