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The Case of the Diamond Princess: Stranded at Sea in a Pandemic (Part 3)

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Special Edition: COVID-19 Crisis

Photo Source: Canva

(July 29, 2020) This Case Study is the Third of a Three-Part Series. Part I shares information pertinent to the period of the Passenger Quarantine. Part II, covers the challenge of Repatriation of the Passengers and the Crew to their Home Countries. And this document, Part III, discusses the Government Relationships and Economic Support of the Cruise Line Industry.

CASE STUDY

Since the first coronavirus case was confirmed in the United States in January of 2020, COVID-19 has had a painful impact on the United States economy. In April, a staggering 20.5 million jobs were lost, bringing the unemployment rate to 14.7%; this is more than 10 times that of the previous unemployment record of 1.96 million in September 1945 after U.S. soldiers returned home from World War II.[1] The April 2020 unemployment rate is the worst our economy has seen since the 24.9% reached during the height of the Great Depression.[2] This unprecedented situation exists alongside a tremendous loss in revenue for the U.S. economy as citizens have been told to stay home and businesses have been forced to shut down to help stop the spread of the virus. According to new projections by the Congressional Budget Office (CBO), COVID-19 will likely cost the United States economy roughly $8 trillion in real economic output over the next decade.[3]

In an attempt to combat the negative economic impact brought upon by COVID-19, the U.S. government passed the Coronavirus Aid, Relief and Economic Security (CARES) Act on March 27, 2020. This $2 trillion stimulus bill was passed into law to help provide economic relief to businesses and individuals across the country. This case study will further explain the various components of the CARES Act and the hospitality industries touched by it. Specifically this Case dives into more detail regarding the economic impact of COVID-19 on the cruise industry, its relationship with the U.S. government, and how that has impacted their ability to receive economic aid during these unprecedented times.

Part III: Economic Bailout of the Hospitality Industry

While the COVID-19 pandemic has certainly been detrimental to every industry globally, the disciplines that have undoubtedly been hit the hardest are travel and tourism. According to Thomas A. Hazinski and Joseph Hansel of global hospitality consultancy HVS[4], the "hospitality and tourism industries have proven to be the most vulnerable (of industries) to the COVID-19 pandemic with percentages of revenue losses far exceeding that of the overall economy."[5] Thus, predictions for revenue losses in the travel sector are greater than the overall decreases in GDP (Gross Domestic Product). An April 2020 Oxford Economics study projected an 81% loss in both April and May travel revenue and a 45% decline in contributions to the 2020 U.S. GDP. However, according to CBO projections, the annual GDP growth for real GDP is only expected to fall by 5.6% in 2020. The U,S. Travel Association with Tourism Economics actually estimates that since the beginning of March, the travel industry has lost somewhere around $195 billion.[6]

At this point in the pandemic, experts, such as American Hotel and Lodging Association CEO Chip Rogers, have now been able to say that "the coronavirus has already had a more severe economic impact on the hotel industry than the September 11, 2001 event and the 2008 recession combined." As a result, industry leaders across all aspects of the tourism industry have had to turn to the government for much needed relief. Rogers reportedly asked for $150 billion from the Trump administration in mid-March, emphasizing that without it, "half of the hotels throughout the country may be forced to close this year."[7] This request was coupled with other travel industry sectors also requesting billions of dollars in bailout from the government, which eventually occurred in the form of the CARES Act.

One of the most influential parts of this act is the Paycheck Protection Program (PPP), administered by the Small Business Administration (SBA). The objective of this program is "to provide short-term funding for small businesses to cover their fixed operating costs with a primary focus on retaining employees."[8] For a loan of this nature, businesses would normally have to meet certain size restrictions to qualify, but these rules do not apply to hospitality businesses classified as accommodations or food services. This is incredibly important for the travel industry as businesses such as hotels, bed and breakfasts, RV parks, campgrounds, restaurants, mobile food services, bars, caterers and food service contractors are eligible to receive aid as long as each individual location has less than 500 employees. For example, a midsize Marriott hotel with less than 500 employees would be eligible even though Marriott as a company clearly has far more than 500 employees in total.[9]

The PPP was structured as such: if proceeds from the bill are used for qualifying expenses during the first eight weeks after the loan closes, up to 100% of the loan may be forgiven. Qualifying expenses include things such as payroll costs, interest on debts secured by real or personal property, interest on debt obligations incurred prior to February 15, 2020, and qualified rent and utilities. This is a life-saving mechanism for businesses that are able to obtain the loans; however, only 25% of the forgiven amount can be non-payroll costs; thus the vast majority of this loan will only be forgiven if it is used to help pay employee paychecks. While well-intended, the PPP structure does set parameters for companies regarding how they are able to spend these funds, when perhaps they would have preferred to spend it elsewhere.

Despite the benefit that the PPP provided, the CARES Act was still not considered universally beneficial to all aspects of travel and tourism. The airline industry certainly benefited most because they were considered a priority by the Trump Administration. Airlines were dealt a $50 billion direct payout as part of the CARES Act that also had some strings attached, but was less restrictive than the PPP loans.[10] Hotels, on the other hand, did not receive the same classification and thus had to work within the associated restrictions to finance their fixed costs, which account for nearly 60% of overall expenses.[11] However, the cruise line industry wasn't offered that option at all; as they were excluded from the stimulus bill entirely. While this may at first appear cruel, the government felt justification in alienating the sector from the bill.

American Cruise Lines Left without U.S. Government Aid?

In order to be eligible to receive United States government aid, companies need to be registered in the United States, which is why the vast majority of cruise line companies were excluded. It is actually a very common practice for cruise lines to register their vessels in other countries, even if they run their operations from the United States. According to the Cruise Line Industry Association (CLIA), 90% of commercial vessels calling on U.S. ports fly foreign flags. This is a tactical decision for these companies. By doing so, they are then subject to the safety, labor and environmental codes of that nation, and not those of the United States.[12]

In fact, the three largest cruise line companies, Carnival Corporation, Royal Caribbean and Norweigan Cruise Lines, operate from offices in Miami, Florida, but are officially considered foreign corporations. These three companies are registered in Panama, Liberia and Bermuda respectively, and combined constitute 70% of the global cruise ship market.[13] The vast majority of cruise ships in the world are *officially* operating out of these three countries, although they generate a substantial amount of their business from U.S. ports. Other countries where cruise ships are often registered are the Bahamas, Bermuda, Italy, Malta and the Netherlands.[14] With registration in foreign countries, these companies are not required to pay the U.S. corporate tax rate of 21%.[15]

President Trump, however, has repeatedly indicated that the cruise ship industry is "deserving of aid", yet CLIA has said that its members have not asked for federal or public assistance.[16] Additionally, if government aid were ever to happen, it would require additional legislation to account for the logistics of giving aid to a *foreign corporation*.[17] However, one way the Federal Reserve has made steps to help the cruise line industry is by announcing plans to "buy unlimited bonds to allow capital for lenders to invest in companies crumbling under corporate debt."[18] In doing so, the Federal Reserve simply unfroze credit markets and made it easier for corporations like Carnival Cruises to raise money from private investors, rather than receiving government aid.[19]

In this manner, Carnival was able to save itself by appealing to investors who were willing to contribute $4 billion in senior secured notes because they came with the promise of a large return in the future, with an interest rate of 11.5%. Although Carnival is technically a foreign corporation, it is still responsible for 421,000 U.S. jobs and brings $8.5 billion in revenue annually to Florida, according to CLIA.[20]

Not all cruise line companies have been as fortunate as Carnival. The third largest company, Norwegian Cruise Lines, says it has “substantial doubt” that it will be able to stay in business due to events like the dramatic decrease of their stock share values.[21] While there is some hope in the form of a $400 million investment from a U.S. private equity firm, L Catterton, the future is still uncertain. Co-chief executive of L Catterton Scott Dahnje said “we expect that the industry will rebound and prosper with even further enhancements to their already rigorous health and safety protocols in place in the future.”[22]

Despite the intrinsic complications of providing aid to cruise companies, President Trump still contemplates the notion of a cruise ship industry bailout, which he hopes would entice them to officially register in America. However, other members of Congress, notably Ted Deutch of Florida have said that it “shouldn’t take a pandemic for the government to make sure every company is paying their fair share of taxes.”[23]

According to Deutch, there are several other sectors of the maritime industry that are more deserving of support than cruise lines, that actually support the recovery of the U.S. economy. Sectors such as container ships, tankers, tug boats, barges, cargo ships and ferries are also under consideration for government aid due to the essential role they play in the country’s logistics and supply chain.

While an argument can be made for nearly every industry that is deserving of aid in order to bring Americans back to work, should considerations be made for what is most essential to the stability of the overall U.S. economy? According to Elizabeth West of Business Travel News, “every moment counts for the travel industry, now severely hollowed by international travel bans, domestic lockdowns and widespread fear gripping consumers in the wake of the COVID-19 outbreak.”[24] Essential business or not, this pandemic is certainly going to change the fabric of the travel and tourism industry for generations to come as every sector will have to make sacrifices and adapt to survive in the post-pandemic world.

As of mid-July 2020 both Carnival plc and RCL Cruises Ltd (which are the UK entities of the global companies, Carnival Corporation and Royal Caribbean) have received millions of pounds of state assistance in the United Kingdom (UK) through a program known as the COVID Corporate Financing Facility. This program issues “short term liquidity support on favorable terms to corporations to help them survive the crisis.” Despite Royal Caribbean’s registration in Liberia and Carnival’s joint registration in Panama and the U.K., both companies were eligible to receive aid from the Bank of England because they are companies that make a “material U.K.

contribution." While both U.K.Prime Minister Boris Johnson and U.S. President Donald Trump have vocally expressed the desire to support the cruise industry, only the United Kingdom has actually taken action to assist thus far.[25]

Discussion Questions

1. Should the cruise line industry be allowed to register in foreign countries when the majority of their business and operations are conducted elsewhere?
2. Is it an appropriate use of government funds to provide aid to companies who are not technically registered in that country? If you were a British citizen, would you approve of what the Bank of England did for the cruise companies?
3. Should companies be able to spend government aid money however they want? Or should there always be stipulations and strings attached that encourage the money to be spent a certain way?

Resources

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