

STATEMENT OF ALBERT E. MAY

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COUNCIL OF AMERICAN-FLAG SHIP OPERATORS

ON

MARITIME ADMINISTRATION AUTHORIZATION

OF

APPROPRIATIONS FOR F.Y. 1987

BEFORE THE

SUBCOMMITTEE ON MERCHANT MARINE

OF THE

HOUSE MERCHANT MARINE AND FISHERIES COMMITTEE

20 FEBRUARY 1986

Good Morning. The Council of American-Flag Ship Operators (CASO) represents a majority of the U.S. flag liner companies serving the foreign commerce of the United States. Our member companies own and operate a modern and diversified fleet of breakbulk, barge-carrying, container, and roll-on/roll-off vessels. All of these ships are available under various programs for use by the United States during time of military emergency. All of the CASO companies have Operating Differential Subsidy contracts covering part or all of their fleets. Accordingly, they have a substantial interest in appropriations for the Maritime Administration.

Before commenting on specific Administration requests for appropriations—or absence thereof—I would like to make a general observation. President Reagan, Secretary of Defense Weinberger, Secretary of Transportation Dole, former Secretary of Transportation Lewis, Secretary of the Navy Lehman and many other senior officials of the Administration have repeatedly emphasized the economic and military importance of the U.S.-flag merchant marine. Despite these undoubtedly sincere and well intentioned statements, we find in this budget, as in those of the earlier Reagan years, a brick-by-brick dismantling of the existing national maritime program. It is true that our basic maritime promotional law was adopted almost fifty years ago. While it was sufficient in those times and served us well for a number of years, changed economic, political, and operational conditions require modification and in some areas fundamental change. Accordingly, we have not been among those fighting a rearguard action against any change, but we must insist that it is folly to continue dismantling the only programs which attempt to put our operators on a par with their foreign competitors without proposing any significant new programs.

This is a good point at which to discuss the failure of the Administration, the Congress and the industry to deal with the most important problem facing our liner fleet.

1. CONSTRUCTION DIFFERENTIAL SUBSIDIES

Once again, as in past years, the President's budget message does not request any funds for shipyard subsidies and states:

"The Administration will continue to pursue previously proposed legislative reforms that would permit subsidized U.S.-flag operators to build or acquire vessels in foreign countries and allow these vessels to be eligible immediately to carry preference cargo."

This support for authority for subsidized U.S. operators to acquire vessels on the world market has been the cornerstone of the Administration's maritime policy since its inception. Unfortunately, legislation to implement this policy has been frustrated by opposition from shipbuilders and others who hoped that the Administration could be forced to restore shipyard subsidies because of the damage that was being done to ship operating companies when they could not build either here or abroad. As Chairman Biaggi has said, "the liner companies have been held as hostages" during the debate on this issue. Many of the vessels now in our fleet were built in the 1960's and early 1970's. Their owners suffer the burden of operating these ships against competition that has acquired more fuel efficient vessels with large slow speed diesel engines which reduce fuel cost by more than 30 percent—and fuel is the largest element of a modern liner vessels' operating costs. Automation advances permit our foreign competitors to crew their ships with 18 to 20 men, about half the complement of our 1960's built vessels—and crew costs are the second largest element of vessel operating costs.

One favorable development is the fact that everyone is now beginning to admit that in the absence of a shipyard parity program it is impossible for U.S. liner operators to build vessels for the foreign trade in U.S. yards because of differences in cost, technology and construction time. Indeed, Mr. William Haggett, Chairman of the Shipbuilders Council of America and President of Bath Iron Works, when asked by Senator Stevens at a hearing in November 1985 whether some type of build foreign authority would represent a fair balance in a bill which included a build and charter program for U.S. shipyards replied:

"Senator, that is a very good example of the type of movement that we have made in our industry. Five years ago we would have been adamantly opposed to foreign construction of any type. Today I think the reality is that we would have to consider a reasonable program, and it is not unrealistic that there should be need for foreign construction at some level or some type, and while we are not promoting construction of ships in foreign countries, I think it is going to be part of any solution and we are prepared to sit and listen and talk to you and others in the industry along those lines."

Without an orderly program of fleet modernization, in which older steam driven, breakbulk, labor intensive ships are replaced with new, economical diesel powered, highly mechanized cargo ships with substantially reduced crew sizes, U.S. operators will simply not be able to maintain a modern, competitive, U.S-flag fleet. For the last two years in testimony before this Committee, we have noted that this is an issue where simple solutions, for political reasons, have become incredibly complex, and that sorting them out would require a firm commitment on the part of the various segments of the maritime industry, the Administration, and the Congress. We are encouraged by the almost universal recognition of the fact that denying operators the right to acquire ships on the world market does absolutely nothing for U.S. shipbuilders. Indeed, there has

not been an order placed in the United States since 1979 for a liner vessel to be used in international trade. We urge the Committee in the strongest possible terms to promptly begin hearings on build foreign legislation so that a bill can be enacted this year.

2. OPERATING DIFFERENTIAL SUBSIDIES

The Administration's budget continues funding for contracts now in effect, stating that:

"A strong U.S. merchant marine is important to national security and the development of foreign commerce. Subsidies are designed to achieve a parity between certain U.S. and foreign ship operating costs."

While some have criticized the ODS labor cost parity program, the only validity to any of the arguments we can find is that it may impose unnecessary constraints on operating flexibility that were not anticipated when ODS contracts were signed many years ago. At that time, there were up to twenty liner operators who held ODS contracts, and today's sophisticated intermodal systems, which have revolutionized liner shipping, were still on the drafting table. There are now only six ODS liner operators serving all U.S. trades, so it can readily be seen why changes may be needed.

For example, the essential trade route system should probably be modified to permit operators to better utilize their vessels and intermodal systems if this can be done without creating inequitable advantage or hardship. Such action would be a first step to assist carriers by providing increased operating flexibility on an equitable basis at no cost to the government. We look forward to working with the Administration and Congress towards its implementation. In addition, the Maritime Administration and carriers with Operating Differential

Subsidy contracts have been discussing a "subsidy simplification program" to improve accounting systems for the determination of subsidy and to reduce contract costs to MarAd and operators. Earlier this month, MarAd published a notice of proposed rule making which included a formula for the development of a per diem subsidy rate for each vessel. As part of this simplification program, vessel days rather than terminated voyage days are recognized for the preparation of vouchers for subsidy payable under the contract. It would be in keeping with the concept of period accounting and the subsidy simplification program that earned subsidy be paid on a vessel day basis. Prompt payment of a per diem subsidy will be mutually beneficial and eliminate protracted withholding of funds pending determination of final rates, which historically has extended over periods of four or even five years. These long delays affect the government budget process and are reflected in undesirably large accounts receivable on the contractor's balance sheets. We intend to work with the Maritime Administration in further developing this new simplification program.

The Administration has requested \$320 million to fund the estimated federal share of costs for subsidized ships under contractual agreements. Of this, we are told, \$255 million is allocated for liner operators. After review, we believe that these funds will be sufficient to meet F.Y. 1987 requirements, and we support their authorization. As you can see from the attached table, net ODS accruals for liner operators have been steadily declining in constant dollars for over twenty years, and are now only one-third of 1964's level. While this reflects a reduction in number of ships in our liner fleet, it also reflects a positive trend toward larger and far efficient vessels.

3. RESEARCH AND DEVELOPMENT

CASO member companies are disturbed to see that the Administration proposes 1987 as "...the final year of funding for Maritime Research and Development activities, which the Administration views as a private sector funding responsibility." This is a rather abrupt change from the position taken less than one year ago by then Maritime Administrator Admiral Shear, when, noting that budget reductions and spending cuts were "...very, very important for the national interests", he went on to state

"Where does research and development and where does advanced technology fit in? Well, certainly it fits in and certainly it has a major role because research and development and advanced technology improvements provide the ways and the means to promote greater productivity, to promote greater efficiency, and to promote greater competitiveness and we simply must accomplish these goals if we are going to have any industry left at all and we certainly are going to do just that."

CASO member companies have continually and actively supported the development of industry-wide technologies, particularly projects currently sponsored by MarAd and its Advanced Ship Operations Office in the areas of fleet management technology, effective manning, and cargo handling. In the area of cargo handling, for example, liner companies have worked together through MarAd's Cargo Handling Cooperative Program to identify common, costly problems and effective solutions to these problems. Sometimes solutions emerge merely because they have been focused upon by the full group. In addition, some of the initiatives being addressed by this program are relatively high risk. Initiatives which individual companies might be less likely to assume on their own. Another current project is MarAd's Effective Manning Research and Development Program, whose objective is to reduce ship operating costs by

developing a realistic view of the shipboard working environment so that U.S. seafaring personnel can be employed more productively and safely through new and improved organizational methods. Other projects currently underway include a cooperative industry research program on fleet management technology and improved data communications systems and electronic data processing systems to link ocean carriers, ports and U.S. Customs.

It is important to remember that these MarAd research and development projects are cooperative projects in which private participants contribute half of the total resources. These government-sponsored cooperative programs allow members to participate in research which would not be economically feasible to conduct on an individual basis. The benefits of all of these projects are given to all U.S. flag operations—even those who did not contribute to the effort.

CASO member companies hope that the Administration will rethink its proposal to abandon entirely its participation in these beneficial research and development projects.

4. DEFENSE ROLE OF THE U.S. FLAG LINER FLEET

As noted above, the President's budget message has again reaffirmed the defense role of the U.S. merchant marine which is only too well known to this Committee. However, it bears repeating in this record because it is so often forgotten even by those who should know better. For instance, the Department of the Treasury in one of the early tax reform proposals suggested that the Capital Construction Fund Program authorized by Section 607 of the Merchant Marine Act of 1936 should be eliminated because the defense role of the merchant marine

which originally justified it was no longer important. In later documents, Treasury corrected this mistake, but it is amazing that it could have occurred in the first place.

The main reason for public support of a U.S. flag merchant marine is its utility as the nation's strategic sealift force in times of war and national emergency. There is an economic justification for a national flag merchant marine, particularly to protect the interests of U.S. exporters, but it is more difficult to quantify and the rationale is endlessly debated by economists within our own government. On the other hand, the military necessity for a U.S. fleet for sealift purposes is disputed by no informed person in a position of responsibility.

Military sealift has taken on a sharply increased level of importance in the evolving strategy of the United States, and is receiving special emphasis in our defense planning. Sealift is absolutely essential to the success of our military strategy and to the execution of our military contingency plans. There is no plan for any major overseas military operation, whether it be general war involving the Soviet Union, or a contingency operation in some remote corner of the globe, that does not involve the use of the seas for the injection of our military forces and the sustaining of American presence in the area.

In 1983, the Office of the Secretary of Defense and the Department of the Navy engaged in several studies relating to sealift and shipbuilding in order to formulate a basis for new initiatives in the area of maritime policy. The long standing problems associated with our U.S. flag shipping and shipbuilding

industries were recognized as beginning to impact adversely on national security.

The military dry cargo requirements for U.S. flag sealift were derived from the Southwest Asia portion of a global war. To meet the Southwest Asia needs, sufficient shipping capacity must be available from U.S. flag sources to fulfill the requirement for 4.6 million deadweight tons (MDWT) of shipping for surge operations, and an additional 3.3 MDWT for sustaining operations.

At the present time only about 2.9 MDWT - 60 percent of the 4.6 MDWT requirement - is available from current assets, of which the U.S. flag merchant marine contributes about 2 MDWT. By 1988 the U.S. flag's sealift position is expected to improve to the point where it can handle about 90 percent of the requirement. The improvement will come mainly through an expansion of the Ready Reserve Force and the utilization of seasheds and flatracks. This latter program, under which U.S. flag containerships will be modified during a contingency to carry military unit equipment will, through increased efficiency, contribute the equivalent of an additional 0.8 MDWT.

To grasp the full impact of the foregoing figures, it is essential to understand that the entire capacity of the U.S. flag merchant marine would be utilized. No vessels are withheld from military service to continue the movement of commercial cargoes along ocean trade routes. U.S. commercial shipping would be, in effect, abandoned.

This inability of U.S. flag sealift assets to satisfy current military strategic lift requirements is of substantial concern to the Department of

Defense. In a letter to the Secretary of Transportation, Secretary of Defense

Weinberger said:

"The decline of the U.S. maritime industries over the past several years has generated significant interest in the merchant marine's capability to support the President's national security objective. The decline in U.S. flag commercial shipping capable of carrying military unit equipment is of particular concern to DOD. Even assuming that the entire U.S. merchant marine is made available to support military requirements, we may not be able to meet DOD's limited policy objectives.

"A merchant marine, even if it were capable of supporting military operations, may not be adequate to satisfy all of our national security requirements during a major conflict. I have not included the civil economy and the industrial base in DOD's statement of maritime requirements." (24 April 1984)

So, according to the Department of Defense, the capacity of the U.S. flag merchant marine to carry out its defense responsibilities for strategic sealift is today inadequate and is projected to be marginal in the future. The reason is the continuing reduction in the size of the American commercial fleet.

Against this background of declining capabilities and growing requirements, it is obvious that some significant actions must be taken to improve the sealift component of our strategic resources. We as a nation must be concerned with the erosion of our U.S. flag liner fleet capabilities, and be prepared to support whatever actions are necessary to halt this decline and restore the U.S. merchant marine to a position of economic strength and strategic capacity adequate to fulfill the industrial and military requirements of the United States.

The main thrust of such a maritime effort should be regulatory reform, increased cargoes, and fleet modernization and replacement.

- Regulatory Reform has been partially accomplished through the Ocean Shipping Act of 1984, which goes a long way toward removing the restrictive burdens currently imposed on U.S. flag carriers.
- Increased cargoes will result in some degree from the improved competitive position deriving from regulatory reform and fleet modernization, but there still remains the problem of competing with foreign carriers which benefit from national policies affording various forms of cargo preference and subsidization. The response to subsidized foreign competition should be three-fold:

First, to require meticulous compliance by all U.S. government agencies with our current cargo preference laws which reserve certain portions of government impelled cargoes to U.S. flag vessels.

Second, the extension of bilateral agreements such as those now in effect with Brazil and Argentina.

Third, improvement of the cargo preference laws by changes such as the farm/maritime compromise which was incorporated last year in Public Law 99-198. This amendment modified Section 901 of the Merchant Marine Act to increase from 50 to 75 percent the amount of certain foreign aid that must be carried on U.S. flag vessels. The Administration's budget recommends repeal of this Section on the ground that moving 75 percent of certain commodities on U.S. flag vessels would cost more than moving 50 percent because U.S. ships sometimes have higher rates than the lowest cost foreign flag vessels. The Administration's statement totally ignores the fact that the agreement reached between major segments of the farm and

maritime industries was a compromise in the best sense of that term and that both sides still perceive it as beneficial. It is true that over three years the amount of government give away cargoes moving on U.S. flag ships will increase from 50 to 75 percent. However, the Administration ignores the fact that cargo preference is also waived on so-called quasi-commercial government food export programs which are much larger in size than the give away programs. The compromise should, and hopefully will, result in greatly increased shipments of farm commodities under programs such as "blended credit" which, as you know, the U.S. District Court recently ruled were subject to cargo preference. The Administration also ignores the fact that present law requires that rates on these government generated cargoes be "fair and reasonable for U.S. flag vessels" and that the Maritime Administration is in the process of developing guidelines to ensure that rates are indeed fair and reasonable.

The principal reason inducement for operating of ships under the U.S. flag is the right to carry a portion of our government's cargo. Every major maritime nation in the world ships, not a portion, but all of its government cargo on its own flag ships when they are available. Any diminution of the cargo preference laws, or failure to implement them affirmatively, will discourage further investment in U.S. flag shipping. We respectfully request that you work with us in urging the Administration to abandon its ill-advised proposal to revise P.L. 99-198. If they do not, we are confident that the Congress will resoundingly reaffirm its 1985 approval of the farm/maritime compromise.

- Fleet modernization requires the construction of new vessels or the modification of existing ships to provide replacement vessels with significantly improved efficiencies in propulsion systems, manning levels, and cargo handling equipment. With U.S. built vessels costing more than three times as much as identical ships acquired in foreign yards, this replacement program can only be effected by allowing all U.S. operators to acquire modern vessels on the world market. The offshore liner industry is unique in the fact that it is exclusively engaged in international trade and therefore in direct competition with foreign shipping. Having no domestic market base, the U.S. flag liner companies must have capital costs comparable to their foreign competition.

Mr. Chairman, that concludes my prepared remarks. I would be pleased to attempt to answer any questions which you or the members of the Committee may have.

Thank you.