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S. Hrg. 103–552

U.S. SHIPBUILDING INDUSTRIES AND THE EFFECT OF FOREIGN SUBSIDIES

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U.S. Shipbuilding Industries and th...

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

ON

S. 990

NOVEMBER 18, 1993

AUG 4 1994

Printed for the use of the Committee on Finance

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U.S. SHIPBUILDING INDUSTRIES AND THE EFFECT OF FOREIGN SUBSIDIES

THURSDAY, NOVEMBER 18, 1993

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL TRADE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 2:02 p.m., in room SD–215, Dirksen Senate Office Building, Hon. John Breaux, presiding.

Also present: Senators Mitchell and Grassley.

[The press release announcing the hearing follows:]

[Press Release No. H–46, November 12, 1993]

INTERNATIONAL TRADE SUBCOMMITTEE SCHEDULES HEARING ON SHIPBUILDING ISSUES, PENDING LEGISLATION

WASHINGTON, DC—Senator Max Baucus (D–MT), Chairman of the Senate Finance Committee's Subcommittee on International Trade, announced today that the Subcommittee will hold a hearing on issues relating to the U.S. shipbuilding industry, including pending legislation to address foreign shipbuilding subsidies.

The hearing will begin at *2:00 p.m. on Thursday, November 18, 1993, in Room SD–215 of the Dirksen Senate Office Building.*

"I have called this hearing to examine the condition of the U.S. shipbuilding industry and its employees," Baucus said. "In particular, the Subcommittee will hear testimony on whether legislation is necessary to address the industry's concerns about foreign subsidies and other practices, in light of the fact that negotiations in the Organization for Economic Cooperation and Development (OECD) have been unsuccessful to date."

On May 19, 1993, Senator Breaux, along with 19 co-sponsors, introduced the "Shipbuilding Trade Reform Act of 1993" (S. 990) to establish a new U.S. administrative procedure to investigate and respond to foreign shipbuilding subsidies. Last Tuesday (November 9), the Ways and Means Subcommittee on Trade marked up and reported to the full Committee a revised version of shipbuilding legislation introduced by its Chairman, Congressman Sam Gibbons.

OPENING STATEMENT OF HON. JOHN BREAUX, A U.S. SENATOR FROM LOUISIANA

Senator BREAUX. The subcommittee will come to order.

This afternoon, the International Trade Subcommittee of the Finance Committee is meeting. Senator Max Baucus, our subcommittee chairman, is on the floor with pending legislation, and has asked that I go ahead and chair the subcommittee hearing this afternoon, which we will do, and I thank him for his cooperation in scheduling this hearing on this legislation.

We have two of our colleagues in the Senate who will be also be presenting testimony this afternoon, as well as other distinguished witnesses.

We are here today to discuss the very important issue of foreign shipbuilding subsidies and the effect that such subsidies have on the U.S. shipbuilding market.

I appreciate, as I have indicated, Chairman Baucus in scheduling these hearings, especially given the tight schedule restraints that we have at the end of this session.

We are pleased that we have many distinguished witnesses appearing before the subcommittee. And again, our two colleagues, Senator Lott and Senator Mikulski presenting their testimony.

I would add that they have both been major players in developing legislation to address the problems of American shipyards, as well as the problems of the American maritime industry as a whole.

It sometimes seems like we have been working on these problems for far too long, but we will continue our efforts.

We point out that since 1981, the United States has had virtually no shipbuilding promotional policy.

It was in 1981 that our country decided to unilaterally stop assisting ship construction. We did not ask for concessions from our countries. We decided to stop assisting our own industry.

We didn't threaten to continue subsidizing if other countries continued their subsidy practices. We just unilaterally decided to stop our shipbuilding program.

Because of this, we are now being forced to negotiate with other shipbuilding countries from a position of weakness.

While I would prefer that this problem be resolved through international negotiations, those negotiations have been unsuccessful to date.

First, the Shipbuilding Council of America filed a Section 301 petition in 1989 to force the countries to stop subsidizing their shipbuilding industry.

The USTR then requested that the petition be withdrawn so that they could negotiate and end the foreign subsidies through the Organization for Economic and Cooperative Development, the OECD.

The OECD talks seemed hopeful. Then, the talks stalled. Then, they seemed hopeful again. Then, they stalled again. And this now has gone on for several years.

Meanwhile, the U.S. shipbuilding industry has continued to decline.

In response to the lack of this action on foreign shipbuilding subsidies, I along with Senators Lott and Mikulski and others introduced S. 990, the Shipbuilding Trade Reform Act of 1993.

The bill seeks to prevent countries from subsidizing shipbuilding by penalizing vessel owners when they call at U.S. ports.

It does not, however, target every vessel built in a subsidized shipyard. Rather, it penalizes the ships that are registered in a country that subsidizes shipbuilding or that are owned by citizens of a subsidizing country.

Among the sanctions that may be imposed are monetary penalties, refusal of clearance into a U.S. port or limitations on the number of sailings into U.S. ports or the amount of cargo that is carried.

Legislation similar to S. 990, the so-called Gibbons bill, has been making its way through the House of Representatives.

I know that many of you who are testifying here today have also testified on the Gibbons bill as well.

It was my understanding in response to your testimony and your suggestions that that bill has been substantially modified in many of its objectives. And notably, most of the administration's objectives have been lifted.

I will be interested to hear the administration's testimony on the Senate bill today, since the administration has just released a shipbuilding promotional proposal.

It is apparent that the House and the Senate are not too far apart on this issue.

Those countries that continue to subsidize their shipbuilding industries should be watching the action in the U.S. Congress with much interest.

There should be great cause for concern on their part that this administration and this Congress will not stand idly by while the American shipyards are made to suffer because of the unfair practices of foreign governments that subsidize their shipbuilding industry.

It is my intent—I think also I share the intent of the gentlewoman from Maryland, the gentleman from Mississippi.

It is our intent to push this legislation for final enactment early on in the next session.

I look forward with my colleagues to a signing ceremony of this legislation at the White House early next year.

With that, I would like to recognize our two colleagues, which I have mentioned in my opening comments and the work that they have contributed to this effort.

Senator Mikulski, Senator Lott said you had another pressing appointment. And I have agreed to let her go first. And since she is here, I recognize her at this time.

STATEMENT OF HON. BARBARA A. MIKULSKI, A U.S. SENATOR FROM MARYLAND

Senator MIKULSKI. Thank you so much, Senator Breaux. And thank you Mr. Lott for allowing me this opportunity.

As you know, I am the original spônsor of the shipbuilding reform bill. And I wanted to be here to testify.

And it is so cogent today because here we are on the brink of waiting for the decision on the North American Free Trade Agreement to talk about opening markets and generating jobs.

And I feel that one of the most important things we need to be focused on is generating jobs and also preserving our industrial base. And that would be in the shipbuilding area.

If the American shipbuilding industry is going to survive, we must eliminate unfair subsidies by foreign governments to shipbuilding and repair operations within their borders, to promote free and fair trade in international shipbuilding, support the shipbuilding and shipper repair industries that are vital to the U.S. national defense and economic security, and prevent the complete disappearance of American commercial shipping.

This legislation will require the Secretary of Commerce to list all countries that subsidize commercial ships.

Those countries will be required to sign an international trade agreement with the United States to stop its unfair trade practices or we would impose sanctions.

In my own home town of Baltimore and other great American industrial maritime cities are cities of contrast.

They are cities of rebirth and revitalization. Yet, they are also becoming cities of empty shipyards and abandoned steel mills.

Now, Baltimore has only one shipyard where it once employed 40,000 workers in the shipbuilding industry.

We used to make liberty ships in Baltimore. Now, they are museum pieces. We used to turn out a ship every two weeks. Of course, those times are gone forever.

From the late 1960's to 1981, Baltimore shipyards built more than 50 ships. Many of them were tanker or container ships.

But since 1981, only two ships were built in Baltimore. And these were for the U.S. Navy.

Mr. Chairman, I know that there are others who want to speak. And I just to want to say that in the United States in 1981, we ended unilaterally all shipbuilding subsidies.

Now, the U.S. merchant ships under construction has gone from 49 over the last decade to zero.

We can compete in this country. The American worker can outcompete, out-work anybody in the world. However, we cannot compete with foreign governments.

And I believe that Bethlehem Steel or Bath shipyards or the great ones in your State or in the State of Mississippi are out there to compete in this new world order.

But we cannot compete against other governments. And the whole purpose of this legislation is to begin to level the playing for the American shipyard industry.

I think it is important to jobs. I think it is important to national security. And if we are going to have free trade in this hemisphere, then we ought to be able to have fair competition. And that is why we advocate this legislation.

Mr. Chairman, I ask unanimous consent that my statement be included in full in the record.

Senator BREAUX. Without objection.

[The prepared statement of Senator Mikulski appears in the appendix.]

Senator MIKULSKI. And I would like to thank you for your leadership, along with Senator Lott's in working for an aggressive maritime policy, whether it is for the American merchant marine flagship fleet or whether it is for American shipyards.

Senator BREAUX. Well, I thank the gentlewoman for her statement. I said before she has been anything but gentle on this issue.

She has been a real bull dog and a tiger in the promotion of the American shipbuilding industry and the American maritime industry.

We thank her for her contribution and for her sponsorship of this legislation.

Let me recognize a distinguished member of the Finance Committee, our Majority Leader, and any comments he may have.

OPENING STATEMENT OF HON. GEORGE J. MITCHELL, A U.S. SENATOR FROM MAINE

Senator MITCHELL. Mr. Chairman, first, thank you very much for holding this hearing.

This is important to the Nation, to your State, to my State, States of Senators Lott and Mikulski and others.

In May, Mr. Chairman, I joined with you and other Senators in introducing the Shipbuilding Reform Act of 1993 because the legislation is an important step toward discouraging foreign government subsidies to their commercial shipbuilding and repair industries, and for bringing fair competition to the international shipbuilding market.

I am pleased that the committee is today hearing testimony on the bill. And I am especially pleased that Duane Fitzgerald, president of the Maine shipyard, Bath Iron Works, will testify today on this important legislation.

Since the United States eliminated direct subsidization of commercial ship construction in 1981, we have seen our commercial shipbuilding industry disappear in the face of unfair foreign trading practices.

Most of the world's shipbuilding nations, including Japan, South Korea, Germany, France, Italy, and Spain have continued to support their domestic commercial shipyards with extensive subsidies.

Our shipyards consequently have not been able to compete in the commercial shipbuilding market.

The U.S. shipbuilding industry has survived by building military vessels for the U.S. Government.

Employing over 150,000 workers, the industry has provided the United States with one of the world's most advanced naval fleets.

However, with the end of the Cold War and the downturn in the demand for military ships, the domestic industry or much of it is losing its principal customer.

If these unfair trade practices are not stopped so the U.S. shipyards can reenter commercial shipbuilding, this Nation risks losing its capacity to build ships. And that is something that we simply cannot permit to happen.

The shipbuilding industry is vital to the economic interests of my State of Maine. Bath Iron Works is Maine's largest private employer. And it is one of the leading shipyards in the Nation.

As Mr. Fitzgerald will testify, Bath Iron Works has successfully delivered 230 naval service combatants and over 200 merchant vessels in the course of its 109 history, including two world-class Arleigh Burke Aegis destroyers.

The Bath shipyard has the technology and the expertise to succeed, but it cannot—and will not—if foreign shipyards are selling below-cost vessels on the international market.

Now, I would prefer that these trade-distorting measures be eliminated in a successful conclusion of the OECD shipbuilding negotiations.

A multilateral agreement would be more effective than unilateral action in eliminating these unfair practices.

But the lack of progress in those multilateral negotiations requires that Congress act promptly on this bill.

The Shipbuilding Trade Reform Act is designed to provide our trade negotiators with the leverage needed to conclude a fair multilateral agreement.

But let's be clear. For those who say don't pass this bill, let the negotiations reach a conclusion, the answer must be the negotiations won't reach a conclusion unless we pass this bill.

Now, I urge all of my colleagues to support the enactment of this important legislation. Encouraging free and fair trade in the international shipbuilding industry will help the survival of our domestic shipyards, protect thousands of jobs, and allow U.S. shipbuilders to compete in the international marketplace.

Mr. Chairman, I want to conclude as I began by commending you for your leadership in this area and by committing myself with other Senators to work with you in achieving early action on this important legislation.

Senator BREAUX. I want to thank the Majority Leader for his statement.

I think that that statement should be heard very clearly, not only here in Washington, but it should be heard clearly in capitals around the world and by other countries who are engaged in OECD talks. I think it is a very clear statement on behalf of the Majority Leader which will go a long way, I think, in helping to resolve this problem.

We thank him for it.

I would welcome the Ranking Minority member on the Merchant Marine Subcommittee, Senator Lott from Mississippi.

STATEMENT OF HON. TRENT LOTT, A U.S. SENATOR FROM MISSISSIPPI

Senator LOTT. Thank you, Mr. Chairman.

And I pleased to see the Majority Leader has been here and made his fine statement. I appreciate him taking the time from his busy schedule to do that.

And it is a pleasure to appear before you, since I am usually with you, but you are certainly everywhere this issue comes up. You are there doing the job. And I really appreciate that fact.

I would like to submit my statement for the record. And I will just highlight from my statement.

Senator BREAUX. Without objection.

[The prepared statement of Senator Lott appears in the appendix.]

Senator LOTT. You have heard me say this before, Mr. Chairman, but I remember when I was running for Congress the first time in 1972.

You had just come to the House of Representatives just about at that time. And there was talk about the need to do something to help merchant marines so that we would have a merchant marine fleet.

And it was something that was discussed in that presidential campaign. We were really going to take some actions. And here we are over 20 years later. And we have done nothing since.

And there has been a slow steady decline in the number of shipyards and the number of related companies that provide supplies

to those shipyards and the number of American shipbuilders' jobs over that 20-year period.

So I think it is long past time that we do something very serious in this area. And I am encouraged by a couple of recent developments.

I am encouraged, first of all, that this hearing is being held before this International Trade Subcommittee.

It is always a pleasure to work with the Senator from Maryland, Senator Mikulski. And she certainly has been an aggressive colleague in this effort. I have enjoyed working with her.

I think we do have good legislation here. I think it has been seriously considered, more so than before.

And I also am pleased with some of the interest being shown by the new administration in this area.

So I think we have an opportunity now to really get some action. I hope that you will move this legislation forward.

It is important to me personally because I do come from a shipbuilding community. My father was a pipe fitter in a shipyard. I have been around ships and shipbuilding all my life.

So it really is something that I feel strongly about and actually emotional about. It is important to my State, like Bath shipyard is important to Maine, the biggest private employer.

The same is true with Ingalls shipyard, a Litton Industry subsidiary in Pasquagulia, MS, by far the largest employer in my State and for a number of years, the largest single employer of Alabamians.

We now have about 14,000 to 15,000 people working in the shipyard.

We have done well with Navy work, but there is a limit, I guess, to how long we can count on that when you look at what is happening with the Navy budget.

So it is important to me, to my State, but also most importantly, I think it is important to America.

Our shipyards provide high-paying jobs for skilled workers. Still, over 100,000 workers are employed in the shipbuilding industry and thousands more employed in related industries.

Shipyards are important for our country's national security. And far too often, we have lost sight of that fact.

We are a maritime nation that relies on trade and the freedom of the seas. The ability to build our own ships is essential to defending our Nation's interests.

And we found out in the Persian Gulf War that it sometimes is a problem just to get the merchant ships to move equipment when we have a national emergency.

And a major concern is the fact that our shipyards are in real danger of dwindling to the point that even more will go out of existence.

Over the past 11 years, approximately 50 shipyards have closed their doors, putting more than 44,000 production workers out of work.

The main reason for this is the foreign shipbuilding subsidies. Now, it has already been pointed out that in 1981, we mistakenly, unilaterally ended our construction differential subsidy or the CDS program.

Instead of dismantling their subsidies, other countries increased subsidies to their yards. Shipbuilding abroad expanded. Our industry started a slow or continued slow decline.

Five years ago to their credit, the Shipbuilders Council of America acted to address foreign subsidies and end this decline.

They filed a Section 301 petition with the U.S. Trade Representative. The petition was withdrawn at the USTR's request. And multilateral negotiations were initiated under the Organization for Economic Cooperation and Development.

Those negotiations are still going on, but frankly, they haven't yielded very much.

And unless we have legislation action or a much more aggressive attitude by this administration than we have had in the past, I do not think they are going to yield that much.

Here are some examples of what foreign Nations have done in supplying subsidies to their shipyards. In the case of South Korea $2.4 billion since 1988, Germany $2.3 billion; Japan $1.9 billion, and Italy $940 million.

S. 990 is the best way to encourage other countries to stop these subsidies and make it clear to them that we are serious, we are not going to take it any longer. And as Senator Mikulski said, enough is enough. And it is time for us to act.

This provides the incentive to end those subsidies by linking discontinuation to access to U.S. ports of vessels of a subsidizing Nation.

The will get very concerned about that. And they should. And that is our intent.

We have a window of opportunity here over the next 10 years. The world market will require $300 to $400 billion worth of new vessel construction. Now, the question is, are we going to be in that market or not?

Are we going to lose more shipyards or more workers in those shipyards job opportunities? We have that choice right now. But if we wait much longer, that choice will be gone.

Now, in the Armed Services Committee, I worked with Senator Cohen of Maine and other House members to see if we couldn't get some pumping going in this area.

And we did pass the National Shipbuilding Initiative for the Department of Defense Authorization Bill. It was not all we wanted, but it was a step in the right direction.

And if there is any area where we need some conversion funds to be used, it seems to me like shipbuilding would be the best place to do it.

So with that new shipbuilding initiative coupled with this bill, we either are going to get foreign countries to start acting responsibly, we are going to get our negotiators to negotiate more aggressively, or, in my opinion, we should pass this legislation and do it quickly.

So I am pleased that you are having the hearing. Let's do what you and I have been working on for almost 20 years.

We tried very hard to close it at the end of the session last year and didn't quite make it. But this time, we have the time and certainly the timing is right. So I look forward to working with you to make that happen.

Senator BREAUX. Well, let me thank you, Senator Lott, for your perseverance and determination and involvement in this area. It has been one that we, as you have said, have worked on together for a very long period of time.

And I really share your thoughts and sense that I think that we are on the brink of getting something accomplished, either legislatively in this Congress, as we heard the Majority Leader, I think, so strongly state just a minute ago about moving this legislation early in the next session of the Congress, or through a successful OECD negotiation.

I don't think any of us are concerned about how it is accomplished, but just that it is in fact accomplished clearly and unequivocally.

Thank you for being with us.

We are pleased to have our colleague, Senator Grassley, with us who has been involved in many of these maritime issues on the floor.

I point out to my good friend and colleague, this is an area where the United States ended all of our subsidies to the shipbuilding industry back in 1981, unilaterally.

And the problem, of course, that we are facing I would suggest is that the other countries around the world have unfairly continued to highly subsidize their industry. And that is what we are trying to reach a settlement on.

So we are pleased to have him as a member of this trade subcommittee present his comments.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. Thank you.

And you probably would not be surprised if I disagreed to some extent with the statement you just made. And I would present just a little bit of information for consideration by the committee and by our witnesses today to that point.

I am not going to be able to be here, but I will be right down the hall at Judiciary, just in case somebody wants me to come back to defend some points I might make, or in the answer to these questions, make some rebuttals that they want me to personally hear.

I appreciate the opportunity to address this committee and our hearing witnesses regarding foreign ship subsidies and shipbuilding.

And I would like each of those testifying today to answer a single question: what benefit is it to the American shipbuilding industry to penalize and harm their customers for making logical and rational business decisions that every other business would make that is, buying the lowest priced product available? In this case, it happens to be vessels.

Retaliating against foreign customers who purchase vessels can only hurt us. The reason should be obvious to all. American shipbuilding will never recover by selling only to U.S. flag carriers.

More important to this country, the passage of this legislation would destroy hundreds of thousands of jobs put at risk by the inevitable trade war that would result.

As we will hear today later, over 2 million jobs will be put at risk. It is more than just a little ironic that while some continue to rationalize maritime subsidies in the name of ensuring that the United States enjoys robust international commerce, that it is the maritime industry that pushes legislation that will actually destroy our international trade and jobs that American workers depend upon.

The only practical and acceptable way to resolve the unfair trade subsidies of foreign governments is to enter into honest negotiations with those governments.

I support multinational maritime negotiations. But while the U.S. maritime industry complains about foreign policies and subsidies, it is also the U.S. maritime industry that is against truly comprehensive negotiations. It is the U.S. maritime industry which refuses to allow its protectionist policies to be put on the GATT table.

If anyone read the Journal of Commerce today, they will have seen the American maritime industry, through its clout with Congress, is at the point of jeopardizing the entire GATT process.

Maritime has negotiated the shipbuilding problems through the Organization for Economic Cooperation and Development. And it has gone nowhere.

Should that be a surprise when OECD and anyone willing to be honest, understand that U.S. protectionist policies—such as the Jones Act, cargo preference, Operation Differential Subsidy—are in fact shipbuilding subsidies?

In fact, rightly or wrongly, many of our foreign trading partners view Navy sea lift construction monies as unfair subsidies that go only to American shipbuilders.

But thanks to the maritime industry, the U.S. negotiators are restrained from putting these protectionist policies on the OECD or GATT tables.

So my second question and last question is to those testifying today. Will you support putting the Jones Act, cargo preference, capital construction funds, ODS, and the new shipbuilding subsidies recently included in our defense bills on the OECD and GATT tables so that the United States can get serious about fighting unfair foreign subsidies?

Now, if the answer is "no," it is an admission that these policies are, indeed, shipbuilding subsidies, which leads to the undeniable conclusion that this disastrous foreign shipbuilding legislation should not be given a second thought.

Mr. Chairman, I also want to submit for the record a copy of an OMB report completed in 1982, entitled U.S. Maritime Programs and Policies.

[The questions and information submitted by Senator Grassley appear in the appendix.]

Senator GRASSLEY. This report describes how ineffective maritime subsidies have been, including the former construction differential subsidy. This gives us critical perspective relative to today's hearing.

Now, I hope that the press will be interested in obtaining copies of this from my office because I was told by OMB staff who pro-

duced this report that the maritime industry exerted its muscle to ensure that it would never be made public.

So today may be the first day that a full report is available. I have that right here. And I will leave that for the record.

This report describes a deteriorating maritime industry which—despite the enormous amounts of subsidies provided by taxpayers—continued to deteriorate.

The report exposed the myths of national security and economic justifications for all maritime programs, including cargo preference and shipbuilding subsidies.

And it also attacked the credibility of the maritime industry and maritime administration studies and claims. And I think it is well worth everybody's consideration.

I thank you.

Senator BREAUX. I thank the Senator for his contribution. I think that he would agree that the goal of eliminating foreign subsidies is a goal that we should share even if we disagree with subsidies.

And, of course, the point is that the United States unilaterally eliminated shipbuilding subsidies, direct subsidies by government to shipyards back in 1981.

We did it unilaterally without getting any quid pro quo for that. I thought that was a mistake when we did it. I think it has proven to be a mistake because other countries have not followed through.

They continue to blatantly subsidize with direct financial assistance their shipyards. And that is the problem that we are facing.

The goals of these hearings is to try and produce legislation which would accomplish what international talks to this point have not been able to accomplish, that is a removal of the foreign subsidies, like the United States has several years ago, two decades ago, when we unilaterally did away with our direct subsidies.

If we could just get foreign countries to do away with their direct subsidies, our companies and our shipyards could be just as productive and I think more productive. And that is really the goal of this legislation.

We want to welcome as our first witness Hon. Don Phillips who is the Assistant U.S. Trade Representative for the U.S. Trade Representative Office, USTR, which had a great success as an office yesterday in the House, and seems to be in the Senate with the NAFTA agreement.

Don, we welcome you. I have read your testimony. If you would like to summarize it, we would get to the questions.

STATEMENT OF DONALD PHILLIPS, ASSISTANT U.S. TRADE REPRESENTATIVE FOR INDUSTRY, WASHINGTON, DC

Mr. PHILLIPS. Thank you, Mr. Chairman and members of the committee.

With your permission I will summarize the statement that has previously been submitted to the committee.

[The prepared statement of Mr. Phillips appears in the appendix.]

Mr. PHILLIPS. We are pleased to report today on international shipbuilding issues and in particular legislation dealing with the problems facing the U.S. shipbuilding industry.

I will not address all those bills, but will give the administration's view on S. 990 and its revised counterpart in the House, H.R. 1402.

In addition, I would like to give you an update on the status of negotiations which are now being actively pursued under the OECD, and to describe briefly the administration's plan to help the shipbuilding industry recover its international competitiveness.

As you have pointed out, Mr. Chairman, this important industry has encountered serious challenges that have reduced demand for its output and forced cutbacks in production and employment and reduced profitability.

During this period, many shipbuilding industries press their governments for assistance. In response, many countries stepped up their aid to shipyards with massive levels of subsidies in virtually every form.

However, as you have pointed out, in 1981, subsidies to the U.S. shipbuilding industry were discontinued.

For a time, U.S. yards were sustained by large orders for naval vessels. In recent years, however, in the face of naval cutbacks

Senator BREAUX. Let me interrupt you. I'm sorry. When did you say the talks were discontinued?

Mr. PHILLIPS. Pardon? The talks?

Senator BREAUX. Yes. The last time.

Mr. PHILLIPS. The talks were discontinued in——

Senator BREAUX. April?

Mr. PHILLIPS. 1992. In April of 1992.

Senator BREAUX. All right. I thought you had said 1991.

Mr. PHILLIPS. No. I actually said the subsidies were discontinued in 1981. I was referring to that. Thank you.

Recognizing that our industry cannot compete with foreign government resources made available to shipyards, the SCA did seek relief under Section 301.

And in response, and with their approval, we initiated negotiation of a multilateral agreement.

The European community, Norway, Finland, Sweden, Japan, and Korea, the major shipbuilding Nations of the world all are participating in these negotiations.

And I would underscore that all interested parties appear to share the view that the conclusion of such a multilateral agreement is the best way to deal with the problems of the world's shipbuilding industry.

At first, a fair degree of progress was made in the negotiations. However, they became drawn out as talks focused on the issues that were most sensitive and complicated.

And in April 1992, we or we had serious doubts that other parties were seriously interested in concluding an agreement.

We told the parties that we were not prepared to schedule further meetings until it was clear that all participants were committed to conclude an agreement and there was a reasonable prospect for success.

In early 1993, a new chairman was appointed for OECD shipbuilding issues, Staffan Sohlmann, the Swedish Ambassador to the OECD.

He called an informal meeting of participants in June. And on the basis of that meeting, the chairman set forth a framework for resumption of negotiations.

That framework called for talks to be completed by year end and set January 1, 1995 as a deadline for eliminating subsidy programs.

All parties agreed to resume negotiations on the basis of the chairman's framework. And subsequently, we have held negotiating sessions in September and November.

There are several outstanding issues. And although we have made progress in closing gaps, important differences still remain.

The chairman has scheduled a meeting in early December, specifically December 6 to 8, at which he will present revised compromise proposals on the outstanding issues. And he anticipates that this package will close the gap and give shape to the final text of the agreement.

At this point, our view would be that although important differences still stand between us and agreement, the prospects of bringing the parties together into an agreement are reasonably good.

Although supportive of an international agreement and negotiations, Congress has repeatedly expressed concern about the slow pace and uncertainty of a positive result.

And in the spring of this year, reflecting continuing concerns about this issue and the then dormant state of negotiations, S. 990 was introduced as well as the newly revised bill by Congressman Gibbons, H.R. 1402.

Both bills would provide for the investigation of countries that subsidize their shipyards and would authorize the imposition of sanctions on the fleets of such countries.

The administration shares the objective of this legislation, namely elimination of shipbuilding subsidies and other distorted practices.

Although we believe that conclusion of an agreement is by far the best solution to the problems facing the U.S. shipbuilding industry and would largely eliminate the reasons for which the legislation was proposed, nevertheless, we are aware of the possibility that an agreement might still elude us.

And consequently, as Ambassador Yerxa testified before the House Ways and Means Trade subcommittee in July of this year, we are prepared to work with Congress to develop remedies for the trade policy problems faced by our shipbuilding industry and ways that would support the long-term objective of eliminating subsidies.

We do have concerns about several aspects of S. 990, as we did about H.R. 1402 when it was introduced earlier this year.

Now, we would like to work with you so as to ensure the legislation would not work at cross purposes with our common objective and would be consistent with our overall trade policy and international obligations.

Some of the areas where we think significant changes are required include the following. We believe that an investigation should be complaint driven, which would not preclude the possibility of self initiation of complaints.

We believe that there should be an adverse effects test whereby sanctions would apply only if it is determined that adverse effects or injury are suffered by U.S. shipbuilders as a result of the practice.

We also believe the administration should have discretion so that sanctions would not be required to be administered in ways that are disproportionate to the subsidies involved or not in the national interest.

We also believe that the cargo diversion remedy poses administrative problems and might be challenged in the GATT.

The recently amended H.R. 1402 seems to address in a largely satisfactory manner all but the last item, i.e. the cargo diversion remedy, which remains a serious concern for the administration, but one which we assume can be worked out.

We would look forward to working closely with you and your Senate colleagues and their staffs on the above points, as well as other detailed changes that might be beneficial.

Let me just add a word or two about the President's plan of assistance to the shipbuilding industry. Our concern is not only with the unfair competitive advantage that foreign shipbuilders have been enjoying, but to help the industry make the transition from defense related to commercial production.

On October 1, President Clinton transmitted to the Congress the administration's proposed program of assistance to the industry, significant parts of which have been incorporated into the Defense Authorization Act.

The main components of the program are as follows. In the first instance, the inclusion of an international agreement to eliminate subsidies is seen as the key to ensuring U.S. shipbuilders access to international markets.

Second, the bill would provide for the establishment of an average of $44 million a year in funding for MARITECH, a new joint effort of the Department of Defense Advanced Research Project and the U.S. shipbuilding industry.

The Title XI Loan Guarantee Program would be extended to provide financing for export sales, as well as domestic sales.

The fourth phase of the program involves reduction of regulations, regulatory burdens. And the fifth phase, an expansion of the Executive Branch activities to assist the marketing efforts of firms.

This five-point program is a transitional program, consistent with Federal assistance to other industries seeking to convert from defense to civilian markets.

It seeks to support, not undercut the negotiations that are currently underway in the OECD.

In this regard, we have made clear our intention to modify this program as appropriate so that it would be consistent with the provision of a multilateral agreement, if and when such an agreement enters into force.

Thank you, Mr. Chairman. I would be glad to answer any questions that you or other members may have.

Senator BREAUX. Well, thank you very much, Don. I appreciate your being with us.

And let me start off by getting some basics before the committee so that I can understand it better.

OECD is not just shipbuilding subsidy talks. There are other things involved. Is that correct?

Mr. PHILLIPS. That is correct.

Senator BREAUX. Like for what?

Mr. PHILLIPS. Well, the OECD conducts a broad range of meetings on basic economic issues that concern essentially the developed countries in the world.

Senator BREAUX. Is it under the auspices of the U.N. or is it a separate organization?

Mr. PHILLIPS. It is a separate organization. It was formed after the war. The shipbuilding negotiations are a bit of an anomaly because usually, they don't negotiate these types of agreements.

But basically, we took advantage of the fact that there was already a working party on shipbuilding. And it already had as members, the key shipbuilding countries.

Senator BREAUX. Would you list for the committee the countries that are participating in the OECD talks with regard to shipbuilding?

Mr. PHILLIPS. Yes. The European community and Japan; the United States, of course; Korea; and then the Nordic countries, Sweden, Finland, and Norway.

Senator BREAUX. Go ahead.

Mr. PHILLIPS. I was just going to say these countries account for approximately 75 or 80 percent of world shipbuilding.

Senator BREAUX. I take it from hearing that list that there are some countries engaged in shipbuilding that allegedly are also engaged in shipbuilding practices that are not part of OECD, China, Taiwan I didn't hear were members. Maybe some other ones come to mind fairly quickly.

If the OECD was to successfully negotiate an agreement that bound the members tomorrow, what effect would it have on non-member countries, if any?

Mr. PHILLIPS. Well, it, of course, would not have any immediate effect on non-members. We would make a strenuous effort to try to get significant shipbuilding countries into the agreement.

We have focused thus far on trying to resolve differences between the countries mentioned.

Senator BREAUX. Outline for my information and the committee's information the type of subsidies that are the subject of the talks, I mean, in sort of generic terms.

I mean, what are we talking about? We still have some programs that could arguably be assistance programs for the shipbuilding industry, some of which are not funded very well, like Title XI loan guarantees.

The United States, as I pointed out, unilaterally gave up the direct construction differential subsidies back in 1981.

What type of subsidies are we trying to eliminate in the OECD talks? What are we talking about?

Mr. PHILLIPS. Well, virtually any type of support that would directly or indirectly involve a subsidy. Now, there have been a wide array of subsidies or support for the shipbuilding industry.

In the first instance, several countries provide direct support. The European community, for example, provides a percentage or

allows member state countries to provide a certain percentage of the contract as a subsidy.

Senator BREAUX. I mean, this is an actual financial contribution towards the construction of that vessel?

Mr. PHILLIPS. Yes. It works essentially in that way.

Senator BREAUX. All right. What else?

Mr. PHILLIPS. They have also provided large subsidies in some countries for restructuring. In other words, giving them funds to modernize their plants, in some cases, also to rationalize in terms of shutting down parts of plants.

Senator BREAUX. What about financing, is that——

Mr. PHILLIPS. Financing is also at issue. And there are home credit schemes which in some cases are coupled with domestic build requirements and we believe can provide an indirect support to the shipbuilders. That is also one of the issues that is under discussion.

Senator BREAUX. Anything else that comes to mind?

Mr. PHILLIPS. Well, the list of practices that are covered is quite extensive, and virtually covers any type of subsidy that might be provided to the shipbuilding industry.

There is allowance for a certain amount of government support or subsidies for research and development.

Senator BREAUX. What about programs it seems to me over the years most countries have with regard to their domestic fleets, programs like a comparable Jones Act program that requires vessels that do trade within a country be built in that country and approved by citizens of that country? Is that an alleged illegal subsidy that's on the table or not?

Mr. PHILLIPS. Well, insofar as we are only dealing with shipbuilding, we have only been concerned with domestic build requirements.

And generally, domestic build requirements are considered to be a distortive practice and would be eliminated.

However, we have taken the view that we would not be prepared to commit to the elimination of the Jones Act home build requirement.

Senator BREAUX. Is that pretty much a consensus of the other countries in the——

Mr. PHILLIPS. No. They are still taking issue with that point, but that has been a position we have taken since the outset of the negotiations.

Senator BREAUX. Do they not have a similar type requirement in most of their countries?

Mr. PHILLIPS. There are home build requirements of various sorts in some of these countries. They have indicated for the most part that they would be prepared to eliminate those.

Senator BREAUX. Of the countries that are participating in the talks, is the United States perhaps the only one that does not have a direct construction differential subsidy type of program in existence?

Mr. PHILLIPS. At this point, there is not a direct differential type subsidy in Japan or Korea. There is in the European community. I think there are also some similar programs in some of the Nordic countries.

Senator BREAUX. Let me ask you, do we come to the talks with clean hands in the sense that we can argue I think with a straight face that meets the laugh test that we are a country that is seeking the elimination of subsidies because we do not have those types of subsidies?

Mr. PHILLIPS. Yes. I think that is essentially true. We have, however, indicated a willingness to change our programs where they would be in conflict with the OECD—whatever rules we would agree to in this multilateral process.

Senator BREAUX. In other words, we are talking about changing some of—perhaps are offering to talk about changing some of our practices that are still on the books if we get something in return, but not to do so unilaterally, like we did in 1981?

Mr. PHILLIPS. We have indicated we are prepared to eliminate distortive practices on the U.S. side with the exception of the Jones Act home build requirement, as I mentioned earlier.

Senator BREAUX. All right. Let me get into the question of GATT consistency with regard to what we may hope to accomplish in the OECD talks.

Are there problems of potential conflict between what we may do and an OECD talking and the existing GATT rules?

Mr. PHILLIPS. There may be some instances, for example, where you were imposing sanctions under the OECD because we anticipate that we will have a binding dispute settlement. So it would allow for some sanctions to be applied in that process.

So there could conceivably be a difficulty with GATT, but the countries would essentially waive their GATT rights in accepting this binding dispute settlement process.

Senator BREAUX. You have a preliminary text I take it?

Mr. PHILLIPS. Yes. There has been a text which has been worked out over the last few years.

Senator BREAUX. What happened in April of 1992 that led to the decision? I'm not sure. Were you there at that time?

Mr. PHILLIPS. Yes.

Senator BREAUX. What led to the decision in April of 1992 to discontinue the talks? I take it that was an initiative on behalf of the United States that felt that we were not getting anywhere.

Mr. PHILLIPS. Yes. That is correct. Essentially, we had set December as a time to conclude negotiations. We had then set April because we had not been able to resolve everything.

We felt that we had built up a certain amount of momentum to conclude the negotiations, but as that particular session evolved, we came to the conclusion that some of the other countries did not really have a mandate or a serious interest in concluding negotiations at that time.

Senator BREAUX. Comment on this. If I was representing another country and heading their delegation at the talks, and I saw that the United States, which is obviously one of the larger markets of the world, no construction subsidy program for their shipyards, and my country does, it would be in my interest to go to all the talks and participate in all the talks and debate at all the talks and talk at all the talks, but never to really be serious about giving up the advantage that my country has because we in fact we would have a subsidy program.

Is that characterization unfair or is that a characterization that has probably crossed your mind at some point?

Mr. PHILLIPS. Well, it has certainly crossed my mind. And as I said, at the April meeting, we were concerned that some parties did not appear to be motivated.

That being said, we think that many of them do have a positive interest in reaching an agreement and are anxious to avoid the expense of subsidies.

Senator BREAUX. Why would they have an interest in giving up an advantage that they have in regard to shipbuilding?

Mr. PHILLIPS. Well, particular in Europe, this program has been quite expensive. And they have been trying to reduce the level of subsidization.

But the——

Senator BREAUX. In other words, a cost factor is the motivating force for them trying to eliminate it.

Mr. PHILLIPS. Yes.

Senator BREAUX. But that's just posed against full employment for their shipyard workers and the addition to the positive cash flow that that type of generates for their government.

Mr. PHILLIPS. Yes.

Senator BREAUX. What effect would the passage of U.S. legislation be that would take action against countries that subsidize those shipyards, at least those ship owners that purchase ships in that country?

What would be in your opinion an effect of an enactment in the signing of that type of legislation on the negotiating countries in the OECD?

Mr. PHILLIPS. Well, let me say first that these countries are well aware of the legislation that has been discussed and proposed in both Houses of Congress.

And I think that has been a concern to them and has——

Senator BREAUX. We can tell by the number of calls we get from embassies about the status of this bill.

Mr. PHILLIPS. And, of course, we would hope to be able to conclude the negotiations very quickly, but I would imagine that legislation—as we have had said in our testimony, we believe that if we are unable to do that, it would be useful to have legislation along these lines.

Senator BREAUX. It is my opinion that the U.S. shipbuilding industry has been very patient and very cooperative in this effort in a sense that since 1981 when we unilaterally gave up subsidies, that they have gone through the regular channels of filing a Section 301 petition.

When the USTR requested that they drop that, they did so. They refiled it when nothing happened. And then, they were requested, I take it, to drop it again, which they did.

I asked a previous U.S. Trade Representative for our country, I quoted to her that every time that they ask the industry to drop their 301 petition and they said they would study it and they did and nothing happened.

I asked if they filed it again, what would be the response. And essentially, I got back that they would study it again. And if they

filed another petition, it would be studied, but no action would be taken on it.

It is my impression that the industry instead of being quick on the draw to seek legislative remedies have been fairly cooperative with our government when they were asked to drop their petition, when they were asked a second time to drop their petition. And only now are they supporting a legislative to this problem.

What is your impression in that regard?

Mr. PHILLIPS. Well, I would agree that they have been cooperative. And we work very closely with them in terms of developing negotiating objectives and the conduct of negotiations. So I would agree on that point.

My impression is that over the last year or so, they have felt that specific legislation would be better than a reopening of the 301 petition.

Senator BREAUX. Let me ask a final question. And I don't want to characterize Senator Grassley, but some may say that this is just an effort on behalf of an industry that cannot compete in the international market place, to seek government bail out through legislation which would penalize more efficient producers of a product in the world.

What is your thought about that?

Mr. PHILLIPS. Well, certainly, the initiative we are involved in in the OECD, which is basically at the behest of the shipbuilders, is aimed at eliminating the distortive practices of other countries, not in gaining some special advantage for our industry.

So I think what our industry is looking for is a chance to compete fairly in world markets and to eliminate the distortions that have affected them in the past.

Senator BREAUX. Is it your understanding that goal that you are pursuing and the talks is to put our industry on a level playing field?

Or do you think that the result would be to give our industry a governmental advantage in the construction of ships on the world market?

Mr. PHILLIPS. No. The intention would be to give them a chance to compete fairly. And by eliminating the subsidization which has been quite extensive by other countries, to now enable them to get a foothold in the market and utilize their skills and talents.

Senator BREAUX. I take it that you have been willing to talk in terms of changing some of our practices as quid pro quo for getting some relief from some of these other practices by foreign governments?

Mr. PHILLIPS. That is correct. And I might add that that position has been supported by the industry.

Senator BREAUX. All right. Have you been made familiar with an ITC report with regard to the effect of the average foreign shipbuilding subsidy?

I know there has been a great deal. I am going to ask the industry about this as well.

The debate over liability and correctness of that study. Are you familiar with it?

Mr. PHILLIPS. Yes. I am familiar with the study.

Senator BREAUX. Do you have any thoughts about it? And how have you handled it when it has been brought up?

Mr. PHILLIPS. Well, we thought there were a lot of flaws in the study. And our basic view is that if we eliminate foreign subsidies, our industry will be able to compete.

There is no doubt that they will have to make some efforts to do so. They have not been in the commercial market for awhile, but we think that the ability is there.

Senator BREAUX. When do the talks resume? What are the dates?

Mr. PHILLIPS. The next meeting is scheduled for December 6, 7, and 8.

Senator BREAUX. There are GATT people that sort of watch out for what you are doing at the OECD talks, interaction?

Mr. PHILLIPS. Yes. We consult closely with others in USTR. And most of us are involved in several other negotiations or activity as well.

Senator BREAUX. Well, I thank you.

We may have some follow up questions, but we are going to follow it very closely with the talks. It may be that it would be appropriate to meet further with you and to consider participation in OECD talks in the round in order to let our negotiating partners know exactly what the intent of the Congress is. And I will talk further with you about that.

Mr. PHILLIPS. All right. Thank you.

Senator BREAUX. Thank you very much.

Let me welcome up the panel, consisting of the shipbuilding industry: Mr. John Stoker, president, Shipbuilders Council of America; Mr. Bill Higgins, executive vice president of McDermott, Inc., a good Louisiana company; and Mr. Duane Fitzgerald who is president of a good Maine company, Bath Iron Works.

It is strictly a coincidence that Louisiana and Maine are on this panel, but we are delighted to have you here.

And, John, do you want to go ahead and begin?

STATEMENT OF JOHN J. STOCKER, PRESIDENT, SHIPBUILDERS COUNCIL OF AMERICA, ARLINGTON, VA

Mr. STOCKER. Thank you, Mr. Chairman.

First of all, Mr. Chairman, let me say that I am very pleased to be appearing this afternoon in front of you, and to applaud your efforts in trying to move this legislation, and all the great help that you have given our industry over the past few years, especially over the past few weeks in regard to Title XI. I want to publicly thank you for your efforts.

I also want to thank you for involving two of perhaps my most distinguished members of the board of directors of the Shipbuilders Council, Mr. Fitzgerald and Mr. Higgins.

It probably is a good thing that you will have an opportunity to hear from real shipbuilders, as opposed to just simply the president of their association.

Senator Breaux, what I would like to do is have my written statement entered into the record.

Senator BREAUX. Without objection.

[The prepared statement of Mr. Stocker appears in the appendix.]

Mr. STOCKER. Let me just hit a couple of the highlights to clarify some of the points that have been discussed here earlier this afternoon. I will keep it brief.

First of all, let me begin by saying that the industry has never doubted the efforts the Office of the U.S. Trade Representative. They have done a very fine job in trying to move this issue forward against almost overwhelming odds.

They had no leverage in the negotiations. And frankly, it has been on the basis of moral persuasion more than anything else that they have been able to make the progress that they have been able to make.

We are disappointed that the multilateral talks have not produced the result that they wanted and we wanted.

It is quite true, as Mr. Phillips stated, we have supported their efforts right from the very beginning.

Even though we are pessimistic and continue to be pessimistic in regard to the success of the talks, we continue to support their effects in achieving some resolution of these issues.

As you mentioned, Mr. Chairman, we have been at this process for some time. I want to thank you for pointing out that we did initiate this activity back in 1989.

I think it is appropriate to say that we have really been quite patient ever since 1981 when our unilateral termination of subsidies in the United States should have triggered a response from our trading partners, but did not.

And I am sure, Mr. Chairman, that you know that the prospects for this industry are quite grim indeed if we do not gain access to the international market.

My testimony points out from a current status of about 100,000 workers, we expect that the decline in defense spending would mean that by 1998, we will lose about 72,000 jobs in our industry and another 100,000 jobs in the supplier base as well.

You were correct in pointing out that programs to support U.S. shipyards were terminated in 1981. I should make the point that unfortunately the timing could not have been worse for such a termination because international shipbuilding was about to enter a period of tremendous growth.

Governments in all the shipbuilding countries with the exception of the United States began escalating aid programs.

We had a situation, Mr. Chairman, that by 1985, 1986, we saw shipyards in Asia that were only covering about 50 cents of every production dollar.

There have been attempts in the past to try to deal with these issues at the multilateral basis.

These talks that Mr. Phillips is leading currently on our side have really been going on since the early 1980's.

Unfortunately, the OECD, working party 6 has been unable to enforce commitments to try to discipline subsidy practices.

The thing that concerns us, Mr. Chairman, is we are beginning to see escalation of activity again in the market place with direct government supports.

This is largely due to the fact that there has been a global recession. This is now affecting shipbuilding in a small way.

We are very concerned about reports that we hear. For example, the Friendship Builders have appealed to the EC to continue subsidies.

A recent study that we have done, for example, has shown that over $9 billion in aid is being provided on an annual basis by the principle shipbuilding countries.

This aid continues in full force despite the commitments that their diplomats have made and trade negotiators have made in Paris at the OECD.

So we can only conclude that our trading partners are interested in hanging onto their programs despite the efforts of our Office of the U.S. Trade Representative.

That is why we believe that a legislative solution is now the only answer.

As you pointed out, Mr. Chairman, the goal of S. 990 is to provide an incentive to discontinue shipbuilding subsidies and ship dumping practices.

Let me point out that S. 990 does not contain an extension of our countervailing and antidumping laws to ships.

There has been quite a bit of theoretical and interesting debate in the legal community regarding the extension of these laws to ships.

We have concluded after discussing this issue with the Commerce Department, that there is sufficient amount of difficulty in applying antidumping mechanisms to ships.

We have reluctantly agreed to drop this concept in recognition of the Commerce Department's problems with applying those provisions.

I am sure, Mr. Chairman, you are well aware of the fact that the companion bill in the House, H.R. 1402 no longer contains this provision.

We are not happy about that. But on the other hand, we would prefer to see a bill moved through the process that gives us at least a basis for taking some action.

As you have correctly pointed out, Mr. Chairman, this bill is an attempt to sanction ships that are domiciled or registered or owned by citizens of countries that subsidize their shipbuilding industries.

The penalty options are very similar to ones that you are familiar with in the Foreign Shipping Practices Act. And so there is some experience in the United States in dealing with these kinds of sanctions.

Mr. Chairman, let me reiterate, we would prefer that this legislation was not necessary. We understand, agree, and believe that a multilateral solution would have been preferable, but unfortunately, that has not worked out the way that we had wanted it to.

So as a result, we urge you to report out S. 990 and to have the Senate enact the legislation as quickly as possible.

As I have mentioned, we are an industry which is not subsidized. It is on the brink of destruction. We cannot fight foreign governments.

Unless our government acts quickly, it will not only be American shipyards and American workers who will be affected, but also steel mills, marine equipment manufacturing plants, and more

than 1,000 other companies that supply parts and components to U.S. shipyards.

Again, I want to thank you for your personal commitment to this issue, Mr. Chairman. I stand ready to answer any questions you might have.

Thank you.

Senator BREAUX. Mr. Fitzgerald, we are delighted to have you here. We worked with you on some of the issues in this session of the Senate with regard to lease charter arrangements. And you have been very effective.

STATEMENT OF DUANE D. FITZGERALD, PRESIDENT AND CHIEF EXECUTIVE OFFICER, BATH IRON WORKS CORP., BATH, ME

Mr. FITZGERALD. Thank you very much, Mr. Chairman. I appreciate the opportunity to be here today.

I have submitted a statement, and I will not read the statement, but simply add a few additional comments if I may do so.

Senator BREAUX. Without objection.

[The prepared statement of Mr. Fitzgerald appears in the appendix.]

Mr. FITZGERALD. As Senator Mitchell noted, our company has been building ships for 109 years. And we think that during that time we have learned a thing or two about how to compete; 109 years of building over 400 ships would demonstrate that fact.

Those 400 ships have consisted almost equally of combatants and commercial ships. We have built commercial ships of all types.

As a matter of fact, the last merchant ship built in a U.S. shipyard under Construction Differential Subsidies was built in our shipyard. And we built 22 merchant ships in the late 1960's and 1970's. So it is not something that we know nothing about.

I suggest, Mr. Chairman, that three policy decisions came together in the late 1970's and early 1980's that has really produced the plight that U.S. shipbuilders find themselves in today.

As you know, our country unilaterally terminated its subsidy program without requiring our trading partners to do the same. But that decision was coupled with the decision of our government to proceed with the 600 ship Navy. And as we all know, we never quite got there.

But I suggest, Mr. Chairman, that that would not have been possible at all if the decision to terminate subsidies had not been coupled with it because I doubt that U.S. shipbuilders would have put all of their eggs in one basket. They never have. And some had chosen never to build combatant ships and had devoted their capacity exclusively to merchant ship construction.

The third policy decision that contributed to the plight that we are in, not that any of us necessarily opposed it at the time, but the procurement programs of the Department of Defense became very large.

The programs became winner-take-all type competitions. So as a result, a handful of shipyards became very large. And the rest virtually went out of business.

So I think we need to look at those things as having come together and then look carefully at the fact that now 10 or 12 or 14

years have elapsed we have been concentrating on becoming world class at combatant shipbuilding while our competitors around the world have mastered the basics of building commercial ships.

There are a number of things we have to do. We have to change many of our business practices. And we cannot expect you to do that for us. We have to take that responsibility.

I will note, Mr. Chairman, that our company is doing that. As you may have learned, we submitted a proposal to the Advanced Research Projects agency.

We were one of 41 companies that received funding in the recently announced first wave of funding. Our proposal is for a focused commercial shipbuilding development project.

We have put together what we think is an innovative alliance of our shipyard, a Japanese shipyard, a northern European shipyard, and two ship owners, one a U.S. flag operator, and one a foreign flag operator.

So we think we are marching out innovatively to try to solve some of the problems that only we can solve.

But there is the other part of the problem that we think our government must solve. And we think that this bill will do it.

I would like to try to respond to Senator Grassley's questions if I may, Mr. Chairman.

Senator BREAUX. Please.

Mr. FITZGERALD. As I understand his first question, he asked what benefit does this bill accomplish if it punishes people for having made a correct economic decision.

I would make several comments in response. First of all, the correct—what appears to be the correct economic decision was made possible only by the unfairness in the market place.

Secondly, I would suggest to him that another reason for passing this bill is that this industry is important. It is important to our National defense. And that case does not need to be made.

But it is important for a whole lot of other reasons. It is important because Bath Iron Works is the largest employer in Maine.

Newport News Shipbuilding is the largest employer in Virginia. And I do not have to tell you that Avondale is the largest employer in Louisiana.

Senator BREAUX. Along with McDermott.

Mr. FITZGERALD. Ingalls is the largest employer in Mississippi. And Electric Boat is the second largest employer in Connecticut.

We must have something like shipbuilding for these highly skilled people to do. I suggest that our economy is not affording too many such opportunities for them.

Second, I would note that this industry has traditionally provided entry level jobs for people, jobs where they could learn a skill, have a hope of getting a high wage, and good benefits and improve their standards of living.

That is what this industry has done in each of the States that I just mentioned.

Senator Lott mentioned that his father worked in shipbuilding as a pipe fitter. My father worked in shipbuilding as a ship fitter.

The fact that I have been the beneficiary of an education is because of the skill that he acquired in the high-paying job that he had in Bath Iron Works.

So good pay and good benefits is another response to Senator Grassley's concerns.

And then, finally, why should we do this? We should do this to correct a very fundamental and basic unfairness.

His second question was would he be willing to put the Jones Act and ODS on the negotiation table if we want our trading partners to surrender their subsidy practices?

A couple of comments with respect to that. First of all, no one should worry about whether or not the Jones Act and ODS has been subsidizing much. To my knowledge, no ships have been built under ODS in the last 8 years. John, you know more than I.

And there have been only a handful of Jones Act ships, a mere handful. So if these are unfair practices, they have not been distorting the market place.

Now, on the other hand, he raises a third question in the final analysis. And if our trading partners do change their practices and eliminate those unfair subsidy practices and once we are given an opportunity to get back into the world market place, then I suspect we might have to consider putting some of those practices on the table.

But it does not add anything to the fairness issue today.

Thank you very much, Mr. Chairman.

Senator BREAUX. I thank you for your testimony.

I want to tell you to take back to the people of Maine how strong fighters for your company and your thousands of employees Senator Cohen and particularly the Majority Leader, Senator Mitchell, have been.

Any time your industry is mentioned and your particular company is mentioned, he has been right there in the forefront of defending whatever is good for citizens of Maine and your company in particular.

Let me welcome Mr. Bill Higgins from McDermott Corp. in State of the Louisiana.

STATEMENT OF WILLIAM L. HIGGINS III, EXECUTIVE VICE PRESIDENT AND GROUP EXECUTIVE, ENGINEERING AND INDUSTRIAL GROUP, MCDERMOTT, INC., NEW ORLEANS, LA

Mr. HIGGINS. Thank you, Senator.

I am honored to have been asked here on behalf of McDermott to make a presentation before this committee with respect to the medium to small shipyards operating in the United States today.

This legislation we feel is very important for the continuation of the industry. It is needed in order that we can penetrate effectively the international shipbuilding industry.

And why do we feel that this is such a great requirement right now? We see that the demand of the market at this point in time will result in almost 10,000 commercial vessels needed to be built between now and the turn of the century.

This legislation will allow the U.S. shipbuilding industry to enter into this huge market whereby it will probably be a closed issue without it.

The top six OECD shipbuilding nations today provide approximately $9 billion a year in annual subsidies to their shipyards. The United States provides none.

I don't think any shipyard in the United States or anywhere else for that matter, regardless of their efficiency or technology could overcome subsidies which could produce 28 to 40 percent reductions in cost.

In many cases, we find ourselves competing against government entities as opposed to private enterprises of other countries. And again, that means that we are basically competing against a tax based financial structure as opposed to a private enterprise.

The OECD negotiations after 3 years have not as yet produced any results that we can see. And the resumption in September, at this point in time does not indicate that there has been any major breakthroughs.

I would like to comment just a little bit about McDermott shipyard and say that we are a company that employs 500 to 700 workers, hourly workers, and that we have seen basic changes in the shipbuilding industry around the world that would lead us to believe that the U.S. shipbuilding industry even today is on the verge of being competitive.

And I emphasize verge. I will take the opportunity in a moment to give you some insights that we have.

We feel that the small to medium shipyards as they stand can compete in most cases against yards of equal size on a competitive basis for vessels of up to about 700 feet long, 40,000 dead weight tons.

McDermott has a unique position in the world that I think that we can present a comparison analysis of the situation regarding the competitiveness of the U.S. heavy steel fabrication component industry to shipbuilding.

As you know, we operate and own fabrication yards around the world. We have fab yards in the offshore construction industry where we build the platforms for the development of offshore hydrocarbon resources for the petroleum industry.

We have a yard in Morgan City, LA. We have a yard in Scotland. We have in a yard in the Middle East, in the United Arab Emirates, Dubai. We also have a yard in Indonesia.

Using the operating conditions and costs that we have internally, we have made an analysis of the competitiveness between our various yards to each other, similarly we can develop comparisons that allow us insight of how our yards compare around the world to other competitors.

Many of these competitors, I might add, are the same shipyards that we are talking about that operate under with subsidies. That is are known to receive shipbuilding subsidies.

And there is no reason for us to believe in the offshore construction side, they are not receiving for the most part, these same subsidies.

There are two versions of this. One deals with the European situation and the other with Asia. I would like to deal with each one separately to give you an insight as to what we feel and see in each area.

I am not sure how many people realize that today, right now, most of the offshore platforms that are built for West Africa and there is even a major project for Tunisia in the Mediterranean,

being built in the U.S. gulf coast area. They are not being built in Europe which is most closer.

If anything, there is a transportation disadvantage to building these facilities in the Gulf of Mexico area as transportation costs are higher from the United States to West Africa or to the Mediterranean than from Europe.

And we are able to compete with and beat regularly, the European fabricators who are, many of the same shipyards that we are referring to in this committee.

We feel that at this point in time, as a smaller shipyard, we can definitely compete on unique one- off vessels against the European or the Scandinavian shipyards.

And even in the cases of multiple smaller, and smaller being 40,000 to 20,000 ton dead weight ton vessels, we think that we can generally compete at this point in time with the European shipyards.

As far as we are concerned, we think that explodes the myth that the American workers, the American shipyards cannot compete with Europe because I think we can.

Going on to Asia, the story is a little different, but again somewhat similar. We find that our analysis indicates both internally and externally again that a platform built in the gulf coast of the United States is cost competitive to a similar platform built and loaded out at the dock in South Korea, certainly in Japan.

Japan, at this point in time, is not even competitive for these structures. We have not found a place in the world that we have been able to identify that can regularly produce an offshore platform cheaper than the U.S. Gulf Coast.

To support our analysis, we have had a little insight from one of our major clients who went around the world, trying to identify offshore fabrication costs on a geographical area.

This client gave us the results of his study. And his analysis indicated that our analysis is correct.

The most competitive location in the world for building offshore structures as of last year when this study was made was the U.S. gulf coast. South Korea was second. Indonesia was third. Japan was substantially higher.

Why then do we hear that the Asians are so much more competitive than the U.S. enterprises? And the reason for that is something that was just touched on by my colleague, just a moment ago, we have historically been out of the commercial shipbuilding industry over the last several years in the United States. We have allowed the Asian yards, as well as the European yards, to tool specifically for multiple construction of vessels of similar construction that are stenciled out of a cooker-cutter type mold with very little customer input or selections.

In other words, what I am saying, what has been done with ships is the same thing that the Japanese have been very successful in doing with cars, producing a car with very few options or versions, the same vessel all the time.

And then, they have been able to obtain the experience of the learning curve and therefore take full advantage of the ability to build the same thing over and over again, very little differential, and drive the man hour content down.

We in the United States have not been afforded that luxury because we have been building, even on the Gulf Coast single one-off vessels. We have not tooled for the major multiple programs.

And then, we have the big yards that have been in the defense industry. They have focused on defense which became the only market in town when the Asians had a decided advantage in labor cost.

So as we see it right now, the Gulf Coast yards can compete on unique one-off vessels. We can compete on multiple vessels with standard design, provided we put forward some capital injection.

But we are not going to get this opportunity to get international work without being able to obtain an experience factor and learn exactly what we can do.

This, we may have to gain by building some domestic vessels initially, but we must get the ability to forecast and have the moxy to forecast the improvements that have been seen in multiple ship constructions by our foreign competitors.

In conclusion, our analysis indicates that U.S. workers are definitely very productive. We feel at this time that the small/medium yards can compete, but they must get time and they must get their room to develop their ability to compete on certain programs.

The elimination of these subsidies will provide a level playing field where we can have a competition based upon true costs.

This will give us this room that we need in order to enter this market on a very serious basis against the Asians on multiple constructed vessels.

We also feel that this legislation will, as I mentioned earlier, reduce the competitions to true head to head competition where we are not competing, a private enterprise against government entities or government supported entities.

We would certainly enjoy the ability to compete directly with our competitors around the world. And then, let the chips fall where they fall.

That concludes my comments. And Senator Breaux, I would like to again thank you very much for your interest in this matter. Our company thinks it is very important.

And all of your colleagues who support it, we congratulate you. And any efforts we can assist on, we stand ready to do so.

Senator BREAUX. Well, thank you, panel and each of you for coming to Washington and presenting the testimony and for Mr. Stocker for representing the industry.

I think the important line in any story on this hearing as far as industry is concerned is that the industry is not asking for subsidies.

I have heard not one of three represented industries request to Congress and say we are asking that you provide a subsidy program to help out U.S. shipyards.

What you are asking for is just the opposite, as I understand it, to eliminate or do what we can legislatively to eliminate those subsidy programs of other countries, that you are not asking that we instate a subsidy program here to offset their subsidies over there. But you are rather asking that Congress do what we can to eliminate subsidies, unfair subsidies to foreign shipyards that we have to compete with.

Mr. Stocker, is that correct?

Mr. STOCKER. Yes. Mr. Chairman, that is true. Subsidies are distortive of the market place, as you know. Operators have had a difficult time making profits in their shipping operations.

This is due in large measure to the fact that there are simply too many ships out there. And those ships were the result of over production, particularly in the early 1970's.

So recognize that subsidies in and of themselves are distortive of the market, that the budget deficit here is serious enough that even if we wanted subsidies reintroduced, it would be difficult for us to ask for them, given this current budgetary environment.

Senator BREAUX. Mr. Fitzgerald, I noted that your testimony indicated some of things that Bath is doing in order to be more productive.

And I was intrigued by the comment about what I understood to be what joint ventures or arrangements with some of the foreign yards around the world?

Mr. FITZGERALD. Yes. That is part of the proposal that we have recently received funding from ARPRA on.

We are aligned with Mitsuie Engineering and Shipbuilding and Kvgerner Masa Marine in Finland and two ship owners, and ship operators.

We hope out of that alliance and out of this project over the next 2 years to figure out the answer to why we are not currently competitive because of issues that are separate from subsidies, Mr. Chairman.

I would not want to mislead you to tell you that we think we could go head to head today with the most efficient in the world. I do not think that is the case.

But I am absolutely certain that we can learn how to do it. And we hope this alliance will produce that answer.

Senator BREAUX. Has your support for the elimination of foreign subsidies put you in a bad state with your foreign partners who are receiving them?

Mr. FITZGERALD. I don't think so. They seem to be as anxious to be a part of this alliance as we are to have them.

My suspicion is that they think they can learn something from us.

Senator BREAUX. I am intrigued by the President's proposal in his five point program. I think it has some things that are pretty significant in it.

The Maritech Program I think is something that would be a good Federal Government to private sector joint venture sharing of technology and research. I think it would be a real positive thing.

Let me ask Mr. Higgins. Bill, you talked about being able to be competitive. I thought you may be going in the direction that you didn't need the legislation because you were doing pretty good even with the foreign subsidies. I take it that is not what you meant.

But could you elaborate on why is it that you feel we cannot compete with the larger vessels, but can with the small and medium size yards and ships that are being in that category? Are the larger ones being subsidized overseas and the smaller ones maybe not or what?

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Mr. HIGGINS. No. Well, there are two things. First, I said that we can compete today against, we feel very competitively, on the one-off unique vessels.

I am not saying there is no hope we can compete against the Japanese on vessels where they are building multiple vessels. They are definitely cheaper than we are at this point in time, or the Koreans or whoever.

We can be competitive where there is one vessel to be built. We have seen that historically. And competitive has a lot of terminology. It does not mean that you have to be necessarily lower, but close enough to be a horse race.

So therefore if the subsidy issue can be resolved, then that would bring a more level playing field even on those vessels or the multiple construction side.

I think it would give us an opportunity to enter the market and be able to pick up the learning curve and give us the incentive to invest the capital that may be required.

Senator BREAUX. I think the bottom line, too, is that in addition, if we eliminated the subsidies by the foreign countries, not only would you be able to be competitive, you would be able to do better than they can.

You would be able to build a better product at a better price if you did not have to also fight the subsidies as well.

Mr. HIGGINS. I certainly feel that way, particular facing the Europeans.

Senator BREAUX. Let me ask you, Mr. Stocker, to comment on the ITC study that was done awhile back that estimated that the average foreign shipbuilding subsidy was about only 5.9 percent of the construction costs.

I guess their point in those figures was that if we eliminated the subsidies, it is still not much of an advantage.

And that is not the reason you are not doing international shipbuilding because the subsidies in their estimation are very, very low. And that is not the problem.

What is your comment on that?

Mr. STOCKER. Well, as I have commented to you before, Mr. Chairman, and I was pleased to hear Mr. Phillips' comments on this same subject, we believe that study was extremely flawed.

Essentially, the data that we provided to them on cost structures in the international market was essentially ignored by the International Trade Commission, including examples of where we could show competitive American pricing in the export market. And they specifically excluded the data that we provided to them on that.

Senator BREAUX. What is your estimate of the value of the subsidies? Do you have any——

Mr. STOCKER. It depends on the country. In some cases, and recently a Norwegian economic institute reported that the value of German subsidies equated to about 50 percent of the production costs.

Senator BREAUX. What type of subsidies do the Germans have, do you know?

Mr. STOCKER. They have direct State aids, both on the part of the Federal Government of Germany, as well as the local and State authorities as well.

They have very attractive financing terms which are essentially brokered by public/State banks and organized by the public/State banks.

Senator BREAUX. These are for private ships?

Mr. STOCKER. For private ships.

Senator BREAUX. These are not naval vessels?

Mr. STOCKER. That's right. These are for private ships.

And as Mr. Phillips noted, your question to him regarding types of subsidies, one of the most recent examples we have seen is massive restructuring assistance that is being provided to the yards in East Germany.

Now, while their unification efforts are clearly understandable, I will say that the net result of that restructuring assistance will be three of the finest shipyards you will see anywhere in the world. And that in and of itself is a subsidy.

It will be very difficult for any American shipyard to access private capital markets and produce a green field site from the ground up, a modern facility in the way the Germans are providing for the eastern shipyards.

Senator BREAUX. Is the shipbuilding industry willing to talk about a lessening of some of the support programs that we may have if indeed the level playing field is achieved?

Mr. STOCKER. In our discussion with the administration and with the House and Senate in regard to the extension of Title XI for export customers, Mr. Chairman, we made it very clear that any program that was extant in the United States would be brought into compliance with the trade agreement once one was achieved.

Our feeling is that we should not attempt do that prematurely or do it before we get a signed trade agreement that all the parties are involved in. That would be disadvantaging ourselves even further.

Senator BREAUX. Now, the penalties and the legislation that I have introduced and I think also that is pending in the House with regard to a U.S. ship owner that would build a vessel in a foreign yard that is subsidized by that country unfairly, but flies with a U.S. crew when they operate would not be subject to the penalties of the legislation.

Can you comment on that?

Mr. STOCKER. Mr. Chairman, yes, that is true. Frankly, there is an argument that can be made that for a number of years, U.S. flag operators have not been able to gain access to subsidy programs here in the United States because we simply have not had them.

There are some who would argue that they have not had a very effective support mechanism, as you know.

The legislation has been specifically designed in such a way that they are not penalized for the fact that there was no program provided to them by the U.S. Government to help equalize their capital construction costs in the market place.

Senator BREAUX. So you have no problem with that?

Mr. STOCKER. I have no problem with that.

Senator BREAUX. Well, gentlemen, we thank you very much. I think that you have provided some valuable testimony.

You have also heard words of the Majority Leader and his comments in the opening of this hearing, as well as our two Senators who testified, which I think all of which are very, very encouraging to the progress of this legislation.

And we thank you for your continued help and support. Thank you very much.

Mr. STOCKER. Thank you.

Mr. HIGGINS. Thank you.

Mr. FITZGERALD. Thank you.

Senator BREAUX. We welcome up our final panel which consists of Ernest Corrado who is president of the American Institute of Merchant Shipping; Ms. Jean Godwin who is the vice president of government relations for the American Association of Port Authorities; and also, Mr. George Miller who is the executive director for the Shippers for Competitive Ocean Transportation.

We welcome you.

Ernie, welcome back. It is good to see you. And we are pleased to receive your testimony.

STATEMENT OF ERNEST J. CORRADO, PRESIDENT, AMERICAN INSTITUTE OF MERCHANT SHIPPING, WASHINGTON, DC

Mr. CORRADO. Thank you very much, Mr. Chairman.

I have submitted my statement for the record.

[The prepared statement of Mr. Corrado appears in the appendix.]

Mr. CORRADO. I would just like to make a few brief comments if I may. Mr. Chairman, critics of the Congress like to say that the system does not work. But those who work up here now and people such as I who have worked here know that by and large it does work.

And I think that this foreign shipbuilding subsidy legislation is a classic example of that. It started out 3 years ago with the original Gibbons bill, H.R. 2056, which was very Draconian by almost every standard. And almost everybody knew that.

It brought the opprobrium of the entire world upon it. And there were many parties of interest against it.

In addition to being the president of the American Institute of Merchant Shipping, I am also chairman of the coalition opposed to the Gibbons bill, which has some 55 entities.

As this legislation progressed, Mr. Chairman, it improved, thanks largely to you and your staff and the minority and to the USTR and to the shipbuilders taking a more statesman like attitude recently. S. 990 was a vast improvement over the original H.R. 2056 and over the originally introduced H.R. 1402.

And now, Mr. Chairman, at the mark up several weeks ago, H.R. 1402 has been amended and, if I may say, is an improvement over S. 990 in many ways.

I would like to just urge the subcommittee to consider adopting some of the changes in the new substitute H.R. 1402 into S. 990 and I think would bring S. 990 into conformity with the new substitute, H.R. 1402. And then, you would have an instrument that in all probability could go forward.

First, we were pleased that S. 990 did not have any CVD or AD provisions in it. And we were very pleased that these provisions were taken out in the new substitute H.R. 1402.

We commend the shipbuilders and Mr. Gibbons for a statesmen like attitude in deleting them.

I would like to say, Mr. Chairman, that the lawyers in the coalition did a super paper on CVD and AD that was a very excellent paper and I think pointed out our arguments very well.

At the end of the mark up on the new substitute H.R. 1402, one of the Congressmen from Florida offered an amendment which changed the effective date from April 1, 1993 to the effective date of the act.

At first blush, it might appear that this was simply a change in date, but in effect what it did was to eliminate existing vessels from the reaches of the legislation.

That is a monumental change, Mr. Chairman. And I would commend this change to the subcommittee. There is no reason why existing vessels should be included. This change makes the legislation prospective, and I think it makes it much more fair.

I would recommend this change to the subcommittee, as well as the other changes in the new substitute H.R. 1402, such as the changes in investigations and determinations which are now complaint driven, as well as initiated by an interested party, and we also recommend an adverse test.

I think this procedure is more fair and a better procedure. And it in fact is modeled after Section 301 procedures in the Trade Act. Many of us thought all along during the course of this legislative ordeal that section 301 was the proper way to go, but the shipbuilders resisted it.

Those new procedures on investigation and determination come largely from section 301 procedures. So we commend conforming S. 990 to the investigation and determination features of the new substitute H.R. 1402.

There is a provision in the new substitute bill that provides that penalties cannot be imposed in certain circumstances, namely, one, in extraordinary circumstances; and two, if there is an adverse effect on the national security of the United States.

I do not believe that this provision is in S. 990, but I think it is a good and a helpful provision.

We would suggest that the monetary penalty of not less than $500,000 and not more than $1 million be changed, be lowered. We think that this high figure is impractical and too severe.

Actually, this whole provision came from section 19 and the FMC administers this. My understanding is that they don't levy fines in excess of between $20,000 and $50,000.

And one has to understand what we are dealing with here. We are dealing with companies that operate on a very small profit margin, not just U.S. flag, but foreign flag. And to levy a fine of between $500,000 to $1 million is just really out of the question.

The last thing I would suggest would be the provision at the end of the new substitute H.R. 1402 in the definition of interested parties in which Mr. Gibbons has included foreign interests.

I would recommend this provision to the subcommittee because it takes some of the sting out of the retaliation argument.

One of the big arguments we have always had against this legislation was retaliation. And retaliation is a very strong argument and a very large negative with respect to the legislation.

But I think this amendment takes the sting out of that. And I would commend this addition that to the subcommittee.

In closing, Mr. Chairman, I would say that even though I am the chairman of the coalition opposed to this legislation, as president of the American Institute of Merchant Shipping, I represent U.S. flag.

Since you folks have taken U.S. flag out of this almost all the way, it makes it very difficult for me to be negative with respect to the legislation or to oppose it.

Senator BREAUX. That is what we were trying to do. [Laughter.]

Mr. CORRADO. And you succeeding admirably.

There are still some elements within the coalition that are opposed and probably will be opposed because it still works some harm to them.

But from the standpoint of the U.S. flag, I think you have made it so the pain is diminished—it is almost painless now with respect to our interests.

At the same time, having been involved in the coalition with these people, it is very difficult for me to walk away totally. So our position is that we will not endorse S. 990 if it conforms to the new substitute H.R. 1402, but neither will we oppose it.

Thank you very much, Mr. Chairman. I would be pleased to answer any questions.

Senator BREAUX. Thank you, Mr. Corrado.

Ms. Godwin.

STATEMENT OF JEAN C. GODWIN, VICE PRESIDENT, GOVERNMENT RELATIONS, AMERICAN ASSOCIATION OF PORT AUTHORITIES, ALEXANDRIA, VA

Ms. GODWIN. Thank you, Senator Breaux.

U.S. Public Ports have a strong stake in the outcome of this issue. We are in a very difficult position here because we obviously benefit from a very strong shipbuilding and repair industry.

Is the problem real? Yes. Are the jobs being lost? Yes.

We agree that U.S. shipyards should not to have compete with foreign governments. And we support the objective of the bill and encourage efforts to level the playing field.

The difficulty here is the proposed solution as it now exists in S. 990, in our view and for U.S. ports and U.S. exports, probably would cause more harm than good and may actually cost more United States jobs than it saves.

The problem being, as it is drafted, the bill could potentially affect up to two-thirds of the world fleet, all at the same time and with severe sanctions, minimum sanctions that are not flexible, and sanctions that are trade stopping sanctions.

Obviously, from a business perspective, someone faced with a choice of calling a U.S. port or a Canadian port, facing a $500 thousand per voyage penalty has an easy decision to make. They will take their cargo to Canada.

We are worried about cargo diversion. We are worried about diversion of cruise operations.

I would specifically ask you to take a close look at testimony that has been filed by two of my members.

The ports of Seattle and Tacoma are particularly vulnerable to diversion because they are so close to the Canadian border.

It is a real issue. And it is happening now frankly because of some of the taxes that have been imposed on cargo coming into U.S. ports, such as the Harbor Maintenance Tax which can cost hundreds of dollars, up to $1,000 per container. We are already seeing cargo lost to Canada.

As Mexico has begun to improve its ports, I think we are going to start to see more diversion in the Gulf area as well. It is already happening.

The same thing on the cruise side. A lot of the cruise packages include plane fare. You fly into a certain city. You're taken to the dock area. And you get on a cruise ship.

Well, you can fly into Nassau just as easily as you can fly into Miami.

Again, a company facing a $500,000 per voyage penalty or something along that line has an easy decision to make. They will move their operations.

I am not going to speak for the shippers. Obviously, George Miller is here from SCOT, but there is also an effect on U.S. exports.

If you're looking at, for example, bulk commodities like coal and grain where pennies a ton or pennies a bushel can make the difference in whether the U.S. company gets the export sale, gets the sale overseas, increasing their transportation costs with these kinds of fines and penalties are limiting their transportation options by keeping vessels from coming into U.S. ports.

We are going to see a major effect on U.S. trade, U.S. exports.

We share the concerns that have been raised by USTR. In testimony on the House side last July, we have suggested while we don't support the need for a legislative remedy, in order to minimize the potential harm that the proposed remedies could cause, we would suggest a complaint process and injury test and more flexibility in the bill.

Just to give you an example, with no flexibility in the bill in the listing process, every country is treated the same. Every country is subject to minimum sanctions.

The worse offenders are treated just as badly—or just as well, I should say, as those who are making a good faith effort to negotiate.

The bill is patterned after the Foreign Shipping Practices Act. And the reason FSPA has worked is because it is flexible.

FMC focuses on one country at a time. They have flexibility to decide what kind of penalty to propose. They tend to propose penalties more along the lines of $10,000 to $50,000 per voyage, nothing like the $500,000.

And they have room to negotiate. They can threaten the penalty. They can back off, give more time. That is what allows the process to work.

The lack of flexibility in this bill makes it less likely to work.

As you correctly pointed out, the House Trade Subcommittee has amended the bill to remove most of its objectionable provisions.

And as Ernie stated, we encourage you to look closely at the changes that were made.

We do think, while we cannot support any bill that creates a unilateral sector specific trade remedy or focuses on stopping vessels from coming into U.S. ports to resolve our trade problems, at least the changes made to the House bill minimize the potential harm that the bill could cause. And we encourage you to look at those changes.

In addition to the specific changes they made to the bill, we would also suggest, as Ernie mentioned, making the level of sanctions flexible, not setting a minimum floor of $500,000, but allowing the flexibility for USTR to decide what level of penalty to impose.

Just in closing, I would like to say, as U.S. Public Ports, we have spent nearly $12 billion in public funds over the last 40 years to develop transportation facilities.

We have spent even more if you start counting in the water side access, money for dredging projects and so on. These are public investments that we need to protect.

We cannot be shooting ourselves in the foot and not understand the potential impact of a bill like this which could cause U.S. ports so much damage and so much harm and drive cargo away.

And I thank you for the opportunity to be here.

Senator BREAUX. Thank you, Ms. Godwin.

[The prepared statement of Ms. Godwin appears in the appendix.]

Senator BREAUX. Mr. Miller.

STATEMENT OF H. GEORGE MILLER, EXECUTIVE DIRECTOR, SHIPPERS FOR COMPETITIVE OCEAN TRANSPORTATION, DAMASCUS, MD

Mr. MILLER. Thank you.

I sincerely appreciate this opportunity to comment for what I believe to be all shippers on their concerns on the impact of passage and implementation of S. 990 on exports and jobs.

Shippers urge the committee not to approve a unilateral action against the world fleet as would be required under S. 990.

It will result in the loss of billions of dollars of exports and hundreds of thousands of jobs.

However, I want to make it very clear that we do support the objective of elimination of subsidies on shipbuilding so that U.S. yards will be able to compete on a fair basis for contracts for construction and repair of commercial vessels in the world market.

It is late in the afternoon. And as requested, I will highlight the argument set forth in the written testimony submitted for the record.

[The prepared statement of Mr. Miller appears in the appendix.]

Mr. MILLER. Shippers object to attempting to force other countries to eliminate subsidies by mandatory reduction in service and/or fines against the world fleet upon which U.S. shippers depend to move 96 percent of the volume of our international trade for the following reasons.

First, you must note that the United States is the largest user of international maritime transportation and depends on the world

fleet to move 83 percent of our liner trade and 99 percent of our bulk trade.

Second, S. 990 requires the Secretary of Commerce to impose severe penalties in every vessel in the world fleet that is owned or is flagged in a country that subsidizes shipbuilding or repair.

As documented in the written testimony, this would require retaliatory action against over 75 percent of the world fleet.

Third, while the fines are imposed on ship owners of the so-called black listed vessels, these severe fines will be passed immediately on to the exporter and the importer.

You are penalizing U.S. commerce, not just the owner of the vessel.

Fourth, imposing severe fines or restricting access to the world fleet will result in major increases in U.S. rates, while the rates for the remainder of the world remain unchanged.

U.S. agriculture and industry will lose a major share of the world market.

Fifth, the alternative penalty, to require the fleet currently used and often contracted under long-term contracts to U.S. shippers, to reduce sailings to U.S. ports by 50 percent will be equally disruptive.

Sixth, the Secretary has no flexibility to consider the impact of the subsidy on U.S. shipping or the adverse impact on U.S. commerce.

Seventh, much of the volume of U.S. trade and a very high percentage of the related jobs is moved in bulk vessels where the U.S. vessels have been unable to compete and move only 1 percent of the volume.

These charter markets are among the most competitive and free markets in the world, and react to impending change immediately.

The threat of removal of a major part of the world fleet from the largest trade area will immediately impact charter rates.

The petroleum industry will be severely hurt by the removal of vessels that are under long-term charter to the oil company and by the inevitable increase in the rates in the U.S. charter market.

U.S. energy costs will increase, affecting all industry, agriculture and transportation. Since this results from unilateral action, only U.S. interests will be adversely affected by this impact on energy.

Eighth, agriculture will be the most severely affected where 825,000 jobs are dependent on exports, most to destinations served by vessel.

Ninth, a very high percentage of U.S. liner exports move under service contracts where the owners commit to supply a continuous flow of containers at inland plants of the shipper, and to move cargo to inland destinations throughout the world.

Up to 75 percent of the liner vessels under contract may be subject to fines and the contracts upon which the U.S. exporter has committed deliveries will be terminated.

In many cases, shippers will not be able to replace the specialized services at any cost. Disruption of service in any major trade route will hurt the industry.

Tenth, in the text, I note the specific concerns of the automobile, the forest and paper products, the chemical, and the coal industries.

Several of these industries are very important in the Louisiana economy.

I will note for the record that there was an error on page 6 where $1,215,000 was used. It should have been $115,000. It is correct on the table on page 4, merely a clerical error.

And eleven, while shippers' primary concern is with the certain severe loss of export markets and jobs, we respectfully request that the Senate also consider the conclusion of the International Trade Commission study for the House Ways and Means, that you have referred to.

This independent study raise serious questions on whether elimination of international subsidies would save jobs, particularly in the short term.

I think some of our representatives indicated that the impact on the shipyards may be long-term, not immediate. I think this is valid.

In summary, unilateral action requiring severe and inflexible penalties against the world fleet places at immediate risk over 2 million jobs and billions of dollars of U.S. exports.

Shippers urge the Senate not to enact a bill that will be severely damaging to the U.S. economy.

Thank you very much.

Senator BREAUX. Gentlemen and Ms. Godwin, thank you very much.

Mr. Miller I thought you were going to do a David Letterman on me and give me 10 reasons, but you gave me 11 reasons why you didn't like it. And you were just going to do 10 ten here. [Laughter.]

Ernie, you have been around a long time and have attended all these international conferences and talks where country delegates get together talk about possible solutions to world problems.

What do you think the effect would be on OECD talks if Congress were to move the legislation that is before the House and the Senate, anything at all?

Mr. CORRADO. Well, Mr. Chairman, as you say, over the years, I have gone to a good many of these international conferences.

Our position from the beginning has been that a multilateral agreement would be better. That is still our position.

I think that is the position of most parties. I think that is what we all would like and would hope for. Frankly, I am very skeptical that any agreement will be reached on December 6, 7 and 8, this year or maybe even December 6, 7, and 8 a year from now, or ever. We would hope so, but it is not too probable.

Even though I do not really agree with the principle of this legislation and I think that it is wrong, in answer to your question, sir, I would think that if the legislation were enacted, it would have an effect on the negotiators, yes.

Senator BREAUX. I take it none of you have any problems if this were resolved through an OECD agreement. None of you all support the subsidies that the other countries are giving to the shipyards.

Mr. MILLER. Very strongly.

Ms. GODWIN. Yes, sir. That is correct.

Senator BREAUX. Well, maybe you might. I take issue for a second——

Mr. CORRADO. Senator, that remains to be seen. We have said all along that we would like to see a multilateral negotiation, and I just said it a minute ago. The multilateral agreement solution to the problem depends, however, upon what the multilateral agreement consists of when it comes back.

Senator BREAUX. Yes.

Mr. CORRADO. We have to see what is in it when it comes back. If they put the Jones Act in it, for example, and take that away from us, I would rather doubt that many of my members would consider this a benefit.

So I would condition our acceptance of a negotiated agreement on what the agreement looks like and what they come back with.

Senator BREAUX. Well, I take it the position that the U.S. negotiator has been taking is one that would be consistent with AIMS' position?

Mr. CORRADO. Up to this point, yes, sir.

Senator BREAUX. All right.

Mr. CORRADO. But let me say, and this applies to GATT, too, when it comes to the very end of negotiations, both in GATT and OECD and it looks like there may be an agreement, I do not personally have great faith or hope that the things that we cherish and hold dear might not be put on the table and given away in the expediency of getting an agreement. I worry about that.

Senator BREAUX. My position and I think the position of the Majority Leader and hopefully others who are sponsors of this legislation and members of the committee is that we would prefer solving these problems through international negotiation.

I objected when we unilaterally did away with the construction assistance program for the U.S. shipbuilding because we were not getting anything for it.

And we literally shot ourselves in our foot at that time. And that was the wrong thing to do in 1981.

I would prefer an international agreement. It may be that the only way we will get a true international agreement is by letting other countries know that the United States could not sit back and allow other countries to subsidize their shipbuilding industries, put ours out of business. And that legislation is an essentially way to do that.

You made some suggestions to some of our amendments that you think will be important. I think I agree with those suggestions.

We plan to incorporate some of those amendments in the legislation which I think would make it an improved package from your perspective.

I understand where you're coming from. I appreciate your thoughts and your recommendations.

We will have a period quite frankly between now and the time Congress comes back to hopefully reach that agreement or to make substantial progress in reaching that agreement which could affect the legislation.

But it is certainly this Senator's intent, as well as I think the intent of the Majority Leader that we are very serious about the leg-

islative fix, and that we cannot continue to allow what is happening internationally to go unanswered in this country.

So your testimony is welcomed and your participation as we work towards coming up with this type of legislation is also going to be welcomed. And I look forward to working with you.

I will conclude this hearing. We thank Senator Baucus for calling this hearing. And we will stand in recess until further call of the chair.

[Whereupon, at 4:02 p.m., the hearing was concluded.

APPENDIX

Additional Material Submitted

Prepared Statement of Ernest J. Corrado

I am Ernest J. Corrado, President of the American Institute of Merchant Shipping (AIMS). Thank you for this opportunity to present testimony on S. 990, "The Shipbuilding Trade Reform Act of 1993" introduced by Senator John Breaux on May 19, 1993. The American Institute of Merchant Shipping (AIMS) is a national trade association representing 23 U.S.-flag carriers which own or operate approximately eleven million deadweight tons of tankers, dry bulk carriers, containerships, and other oceangoing vessels engaged in the domestic and international trades of the United States. AIMS represents a majority of U.S.-flag tanker and liner tonnage.

The media and other critics of the Congress are always quick to point out that the so-called "system" doesn't work. Admittedly the "system" has imperfections, but those who work in the Congress and those such as I who worked in the Congress for many years know that the "system," by and large, does work. The evaluation of the foreign shipbuilding subsidy legislation now before us is a perfect example of the hearings, synthesis, analysis and concluding factors of the process which have finally resulted in the vastly improved new substitute H.R. 1402, so that it is difficult to find fault with the new substitute Gibbons bill. In my view, all accolades should go to Senator Breaux, his staff and the USTR for leading the way over the past several years to substantial improvements in what has been a very contentious and unacceptable legislative initiative.

Obviously, U.S. ocean carriers, U.S.-flag tankers and the entire U.S. fleet are vitally interested in this bill. S. 990 is similar in some respect to S. 3338 in the last Congress and with some exceptions, which I will describe below, the bill is also similar to H.R. 1402, the bill introduced by Congressman Gibbons this year. H.R. 1402 was significantly revised at a Subcommittee markup on November 9, 1993. AIMS will not endorse S. 990 at this time. AIMS will not oppose S. 990 at this time. AIMS will describe some of the difficulties which still remain with respect to S. 990. AIMS finds S. 990 a vast improvement over the introduced H.R. 1402 and AIMS finds S. 990 a bill we can work with to attempt to reach a consensus. I will discuss AIMS views on S. 990 and the new substitute H.R. 1402 as to treatment of existing vessels, the "injury test," investigations and determinations, imposition of sanctions, and potential retaliation.

BACKGROUND

For the record, AIMS strongly opposed enactment of H.R. 2056, the bill on this subject introduced in the 102nd Congress by Chairman Gibbons. The approach in this bill was a nightmare which would have brought international waterborne commerce to a complete halt. In this Congress we strongly opposed H.R. 1402. (See hearing record of July 1, 1993, before the Subcommittee on Trade, House Ways and Means Committee.) At the same time, we support the on-going efforts to reach an international agreement to discipline shipbuilding subsidies worldwide. The multilateral approach embodied in the draft OECD Agreement is much preferable to a U.S. unilateral effort. Chairman Gibbons has stated that indeed a multilateral agreement would be the best resolution. In the past, to the extent OECD talks are further delayed, we had suggested that it would be far better for U.S. shipbuilders to proceed with their Section 301 unfair trade complaint against foreign shipbuilding subsidies.

AIMS and the Coalition of Interests Opposed to H.R. 1402 found Title I of the *original* version of H.R. 1402 totally objectionable and certain provisions of Title II extremely troublesome. To a very large degree our objections have been answered

in the new substitute H.R. 1402. Title I has been deleted and Title II has been revised considerably. Thousands of ships call at U.S. ports to transport most of our country's exports and imports. The adverse economic effects of enactment of the original version of H.R. 1402 would have been great. I encourage the Committee to use as background for this issue the information presented in a study completed in April 1985 by the International Trade Commission (ITC) on shipbuilding matters and the June 1992 study also put together by ITC.

I understand that S. 990 does not address new Countervailing Duty and Antidumping Laws (CVD/AD). AIMS opposes any legislation which would contain CVD/AD, as did Title I of the original version of H.R. 1402. Although S. 990 and the new substitute H.R. 1402 do not contain any CVD/AD provisions, I am nevertheless attaching a memorandum explaining why enactment of any new CVD/AD laws would:

(1) improperly extend countervailing duty and antidumping (CVD/AD) laws to U.S.-flag and U.S.-owned ships in international commerce adding to the demise of the U.S.-flag fleet and to shipping in general in the United States;

(2) do nothing to relieve U.S.-flag operators from existing requirements to build and repair their vessels in U.S. yards such as repeal the 50% *ad valorem* duty on maintenance and repair;

(3) disrupt trade at America's ocean ports and induce worldwide retaliation; and

(4) severely harm America's exporters and importers.

The attached outline (Attachment 1) details AIMS' past objections to any new CVD/AD laws in the context of vessel ownership. Although S. 990 never contained, and since the November 9, 1993 markup, H.R. 1402 no longer contains such language, it is essential to note that AIMS would oppose S. 990, or any legislation, if amended to include these controversial and deleterious provisions. Senator Breaux and his staff and Congressman Gibbons and his staff and the USTR are to be congratulated on leading the way for all the interested parties in this significant improvement to this foreign shipbuilding subsidy legislation.

U.S. SHIPBUILDERS ARE IN A DIFFICULT TRANSITION

Government officials need to evaluate carefully the actual extent to which foreign shipbuilding subsidies are the reason that commercial vessels are not being built in the United States unless required by U.S. law or funded by the government.

In this regard, I urge this Subcommittee to understand that existing U.S. laws now provide significant protections to domestic shipbuilders. These laws, at the same time, impose cost disadvantages on U.S.-flag ship operators. Importantly, these include the imposition of a 50% *ad valorem* duty on repairs of U.S.-flag vessels in foreign shipyards. They also include various U.S.-built requirements in the Merchant Marine Act of 1936 (e.g. tax deferred funds in the Capital Construction Fund program may be used only for U.S.-built ships; Operating Differential Subsidy generally may be paid only for employing U.S. seamen aboard U.S.-built ships). Foreign built vessels are not fully eligible to compete for government-impelled cargoes until they have been under U.S. registry for three years. (*See attachment 2, George Washington University Law Review "The Fifty Percent *Ad Valorem* Duty on Foreign Ship Repairs: Scope of Application and Proposals for Elimination." 1990) All of this is in addition to the Jones Act which legislative history indicates was enacted to aid and protect U.S. shipyards.

Moreover, U.S. commercial shipbuilders continue to benefit from billions of dollars of Navy shipbuilding. This includes expansion of the military's sealift capabilities to the extent of 2.9 billion dollars, as well as hundreds of millions to be spent for refitting Ready Reserve Fleet ships and repairs to the large U.S. Navy fleet. Indeed, just last week the Appropriations Committee added another $1.2 billion to the fast sealift fund so there is now approximately $4 billion of government money for construction of fast sealift vessels in U.S. yards at approximately $265 million per vessel. If that is not a gigantic subsidy for U.S. yards I do not know what is!

If this was not enough, H.R. 2151, the Maritime Reform Act which recently passed the House has in it a *direct* subsidy of $200 million for series construction in U.S. yards and the Administration's shipbuilding package recently sent to the Congress has approximately $200 million which would result in some $3 billion in Title XI loan guarantees for construction in U.S. yards, even for foreign customers. All subsidies to U.S. yards.

In addition, U.S. ship repair and maintenance facilities generate hundreds of millions of dollars in revenue each year for services performed on *foreign-flag ships.* Oceangoing tankers and containerships and especially cruise ships frequently decide to repair in U.S. facilities due to timing of repair needs, business logistics, and

emergencies. Thus, U.S. repair yards in fact serve the heavy traffic of foreign-flag customers, despite significant cost disadvantages.

The commercial reality is that, absent a legal requirement to do so, U.S.-flag operators are not building vessels in U.S. yards for the simple reasons that it costs much more and takes far longer than overseas. Actually, it has cost significantly more to build a ship in a U.S. yard than in a foreign yard for several decades. Until 1982, however, the U.S. Government subsidized the difference in U.S. shipbuilding costs (up to 50% of the U.S. cost). Not surprisingly, since the Government eliminated funding for the ship construction program (CDS) in 1982, U.S.-flag vessels for commercial operation in the international trades have not been built in any significant number in the U.S.

To a great extent, the higher costs and longer time frames in U.S. shipyards result from much lower productivity. For example, a 55,000 gross ton containership built in the United States in 1983 involved 2.3 million man hours. A larger, 80,000 gross ton containership built in 1988 in Europe involved only 900,000 man hours. Productivity includes many factors, such as planning, engineering and design, shipyard plant and equipment, shipyard automation and economies of scale achieved with series construction.

As a result of lagging domestic shipbuilding productivity, by 1987 it was estimated to cost more than two times as much to build a vessel in a domestic yard and to take over twice as long to complete the job. Despite exchange rate changes, rising foreign wages, and a shortage of foreign shipyard berths, best estimates are that it still cost usually *more than two times as much to build* a ship in the U.S. and *delivery still takes twice as long.*

DISCIPLINING SHIPBUILDING SUBSIDIES

The proposed multilateral agreement under OECD auspices offers the best chance of disciplining shipbuilding subsidies worldwide. The USTR testified before the House Ways and Means Trade Subcommittee on July 1, 1993 in support of a multilateral agreement. Aware that an agreement may not be concluded, USTR expressed concern over several aspects of H.R. 1402. The Coalition Opposed to H.R. 1402 also testified at the Trade Subcommittee hearing. At that time the Coalition Opposed to H.R. 1402 was asked to submit proposed amendments. The Coalition did so in a timely manner. In large part H.R. 1402 has been revised to reflect recommendations made at the July hearing. Now AIMS urges this Subcommittee to consider making changes to S. 990 to bring it into conformity with the new substitute Gibbons bill, H.R. 1402.

AN INTERNATIONAL AGREEMENT

If an International Agreement can eventually be agreed to, it offers considerable advantages. First, the multilateral approach to the elimination of shipbuilding subsidies worldwide affords each country participation in a uniform and structured regime. One indication of the complexity in devising such a regime is the difficulty in determining the definition of a subsidy. If each country were to determine individually the definition of a subsidy and the limitations on its subsidy reform, the likely result would be a chaotic and ineffective system. A series of conflicting unilateral laws would be created, perhaps to the detriment of American owners and operators of vessels. For example, foreign governments might well perceive as "subsidized" some U.S.-built vessels that have benefited from federal programs, perhaps even from construction programs that are no longer in effect.

Finally, a multilateral agreement also offers the best chance of ensuring that operators of U.S.-flag vessels are able to acquire and repair their vessels on the world market at internationally competitive prices—just as their foreign competitors do. AIMS supports the repeal of the 50% *ad valorem* duty on foreign ship repairs.

We understand that the negotiations have proven complicated and difficult. In part, of course, this is because the USTR is pursuing a meaningful agreement as sought by the Shipbuilders Council of America—an agreement that would restrict subsidies for shipbuilding far more than for other industries. Despite the frustration of awaiting a resolution of those talks, it is far better to bring the international negotiations to a successful conclusion than to precipitate the unnecessary confrontation and confusion that would result from enactment of domestic, sector-specific, unilateral legislation.

A MORE FLEXIBLE VERSION OF S. 990

AIMS has several specific recommendations with respect to S. 990. We regard S. 990 as a measure that does not disproportionately disadvantage the U.S.-flag fleet. We urge the Subcommittee to consider the points outlined below. We strongly urge

that S. 990 now be brought into conformity with the new substitute H.R. 1402 which has been improved in significant major ways.

Existing Vessels

The penalties for "existing affected" vessels contained in S. 990 should be deleted. There is no reference to "existing affected" vessels in the new H.R. 1402. The imposition of penalties for the subsidies for vessels built in the past is unfair. It creates a penalty that reaches back in time. S. 990 should be a prospective bill applying only to "affected vessels" as defined in the new version of H.R. 1402. The Shaw amendment to H.R. 1402 changed the effective date from "April 1, 1993" to "the date of enactment." The bill is now a prospective bill. We urge that S. 990 be improved in this way.

Injury Test

In S. 990 the definition for the phrase "conditions unfavorable to the ability of any U.S. shipbuilder to engage in the construction or repair of vessels for international commerce" is similar to the definition in H.R. 1402, as amended, for the phrase "burden or restriction on U.S. commerce." This definition is still troublesome. As a so-called "injury test" it is vague and overly broad. It encompasses almost every condition imaginable and is not sufficiently tailored to find a nexus between unfair subsidies and harm caused to U.S. yards. The definition should resemble the Section 301 approach which focuses on a "burden or restriction on U.S. Commerce" rather than a condition unfavorable to one sector of U.S. Commerce.

AIMS favors the new version of H.R. 1402 in this respect and urges that S. 990 be amended to conform to the new H.R. 1402 in this respect.

Investigations and Determinations

Under the "Investigations" section (Sec. 4(c)) of S. 990 the Secretary of Commerce shall initiate an investigation based on an interested party's petition or because the Secretary has reasonable cause to believe that the country provides subsidy. A similar process is contained in the new substitute H.R. 1402, except the process is much more complicated under the new H.R. 1402. H.R. 1402 requires alternate procedures and consultation between USTR and the Commerce Department. This appears to be a somewhat complicated arrangement but it serves to strike a proper balance between the duties and responsibilities of both agencies regarding disciplining foreign subsidies. In addition it is similar to the procedures established in the Section 301 device. S. 990 should establish the same alternate processes as contained in the new H.R. 1402.

Flexibility in the Imposition of Sanctions

Presumably the objective of the legislation is to discipline subsidies paid by foreign governments to their shipbuilders. S. 990 forces the U.S. to penalize offending foreign governments or foreign shipyards as well as penalizing foreign carriers. S. 990 sanctions are applied solely within the discretion of the Department of Commerce. AIMS favors the more flexible approach to imposing sanctions which is provided in the new version of H.R. 1402.

It is the foreign governments with all the complexity of each government's finance ministry that are the entities properly responsible for their subsidy practices to their respective shipyards. Research, investigation and administration of sanctions against shipowners and their governments is likely to be disruptive and costly. It makes sense that USTR should have a role in this complex process.

Section 5 of S. 990 addresses "Penalties." S. 990 requires the Secretary of Commerce to impose penalties. Under H.R. 1402, USTR would impose penalties. Penalties potentially levied against new affected vessels under S. 990 are essentially the same as under H.R. 1402. AIMS urges that S. 990 be amended to adopt the role of USTR as contained in H.R. 1402.

Moreover, the monetary penalty of not less than $500,000 nor more than $1 million is burdensome and impractical. Ordinarily, the penalties assessed by the Federal Maritime Commission, upon which S. 990's penalty section is modeled, vary between $20,000 and $50,000. We recommend that both S. 990 and H.R. 1402 be amended to reflect these more reasonable penalty levels.

International Retaliation

Enactment of S. 990 may invite international retaliation. Foreign governments may well act against perceived "subsidized" U.S.-built vessels that have benefited from federal programs, perhaps even from construction programs that are no longer in effect. Moreover, it is quite possible that foreign governments may take action not only against U.S. shipyard subsidy programs, but U.S. indirect assistance programs as well.

In S. 990 the definition for "interested party" seems to apply to U.S. interests only. The definition for the same term in the new H.R. 1402, substitute, as amended, includes foreign interests which are the subject of an investigation under this Act and the government of the foreign country under certain conditions. AIMS recommends that S. 990, be changed to adopt the definition of "interested party" in the new H.R. 1402. A broadened definition of "interested party" which includes foreign interests would create a venue by which foreign interests may resolve disputes with USTR on this issue. Perhaps this would mitigate instances of foreign retaliation against U.S. interests if this provision where to be included in S. 990.

CONCLUSION

Foreign shipbuilding subsidies should not be condoned. However, the correct approach in addressing such subsidies is through a legislative framework that penalizes offending foreign governments and shipbuilders, not shipowners, ship operators, ports and American exporters and importers. To the extent unilateral action is deemed necessary, then it absolutely should be free of the CVD/AD penalties on ships and owners especially U.S. vessels. A successful remedy should not reach existing vessels but should be prospective and instead should focus on the nations refusing to halt the grant of subsidies to their shipyards. The "injury test" in S. 990 is inadequate. The role of the USTR under S. 990, particularly with regard to investigations, determinations and the imposition of sanctions, is also inadequate. On these issues the process contained in the new H.R. 1402, as amended, should be adopted. We appreciate the opportunity to appear here today to present our views.

ATTACHMENT 1—AIMS OPPOSITION TO CVD/AD: CVD/AD SHOULD APPLY ONLY TO "MERCHANDISE IMPORTED FOR DOMESTIC CONSUMPTION"

Title I of H.R. 1402 would be a grave and harmful departure from current law. It contains new countervailing duty (CVD) and antidumping (AD) provisions to penalize only U.S. ships and U.S. companies. If enacted, Title I would help to shrink the U.S.-flag merchant fleet and dissuade U.S. investors from new ship commitments.

The definition of vessel is contained in this section: "(a) Definition—The term "vessel" means any vessel of a kind described in heading 8901, 8902.00.00, or 8906 (other than a warship) of the Harmonized Tariff Schedule of the United States of not less than 100 gross tons, as measured under the International Convention on Tonnage Measurement of Ships, 1969. This means virtually every vessel contracted by a "U.S. person" whether foreign-flag or U.S.-flag would be susceptible to CVD and AD actions. Foreign-owned ships would not be affected, but U.S.-owned ships in foreign commerce would be penalized.

Title I would establish for the first time under U.S. law that vessels are considered as *imported merchandise,* that certain countervailing and antidumping duty laws will apply to vessels built or repaired in foreign yards, even though they do not enter domestic commerce and remain instruments of international commerce.

The U.S. antidumping and countervailing duty laws authorize the imposition of additional duties on imported merchandise, commodities, if you will, which are found, after investigation, to have been dumped or subsidized and to have caused injury to a domestic industry. Under longstanding precedent, ocean-going vessels and aircraft, in foreign commerce, as well as other means of transportation used to convey goods in international trade are instruments of international commerce and not "imported merchandise" subject to import procedures or payment of import duties. Accordingly, such vessels, aircraft, and other instruments of international commerce are not subject to antidumping or countervailing duties that may be imposed on imported merchandise (commodities). Foreign commerce vessels have not been singled out for differential treatment; rather, the law applies equally to all instruments of international commerce. The principle that vessels in international commerce are not imported products is recognized by U.S. courts, U.S. statutes, international agreements, and the laws of other countries.

The antidumping and countervailing duty laws apply only to "merchandise" that is imported "for consumption" in the domestic market. Merchandise that is not entered for consumption, and articles of international commerce that are not imported, are not subject to the import relief laws.

This scope of application of the U.S. import relief laws conforms with the international agreement governing acceptable procedures for imposing antidumping and countervailing duty measures. Article VI of the General Agreement on Tariffs and Trade (GATT) defines "dumping" as the process by which "products of one country are introduced into the commerce of another country at less than the normal value of the products," and recognizes countervailing duties as permissible counter-

measures levied on subsidized products "imported into the territory" of another country.

U.S. shipbuilders already enjoy complete and *absolute* protection against imports of any foreign-made vessel for use in the domestic commercial market by the strict U.S.-build requirement of the Jones Act (46 U.S.C. Sec. 883). U.S. shipyards are thus fully protected against incursion in the domestic market for commercial vessels by foreign shipyards receiving subsidies from their governments. Existing CVD/AD provisions would apply but for the Jones Act prohibition against importation of foreign-built ships into U.S. domestic commerce.

Title I's proposed application of CVD and AD to U.S. vessels in foreign commerce is improper and Title I should be deleted from H.R. 1402. *See Memorandum on Non-applicability of U.S. Antidumping and Countervailing Duty Laws to Vessels, Aircraft and other Instruments of Trade Used or Operated in International Commerce.

SECTOR SPECIFIC DOMESTIC LEGISLATION SOUGHT BY THE SHIPBUILDERS FAILS TO CALL FOR SHOWING OF INJURY DUE TO FOREIGN SUBSIDIES

Title I of H.R. 1402 would bring vessels in foreign commerce under CVD/AD statutes. But domestic industries in countervailing duty investigations are generally required to prove that they have been injured by reason of foreign subsidies.

This "injury test" verifies the inference that subsidy practices are the "cause" of the problem in the related domestic industry. If the correlation is absent, it is doubtful that a countervailing duty should apply at all.

This is particularly troublesome because shipowners strongly believe that H.R. 1402 would improperly apply CVD/AD to U.S. ships engaged in international commerce, not domestic commerce. In short, H.R. 1402, without an injury test, is out of step with current U.S. fair trade laws. (H.R. 1402 would extend the countervailing duty and antidumping laws to cover vessels in foreign commerce—even though such ships truly are instruments of international commerce and not imported goods.) Some argue that subsidies are per se bad and therefore should be limited. They point out that a successful Section 301 complaint does not require proving injury. But these arguments neglect both the statutory requirement of a showing that the foreign practices burden U.S. commerce and the much more flexible process that permits tailored sanctions that do not harm other American industries.

Attachment 2

THE FIFTY PERCENT *AD VALOREM* DUTY ON FOREIGN SHIP REPAIRS: SCOPE OF APPLICATION AND PROPOSALS FOR ELIMINATION

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NOTE

THE FIFTY PERCENT *AD VALOREM* DUTY ON FOREIGN SHIP REPAIRS: SCOPE OF APPLICATION AND PROPOSALS FOR ELIMINATION

I. Introduction

United States policy has consistently emphasized maintaining a strong maritime industry.[1] Nevertheless, legislation aimed at promoting the maritime industry generally has failed. Indeed, maritime legislation designed to benefit the maritime industry often results in minimal advantages to one segment of the industry while severely disadvantaging another.[2] To complicate matters, shipyard and shipowning segments of the maritime industry seldom pursue similar aims when advocating maritime policy.[3] Since the late 1700s, Congress has favored shipyards, including shipbuilding and repair, over shipownership and operation.[4]

The fifty percent *ad valorem*[5] duty on the cost of equipment purchased for and repairs made to U.S.-documented vessels[6] outside the United States is one example of legislation that promotes shipyards at the expense of shipownership and operation. Since 1866, Congress has passed various versions of this duty.[7] Congress intends for the duty to encourage U.S. shipowners to

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1. *See* Merchant Marine Act, § 1, 41 Stat. 988 (1920) (codified as amended at 46 U.S.C. app. § 861 (1988)); Merchant Marine Act, § 101, 49 Stat. 1985 (1936) (codified as amended at 46 U.S.C. app. § 1101 (1988)). *See also* H. Bess & M. Farris, U.S. Maritime Policy: History and Prospects (1981) (providing an overview of maritime promotional programs); P. Zeis, American Shipping Policy (1938) (summarizing maritime promotional programs between 1789 and 1935).

2. H. Bess & M. Farris, *supra* note 1, at 12. The U.S. maritime industry is comprised of both a shipowning and operating element and a shipbuilding element.

3. *Id.*

4. *See* W. Leback & J. McConnell, The Jones Act: Foreign-Built Vessels and the Domestic Shipping Industry 17, 24 (Nov. 9-12, 1983) (on file at the Society of Naval Architects and Marine Engineers, New York, N.Y.).

5. The term "*ad valorem*" means according to value; when used with respect to duties, it means a fixed percentage of the certified value of goods. Webster's Third New International Dictionary 30 (1976).

6. 19 U.S.C. § 1466 (1988). For the Special Statistical Reporting Number of the Harmonized Tariff Schedule of the United States, see U.S. Int'l Trade Comm'n, Harmonized Tariff Schedule of the United States 99-61 (1990).

7. *See infra* notes 39-106 and accompanying text.

utilize domestic shipyards for maintenance and repair.[8] Yet, by limiting the duty's scope to "equipment"[9] and "repairs,"[10] Congress lessened the duty's impact on shipowners. Furthermore, Congress has enacted a number of exceptions to the duty in order to reduce the duty's burden on shipowners.[11]

Congressional attempts to balance shipyard and ship operator interests in constructing the repair duty have resulted in a very complex statute. The U.S. Customs Service administers the repair duty through equally complex regulations.[12] Moreover, several international trade agreements' negotiations have discussed the repair duty, agreeing upon limitations on the duty's scope.[13] As a result, neither shipowner interests nor shipyard interests favor the repair duty in its current form.[14]

This note traces the background of the repair duty statute from its inception in 1866 to the present. The note also discusses Customs' administration of the repair duty, including procedures for compliance. The note then reviews and classifies the scope of the duty's application. Finally, the note proposes that the repair duty be repealed and examines several alternatives for its elimination, including domestic legislation and international trade agreements.

II. History and Administration of the Repair Duty Statute

Periodically, Congress has revised the federal statute which imposes the fifty percent *ad valorem* duty on the cost of foreign equipment and repairs for U.S.-documented vessels.[15] Generally, these revisions have limited the scope of foreign equipment

8. *See infra* note 44 and accompanying text.

9. "Equipment" generally includes any portable item used for preparing a constructed vessel's hull and fittings for service. *See infra* notes 163-178 and accompanying text.

10. "Repairs" generally include work involving the restoration of a vessel or its equipment to its original state after decay, waste, partial destruction, or injury. *See infra* notes 133-162 and accompanying text.

11. *See infra* notes 62-74 and accompanying text.

12. 19 C.F.R. § 4.14 (1988).

13. *See infra* notes 267-270 and accompanying text.

14. U.S. shipowner interests favor total or partial repeal of the repair duty, while shipyard interests favor expanding the duty to cover all foreign work. *See infra* notes 245-249 and accompanying text.

15. Congress has revised or amended the repair statute, 19 U.S.C. § 1466 (1988), seven times since its inception in 1866. *See infra* notes 61-105 and accompanying text.

and repairs subject to the duty.[16] Courts have interpreted the congressional intent in amending the statute as an effort to assist the domestic ship repair industry[17] and, at the same time, to provide shipowners relief from the duty for various types of work.[18] Despite the provisions for relief from the repair duty, the duty continues to be an extreme burden on U.S. commercial vessel owners.[19] The complex set of Customs Service regulations promulgated for collecting the duty further increase the duty's burden.[20]

A. *Background of the Statute*

Prior to 1900, Congress primarily used duties and taxes to promote U.S. shipbuilders and shipowners and protect them from foreign competition.[21] For example, the First Congress estab-

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16. *See infra* notes 62-106 and accompanying text. The primary exception to such revisions is the 1922 amendment. *See infra* notes 50-59 and accompanying text.

17. *See* Mount Washington Tanker Co. v. United States, 665 F.2d 340, 344 (C.C.P.A. 1981); United States v. Gissel, 353 F. Supp. 768, 772 (S.D. Tex. 1973), *aff'd*, 439 F.2d 27 (5th Cir. 1974).

18. *See infra* notes 60-106 and accompanying text.

19. Twice courts have upheld the constitutionality of the repair duty under due process challenges. Oswego Barge Corp. v. United States, 664 F. Supp. 1546 (Ct. Int'l Trade 1987); Erie Navigation Co. v. United States, 475 F. Supp. 160 (Cust. Ct. 1979). *Oswego Barge Corp.* involved the grounding of a fuel oil barge on the Saint Lawrence Seaway during fog, resulting in severe damage to the barge. *Oswego Barge Corp.*, 664 F. Supp. at 1547. The barge unloaded in Oswego, New York, but allegedly required repairs in a Canadian shipyard because no U.S. yard with drydock facilities could be found within a safe distance. *Id.* The owner claimed that because no U.S. shipyard could make the repairs, the statute, as applied to the facts of the case, violated the due process clause of the fifth amendment. *Id.* However, the Court of International Trade held that the owner failed to establish the facts necessary to prove the statute's unreasonableness, since a domestic yard could have performed the work. *Id.* at 1549-50.

In upholding the statute, the court applied the same "rational relationship" test that the Customs Court had applied in *Erie Navigation Co.*, 475 F. Supp. at 160. The test merely required that a "rational relationship" exist between the legislative purpose and the method, *i.e.*, the statute, selected to achieve that purpose. Nebbia v. New York, 291 U.S. 502, 537 (1934). A court may assume facts that support the statute's constitutionality. United States v. Carolene Prods. Co., 304 U.S. 144, 152 (1938). Finally, the plaintiff bears the burden of proving that the law is not rationally related to its purpose. *Id.* at 153-54.

The *Erie* court had held that the repair duty statute was constitutional because the imposition of a duty on foreign repairs is rationally related to Congress' purpose in protecting U.S. shipyards. *Erie Navigation Co.*, 475 F. Supp. at 163-65. Therefore, the constitutionality of the repair duty statute appears settled.

20. 19 C.F.R. § 4.14 (1988).

21. *See* H. Bess & M. Farris, *supra* note 1, at 12-19; P. Zeis, *supra* note 1, at 1-12. An early exception to the use of duties and taxes arose in 1789, however, when Congress adopted a law restricting U.S. vessel registration to ships that U.S. citizens owned and built domestically. Act of Sept. 1, 1789, ch. 11, §§ 1, 22-23, 1 Stat. 55, 60-61.

lished a tariff on imported goods, but provided a ten percent reduction in duties on goods carried on U.S.-registered ships.[22] In addition, Congress enacted a system of port tonnage taxes[23] designed to discriminate in favor of U.S. shipping interests.[24] The port tonnage tax system effectively reserved American coastal trades for U.S.-registered vessels.[25] Several months later, the First Congress limited vessels eligible for U.S. registry to those built in the United States, regardless of the vessel's ownership.[26] Thus, the port tonnage taxes primarily benefitted domestic shipyards by limiting coastal trades to U.S.-built vessels.[27]

Prior to the Civil War, these protections had little impact on owners of U.S.-registered ships because U.S. shipbuilders were cost competitive with their foreign counterparts.[28] Consequently, the laws merely encouraged investment in domestically-built ships. After the Civil War, however, the U.S. maritime industry, including the shipyard and shipowning elements, began a long and continuous decline.[29] Iron replaced wood as the construction material for merchant ships and steam replaced sails as the propulsion method.[30] The United States adapted slowly to steam propulsion since the U.S. iron industry was relatively undeveloped.[31] Further worsening this situation, Congress imposed high tariffs on shipbuilding materials, such as iron, in order to encourage the development of domestic industries.[32] As a result, U.S. shipbuilding costs became considerably greater

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22. Act of July 4, 1789, ch. 2, § 5, 1 Stat. 24, 27. The "registry" of a vessel generally refers to the particular country whose maritime laws and regulations govern the vessel. BLACK'S LAW DICTIONARY 1155 (5th ed. 1979).

23. Act of July 20, 1789, ch. 3, §§ 1-3, 1 Stat. 27, 28.

24. Under the system, U.S.-registered ships paid a port tax of six cents per ton; U.S.-built vessels owned wholly or in part by foreign citizens paid thirty cents per ton; and, all foreign-built vessels, regardless of ownership, paid fifty cents per ton. *Id.* Furthermore, U.S.-registered vessels paid the tax once a year, whereas foreign vessels were liable upon each entry into a U.S. port. *Id.* §§ 2-3; 1 Stat. at 27-28.

25. P. ZEIS, *supra* note 1, at 4.

26. Act of Sept. 1, 1789, ch. 11, §§ 1, 22-23, 1 Stat. 55, 60-61.

27. P. ZEIS, *supra* note 1, at 3.

28. *Id.* at 12. The United States became dominant in the shipbuilding industry due to the U.S. industry's use of wood in ship construction. H. BESS & M. FARRIS, *supra* note 1, at 10-11. The United States, in contrast to many European countries, had an abundance of fine shipbuilding timber. *Id.* In fact, as early as 1776, U.S. colonies supplied Great Britain with one-third of its oceangoing merchant marine. *Id.* at 11. This dominance lasted until the Civil War. P. ZEIS, *supra* note 1, at 12.

29. H. BESS & M. FARRIS, *supra* note 1, at 26-29.

30. P. ZEIS, *supra* note 1, at 12.

31. *Id.* at 14.

32. *See* Act of June 30, 1864, ch. 171 § 3, 13 Stat. 202, 203; H. BESS & M. FARRIS, *supra* note 1, at 27-28.

than foreign shipbuilding costs.[33]

United States shipowners could not compete with foreign-built vessels because of the higher cost of U.S.-built ships.[34] Adding to the decline of the U.S. fleet, Congress passed a law in 1866 preventing U.S.-registered vessels transferred to foreign registry during the Civil War from being re-registered in the United States.[35] Additionally, U.S. shipowners could not improve competitiveness by purchasing lower cost, foreign-built vessels because various shipping laws generally restricted U.S. commerce to domestically-built, U.S.-registered vessels.[36] Shipbuilding and shipowning interests began to conflict as they competed for beneficial legislation.[37] Both groups agreed with Congress that the maritime industry needed assistance; considerable disagreement existed, however, as to the method of support for the industry.[38]

B. *The 1866 and 1922 Acts*

Congress imposed a fifty percent *ad valorem* duty, in the Act of July 18, 1866 (1866 Act),[39] on the costs of equipment purchased for and of repairs made to certain U.S.-documented vessels in

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33. H. Bess & M. Farris, *supra* note 1, at 28.

34. *Id.* at .6-28.

35. Act of Feb. 10, 1866, ch. 8, 14 Stat. 3. Shipowners transferred one-third of the entire U.S. fleet to foreign ports during the war. P. Zeis, *supra* note 1, at 15.

36. The Navigation Act of 1817 required all imported merchandise to be carried on U.S. vessels or vessels of the nation from which the goods originated. Act of Mar. 1, 1817, ch. 31, § 1, 3 Stat. 351. The Act provided an exception for countries without similar laws. *Id.*

The Act also explicitly excluded foreign vessels from the U.S. coastal trade. *Id.* § 4. While tonnage taxes effectively accomplished the same result as this provision, *see supra* note 25 and accompanying text, the exclusion, known as "cabotage," became an important part of U.S. maritime policy. *See* H. Bess & M. Farris, *supra* note 1, at 17. For a discussion of the history of U.S. cabotage laws, see Aspinwall, *Coastwise Trade Policy in the United States: Does it Make Sense Today?*, 18 J. Mar. L. & Com. 243 (1987).

37. For a discussion of the conflicting interests of shipbuilders and shipowners during this period, see H.R. Rep. No. 28, 41st Cong., 2d Sess. 1-30 (1870).

38. *Id.* T· simplest solution for shipowners was to allow the purchase of foreign-built vessels for the U.S. registry. H. Bess & M. Farris, *supra* note 1, at 24. Accordingly, U.S. shipowners advocated the "free ship policy," whereby foreign-built ships could be registered in the Unites States. *Id.* As an alternative to the free ship policy, shipbuilders advocated government subsidies to shipbuilders and shipowners to compensate for the higher cost of U.S.-built vessels. P. Zeis, *supra* note 1, at 16-17. Congressional representatives from states with large shipbuilding activity advocated emphatically the shipyards' interests. *Id.* at 17-18. Eventually, shipowners lost the free ship proposal. *Id.* at 19-21.

39. Act of July 18, 1866, ch. 201, 14 Stat. 178.

foreign countries.[40] Unfortunately, no legislative history discusses the 1866 Act's repair duty.[41] The Treasury Department[42] drafted the Act and the Senate Commerce Committee made only technical changes to the repair duty provision; the full Senate approved the provision without debate.[43]

The drafters of the Act designed the repair duty to encourage owners of U.S.-registered ships to utilize materials made in the United States and domestic shipyards for repairs.[44] By 1866, the price of U.S.-built vessels made competition with foreign shipbuilders virtually impossible, leaving domestic shipyards with few new orders and little work.[45] The drafters' choice of using duties was consistent with Congress' earlier efforts to promote the maritime industry through port tonnage taxes.[46] The drafters limited the duty's scope to foreign repairs on vessels "enrolled and licensed . . . to engage in the foreign and coasting trade on the northern, northeastern and northwestern frontiers of the United States."[47] This provision limited the repair duty to vessels that could most easily purchase and conduct repairs in the

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40. The 1866 Act, in relevant part, provided:

> [t]hat the equipments . . . purchased for, or the expenses of repairs made in a foreign country upon a vessel enrolled and licensed under the laws of the United States to engage in the foreign and coasting trade on the northern, northeastern, and northwestern frontiers of the United States . . . shall on the first arrival of such vessel in any port of the United States, be liable to entry and the payment of an ad valorem duty of fifty per centum on the cost thereof in such foreign country; and if the owner or owners or master of such vessel shall willfully and knowingly neglect or fail to report, make entry, and pay duties as herein required, such vessel, with her tackle, apparel, and furniture, shall be seized and forfeited: *Provided*, that if the owner or owners or master of such vessel shall furnish good and sufficient evidence that such vessel, while in the regular course of her voyage, was compelled, by stress of weather or other casualty, to put into said foreign port and purchase such equipments, or make such repairs, to secure the safety of the vessel to enable her to reach her port of destination, then it shall be competent for the Secretary of the Treasury to remit or refund such duties, and such vessel shall not be liable to forfeiture.

Id. ch. 201, § 23, 14 Stat. at 183.

41. For the congressional debates on the 1866 Act, see CONG. GLOBE, 39th Cong., 1st Sess. 2563-96, 3440-43 (1866).

42. *See id.* at 2563-64.

43. *Id.* at 2569.

44. Mount Washington Tanker Co. v. United States, 665 F.2d 340, 344 (C.C.P.A. 1981); United States v. Gissel, 353 F. Supp. 768, 772 (S.D. Tex. 1973), *aff'd*, 439 F.2d 27 (5th Cir. 1974); Suwannee S.S. Co. v. United States, 435 F. Supp. 389, 394 (Cust. Ct. 1977). *See* H.R. REP. No. 719, 78th Cong., 1st Sess. 1-2 (1943). *See also* 33 Op. Att'y Gen. 432, 434 (1923) (stating that the purpose of the repair duty is to protect domestic manufacturers of ship parts and ship workers).

45. *See supra* notes 28-34 and accompanying text.

46. *See supra* notes 23-27 and accompanying text.

47. Act of July 18, 1866, ch. 201, § 23, 14 Stat. 178, 183. Vessels licensed to engage in trades on the northern, northeastern, and northwestern frontiers were pre-

United States by excluding vessels engaged in foreign trade. The drafters further limited the scope of the duty to the cost of "equipment" purchased and "repairs" made.[48] Finally, the drafters allowed the Secretary of Treasury to refund or remit the duty where a shipowner established by "good and sufficient evidence" that "stress of weather or other casualty" compelled the vessel to purchase equipment or seek repairs in a foreign port.[49]

Prior to the enactment of the Tariff Act of 1922 (1922 Act),[50] the repair duty remained essentially unchanged.[51] Shipowners advocated a "free ship policy" whereby shipowners could acquire less expensive, foreign-built vessels for the U.S. registry, while congressional representatives of shipbuilding states rejected such arguments.[52] Nevertheless, while failing in that effort, U.S. shipowners were successful prior to World War I in implementing a gradual liberalization of the protective tariffs on shipbuilding materials.[53] However, at the behest of the steel industry,[54] Con-

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sumably limited to contiguous country trades in the British North American provinces. *See* Act of Mar. 2, 1799, ch. 22, §§ 92, 105-06, 1 Stat. 697-98.

48. Act of July 18, 1866, ch. 201, § 23, 14 Stat. 178, 183. For a discussion of the interpretation of these terms, see *infra* notes 133-178 and accompanying text.

49. Act of July 18, 1866, ch. 201, § 23, 14 Stat. 178, 183. The "stress of weather or other casualty" exception was only applicable when the casualty occurred during the "regular course" of a voyage. *Id.* Accordingly, a vessel trading domestically could not undertake repairs in Canada because of a casualty and still fit within the exception. The exception was needed for vessels trading with the British North American provinces because public policy disfavored imposing a tax burden that would tend to make a shipowner postpone measures necessary to ensure the safety of the ship. *See* 33 Op. Att'y Gen. 432, 435 (1923).

50. Tariff Act of 1922, Pub. L. No. 318, 42 Stat. 858.

51. When Congress consolidated the statutes of the United States into the Revised Statutes, *see* Act of June 22, 1874, 18 Stat. 1, the repair duty was codified in §§ 3114 and 3115. *Id.* ch. 11, §§ 3114, 3115, 18 Stat. 598. Section 3114 contained the language imposing the duty and providing for its collection; § 3115 contained the remission language for certain repairs. *Id.* Only minor editorial changes were made to the text of the statute. The codifiers placed the sections in title 34, "Collection of Duties Upon Imports" and chapter 11, "Provisions Applying to Commerce with Contiguous Countries." *Id.* By approving the placement of the duty in title 34, Congress indicated that the Customs Service would administer the duty. Also, by placing the duty in the chapter applying to commerce with contiguous countries, Congress affirmed that the duty would not apply to vessels trading overseas.

52. *See supra* note 38.

53. P. Zeis, *supra* note 1, at 123. The duties discriminating in favor of U.S.-built vessels were repealed in 1815. *See supra* notes 22-25 and accompanying text. In an effort to revive the foreign trade fleet, Congress passed legislation in 1913 providing for a five percent reduction of import duties on merchandise shipped on domestically-built, U.S.-registered vessels. Act of Oct. 3, 1913, ch. 16, § 11, 38 Stat. 114, 196. The Supreme Court later struck down the duties as contradictory to various reciprocal commercial treaties between the United States and foreign nations. Five Percent Discount Cases, 243 U.S. 97 (1917).

gress reversed this policy by exacting protective duty rates on shipbuilding materials in the 1922 Act, thus increasing the cost of building in domestic shipyards again.[55]

While effectively increasing the cost of U.S. built ships in the 1922 Act, Congress provided shipyards with protection, at the expense of shipowners, through a revision to the repair duty.[56] First, Congress expanded the duty to apply to any vessel "documented under the law of the United States,"[57] rather than to vessels trading solely in domestic trades and trades with the British North American Provinces. Second, besides "equipment" and "expenses of repairs," Congress included within the duty's scope the cost of "repair parts or materials to be used [in repairs]."[58] By expanding the scope of the repair duty, the 1922 Act proved harmful to shipowners.[59]

C. *The 1930 and 1943 Acts*

Immediately following World War I, the U.S. merchant marine flourished as the wartime fleet provided a source of vessels available at low cost.[60] By the late 1920s, however, foreign shipyards were again out-producing domestic yards, placing the U.S. commercial fleet at a competitive disadvantage.[61] Congress reacted with legislation aimed at promoting both U.S. shipyards and the operating fleet.[62] Congressional amendments to the repair duty,

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54. G. Jones, Government Aid to Merchant Shipping 455-56 (1925).

55. Tariff Act of 1922, Pub. L. No. 318, 42 Stat. 858. *See* P. Zeis, *supra* note 1, at 123 (discussing the status of the maritime industry in the 1920s). The 1922 Act adopted cost parity as the governing principle for fixing rates on dutiable articles. Tariff Act of 1922, Pub. L. No. 318, § 315(a), 42 Stat. at 858. Accordingly, the President, upon certain findings, could adjust tariffs to equalize U.S. and foreign costs. This procedure, known as the "flexible tariff," technically exists today with respect to articles that trade agreements do not cover. S. Lawrence, United States Merchant Shipping Policy and Politics 50 n.1 (1966).

56. Tariff Act of 1922, Pub. L. No. 318, § 466, 42 Stat. at 957-58.

57. *Id.*

58. *Id.* The report accompanying the bill does not provide an explanation of the repair duty provision. *See* S. Rep. No. 595, 67th Cong., 2d Sess. (1922). Presumably, Congress determined that the competitiveness of U.S. vessels in foreign trade no longer justified an exception. Furthermore, Congress wished to ensure that the cost of materials used in making repairs was dutiable.

59. P. Zeis, *supra* note 1, at 123.

60. H. Bess & M. Farris, *supra* note 1, at 46.

61. *Id.* at 46-47. *See also* S. Lawrence, *supra* note 55, at 33-42 (discussing post-World War I maritime policy).

62. *See* Merchant Marine Act of 1928, ch. 675, 45 Stat. 689. The Merchant Marine Act reaffirmed the U.S. policy of maintaining a strong maritime industry, continued existing mail subsidy payments to U.S. carriers under new contract provisions, and

as in the Tariff Act of 1930 (1930 Act),[63] reflected the policy of promoting the U.S. fleet and of protecting sea-going labor.[64]

Revisions to the repair duty, in general, relieved U.S. shipowners from several of the duty's more burdensome effects. First, Congress excluded from the duty any compensation paid to members of a vessel's regular crew in a foreign country in connection with the performance of repairs or the installation of equipment, even if the repairs or equipment were dutiable.[65] Second, Congress expanded the "stress of weather" exception[66] to include remission or refund for equipment and repairs necessary to secure the "seaworthiness" of the vessel.[67] Lastly, Congress added a "domestic materials" exception for the overseas installation of equipment, repair parts, or materials that were manufactured or produced in the United States by U.S. residents

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increased the size of a construction loan fund. *Id.* For a discussion of the Merchant Marine Act of 1928, see H. Bess & M. Farris, *supra* note 1, at 47-50.

63. Tariff Act of 1930, Pub. L. No. 361, § 466, 46 Stat. 590, 719 (codified as amended at 19 U.S.C. § 1466 (1988)).

64. The 1930 Act included the protection of American labor as a primary purpose. *See Tariff Readjustment—1929, Hearings Before the House Comm. on Ways and Means,* 70th Cong., 2d Sess. (1929); H.R. Rep. No. 7, 71st Cong., 1st Sess. 251 (1929).

65. Tariff Act of 1930, Pub. L. No. 361, § 466, 46 Stat. at 719 (codified at 19 U.S.C. § 1466(a) (1988)). Congress enacted the crew compensation exception in response to a previous Attorney General ruling that crew member compensation was not within the duty's scope. 33 Op. Att'y Gen. 432 (1923). *See* H.R. Rep. No. 7, 71st Cong., 1st Sess. 344 (1929). Because the duty is equal to fifty percent of the total cost for all equipment and repairs, *see supra* note 5 and accompanying text, subtracting labor from the total cost could substantially reduce the amount of the duty.

66. *See supra* note 49 and accompanying text.

67. Tariff Act of 1930, Pub. L. No. 361, § 466, 46 Stat. at 719 (codified as amended 19 U.S.C. § 1466(d)(1) (1988)). The House bill provided remission for any equipment or repair expense incurred: (1) to maintain the vessel in seaworthy condition; (2) to repair damages suffered or to replace equipment damaged or worn out during the voyage; or, (3) to maintain the vessel in a sanitary and proper condition for the carriage of cargo or passengers. H.R. 2667, 71st Cong., 1st Sess. (1929). The House proposed this broader stress of weather exception because the existing remission language was too strict, resulting in an unnecessary burden on U.S. shipping. H.R. Rep. No. 7, *supra* note 64, at 344. The House did not contemplate, however, that general overhauling, reconditioning, alterations, or improvements would be exempt from the duty under this section. *Id.* at 345. On the other hand, the Senate believed that the House language, in effect, would have permitted almost any foreign work short of overhauling and reconditioning to be duty-free. S. Rep. No. 37, 71st Cong., 1st Sess. 72 (1929). The Senate insisted that the House provision would be detrimental to U.S. shipyards and that existing law was "sufficiently generous" to U.S. shipping interests. *Id.* Consequently, Congress adopted the Senate version which added only the exception for the seaworthiness of the vessel.

Seaworthiness is defined as "the sufficiency of a vessel in materials, construction, equipment, crew, and outfit for the trade or service in which it is employed." R. de Kerchove, International Maritime Dictionary 699 (2d ed. 1961).

or members of the regular crew.[68]

The domestic materials and crew member exceptions reflected two of Congress' purposes in enacting the 1930 Act—to protect U.S. labor and to encourage the use of domestic goods.[69] Congress recognized that certain shipowners often drydocked or laid up vessels for winter in nearby foreign nations.[70] Accordingly, Congress sought to encourage the use of readily available domestic materials and U.S. labor in preparing these vessels for a return to service.[71]

During World War II, Congress suspended the application of the repair duty statute for two years, retroactive to December 8, 1941, in the Act of December 17, 1943 (1943 Act).[72] Congress determined that suspension of the duty would relieve congestion in domestic repair facilities caused by the war and expedite vessel repair without an adverse effect on the U.S. shipyards' business.[73] More significantly, German U-boats had depleted the maritime fleet in the early years of the war, and Congress wanted to maximize the use of remaining vessels by allowing shipowners to repair in foreign yards without penalty.[74]

D. *Recent Amendments*

Following the 1943 Act, Congress continued to promote the U.S. fleet and domestic shipyards by enacting beneficial legislation linking the two segments of the industry.[75] Yet, because of

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68. Tariff Act of 1930, Pub. L. No. 361, § 466, 46 Stat. at 719 (codified at 19 U.S.C. § 1466(d)(2) (1988)).

69. *See supra* note 64.

70. H.R. Rep. No. 7, *supra* note 64, at 345. The lay ups would occur mainly on the Great Lakes where the navigating season generally lasts from March through mid-December.

71. *Id.* In most circumstances, foreign governments will restrict U.S. labor from entering foreign nations to perform shipyard work. With this restriction, the exception remains largely ineffective in compelling shipowners to utilize domestically-manufactured parts following drydock or lay up periods unless crew members can perform the work. Furthermore, shipowners could transport most domestic repair materials and equipment to foreign shipyards. However, contrary to the intent expressed in the statute, *see supra* note 65, shipowners have no incentive to use domestic materials because the higher cost of such materials will result in a greater duty when foreign labor is employed.

72. Act of Dec. 17, 1943, ch. 345, 57 Stat. 601.

73. H.R. Rep. No. 719, 78th Cong., 1st Sess. 1 (1943). Because of the ongoing war, domestic shipyards were operating at full capacity with work backlogs. *Id.*

74. *Id.* at 1-2.

75. *See* Merchant Marine Act of 1936, ch. 858, 49 Stat. 1985 (codified as amended at 46 U.S.C. app. §§ 1101-1127 (1988)); Merchant Marine Act of 1970, Pub. L. No. 91-469, 84 Stat. 1018 (amending 46 U.S.C. app. §§ 1101-1127 (1988)); Cargo Preference

this linkage, the laws failed to consistently ensure a strong maritime industry.[76]

To promote the U.S. commercial fleet, Congress began enacting another series of exceptions to lessen the repair duty's impact, rather than repeal the duty. In 1971, Congress amended the repair duty to provide several additional exceptions.[77] First, Congress added the dunnage and tank exception which authorized a remission or refund for equipment, material, or labor used for cargo dunnage and shoring,[78] for the erection of temporary bulkheads to control bulk cargo, and for the necessary preparation of tanks to carry liquid cargo.[79] Second, the two-year exception was added which eliminated the duty for certain vessels remaining continuously outside the United States for two years or more.[80] However, Congress specifically maintained the duty for items purchased during the first six months after departing the United States, and for fish nets and netting.[81]

In providing the two-year exception, Congress recognized that where vessels remain outside the United States for extended periods, the repair duty fails to encourage the use of U.S. shipyards.[82] Because vessels remaining outside the United States for more than two years generally cannot be maintained and repaired in domestic yards, imposing the duty was particularly onerous and provided no benefit to domestic shipyards or to U.S.

Act of 1954, ch. 936, 68 Stat. 832 (codified as amended at 46 U.S.C. app. §§ 1241(b), 1241d-1241p (1988)).

76. *See* H. Bess & M. Farris, *supra* note 1, at 210-17.

77. Act of Jan. 5, 1971, Pub. L. No. 91-654, 84 Stat. 1944.

78. Dunnage constitutes pieces of wood or similar material that are placed against the sides and bottom of the hold of a vessel that preserves the cargo from the effects of leakage, sweating, contamination, or damage from nearby cargoes. Black's Law Dictionary 451 (5th ed. 1979). Shoring is wood or similar material used to brace cargo to prevent it from shifting at sea. R. de Kerchove, *supra* note 67, at 700.

79. Act of Jan. 5, 1971, Pub. L. No. 91-654, § 1, 84 Stat. at 1944 (codified at 19 U.S.C. § 1466(d)(3) (1988)). Prior to the 1971 Act, courts considered the items contained in this exception as outside the scope of "repairs," but had ruled dunnage as dutiable equipment. *See infra* note 167 and accompanying text. Tank cleaning as a repair still presents disputes in interpretation. *See infra* notes 145-154 and accompanying text.

80. Act of Jan. 5, 1971, Pub. L. No. 91-654, § 1, 84 Stat. at 1944 (codified at 19 U.S.C. § 1466(e) (1988)).

81. *Id.*

82. S. Rep. No. 1474, 91st Cong., 2d Sess. 3, *reprinted in* 1970 U.S. Code Cong. & Admin. News 5910, 5912. The original House Bill, H.R. 16745, only exempted shrimp vessels from the duty. *Id.* at 5910-11. However, the Senate felt that the exemption should apply to all "special purpose vessels" remaining outside the United States for extended periods. *Id.*

labor.[83] Even so, Congress limited the exception solely to "special purpose vessels."[84] Furthermore, to ensure that vessels were outfitted with all of the necessary equipment and that they performed all anticipated repairs in domestic shipyards before departing, Congress retained the duty for all entries incurred after the first six months of departing the United States.[85]

In 1978, Congress revised the penalty provisions of the repair duty statute as part of the Customs Procedural Reform and Simplification Act (1978 Act).[86] Prior to this revision, the statute penalized willful and knowing neglect, failure to report, or failure to pay duties with seizure and subsequent sale of the vessel.[87] However, Congress believed vessel forfeiture imposed too severe a penalty relative to the revenue lost in many cases.[88] Accordingly, as an alternative to forfeiture, the 1978 Act provided a monetary penalty up to the value of the vessel.[89] Additionally, Congress expanded the scope of liability to include the making of purposeful false statements about ship repairs or equipment.[90] Finally, in expanding liability, Congress included a pre-penalty notice provision for alleged violations of the statute to permit rapid resolution of disputes.[91]

The legislation implementing the Agreement on Trade in Civil Aircraft[92] included another exception to the repair duty for repair parts, materials, and expenses of repairs, purchased or

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83. *Id.* at 5911.

84. *Id.* Special purpose vessels generally do not carry cargo in commercial trades. Special purpose vessels include fishing vessels, barges, oil drilling vessels, and oceanographic vessels, among other vessels. *Id.*

85. *Id.*

86. Customs Procedural Reform and Simplification Act of 1978, Pub. L. No. 95-410, 92 Stat. 888 (codified as amended in scattered sections of 19 U.S.C.). The repair duty penalty, notice and violation provisions are codified at 19 U.S.C. § 1466(a)-(c) (1988).

87. *See* Tariff Act of 1930, Pub. L. No. 361, § 466, 46 Stat. 590, 719.

88. S. Rep. No. 778, 95th Cong., 2d Sess. 29, *reprinted in* 1978 U.S. Code Cong. & Admin. News 2211, 2240.

89. Customs Procedural Reform and Simplification Act of 1978, Pub. L. No. 95-410, § 206(1), 92 Stat. at 888.

90. *Id.*

91. S. Rep. No. 778, *supra* note 88, *reprinted in* 1978 U.S. Code Cong. & Admin. News 2240. Congress considered the pre-penalty notice procedure appropriate because an analogous procedure was provided in 19 U.S.C. § 1592 which governed penalties for fraud, gross negligence, and negligence. *Id.* The procedure requires Customs officers to provide specific notification of alleged violations and to provide an opportunity for the alleged violator to challenge the accusations both orally and in writing. 19 U.S.C. § 1466(b)-(c) (1988).

92. Agreement on Trade in Civil Aircraft, Jan. 1, 1980, 31 U.S.T. 619, T.I.A.S. No. 9620, 1186 U.N.T.S. 170, *reprinted in* House Comm. on Ways and Means and Senate

performed in a foreign country on U.S. civil aircraft.[93] Congress continued the existing requirement, however, that the purchase of repair parts and materials and the expenses of repairs incurred abroad be documented upon return of the aircraft.[94]

The next revision occurred in 1980 when Congress provided a temporary exemption from the repair duty for the cost of purchase and repair of tuna purse seine nets.[95] This exemption applied between October 1, 1979 and December 31, 1981 to tuna purse seine vessels weighing over 500 gross tons or to similar vessels required to carry a certificate of inclusion under the general permit issued to the American Tunaboat Association.[96] The temporary exemption served several purposes. First, the exemption allowed the U.S. tuna fleet continued access to nets and netting repairs in Panama without duty payment.[97] Second, it provided a temporary suspension of duties allowed domestic net manufacturers to develop suitable products.[98] Finally, Congress recognized that only foreign manufacturers provided

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COMM. ON FINANCE, 96TH CONG., 1ST SESS., MULTILATERAL TRADE NEGOTIATIONS 289-302 (Comm. Print 1979) [hereinafter CIVIL AIRCRAFT AGREEMENT].

The parties negotiated the Agreement on Trade in Civil Aircraft during the Tokyo Round of Multilateral Trade Negotiations (MTN). For a review of the MTN, see 1 DIRECTOR-GENERAL OF GATT, THE TOKYO ROUND OF MULTILATERAL TRADE NEGOTIATIONS (1979); 2 DIRECTOR-GENERAL OF GATT, THE TOKYO ROUND OF MULTILATERAL TRADE NEGOTIATIONS (1980). The MTN negotiations were conducted under the auspices of the General Agreement on Tariffs and Trade (GATT). General Agreement on Tariffs and Trade, *opened for signature* Oct. 30, 1947, 61 Stat. A3, T.I.A.S. No. 1700, 55 U.N.T.S. 187 [hereinafter GATT].

93. Trade Agreements Act of 1979, Pub. L. No. 96-39, § 601(a), 93 Stat. 144, 268, *as amended by* Act of Oct. 17, 1980, Pub. L. No. 96-467, § 14, 94 Stat. 2220, 2225 (codified as amended at 19 U.S.C. § 1466(f) (1988)).

94. *Id.* § 601(a). For a discussion of the legislation implementing the Civil Aircraft Agreement, see S. REP. No. 249, 96th Cong., 1st Sess. 185-88, *reprinted in* 1979 U.S. CODE CONG. & ADMIN. NEWS 381, 571-74. Prior to implementation of the Civil Aircraft Agreement, Congress applied the repair duty statute to civil aircraft. *See* C.S.D. 79-51, 13 Cust. B. & Dec. 1076 (1978).

95. Act of Dec. 28, 1980, Pub. L. No. 96-609, § 115(a), 94 Stat. 3555, 3558 (codified at 19 U.S.C. § 1466(g) (1988)). In the two-year exemption provision, Congress specifically retained all fish nets and netting within the duty's scope. *See* Act of Jan. 5, 1971, Pub. L. No. 91-654, § 1, 84 Stat. 1944.

96. Act of Dec. 28, 1980, Pub. L. No. 96-609, § 115(a), 94 Stat. 3558 (codified at 19 U.S.C. § 1466(g) (1988)). The Marine Mammal Protection Act of 1972, Pub. L. No. 92-522, § 104, 86 Stat. 1027, 1034, requires the permit.

97. *See* S. REP. No. 999, 96th Cong., 2d Sess. 18-19 (1980). Prior to 1979, all equipment purchased and repairs performed in Panama were not subject to the duty because the Panama Canal Zone was not considered a "foreign country" within the meaning of the repair duty statute. *Id.* at 19. However, duty-free status in the Canal Zone ended with adoption of the Panama Canal Zone Treaty, Sept. 7, 1977, United States-Panama, 33 U.S.T. 1, T.I.A.S. No. 10,029.

98. *See* S. REP. No. 999, *supra* note 97, at 19.

required nets and that fuel costs to return from Panama to the United States solely to obtain or repair nets was prohibitively expensive.[99]

The repair duty statute was last changed in 1984 when Congress extended the two-year exemption to include all vessels, regardless of service.[100] Congress, however, retained the duty for vessels departing the United States solely for the purpose of obtaining equipment or repairs abroad.[101]

The changes to the two-year exception served two functions. First, the 1984 Act recognized that U.S. vessels competing directly with foreign-flag vessels in trade between foreign countries operated at a competitive disadvantage due to the lower wages, shipyard maintenance, and repair costs of foreign operators.[102] Because U.S. vessels in foreign-to-foreign trades were not eligible for operating subsidies,[103] Congress intended that the exemption from the repair duty would enhance the competitive posture of U.S. vessels in these trades.[104] Second, Congress acknowledged that many small vessels supply logistical support to offshore oil exploration and production operations which often requires extended periods outside the United States.[105] The two-year exemption enhanced the ability of U.S. supply vessels to compete in this trade.[106]

E. *Customs Entry Procedures*

The Customs Service is authorized by statute to administer the repair duty.[107] Title 19 of the Code of Federal Regulations con-

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99. *Id.*

100. *See* Trade and Tariff Act of 1984, Pub. L. No. 98-573, § 208, 98 Stat. 2948, 2976 (codified at 19 U.S.C. § 1466(e) (1988)). The previous statute only offered the exemption to special purpose vessels. *See supra* note 84 and accompanying text.

101. Trade and Tariff Act of 1984, Pub. L. No. 98-573, § 208, 98 Stat. at 2976.

102. H.R. Rep. No. 1015, 98th Cong., 2d Sess. 65, *reprinted in* 1984 U.S. Code Cong. & Admin. News 4960, 5024.

103. *See* Merchant Marine Act of 1936, § 601, 49 Stat. 1985, 2001 (codified as amended at 46 U.S.C. app. § 1171 (1988)). Operating subsidies are direct payments to certain U.S. commercial vessels engaged in foreign commerce. These subsidies are designed to equal approximately the difference between a U.S. vessel's costs for the crew and operations and the corresponding foreign competitors' costs. *Id.*

104. H.R. Rep. No. 1015, *supra* note 102, at 65, *reprinted in* 1984 U.S. Code Cong. & Admin. News at 5024.

105. *Id.*

106. *Id.*

107. 19 U.S.C. §§ 3, 1481-1528 (1988). The First Congress established the U.S. Customs Service, an agency within the Department of Treasury. Act of July 31, 1789, ch. 5, 1 Stat. 29 (repealed 1890). In addition to administering and enforcing various

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tains Customs regulations governing the duty's collection.[108] In general, these regulations set forth items and vessels subject to the duty, declaration and entry requirements, bases for duty remission, procedures for remission of duties, and penalties for avoiding the duties.[109]

Upon first arrival of a U.S. vessel into the United States, the owner or master must declare all equipment and repairs acquired outside the United States[110] as part of the original manifest.[111] Estimated duties must be deposited, or a bond equal to the estimated duties must be filed, before departure of the vessel.[112] Items listed on an entry may be non-dutiable if they are outside the scope of "equipment" or "repairs."[113] Additionally, dutiable items may be subject to remission under one of the exceptions in the repair duty statute.[114]

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tariff laws, the Customs Service administers and enforces various U.S. navigation laws. *Id.* §§ 1581-1654.

108. Equipment and Repair Duty Regulations, 19 C.F.R. § 4.14 (1989).

109. *Id.* § 4.14(a)-(g).

110. For the purpose of the equipment and repair duty, American Samoa, Guam, Guantanamo Bay Naval Station, Puerto Rico, and the U.S. Virgin Islands are not considered outside the United States. *Id.* § 4.14(a)(1). In addition, prior to 1979, equipment and repairs obtained in the Panama Canal Zone were exempt. *See supra* note 97.

111. 19 C.F.R. § 4.14(b)(1) (1989). The regulations require the declaration regardless of the dutiable status of such items. *Id.*; C.S.D. 90-75, 24 Cust. B. & Dec. No. 30, at 22 (1990). The entry must be filed with local Customs officials within five days after arrival. 19 C.F.R. § 4.14(b)(2) (1989). Additionally, the owner of the vessel must inform Customs officials of the cost of each of the items listed within 60 days of the vessel's arrival. However, extensions may be granted. *Id.* § 4.14(b)(2)(ii). Furthermore, if the owner fails to furnish the required evidence in a timely manner or if the information is of doubtful authenticity, the appropriate regional commissioners may use all available means to obtain the information and may refer the matter to the Office of Investigations. *Id.* § 4.14(b)(2)(ii)(A). Local Customs officials forward all entries to one of three regional repair liquidation units in New York, New Orleans, or San Francisco. *Id.* § 4.14(b)(2), (c)(1). Congress, however, recently approved a Customs Plan to consolidate the liquidation function in one location. H.R. Rep. No. 267, 101st Cong., 1st Sess. (1989).

112. 19 C.F.R. § 4.14(b)(1). The usual practice involves hiring a local port or berth agent to file blanket bonds providing for the assumption of the duties on the vessel. This practice facilitates and expedites departure. However, the government may hold the bond sureties liable for the amount of duty in issue if the owner fails to pay, and the agent's only recourse is against the owner or master of the vessel. *See* United States v. Gissel, 353 F. Supp. 768 (S.D. Tex. 1973) (holding a local berthing agent who filed blanket bonds on behalf of a shipowner liable for the duty after the ship owner filed for bankruptcy); Caldwell Shipping Co. v. United States, 53 Cust. Ct. 311 (1964) (noting that where an agent voluntarily pays duties, his action is the action of the principal if within the scope of the agent's authority).

113. For definitions of these terms, see *infra* notes 133-178 and accompanying text.

114. *See, e.g.*, 19 U.S.C. § 1466(d) (1988) (providing remission for necessary repairs, including the stress of weather exception).

To obtain a remission or refund, an application for relief must be filed with the appropriate Customs officer at the port where the vessel entered the country.[115] The application should state that the entry either falls outside dutiable equipment or repairs, or that the entry is subject to remission.[116] Even though the application for relief need not be in any particular form,[117] the applicant must specify the basis upon which the remission of duties is sought.[118] Applications for relief must also include various pieces of evidence supporting the applicant's claim for remission.[119]

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115. 19 C.F.R. § 4.14(d)(1)(ii) (1989). The application may also be filed with the appropriate vessel repair liquidation unit. *Id.* The application must be filed within a 60-day time period. *Id.* § 4.14(b)(2)(ii)(B); C.S.D. 80-196, 14 Cust. B. & Dec. 1063 (1980) (holding an application for remission untimely where the owner failed to file before liquidation and did not file a protest within 90 days after liquidation).

116. 19 C.F.R. § 4.14(d)(1)(i) (1989). Within 60 days after receiving an application, the repair liquidation unit must approve or deny the request, or forward it to the Carriers Rulings Branch at Customs Headquarters in Washington, D.C., for advice. *Id.* § 4.14(d)(1)(v). Regional Commissioners must provide written notice of final decisions to applicants. *Id.* In addition, the regulations require suspension of liquidation of repair entries until 30 days after applicants receive written notice. *Id.* § 4.14(d)(1)(vi).

117. *Id.* § 4.14(d)(1)(i).

118. Chas. Kurz & Co. v. United States, 698 F. Supp. 268, 272 (Ct. Int'l Trade 1988) (holding that vessel owner's petition failed to seek remission under the proper exemption, thereby not satisfying the requirements of a request for remission). The owner files the application in the same manner as the original entry. 19 C.F.R. § 4.14(d)(1)(ii) (1989); *see supra* notes 110-111 and accompanying text. However, the owner must sign the application and certify that all foreign equipment and repairs that took place within one year immediately preceding the application have been declared. 19 C.F.R. § 4.14(d)(1)(ii) (1989). Lack of proper certification makes an application invalid or incomplete. *Id.* Unless the owner takes steps within the 60-day time period to certify the application, the entry is subject to liquidation at the expiration of the 60-day period. C.S.D. 89-32, 23 Cust. B. & Dec. No. 82, at 3, 4 (1989).

119. 19 C.F.R. § 4.14(d)(1)(iii) (1989). Among the most important documents supporting claims for remission are copies of itemized bills, receipts, and invoices that segregate the cost of non-dutiable entries from all other items listed on the entry. *See* Routh, *Cutting Uncle's Cut of Foreign Repairs*, Marine Log, Nov. 1987, at 69 (noting that huge duty savings are possible when foreign yard work is planned with the duty and provisions for refund or remission in mind, and then Customs entries are prepared carefully to minimize the duty).

Accordingly, itemized invoices should be requested before performing any foreign work to facilitate obtaining refunds and remissions. *See* Routh, *supra*, at 71. Other pieces of evidence include copies of the ship's logs, classification society reports stating the cause and type of damages or the type of corrective work performed, certificates of seaworthiness, and affidavits, certification, or written reports by the master or responsible officer with knowledge of the circumstances warranting remission. 19 C.F.R. § 4.14(d)(1)(iii)(A)-(F) (1989). However, evidence showing that repairs made to shipboard barges and similar crewless vessels were necessary to ensure safety and seaworthiness, after departing the United States in seaworthy condition, is sufficient. *Id.* § 4.14(d)(1)(iii)(G).

Upon denial of a proper application for relief, an applicant may file a petition for review with the Commissioner of Customs.[120] The petition must be filed with the appropriate repair liquidation unit within thirty days after notice of a final decision.[121] The Regional Commissioner then forwards the petition to the Carriers Rulings Branch in Washington, D.C., with any recommendations for a decision.[122] Filing a petition automatically suspends liquidation of the entry until further notification of the Customs' decision.[123] Following liquidation of an entry, a protest may be filed with district directors;[124] if the protest is denied in whole or in part, judicial review may be obtained by filing a civil action in the U.S. Court of International Trade (CIT).[125]

III. Scope of the Duty and Remissions

Courts have interpreted the congressional intent expressed in the repair duty statute as being to "equalize . . . the relative costs of repairs performed by foreign versus domestic labor, in order to encourage U.S. shipowners to employ U.S. labor whenever possible."[126] While the duty favors shipyard interests, the language of the statute and the history of subsequent amendments indicate an attempt to balance both shipyard and shipowner interests by reducing the duty's impact on shipowners.[127] In other words, Congress never intended to totally insulate domestic yards from foreign competition in the maintenance and repair markets for U.S. commercial vessels. As a result, interpretation

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120. 19 C.F.R. § 4.14(d)(2)(i)-(ii) (1989).

121. *Id.* § 4.14(d)(2)(ii).

122. *Id.* § 4.14(d)(2)(iii); *see supra* note 116.

123. 19 C.F.R. § 4.14(d)(2)(ii), (iv) (1989). Liquidation refers to the act or process of final payment, satisfaction, or collection. Black's Law Dictionary 839 (5th ed. 1979).

124. 19 C.F.R. § 4.14(f) (1989). Procedures for filing protests are set forth in 19 C.F.R. § 174. The owner of a vessel must file a protest within 90 days of the notice of liquidation or of the date of decision. *Id.* § 174(e). For an example of procedural events tolling the 90-day period of limitations for filing protests, see Farrel Lines v. United States, 657 F.2d 1214, 1217-18 (C.C.P.A. 1981) (tolling 90-day period from date that petition for cancellation was filed), *modified*, 677 F.2d 1017 (1982). *But cf.* Transmarine Navigation Corp. v. United States, 7 Ct. Int'l Trade 42 (1984) (holding that a demand for payment made more than two years after the last date that the merits of a dispute were considered is insufficient to revive the dispute).

125. 19 C.F.R. § 174.31 (1989). Procedures for bringing actions before the Court of International Trade are set forth in 28 U.S.C. §§ 2631-2638 (1989).

126. Mount Washington Tanker Co. v. United States, 665 F.2d 340, 344 (C.C.P.A. 1981).

127. For example, Congress limited the scope of the duty to equipment and repairs, 19 U.S.C. § 1466(a) (1988), and provided for refunds and remissions in certain circumstances. *Id.* § 1466(d)(e).

of the statute involves several issues, including: (1) whether the particular work constitutes an "equipment" or "repair" within the scope of the duty;[128] (2) whether a dutiable entry falls within a statutory category for remission;[129] and, (3) whether the particular vessel or trade is excepted from the duty.[130]

A. *Definition of Equipment and Repair*

The language of the repair duty statute as set forth in section 1466(a) limits dutiable items to: (1) equipment purchased; (2) repair parts or materials used for repairs; and (3) expenses of repairs.[131] All other entries are outside the duty's scope; if Customs collects duties, Customs officials must refund those duties. Accordingly, the first step in determining the applicability of the duty is to examine whether the overseas purchases or work falls within the definition of "equipment" or "repairs." However, in considering whether particular entries must be refunded as outside the scope of the repair duty statute, the CIT gives broad deference to Customs' decisions.[132]

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128. *See infra* notes 133-178 and accompanying text.

129. *See infra* notes 179-208 and accompanying text.

130. *See infra* notes 209-232 and accompanying text.

131. 19 U.S.C. § 1466(a) (1988).

132. *See* Gerhart, *Judicial Review of Customs Service Actions*, 9 L. & Pol. Int'l Bus. 1101, 1135-89 (1977). *See generally* W. Futrell, The History of American Customs Jurisprudence (1941) (discussing Customs' interpretation of various tariff laws); E. Rossides, U.S. Customs, Tariffs and Trade (1977) (describing steps needed to protest Customs' decisions in U.S. courts).

The Court of International Trade (CIT) must review Customs' decisions in accordance with the Administrative Procedure Act (APA), 5 U.S.C. § 706 (1988). *See* 28 U.S.C. § 2640(d) (1988). In addition to the APA, the CIT must follow the Supreme Court's two-part test for judicial review of an agency's construction of a statute. Chevron, U.S.A. v. NRDC, 467 U.S. 837, 842-43 (1984). The first prong of the test asks whether Congress has expressly stated its intent on the precise question at issue; if it has, that intent governs. *Id.* The second prong examines whether the statute is silent or ambiguous as to the specific issue; if it is, the reviewing court only determines whether the agency based its decision on a permissible construction of the statute. *Id.* However, under the second prong of the Supreme Court's test, a court will not substitute its discretion for that of the agency unless the agency bases its decision on a misconstruction of the relevant statute. Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983).

The agency further must provide the reviewing court with an explanation of the agency's actions. Bowman Transp. v. Arkansas-Best Freight Sys., 419 U.S. 281, 285 (1974); Camp v. Pitts, 411 U.S. 138, 139-40 (1973). Moreover, where the agency sufficiently explains its reasoning, the court only needs to consider those reasons provided. *See Bowman Transp.*, 419 U.S. at 285-87. Thus, courts often defer to Customs' interpretations of the repair duty statute. For examples of this deference, *see Oswego Barge Corp.*, 664 F. Supp. at 1548; *Mount Washington Tanker Co.*, 505 F. Supp. at 212; *Suwannee S.S. Co.*, 435 F. Supp. at 392-93.

1. Definition of Repair

The term "repair" is generally defined as restoring or mending an item that is torn or broken.[133] Ship repair involves the restoration of a vessel or its equipment to its original state after decay, waste, partial destruction, or injury.[134] Applying this definition, many expenses associated with repairs are excluded from the duty.

The first category of excluded repair expenses relates to the costs of the facility performing the work.[135] This exclusion is derived from the judicially created "docking rule" established in *United States v. Geo. Hall Coal Company*.[136] The docking rule excludes from the repair duty the expense of docking a vessel to effect repairs.[137] Today, the docking rule extends to additional expenses associated with modern drydocking, including shoreside electrical power, supplies, and local heating.[138]

Similarly, the repair duty does not apply to the examination of a vessel's apparatus and machinery, so long as the inspection does not result in repairs.[139] However, when an inspection or survey results in repairs, the inspection is a dutiable "expense of repair."[140] As a result, annual and periodic inspections and surveys required by the U.S. Coast Guard and ship classification

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133. Webster's New Collegiate Dictionary 972 (1st ed. 1981)

134. *See, e.g.*, United States v. Admiral Oriental Lines, 18 C.C.P.A. 141, 147 (1930) (holding that installation of a steel swimming tank is not a repair); American Viking Corp. v. United States, 150 F. Supp. 746, 754 (Cust. Ct. 1956) (holding that work which did not involve restoration of the boilers or the turbine to operable condition after deterioration or destruction was not a repair); Waterman S.S. Corp. v. United States, 26 Cust. Ct. 114, 122 (1951) (holding that the annealing of loading gear to ascertain the present condition of the gear is not a dutiable repair); *cf.* E.E. Kelly & Co. v. United States, 17 C.C.P.A. 30 (1929).

135. *American Viking Corp.*, 150 F. Supp. at 752.

136. United States v. Geo. Hall Coal Co., 134 F. 1003 (C.C.N.D.N.Y. 1905).

137. States S.S. Co. v. United States, 73 Treas. Dec. 718 (1938).

138. *American Viking Corp.*, 150 F. Supp. at 752 (exempting from the duty the cost of heating, electrical light, and power after a failure of the vessel's generators); *States S.S. Co.*, 73 Treas. Dec. at 720-21 (excluding expenses for drydocking a vessel while undergoing repairs). Additional entries that may be excluded if properly itemized on invoices include drydock block arrangement, scaffolding sea water supply, air supply, hose connection and disconnection, watchperson services, crane services for drydock operations, phone calls, and drydock cleaning. *See* Cust. Rul. Ltr. 104,398 (Mar. 25, 1980).

139. *American Viking Corp.*, 150 F. Supp. at 754 (exempting from the duty the cost of boiler inspections and all expenses associated with the inspections).

140. *Id.* Congress added the cost of "repair parts and materials" to the duty's scope in the 1922 Act. *See supra* note 58 and accompanying text. Congress apparently intended to distinguish these items from the expense of labor. *See American Viking Corp.*, 150 F. Supp. at 754. Thus, where the duty applies to the cost of repair parts, labor costs are automatically dutiable. *See id. But cf.* 19 U.S.C. § 1466(a) (1988) (excluding labor

societies are not usually subject to the duty.[141]

Whether the repair duty applies to ship painting, cleaning, and general maintenance largely depends on the facts of each case. Because painting is essential to the preservation of a ship's structure[142] and paint must be restored when destroyed or decayed from weather or other causes, painting falls within the definition of dutiable repairs.[143] Furthermore, chipping, scaling, and cleaning in preparation of painting are within the definition of repairs.[144]

In contrast, mere cleaning is not a dutiable repair unless performed for the purpose of restoring the vessel after damage, deterioration, or decay.[145] For example, dutiable repairs do not include the scraping and cleaning of rose boxes[146] to ready the ship for its next cargo.[147] Nevertheless, if a coating is applied to cargo tanks to enable the vessel to carry a cargo it could not previously carry or to protect the tanks from deterioration, the duty applies.[148]

Recently, Customs ruled that the repair duty applies to recommended tank cleaning to prepare for an inspection and for subse-

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costs supplied by members of the vessel's regular crew); 19 U.S.C. § 1466(d)(2) (1988) (excluding domestic labor costs where equipment is manufactured in the United States).

141. C.S.D. 80-195, 14 Cust. B. & Dec. 1061 (1980).

142. The painting of a ship's hull often takes place after rust begins to form.

143. H.C. Gibbs v. United States, 41 C.C.P.A. 57, 60 (1953); American Mail Line v. United States, 24 C.C.P.A. 70, 70-71 (1936); E.E. Kelly & Co. v. United States, 17 C.C.P.A. 30, 32-33 (1929). An exception to this rule would occur if the painting was strictly ornamental. *See H.C. Gibbs*, 41 C.C.P.A. at 60.

144. States S.S. Co. v. United States, 73 Treas. Dec. 718 (1938). Compensation paid to foreign labor for painting is included within "expenses of repairs." Traders S.S. Co. v. United States, 37 Cust. Ct. 224 (1956).

145. Northern S.S. Co. v. United States, 54 Cust. Ct. 92, 98-99 (1965); C.S.D. 80-148, 14 Cust. B. & Dec. 968 (1980).

146. Rose boxes are iron boxes perforated with holes and fitted at the ends of certain types of pipes in order to prevent them from becoming obstructed with solid matter. R. de Kerchove, *supra* note 67, at 659. If cleaning is performed in conjunction with or in preparation of dutiable repairs, the cost of the cleaning is dutiable. C.S.D. 81-188, 15 Cust. B. & Dec. 1103 (1981).

147. *Northern S.S. Co.*, 54 Cust. Ct. at 98-99. The *Northern S.S. Co.* court based the "cleaning rule" on several prior rulings that tank cleaning to prepare for new cargo is not a dutiable repair. *See, e.g.*, American Mail Line v. United States, 34 Cust. Ct. 197, 200 (1955) (stating that the cleaning and sweeping of holds in preparation for non-bulk cargo is not dutiable); American Hawaiian S.S. Co. v. United States, 71 Treas. Dec. 1174, 1176 (1937) (holding the cleaning of deep tanks nondutiable).

148. C.S.D. 79-509, 14 Cust. B. & Dec. No. 1 at 88 (1979). Application of coatings may be viewed as similar to painting. Yet, if coatings are applied after alterations are made to the hull and fittings of the vessel, the cost remains non-dutiable, as these costs fit within the definition of "vessel" rather than "equipment." *Id. See infra* notes 158-162 and accompanying text.

quent carriage of water ballast.[149] The case involved several ballast wing tanks coated with cargo oil that required cleaning to restore the tanks to original condition suitable for water ballast.[150] Other tanks were apparently repaired,[151] while the tanks in question were merely cleaned for inspection and for ballast suitability.[152] Even though inspections not resulting in repairs are generally nondutiable,[153] Customs relied on the fact that, although not mandatory, the cleaning restored the vessel to its former condition.[154]

Several additional categories of ship repairs are outside the definition. For example, dutiable repairs do not include travel expenses for repairworkers,[155] and crating and shipping charges for repair materials.[156] Also, dutiable repairs do not include charges paid to foreign governments for customs duties.[157]

Finally, dutiable repairs do not include work performed pursuant to a warranty or guarantee clause in the construction contract of a vessel built abroad.[158] Such work is considered part of the original vessel rather than a repair on the vessel, provided that the work is performed within a reasonable time after delivery.[159] However, the costs of repairs made under a service contract remain dutiable even when the cost of the contract is prepaid with a foreign shipyard or manufacturer.[160] Additionally, when a vessel is delivered with a complement of spare parts, all replace-

149. Customs Ltr. Rul. 110,177 (May 9, 1989).

150. *Id.*

151. *Id.*

152. *Id.*

153. *See supra* note 139 and accompanying text.

154. Customs Ltr. Rul. 110,177 (May 9, 1989). This ruling seems to ignore two considerations. First, the cleaning was not performed in conjunction with dutiable repair work; rather, the cleaning merely facilitated an inspection. *Id.* Second, the definition of dutiable repairs requires restoration after decay, waste, destruction, or injury. *See supra* note 134 and accompanying text. Restoration necessary to return a vessel to its suitable function alone is insufficient.

155. Mount Washington Tanker Co. v. United States, 505 F. Supp. 209, 216 (Ct. Int'l Trade 1980); International Navigation Co. v. United States, 148 F. Supp. 448, 455-56 (Cust. Ct. 1957).

156. American Viking Corp. v. United States, 150 F. Supp. 746, 752 (Cust. Ct. 1956).

157. *International Navigation Co.*, 148 F. Supp. at 455-56.

158. Sea-Land Serv., Inc. v. United States, 683 F. Supp. 1404 (Ct. Int'l Trade 1988). Prior Customs' decisions considered expenses due to failure of a new vessel's equipment that a warranty covers as a "casualty" subject to duty remission if the equipment fails during the vessel's first-round voyage. C.S.D. 80-143, 14 Cust. B. & Dec. 951 (1980). However, Customs now applies the duty to items that a foreign shipyard warranty covers, in accordance with the purpose of the statute. *Id.*

159. *Sea-Land Serv., Inc.*, 683 F. Supp. at 1407-09.

160. T.D. 78-31, 12 Cust. B. & Dec. 56 (1978).

ments of the original spare parts that the owner purchases or installs overseas are dutiable.[161] Nevertheless, the original complement of duty-free spare parts include only those placed aboard the vessel on delivery.[162]

2. Definition of Equipment

Vessel "equipment" must initially be distinguished from the vessel itself.[163] For a particular item to be included within the definition of "vessel," it must be both permanent and essential to the vessel's successful operation.[164] In contrast, items falling within the definition of vessel "equipment" generally include any portable item used for preparing a vessel whose hull is already finished for service.[165]

Consequently, a "permanency" rule has evolved whereby dutiable equipment does not include the installation of an article likely to remain on board if the vessel is laid up for a long period of time.[166] Conversely, items that may easily be removed from the vessel, such as furnishings, items necessary for passengers and crew members or for the vessel's proper navigation or safety, and items that are used in connection with a particular voyage, are deemed vessel equipment.[167] Additionally, labor charges

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161. C.S.D. 89-38, 23 Cust. B. & Dec. No. 16 (1989).

162. C.S.D. 90-45, 24 Cust. B. & Dec. No. 18, at 13 (1990) (holding that an anchor not carried aboard a vessel but airlifted from a foreign builder to a foreign port cannot be classified as a duty-free spare part).

163. Historically, vessels themselves have not been subject to any duties under the tariff laws. *See* The Conqueror, 166 U.S. 110, 115-18 (1897); U.S. Int'l Trade Comm'n, *supra* note 6, General Headnotes and Rules of Interpretation, sched. 6, pt. 6, subpt. D.

164. 27 Op. Att'y Gen. 228 (1909).

165. Otte v. United States, 7 C.C.P.A. 166, 167-69 (1916) (holding that trawl nets were part of a vessel's equipment).

166. *See* United States v. Admiral Oriental Line, 18 C.C.P.A. 137, 139 (1930) (holding the installation of a steel swimming tank as nondutiable equipment); C.S.D. 84-5, 18 Cust. B. & Dec. 840 (1984) (finding that work performed on the vessel to permanently increase its height is non-dutiable); C.S.D. 83-35, 17 Cust. B. & Dec. 785 (1983) (stating that machinery installed to enable a vessel to engage in crab processing was a nondutiable addition to the hull and fittings); C.S.D. 83-18, 17 Cust. B. & Dec. 752 (1983) (noting that stack covers used to protect the boilers and engine room of a ship during long periods in port and lay-ups are non-dutiable additions to the hull and fittings); C.S.D. 81-206, 15 Cust. B. & Dec. 1137 (1981) (holding the alteration or modification of a vessel's coding system to convert from salt to fresh water operation is nondutiable); C.S.D. 79-278, 13 Cust. B. & Dec. 1397 (1979) (deciding that the installation of gantry cranes and the modification of the vessel for its installation is non-dutiable as hull and fittings).

167. H.C. Gibbs v. United States, 41 C.C.P.A. 57, 61 (1953). *See also* Southwestern Shipbuilding Co. v. United States, 13 C.C.P.A. 74 (1925) (providing an extensive list of items considered to be dutiable equipment); States Marine Corp. v. United States, 42

involved in installing "equipment" are dutiable.[168] Even though an installation may be excluded from the definition of equipment under the "permanency" rule, it may, nevertheless, be dutiable as part of a repair.[169] For instance, the duty does not apply to the cost of removal of a vessel's structures or equipment unless removed in conjunction with the vessel's repair.[170] Additionally, because the cost of a foreign-built vessel is not dutiable,[171] such vessel's original equipment falls outside the definition of equipment.[172] In some cases, an item may have the attributes of both "vessel equipment" and "additions to the hull and fittings."[173] In such a case, the decision of whether to apply the duty will depend largely on the detail and accuracy of drawings and invoice descriptions of the work performed.[174] Accordingly, courts will normally defer to Customs' decisions.[175]

Finally, the duty on equipment conflicts with another section of the 1930 Tariff Act which provides that vessels "may retain on board without payment of duty . . . the legitimate equipment of such vessels."[176] Congress intended to treat this section as sepa-

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Cust. Ct. 15 (1958) (deciding that empty grain bags carrying wheat cargo to promote the stability of the vessel were equipment); R.P. Child v. United States, 18 Cust. Ct. 11 (1947) (stating that shifting boards and feeder boxes necessary for the transportation of grain were equipment); Pacific & Atl. S.S. Co. v. United States, 2 Cust. Ct. 761 (1939) (finding du· ıage mats as equipment); Admiral Oriental Line v. United States, 56 Treas. Dec. 234 (holding temporary additional passenger accommodations as equipment). Since the 1971 Act, the dunnage and tank preparation exception allows remission for "equipment" used in connection with a particular voyage to secure, control, or protect cargo, and to prepare tanks to carry liquid cargo. 19 U.S.C. § 1466(d)(3) (1988); *see supra* note 79 and accompanying text. This exception is not applicable if the equipment added results in a permanent repair or alteration. *Id.* § 1466(d)(3).

168. *See R.P. Child*, 18 Cust. Ct. at 11; American Mail Line v. United States, 34 Cust. Ct. 197, *aff'd on rehearing*, 35 Cust. Ct. 142 (1955). However, the cost of placing dunnage mats in the proper location is not considered an "installation" expense since it does not involve attaching something to the vessel. *Id.*

169. *See* C.S.D. 81-75, 15 Cust. B. & Dec. 889, 890 (1981) (holding dutiable the welding of plates to the deck of a vessel to strengthen the deck's partitions).

170. *See* Northern S.S. Co. v. United States, 54 Cust. Ct. 92, 99-100 (1965) (holding that the cost of removing cement ballast from a vessel's lower holds is not dutiable).

171. *See supra* text accompanying note 158.

172. *See* Sea-Land Serv., Inc. v. United States, 683 F. Supp. 1404, 1406-07 (Ct. Int'l Trade 1988).

173. R. STURM, CUSTOMS LAW & ADMINISTRATION § 56.2 (3d ed. 1987) (citing crab processing machinery as an example).

174. *Id.*

175. *See supra* note 132 and accompanying text.

176. Tariff Act of 1930, Pub. L. No. 361, § 446, 46 Stat. 590, 719 (codified as amended at 19 U.S.C. § 1446 (1988)).

rate from the repair duty.[177] Thus, the repair duty only applies to vessel equipment. Any other duties imposed on vessel equipment are exempt.[178]

B. *Provisions for Remission and Exemptions*

1. Remission of Duties

Section 1466(d) of the repair duty statute provides for remission of duties for certain "necessary repairs."[179] These repairs include the stress of weather exception,[180] the domestic materials exception,[181] and the dunnage and tank preparation exception.[182]

To qualify for remission due to "stress of weather or other casualty," the equipment or repairs must be necessary to secure the safety and seaworthiness[183] of the vessel in reaching her port of destination.[184] Additionally, Customs usually allows remissions

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177. *See* H.C. Gibbs v. United States, 41 C.C.P.A. 57, 61 (1953); R.P. Child v. United States, 18 Cust. Ct. 11 (1947).

178. 19 U.S.C. § 1446 (1988).

179. 19 U.S.C. § 1466(d) (1988). An initial issue is whether these exceptions preclude judicial review of final Customs' decisions under § 701 of the APA, as they merely authorize the refund of duties, rather than mandate the return of the duties. 5 U.S.C. § 701 (1988). Section 701 provides in relevant part, that "[t]his chapter applies, according to the provisions thereof, except to the extent that (1) statutes preclude judicial review; or (2) agency action is committed to agency discretion by law." *Id.*

Several early cases held that Customs' decisions on remission for the stress of weather exception were final and that courts did not have jurisdiction to review such decisions. *See* United States v. Cottman Co., 190 F.2d 805 (4th Cir. 1951); Waterman S.S. Co. v. United States, 30 C.C.P.A. 119 (1942); International Navigation Co. v. United States, 148 F. Supp. 448 (Cust. Ct. 1957). However, the Customs Court later overturned these rulings and held that judicial review extends to all decisions that the Secretary of Treasury or his delegates make under the repair statute. Suwannee S.S. Co. v. United States, 354 F. Supp. 1361 (Cust. Ct. 1973). The court stated that judicial review is not precluded unless a persuasive reason exists to believe that Congress intended for there to be no judicial review, or that Congress failed to provide a law to apply. *Id.* at 1363-64 (citing Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 410 (1971)). With respect to the repair duty, the court noted that Congress did not specifically preclude judicial review, or fail to provide a standard to apply. *Id.* at 1365-67. Consequently, Customs' decisions concerning remissions or refunds of the repair duty are judicially reviewable in all circumstances. *See supra* text accompanying note 132 (summarizing the CIT standard of review).

180. 19 U.S.C § 1466(d)(1) (1988); *see supra* note 49 and accompanying text.

181. 19 U.S.C. § 1466(d)(2) (1988); *see supra* note 68 and accompanying text.

182. 19 U.S.C. § 1466(d)(3) (1988); *see supra* notes 78-79 and accompanying text.

183. A seaworthy vessel is properly staffed, constructed, prepared, equipped, and provided for the voyage intended. BLACK'S LAW DICTIONARY 1212 (5th ed. 1979). *See also supra* note 67.

184. *See* Oswego Barge Corp. v. United States, 664 F. Supp. 1546, 1549 (Ct. Int'l Trade 1987) (upholding the duty's application despite a grounding in fog since the required repairs were not necessary to enable the vessel to reach its port of destination).

only for minimal repairs that are necessary for the safety of the vessel.[185]

Courts have reached conflicting decisions on the remission of duties on the basis of "other casualty." Several early decisions held that the "the phrase 'or other casualty' is supplemental to and qualifies the phrase 'stress of weather,' "[186] thereby broadening the erm to include casualties similar to stress of weather.[187] Along these lines, the Customs Court held that a "casualty" could only result from "the violence of the turbulent forces of nature."[188] For example, the Customs Court denied remission when the contamination of boilers with salt water after heavy seas forced the ballasting of empty fresh water tanks with sea water.[189] The court held that the contamination did not result from the "violence of the turbulent forces of nature,"[190] but rather the damage was attributable to the negligence of the chief engineer in failing to flush the fresh water tanks after the voyage.[191]

Vessel casualties under the "turbulent forces of nature" test have included: (1) fires, provided there is no evidence of cause by normal wear and tear;[192] (2) collisions and bottom fouling;[193] and, (3) stranding or grounding.[194] Notably, the foreseeability of the event is irrelevant in determining whether a casualty has occurred.[195] Furthermore, the other conditions of the exception must be satisfied.[196]

In spite of these conditions, the Customs Service has disregarded the force of nature test in several recent cases. In one case, Customs held that casualties include single acts of officer or crewmember negligence which cause damage to vessels, provided no evidence of owner direction or inducement exists.[197] In

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19 U.S.C § 1466(d)(1) (1988). Customs regulations define the "port of destination" as a location within the United States. 19 C.F.R. § 4.14(c)(3)(i) (1990).

185. 19 C.F.R. § 4.14(c)(3)(i) (1990).

186. Dollar S.S. Lines, Inc. v. United States, 5 Cust. Ct. 23, 28-29 (1940).

187. *Id.*

188. *Id.* at 29; *accord* International Navigation Co. v. United States, 148 F. Supp. 448 (Cust. Ct. 1957).

189. Suwannee S.S. Co. v. United States, 435 F. Supp. 389, 390 (Cust. Ct. 1977).

190. *Id.* at 395-96.

191. *Id.*

192. C.S.D. 79-823, 13 Cust. B. & Dec. 1412 (1979).

193. C.S.D. 79-426, 13 Cust. B. & Dec. 1641 (1979).

194. C.S.D. 89-61, 23 Cust. B. & Dec. No. 19, at 14 (1989).

195. C.S.D. 79-426, 13 Cust. B. & Dec. 1641 (1979).

196. *See supra* notes 183-185 and accompanying text.

197. C.S.D. 82-42, 16 Cust. B. & Dec. 746 (1982). *Contra* Suwanee S.S. Co. v. United States, 435 F. Supp. 389 (Cust. Ct. 1977). The negligence in this case resulted from a

another case, Customs ruled that casualties include damages caused by latent defects in the manufacture of parts.[198]

Recently, a dispute developed regarding the definition of "port of destination" when a vessel casualty occurred en route to a European port,[199] forcing the ship to undergo repairs in a nearby foreign port before continuing on to the European port.[200] Customs refused to remit the repair duties because Customs considered the first port the "port of destination," so that the voyage to the repairing port nullified the remission.[201]

Two requirements must be met to qualify for remission for domestic materials.[202] First, the equipment or parts must be manufactured or produced in the United States.[203] Second, U.S. labor or members of the ship's regular crew must be used to install the equipment.[204] These requirements have led to the imposition of the repair duty in several unexpected situations. For instance, where foreign labor installs U.S.-manufactured goods overseas, the duty applies to both the goods and the labor.[205] Also, the duty applies to equipment purchased abroad, transported on a U.S.-registered vessel, and installed on the vessel after its arrival in the United States.[206] Moreover, if the shipowner installs foreign manufactured goods on a vessel of the importing carrier, Customs may charge both an import duty and a repair duty.[207] Nevertheless, under the domestic materials

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transfer of ballast when the ship operator dismantled the bilge suction valve, leading to a flooding of the engine room bilge, which caused the damages. *Id.* at 746-47.

198. C.S.D. 82-120, 16 Cust. B. & Dec. 912 (1982).

199. Customs Ltr. Rul. 109625GV (Aug. 15, 1988).

200. *Id.*

201. *Id.* This decision ignored the fact that the vessel's condition precluded a voyage to the United States for repairs, and that Customs' own regulations define the port of destination as a location in the United States. 19 C.F.R. § 4.14 (c)(3)(i) (1989); *accord* 33 Op. Att'y Gen. 432, 435-37 (1923).

202. 19 U.S.C. § 1466(d)(2) (1988).

203. *Id.*

204. *Id.*

205. C.S.D. 89-61, 23 Cust. B. & Dec. No. 19, at 12 (1989).

206. United States v. Standard Oil Co., 27 C.C.P.A. 334 (1940) (upholding the duty for parts of a diesel engine purchased in Germany). The duty is not assessed, however, if an unrelated carrier imports the foreign goods. C.S.D. 89-61, 23 Cust. B. & Dec. No. 19, at 14.

207. C.S.D. 89-61, 23 Cust. B. & Dec. No. 19, at 12. Besides equipment, the full cost of the installation is dutiable, with the exception of the labor costs attributable to work that the vessel's crew performed. *Id.* Furthermore, foreign-made repair parts or materials remain dutiable even though the owner previously imported the parts, paid the duty, and then exported the parts for installation or placement aboard a vessel. *Id.* *But see infra* notes 253-257 and accompanying text.

exception, if the shipowner uses the ship's crew to install spare parts and other domestic materials when overseas, the duty can be avoided.[208]

2. Exemptions for Certain Vessels and Trades

Section 1466(a) provides that the repair duty only applies to vessels documented under the laws of the United States which engage in "foreign or coasting trade."[209] Because of this limitation, several early courts held that noncargo vessels used for purposes other than foreign or coasting trades were exempt from the duty.[210] Following the addition of the two-year exception in the 1971 Act,[211] the Federal Circuit and the CIT interpreted the new two-year exception, which applied to "special purpose vessels" remaining outside the United States two years or more, as eliminating the general judicial exception for noncargo vessels.[212] In particular, the Federal Circuit and the CIT ruled that the addition of the two-year exception made the repair duty applicable to special purpose vessels,[213] as well as cargo vessels, unless these vessels met the statutory conditions of the two-year exception.[214]

Notably, the Federal Circuit and the CIT followed different lines of reasoning in reaching the decisions. The Federal Circuit

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208. *See* 19 U.S.C. § 1466(d)(2) (1988).

209. *Id.* § 1466(a); *see supra* note 42 and accompanying text. The statutes governing requirements for the documentation of vessels are found at 46 U.S.C. §§ 12101-12122 (1988).

210. *See* United States v. American Whaling Co., 38 C.C.P.A. 164, 165 (1951); United States v. Western Operating Corp., 35 C.C.P.A. 71, 73 (1947). The Customs Court later extended this exception to include vessels involved in oceanographic research. Corpus Co. v. United States, 350 F. Supp. 1397, 1401-02 (Cust. Ct. 1972). The court noted that the Oceanographic Research Vessel Act, Pub. L. No. 89-99, 79 Stat. 424 (1965) (codified at scattered sections of 46 U.S.C. (1988)), intended to treat such vessels as not engaged in trade or commerce. *See* H.R. Rep. No. 599, 89th Cong., 1st Sess., *reprinted in* 1965 U.S. Code Cong. & Admin. News 2383-84.

211. 19 U.S.C. § 1466(e) (1988); *see supra* note 80 and accompanying text.

212. *See* South Corp. v. United States, 690 F.2d 1368, 1373. (Fed. Cir. 1982) (holding that repairs to oceanographic research vessels are dutiable); Elizabeth River Terminals v. United States, 509 F. Supp. 517 (Ct. Int'l Trade 1981) (holding that a barge purchased for use as a crane platform was a vessel within the meaning of the repair duty statute).

213. Special purpose vessels are vessels used primarily for purposes other than transporting passengers or property. *See supra* note 84.

214. *South Corp.*, 690 F.2d at 1373; *Elizabeth River Terminals*, 509 F. Supp at 524. To qualify for the two-year exception, the vessel essentially must remain outside the United States for at least two years and not undertake repairs during the first six months after departure from the United States. 19 U.S.C. § 1466(e); *see supra* notes 80-81 and accompanying text.

disagreed with the earlier decisions holding that section 1466(a) did not apply to noncargo vessels, rather than simply basing its decision on the addition of the two-year exception.[215] The court noted that while the statutory language of section 1466(a) applies to vessels documented to engage in trade, no requirement in the statute mandates that the vessel actually be engaging in trade or that the owner document the vessel for the purpose of engaging in trade.[216] The owners' intended use of the vessel, according to the court, is relevant only with respect to nondocumented vessels.[217] Moreover, the court believed that the enactment of the two-year exception for special purpose vessels reflected Congress' understanding that section 1466(a) applied to noncargo vessels, as well as to cargo vessels.[218]

Meanwhile, the CIT conceded that noncargo vessels fall outside the scope of section 1466(a), but concluded that the section 1466(e) definition of special purpose vessels reintroduced such vessels under the two-year rule.[219] The extension of the two-year exemption for special purpose vessels in the 1984 Act[220] to all vessels within the scope of the repair duty under section 1466(a)[221] makes the distinction between the reasoning of the two courts important. The CIT reasoning indicates that noncargo vessels would again be exempt from the duty because the 1984 Act removed the reference to special purpose vessels in the two-year exception and the exception now only refers to vessels initially included within the scope of section 1466(a).[222] However, the Federal Circuit's reasoning suggests that the statute's initial scope would continue to apply the duty to all non-cargo vessels.[223]

The repair duty applies solely to vessels that the owner has

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215. *South Corp.*, 690 F.2d at 1371-73.

216. *Id.* at 1371.

217. *Id.*

218. *Id.* at 1373; *see* S. Rep. No. 1474, *supra* note 82.

219. Elizabeth River Terminals v. United States, 509 F. Supp. 517, 522 (Ct. Int'l Trade 1981).

220. Trade and Tariff Act of 1984, Pub. L. No. 98-573, § 208, 98 Stat. 2948, 2976; *see supra* notes 100-101 and accompanying text.

221. The scope includes "a vessel documented under the laws of the United States to engage in the foreign or coasting trade, or a vessel intended to be employed in such trade." 19 U.S.C. § 1466(a) (1988).

222. *See Elizabeth River Terminals*, 509 F. Supp. at 522-24.

223. *See South Corp.*, 690 F.2d at 1371-73. While the courts have never clarified the scope of section 1466(a) since the 1984 Act, the reasoning of the Federal Circuit appears correct given the statute's purpose of encouraging the use of domestic shipyards. *See supra* note 126 and accompanying text.

documented under the laws of the United States prior to its arrival at a U.S. port, and only to dutiable equipment and work obtained during the period relating back to the date of U.S. registry.[224] In other words, Customs uses the documentation of the vessel during the period when repairs occurred as the criterion for the duty's applicability.[225] Furthermore, the intended use of the vessel may be decisive. To illustrate, Customs ruled that the repair duty does not apply to a U.S. vessel documented to engage in foreign trade which obtains repairs in a foreign port, and subsequently relinquishes its U.S. documentation and enters the United States under a foreign flag.[226] Customs noted that owners only incur repair duty liability if, upon arrival in a domestic port, the vessel in question was U.S.-documented.[227] In contrast, where an owner temporarily removes a vessel from U.S. documentation prior to or during work in a foreign shipyard, and then the owner redocuments the vessel under the U.S. flag with the intent of engaging in foreign or coastwise trade, the repair duty applies.[228]

The Court of Customs and Patent Appeals interpreted the meaning of "foreign country" within the context of the repair duty statute[229] in *Mount Washington Tanker Co. v. United States*.[230] The court held that dutiable repairs performed by a special foreign repair crew in international waters are performed in a foreign country for purposes of the repair duty statute.[231] Essentially, the court concluded that the legislative purpose of the duty—to protect U.S. shipyards and labor—would be frustrated if such work was not dutiable.[232]

IV. Proposals to Eliminate the Repair Duty

Overall, the repair duty is a small part of Customs' duty collections.[233] Nevertheless, the duty imposes a substantial burden on U.S. shipowners. In fiscal year 1988, Customs collected $14.6

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224. C.S.D. 79-265, 13 Cust. B. & Dec. 1365, 1366 (1979).
225. C.S.D. 83-71, 17 Cust. B. & Dec. 881, 883 (1983).
226. T.D. 75-146(1), 9 Cust. B. & Dec. 307, 308 (1975).
227. *Id.*
228. C.S.D. 90-22, 24 Cust. B. & Dec. No. 12, at 3 (1990).
229. 19 U.S.C. § 1466(a) (1988).
230. Mount Washington Tanker Co. v. United States, 665 F.2d 340 (C.C.P.A. 1981).
231. *Id.* at 344-45.
232. *Id.* at 345.
233. In fiscal year 1988, vessel repair duties amounted to approximately 0.01 percent of the number of import entries and 0.09 percent of the dollar value of import entries. *See* General Accounting Office, Pub. No. RCED-89-152, Customs Service: Adminis-

million in repair duties from U.S. carriers.[234] Furthermore, the amount of repair duty collections has increased significantly over the past twenty years, even when adjusted for inflation, despite the exemptions Congress enacted to lessen the duty's impact.[235]

The increase in duties collected may be attributed to several factors. First, shipowners utilize foreign shipyards because the cost differential between U.S. and foreign shipyards in some cases exceeds the fifty percent cost of the repair duty. Second, in the late 1970s, the U.S. Maritime Administration eliminated U.S. government subsidies that paid for the difference in costs between work performed in domestic shipyards and in foreign shipyards.[236] Third, U.S. carriers built thirty-six diesel engine vessels in foreign shipyards in the 1980s after amendments to the maritime subsidy statutes.[237] Owners of diesel vessels often prefer to do necessary work overseas because foreign shipyards are more familiar with diesel engine repairs.[238] Fourth, during the 1980s, domestic yards enjoyed an abundance of Navy work in new construction and repair contracts[239] and were often unavailable to perform commercial repair work. Finally, if a ship is located abroad when work becomes necessary, the owner will most likely repair the vessel overseas, even if the work does not qualify for an exemption, as transportation and repositioning expenses often outweigh the cost of the duty.

Congress has expressed a policy of maintaining a strong fleet

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TRATION OF TARIFF ON FOREIGN REPAIRS TO UNITED STATES FLAG VESSELS 2 (1989) [hereinafter GAO REPORT].

234. *See* U.S. CUSTOMS SERVICE, CUSTOMS U.S.A. (1989). The economic effect of the duty is compounded because equipment purchased in a foreign country that subsequently lands in the United States is subject to regular import merchandise duty, as well as the duty under section 1466, thereby creating the effect of a double duty. *See* C.S.D. 82-77, 16 Cust. B. & Dec. 817 (1982).

235. *See* GAO REPORT, *supra* note 233, at 3, 8-9. The congressional exemptions generally limit liquidation of duties to approximately 50 percent of entries received. *Id.* at 12.

236. *See* Merchant Marine Act of 1936, ch. 858 § 603(b), 49 Stat. 1985, 2002 (codified in 46 U.S.C. app. § 1173 (1988)); GAO REPORT, *supra* note 233, at 10.

237. *See* Omnibus Budget Reconciliation Act of 1981, § 1610, 95 Stat. 357 (codified at 46 U.S.C. app. § 1185 (1988)). This law amended the Merchant Marine Act of 1936 by adding a new section 615 which allowed existing U.S. carriers, for a one-year period, to acquire foreign-built vessels that would be deemed U.S.-built for the purpose of operating subsidy eligibility. *Id.*

238. GAO REPORT, *supra* note 233, at 10.

239. In 1987, the U.S. Navy spent over $1.5 billion in domestic repair yards, compared with $261 million from all commercial work, both U.S. and foreign flag. SHIPBUILDERS COUNCIL OF AMERICA, SHIP REPAIR REPORT 14 (1987) [hereinafter SCA REPORT].

of U.S.-documented vessels to support the economic and military security of the United States on several occasions.[240] Notwithstanding this stated objective, the size of the U.S. commercial fleet has declined alarmingly over the past two decades.[241] United States ships carry about four percent of U.S. foreign oceanborne commerce; by the year 2000, they may carry less than one percent.[242] Defense planners fear that these numbers may be insufficient to support a strategic sealift during a war or national emergency.[243] Meanwhile, Congress continues to burden shipowners with one of the highest duty rates listed in the Harmonized Tariff Schedules of the United States.[244]

As exemplified by the repair duty, Congress generally has promoted the U.S. maritime industry by linking shipowning and operating support programs to domestic shipyard requirements.[245] Although few dispute the need for a viable national shipyard industry,[246] the decline of the U.S. fleet indicates that the congressional policy has failed. To reverse the decline of the commercial shipping fleet, all links between shipowners and shipyards, beginning with the repair duty, should be eliminated.

The repair duty statute has evolved into a balance of interests

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240. *See supra* note 1 and accompanying text.

241. The number of active U.S.-flag merchant ships declined from 843 in 1970 to 369 at the beginning of 1987. U.S. MARITIME ADMIN., VESSEL INVENTORY REPORT 3 (1988).

242. *See* COMMISSION ON MERCHANT MARINE AND DEFENSE: FIRST REPORT 1 (1987).

243. *Id.* at 3. Recent events relating to Operations Desert Shield and Desert Storm illustrate the defense problems presented by the inadequate U.S. commercial fleet. To support the massive sealift required to move military equipment to the Persian Gulf, the United States had to use more than 40 ships from the Ready Reserve Force (RRF) and 35 ships from foreign-flag operators. R. O'ROURKE, SEALIFT AND OPERATION DESERT SHIELD 15-24 (Cong. Res. Serv., Sept. 17, 1990). Many RRF vessels could not be placed into service according to schedule and other RRF ships suffered major machinery system failures. *Id.* at 19-22. As a result, the full deployment was delayed for more than a month. *Id.* at 2-3.

244. *See* U.S. INT'L TRADE COMM'N, *supra* note 6.

245. Additional laws providing this linkage include the operating-differential subsidy program, 46 U.S.C. app. § 1171 (1988) (conditioning the receipt of operating subsidies on utilizing U.S.-built ships); the capital construction fund program, 46 U.S.C. app. § 1177 (1988) (allowing tax deferred funds to be used only in domestic shipyards); the federal ship mortgage insurance program, 46 U.S.C. app. §§ 1271-1280 (providing government loan guarantees for domestically-built vessels); the cargo preference program, 46 U.S.C. app. § 1241a (reserving a portion of government financed exports to U.S.-built vessels or vessels registered in the United States for a three-year period); and the coastwise trade reservation, 46 U.S.C. app. § 883 (1988) (reserving domestic trades to U.S.-built vessels).

246. *See* COMMISSION ON MERCHANT MARINE AND DEFENSE, *supra* note 242. The Commission's report affirms that existing programs have failed to sustain domestic shipyards at levels necessary to ensure national security. *Id.*

that no longer serve the duty's intended purpose. Several factors indicate that domestic shipyards would not be impacted adversely if the repair duty were diminished. First, Congress never intended for the repair duty to provide complete insulation from foreign competition.[247] Also, factors apart from the repair duty dictate the location of vessel work.[248] Finally, recent investments have significantly increased the repair capability, capacity, productivity, and competitiveness of domestic shipyards.[249]

Repeal of the repair duty would enable U.S.-flag carriers to compete more effectively against foreign carriers. Thereafter, if shipyards require assistance, that support should come from direct government assistance programs, rather than programs that simultaneously burden shipowners and operators.[250] Several means exist for eliminating the duty, including unilateral domestic legislation, bilateral trade agreements, and multilateral trade agreements.

A. *Domestic Legislation*

Congress is not likely to eliminate the repair duty in the foreseeable future, even though the duty burdens shipowners. Congress has not been willing to eliminate the linkage between shipyard and shipowner interests since shipyards are larger employers and represent a much larger constituency than shipowners.[251] Shipyards will oppose any congressional attempt to eliminate the duty unless equal or greater protection is offered in exchange. In the end, shipyard opposition to eliminating the duty will prevail.

Rather than repeal the duty, Congress is more likely to continue enacting exemptions. During the 101st Congress,[252] legislators considered several proposals relating to the duty and again enacted legislation limiting the duty. The legislation enacted

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247. *See, e.g., supra* notes 44-47 and accompanying text (reviewing legislative intent for the early imposition of the duty).

248. *See supra* notes 236-239 and accompanying text.

249. *See generally* U.S. Dep't of Transportation Maritime Admin., 1988 Report on Survey of U.S. Shipbuilding and Ship Repair Facilities (1988) (describing the current economic status of domestic repair facilities).

250. Alternatives for government programs include tax benefits, government-backed grants, low interest government loans, and utilization of domestic shipyards for all government owned ships.

251. *See supra* note 4 and accompanying text. Shipowners encountered this problem when advocating the "free ship" policy in the late 1800s. *See supra* notes 38 & 52 and accompanying text.

252. The 101st Congress runs from 1989 through 1991.

temporarily eliminates the duty for Lighter Aboard Ship (LASH) barges[253] and for certain imported foreign-made repair parts.[254] The LASH barge exception lessens the economic disadvantage that the duty places on LASH operators against container ship operators who do not pay a duty on container repairs.[255] The exception for imported repair parts allows an owner to pay the appropriate import duty rather than pay both an import duty and an equipment duty.[256] These exemptions expire on December 31, 1992, however, as Congress limited the relief to a two-year period.[257]

A bill implementing the recommendations of the Commission on Merchant Marine and Defense contained another congressional proposal.[258] The bill would have provided U.S. shipowners with a credit that could be applied against the repair duty for work performed in domestic yards over a five-year period.[259] However, items subject to the duty would have been broadened to include most foreign work.[260]

Finally, several members of Congress introduced a bill to limit application of the duty solely to equipment and work "purchased or performed in a foreign country that provides any subsidy, direct or indirect, to its ship construction or repair industry."[261] The bill would have expanded the scope of the duty to include nearly all nonemergency foreign work.[262] While this legislation recognized the potential benefits from eliminating the repair duty, its contingency on the absence of ship construction subsidies seems inappropriate given the narrow scope of the provision.

These bills continue the trend begun in 1930 of providing limited exceptions to the more burdensome situations that the repair duty creates. Congress is not likely to change this trend

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253. LASH barges are crewless barges, "lighters," that are loaded onto a LASH ship by onboard crane for the ocean voyage. The Customs Service considers lighters as documented vessels subject to the duty. 19 C.F.R. § 4.14(a)(2)(iv) (1989).

254. Customs and Trade Act of 1990, Pub. L. No. 101-382, § 484E (to be codified at 19 U.S.C. § 1466 (1988)).

255. 135 CONG. REC. S16054-55 (daily ed. Nov. 17, 1989) (statement of Senator Breaux).

256. *Id.*

257. Customs and Trade Act of 1990, Pub. L. No. 101-382, § 484E.

258. H.R. 2463, 101st Cong., 1st Sess. § 801 (1989).

259. *Id.* § 802(1).

260. *Id.*

261. H.R. 5361, 101st Cong., 2d Sess. § 4(a)(1) (1990); S. 2921, 101st Cong., 2d Sess. § 4(a)(1) (1990).

262. *Id.* § 4(a)(2)(E).

until it recognizes that U.S. fleet operations and shipyard programs must be supported separately.

B. *Bilateral Trade Agreements*

Bilateral trade agreements provide a means for eliminating the repair duty with respect to specific countries. Section 1102(c) of the Omnibus Trade and Competitiveness Act of 1988 authorizes the President to negotiate and enter into bilateral trade agreements, before June 1, 1993, that provide for the elimination of any duty imposed by the United States.[263] More importantly, U.S. domestic legislation implements bilateral trade agreements through "fast track" procedures.[264] These procedures set forth a strict time table for the consideration of implementing legislation.[265] These procedures do not allow for amendment; rather, Congress must accept or reject the entire trade agreement.[266] Therefore, if a bilateral trade agreement provides for the elimination of the repair duty, shipyards could not lobby for the specific removal of this provision.

The Administration has adopted this approach to eliminating the repair duty in two bilateral trade agreements. First, the United States-Israel Free Trade Agreement[267] contains a provision removing the duty.[268] Second, the U.S.-Canada Free Trade Agreement[269] phases the duty out over a ten-year period.[270]

The United States can benefit from including a discussion of the repair duty in the context of bilateral trade agreements. Countries with competitive shipyards may open protected markets or eliminate protective tariffs in exchange for abolishing the repair duty. Furthermore, domestic shipyards may benefit from eliminating the duty in trade agreements. For example, Canada maintained heavy duties on foreign ship repairs that generally precluded Canadian vessels from repairing in U.S. yards.[271]

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263. Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, § 1102(c), 102 Stat. 1127 (codified at 19 U.S.C. § 2902(c) (1988)).

264. *See id.* § 1103.

265. *Id.* § 1103(b), (c).

266. *Id.* § 1103(b).

267. United States-Israel Free Trade Agreement Implementation Act of 1985, Pub. L. No. 99-47, § 4(a), 99 Stat. 82.

268. *See id.*; Proclamation No. 5924, 53 Fed. Reg. 51,725 (1988).

269. United States-Canada Free Trade Agreement Act of 1988, Pub. L. No. 100-449, 102 Stat. 1851.

270. *See id.*; Proclamation No. 5923, 53 Fed. Reg. 50,639 (1988).

271. *Canadian Ship Uses U.S. Yard for its Repairs*, J. Commerce, Oct. 4, 1989, at 3B, col. 2.

Since these duties were reduced in the trade agreement, the first Canadian bulk vessel in years entered a U.S. repair yard for hull work in 1989.[272] In sum, negotiating the elimination of the repair duty in bilateral trade agreements would serve the overall interests of the United States.

C. *Multilateral Trade Agreements*

Multilateral trade agreements provide the most preferable means of eliminating the repair duty. Two international regimes currently in place have a framework for negotiating the repair duty: the General Agreement on Tariffs and Trade (GATT)[273] and the Organization for Economic Cooperation and Development (OECD).[274] Negotiating through these forums allows two primary advantages. First, many more countries are bound by multilateral agreements than by bilateral agreements; thus, the duty could be eliminated for work in most countries. Second, these forums facilitate international negotiation of all government aid, both direct and indirect, to shipyards.

Section 1102 of the 1988 Trade Act grants the President negotiating authority in multilateral trade agreements.[275] This section allows the President to enter into trade agreements upon determining that "existing duties or other import restrictions of . . . the United States are unduly burdening and restricting foreign trade [in] the United States."[276] Section 1102 also grants the President authority to modify any existing duty subject to a trade agreement.[277] However, the President may reduce by proclamation existing U.S. duties in excess of five percent *ad valorem* by only fifty percent.[278] Accordingly, if a trade agreement called for the elimination of the fifty percent repair duty, the president could only reduce the duty to twenty-five percent. Duties in excess of five percent *ad valorem* may be eliminated by Congress, however, through legislation implementing the trade agreement with a specific provision repealing the duty.[279] Finally, the 1988

272. *Id.*

273. GATT, *supra* note 92, art. VIII.

274. Convention on the Organization for Economic Cooperation and Development, *opened for signature* Dec. 14, 1960, arts. 6-12, 12 U.S.T. 1728, T.I.A.S. No. 4891, 888 U.N.T.S. 179.

275. Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, § 1102, 102 Stat. 1127.

276. *Id.* § 1102(a)(1).

277. *Id.* § 1102(a)(1)(B)(i).

278. *Id.* § 1102(a)(2)(A).

279. *Id.* § 1102(a)(6).

Trade Act provides legislation implementing multilateral trade agreements with the same "fast track" procedures in Congress that are used with bilateral agreements.[280]

The U.S. shipyard industry has complained that direct and indirect subsidies provided by foreign nations to their shipyards have effectively prevented U.S. shipyards from competing in world markets.[281] In June 1989, the Shipbuilders Council of America (SCA) filed an unfair trade petition pursuant to section 301 of the Trade Act of 1974[282] against the governments of Japan, Norway, South Korea, and West Germany.[283] The SCA alleged that numerous subsidies were provided to shipyards in the four countries.[284] However, the SCA agreed to suspend action on the petition after the U.S. Trade Representative announced the initiation of accelerated multilateral negotiations on shipyard subsidies through the OECD and GATT.[285]

The Revised General Arrangement for the Progressive Removal of Obstacles to Normal Competitive Conditions in the Shipbuilding Industry (RGA) contains the framework for eliminating the repair duty in the OECD.[286] The OECD Council established an ad hoc working group on shipbuilding in 1966 and developed the RGA in the 1970s.[287] The RGA includes a statement of intent to remove the parties' direct and indirect subsidies to the shipbuilding industries.[288] In 1983, the OECD Council

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280. *See id.* § 1103; *supra* notes 264-266 and accompanying text.

281. For a summary of various aids that foreign countries provide to their shipbuilding and repair industries, see SHIPBUILDERS COUNCIL OF AMERICA, SHIPBUILDING AID IN THE WORLD'S LEADING SHIP-PRODUCING NATIONS (1988).

282. Trade Act of 1974, Pub. L. No. 93-618, § 301, 88 Stat. 2364 (codified as amended at 19 U.S.C. § 2411 (1988)). The current version of § 301 provides that foreign shipyard direct and indirect subsidies may unfairly burden and restrict U.S. commerce, and these subsidies therefore arguably fall within practices actionable under section 301. 19 U.S.C. § 2411(d)(2) (1988). For a discussion of this provision, see S. REP. No. 249, 96th Cong., 1st Sess. 237, *reprinted in* 1979 U.S. CODE CONG. & ADMIN. NEWS 381, 632; H.R. 317, 96th Cong., 1st Sess. 175 (1979).

283. Shipbuilders Council of America, Petition for Relief Under Section 301 of the Trade Act of 1974, as amended (June 8, 1989) (available at the office of the U.S. Trade Representative, Washington, D.C.).

284. *Id.* at 32-126.

285. *U.S. Trade Rep Will Move to Eliminate Foreign Shipbuilding Subsidies*, SHIPYARD WEEKLY, July 24, 1989, at 1.

286. *See* Resolution of the Council Concerning a Revision of the General Arrangement for the Progressive Removal of Obstacles to Normal Competitive Conditions in the Shipyard Industry C (82) 194 (final 1983) (available at the U.S. Department of State, Bureau of European Affairs).

287. *Id.*

288. *Id.* app. 3-4.

adopted a resolution inviting the Working Party to continue efforts to facilitate the gradual reduction of subsidies to shipbuilding industries and to continue to review the implementation of the RGA.[289] The RGA has generally been ineffective, however, primarily because it lacks any dispute resolution mechanism or procedure and because it allows governments to withdraw from the agreement upon notice.[290]

In February 1990, the European Community (EC), Japan, Korea, and the United States each proposed new draft agreements entitled "Measures Inconsistent with Normal Competitive Conditions in the Commercial Shipbuilding and Repair Industry."[291] The drafts set forth various measures of prohibited assistance that governments provide or have provided to the commercial shipbuilding and repair industry.[292] Among the measures of prohibited assistance are customs tariffs and other import barriers.[293] However, only the EC draft includes customs tariffs on ship repairs and repair parts;[294] the other drafts, with the exception of the Korean draft which does not address Customs tariffs, limit the restrictions to tariffs on foreign-built ships.[295] Because the United States historically has not imposed duties on the cost of foreign-built vessels,[296] its provision on customs tariffs makes little sense. Therefore, the EC tariff provision must be adopted to eliminate the repair duty in the OECD.[297]

Besides the potential for eliminating the repair duty, the OECD drafts would preclude most of the linkages between ship-

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289. *Id.* at 2.

290. *See id.* at 3-5.

291. MEASURES INCONSISTENT WITH NORMAL COMPETITIVE CONDITIONS IN THE COMMERCIAL SHIPBUILDING AND REPAIR INDUSTRY, COMPARATIVE DRAFTS OF THE UNITED STATES, EC, JAPAN, AND KOREA (Feb. 1990) [hereinafter OECD DRAFT].

292. *Id.* annex I, at 28.

293. *Id.* annex I, para. C, at 32 (U.S., EC, and Japanese drafts).

294. *Id.* (EC draft).

295. *Id.* (U.S. and Japanese drafts).

296. *See supra* note 163.

297. The U.S. draft provides an enforceable dispute resolution mechanism which includes, after certain preliminary consultations, final and binding arbitration. OECD DRAFT, paras. 6-8, at 9-13 (U.S. Draft). If the arbitration tribunal finds that measures of assistance are inconsistent with the agreement, the arbitrators could impose sanctions. *Id.* at 18-19.

Shipowners could protect themselves against such sanctions by inserting an indemnity clause in all shipyard building and repairs contracts. In effect, an indemnity clause would place the penalty for violating the agreement directly upon the shipyard receiving the illegal assistance. However, the dispute procedure should contain a limitations clause so that shipowners become aware of potential sanctions within a reasonable period.

owners and shipyards in the OECD nations.[298] Although U.S. maritime policy based on these linkages has failed, Congress seems unwilling to change unilaterally.[299] Ratification of an OECD agreement would force congressional action. The U.S. maritime industry would benefit greatly if the drafters finalize and implement the draft agreements, including the EC provision on ship repairs.

The Civil Aircraft Agreement offers a GATT model for eliminating the repair duty.[300] Several industrialized GATT participants agreed during the Tokyo Round to eliminate all customs duties and similar charges of any kind on civil aircraft, aircraft parts, and repairs to civil aircraft.[301] The Agreement also eliminates: (1) technical barriers to trade; (2) government-directed procurement, mandatory subcontracts, and inducements; (3) trade restrictions; and, (4) government support, export credits, and civil aircraft marketing.[302] Additionally, the agreement provides for enforcement and dispute settlement through the GATT procedures.[303]

The drafters designed the Civil Aircraft Agreement to mitigate the effect of government support for industries in the trade of aircraft and parts.[304] The agreement's policies include the development of the aeronautical industry, the advancement of fair and equal competitive opportunities for all producers, and the elimination of adverse trade effects resulting from governmental support of civil aircraft development, production, and marketing.[305]

Applying this framework to shipbuilding and ship repair during the current Uruguay Round of GATT, non-competitive conditions in the industry, including the ship repair duty, could be

298. The OECD Draft provisions that would eliminate the other linkages between ship operating and shipbuilding programs include a prohibition of direct official operating support for commercial shipbuilding and repair, OECD Draft, para. B; a ban on preferential tax policies and practices, OECD Draft, para. D; a disallowance of official regulations and practices that limit free competition, free market access, or discriminate in favor of the domestic industry, OECD Draft, para. E; and a prohibition on grants or loans on terms inconsistent with normal commercial terms, OECD Draft, para. G. However, the U.S. draft makes an explicit exception for the Jones Act, 46 U.S.C. app. § 883. OECD Draft, para. E, at 18-19 (U.S. Draft).

299. *See supra* notes 233-246 and accompanying text.

300. Civil Aircraft Agreement, *supra* note 92.

301. *Id.* para. II.

302. *Id.* paras. III-VI.

303. *Id.* para. VIII.

304. S. Rep. No. 249, 96th Cong., 1st Sess. 189, *reprinted in* 1979 U.S. Code Cong. & Admin. News 571, 575.

305. *Id.* at 571.

eliminated. Vessels, vessel parts and components, and vessel repairs could be substituted for the aircraft terms in a proposed agreement on "Trade in Commercial Vessels." The result would be similar to the objectives that the participants are seeking in the OECD negotiations, but would have wider application given the greater number of nations participating in the Uruguay Round.[306]

V. Conclusion

The vessel repair duty has burdened U.S. shipowners and U.S. trade for over 120 years. The time has arrived to eliminate the duty, along with all other provisions of U.S. law linking U.S. shipowners to domestic shipyards. Unless the United States eliminates the duty, along with other linkages, the United States will never have a strong fleet of commercial U.S.-documented vessels. The United States should pursue an end to the repair duty and other linkages through bilateral, OECD, and GATT trade negotiations. In the meantime, U.S. shipowners can minimize the duty's impact by considering the scope of the repair duty when planning foreign shipyard work and by ensuring that Customs properly remits duties for work outside the scope of the repair duty.

Lawrence M. Hadley

306. If trade negotiations take place on an "Agreement of Trade in Commercial Vessels" during the Uruguay Round as proposed in this note, negotiators may wish to include a more enforceable dispute resolution mechanism, rather than the existing GATT procedure.

U.S. ANTIDUMPING AND COUNTERVAILING DUTY LAWS DO NOT APPLY TO VESSELS, AIRCRAFT, AND OTHER INSTRUMENTS OF INTERNATIONAL COMMERCE

- **AD and CVD Laws Apply Only to "Imported Merchandise"**

The antidumping (AD) and countervailing duty (CVD) laws protect the U.S. domestic market. They authorize the imposition of additional duties only on "imported merchandise" found to have been dumped or subsidized and to have caused injury to a domestic industry. AD and CVD duties are not imposed on articles which may be physically present in the U.S. but have not been imported for consumption.

- **Instruments of International Trade Are Not Imported Merchandise**

U.S. and international laws and practice have long recognized the special role played by ocean-going vessels, aircraft, shipping containers and other means of transportation used to convey goods in international trade. These indispensable vehicles for trade are considered "instruments of international commerce" and not "imported merchandise" subject to import procedures or payment of import duties. Therefore, they never have been subject to the duties applicable to imported merchandise.

- **Aircraft and Vessels Operated in International Commerce Are Treated Alike**

Vessels have not been singled out for differential treatment; rather, aircraft are specifically subject to the same procedures as vessels used in international commerce.

- **The U.S. Shipbuilding Industry Already Enjoys Absolute Protection in the Domestic Market**

The U.S. shipbuilding industry differs from the U.S. aircraft industry in that it already enjoys, through the U.S.-build requirement of the Jones Act, absolute protection in the U.S. domestic market against imports of foreign-built vessels.

- **The AD and CVD Laws Should Not Be Extended to Means of International Transportation**

Other trade laws, such as Section 301, address unfair foreign practices in foreign markets. A change in the law to treat instruments of international commerce as "imported merchandise" would substitute a legal fiction for the realities of international commerce, would be inconsistent with longstanding U.S. and international practice, and would violate our international obligations under GATT.

March 1, 1993

MEMORANDUM

Re: Non-Applicability of U.S. Antidumping and Countervailing Duty Laws to Vessels, Aircraft, and Other Instruments of Trade Used or Operated in International Commerce

I. Summary and Overview

The antidumping and countervailing duty laws authorize the imposition of additional duties on imported merchandise which is found, after investigation, to have been dumped or subsidized and to have caused injury to a domestic industry. Under long-standing precedent, ocean-going vessels, aircraft, and other means of transportation used to convey goods in international trade are considered to be instruments of international commerce and not "imported merchandise" subject to import procedures or payment of import duties. Accordingly, such vessels, aircraft, and other instruments of international commerce are not subject to antidumping or countervailing duties that may be imposed on imported merchandise. Vessels have not been singled out for differential treatment; rather, the law applies equally to all instruments of international commerce.

II. The Antidumping and Countervailing Duty Laws Provide Protection to the U.S. Domestic Market from Unfairly Traded Imports

The U.S. antidumping and countervailing duty laws (codified in § 303 and Title VII of the Tariff Act of 1930, as amended, 19 U.S.C. §§ 1303, 1671 et seq.) provide a means for U.S. industries selling in the U.S. domestic market to obtain relief against unfairly traded imports. These import relief laws are intended only to redress the impact of imports on the U.S. market; other trade laws, such as Section 301 of the Trade Act of 1974, as amended, 19 U.S.C. § 2411 et seq. (1988 & Supp. I 1990), are addressed to unfair foreign trading practices that affect U.S. sales in foreign markets.

A. The Import Relief Laws Apply Only to Merchandise Imported for Domestic Consumption

The antidumping and countervailing duty laws apply only to "merchandise" that is imported "for consumption" in the domestic market. Specifically, liability for the additional duties attaches at the same time as liability for normal import duties: when the merchandise is entered, or withdrawn from a bonded Customs warehouse, "for consumption".[1/] *See*, *e.g.*, 19 U.S.C. § 1671b(d)(1) (1988) (preliminary countervailing duty determination applies to "all entries of merchandise subject to the determination which are entered, or withdrawn from warehouse, for consumption on or after the date of publication of the notice of the determination"); 19 U.S.C. § 1673b(d)(1) (1988) (parallel application for preliminary antidumping duty determination). Merchandise that is not entered for consumption, and articles of international commerce that are not imported, are not subject to the import relief laws.

This scope of application of the U.S. import relief laws conforms with the international agreement governing acceptable procedures for imposing antidumping and countervailing duty measures. Article VI of the General Agreement on Tariffs and Trade defines "dumping" as the process by which "products of one country are <u>introduced into the commerce</u> of another country at less than the normal value of the products," and recognizes countervailing duties as permissible countermeasures levied on subsidized products "<u>imported into</u> the territory" of another country. GATT Art. VI, para. 1, 3 (emphasis added).

1/ The formal process of importation of merchandise requires that the "importer of record" (the person on whose behalf the importation is made) "enter" the merchandise by filing the requisite documentation with the U.S. Customs Service. 19 U.S.C. § 1484 (1988). The importer of record must also deposit estimated duties (both normal import duties and any AD or CVD deposits) and pay the duties ultimately assessed when the entry is finally "liquidated." 19 U.S.C. § 1505 (1988).

B. Mere Physical Presence in the U.S. Does Not Require an Entry for Consumption

Merchandise may be physically transported into U.S. territory but not imported "for consumption" in the U.S. market. Thus, merchandise may be imported under bond for storage in a Customs-bonded warehouse, without being entered "for consumption." 19 U.S.C. § 1557(a) (1988). Under this provision, a company may ship merchandise from other countries to a bonded warehouse in Miami as a central distribution point for sales to markets in the Caribbean and Latin America. Similarly, merchandise may be imported under bond for transportation through the U.S. and exportation to a foreign country. 19 U.S.C. § 1553 (1988 & Supp. I 1990). For example, merchandise shipped from Europe for the Canadian market may be transported in bond through the port of New York and carried by truck or rail to Canada. Neither the merchandise stored in a bonded warehouse nor the merchandise transported in bond is sold in the U.S. domestic market. Therefore, in neither case would the merchandise be subject to any U.S. import duties, including antidumping or countervailing duties, even though the merchandise was physically within U.S. territory before being transported abroad.

C. Vessels and Aircraft May Be Imported Merchandise When Used in the Domestic Market

Vessels and aircraft may be treated as imported merchandise when brought into the U.S. for use in the domestic market. As imported merchandise, such vessels and aircraft would be subject to entry as merchandise and payment of normal import duties (if any), and would also be subject to any antidumping or countervailing duty order applying additional duties on imports of that class of merchandise.

In the case of ocean-going vessels, however, the applicability of the import relief laws is purely theoretical: the strict U.S.-build requirement of the Jones Act (46 U.S.C. app. § 883) already provides absolute protection against imports of any foreign-made vessels for use in the domestic commercial

market. U.S. shipyards are thus fully protected against incursion in the domestic market for commercial vessels by foreign shipyards using unfair trading practices. Manufacturers of sailboats and other pleasure craft, on the other hand, do not enjoy such a closed market. Those types of vessels, when imported, could be subject to an antidumping or countervailing duty order, if appropriate.

In the case of aircraft, there have been two instances in which countervailing duty petitions have been filed against imports of commuter airplanes for use by U.S. domestic airlines. In both instances, however, the preliminary, 45-day investigations showed no reasonable indication that the domestic commuter aircraft industry was being injured by the imports, and the investigations were terminated.[2]

III. Vessels in International Service Are Instruments of Commerce, Not Products Imported into a Country

The principle that vessels in international commerce are not imported products is recognized by U.S. courts, U.S. statutes, and international agreements.

A. U.S. Courts Have Consistently Held That Vessels Are Instruments of Commerce and Are Not Imported Articles

Almost a century ago, the Supreme Court ruled definitively that a foreign-built vessel capable of use as a means of waterborne transportation is not a dutiable imported product. The Conqueror, 166 U.S. 110 (1897).

The Court found that since the beginning of the Republic vessels were "treated as sui generis, and subject to an entirely different set of laws and regulations from those applied to imported articles." Id. at 118. Thus Congress had never specifically imposed duties on vessels, although it had regularly

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2/ Certain Commuter Airplanes from France and Italy, Inv. Nos. 701-TA-174, 175 (Preliminary), USITC Pub. 1269 (July 1982); Certain Commuter Airplanes from Brazil, Inv. No. 701-TA-188 (Preliminary), USITC Pub. 1291 (Oct. 1982).

imposed tonnage taxes on vessels. "Vessels certainly have not been treated as dutiable articles, but rather as the vehicles of such articles . . . [and have not been] charged with duties when entering our ports, though every article upon them, that is not part of the vessel or of its equipment or provisions, is subject to duty, unless expressly exempted by law." Id. at 115.[3/]

The Conqueror's ruling and reasoning continue to be applied today. Thus, in Sea-Land Service, Inc. v. United States, 683 F. Supp. 1404, 1406-7 (CIT 1988), the court held that a vessel's original equipment, as well as the vessel itself, was not a dutiable article: "The Supreme Court in The Conqueror, left no doubt that while a vessel may bear items that enter the stream of commerce, the vessel itself is not an article of commerce. The principle, therefore, is clear that, although the vessel is a vehicle of dutiable articles, the vessel itself is not a dutiable article." Id.[4/]

3/ The Court also noted that it would make no sense to apply duties to vessels purchased by Americans when no such duties were paid by foreigners. It was not ownership that was important, but rather whether or not a vessel was imported. The Court found that vessels are "not imported or taken into the country in the ordinary sense in which that term is used with reference to other articles . . . ." Id. at 115.

4/ In United States v. Seagull Marine, 627 F.2d 1083, 1085 (C.C.P.A. 1980), the court followed the reasoning of The Conqueror to hold that inflatable rubber life rafts were not vessels entitled to duty-free treatment, but were dutiable as pneumatic craft. "The subject liferafts are undocumented [as vessels], incapable of use as commercial transportation, and do not serve as vehicles for importation of other merchandise." Id. The Supreme Court had employed similar logic in The Conqueror when it distinguished canoes, small boats, launches, etc.

B. Current U.S. Customs Statutes Explicitly Exclude Vessels From Customs Duties Applicable to Imported Articles

The Headnote to Chapter 89 of the current Harmonized Tariff Schedule of the United States clearly states: "Vessels if in use in international trade or commerce . . . shall be admitted without formal customs consumption entry or the payment of duty." HTSUS (1993), Chapter 89, Additional U.S. Note 1.[5/]

Vessels in international trade are also treated specially under the distinct laws and regulations governing the entry of vessels arriving from a foreign port or place. These provisions specify the entry process for vessels (including the deposit of the vessel's register and submission of the cargo manifest) but do not impose duties (as distinguished from tonnage taxes) on the vessels themselves. 19 U.S.C. §§ 1401, 1434, 1435 (1988); 46 U.S.C. app. § 121 (1988 & Supp. I 1990); 19 C.F.R. Part 4 (1992).

C. The GATT Treats Vessels in International Commerce as Traffic in Commerce and Not Subject to Duties

Article V of the General Agreement on Tariffs and Trade (GATT) requires freedom of transit through the territory of each contracting GATT party. Art. V(2). Among other things, this means that "traffic in transit" from the territory of other contracting parties is exempt from customs duties. Art. V(2), V(3). Vessels are considered "traffic in transit" if the

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5/ A similar provision in General Headnote 5(e) to the former Tariff Schedules of the United States treated vessels as "intangibles" and not as articles subject to the tariff schedules. See United States v. Seagull Marine, 627 F.2d 1083, 1084 (C.C.P.A. 1980).

vessel's passage across a party's territory "is only a portion of a complete journey beginning and terminating beyond the frontier of the contracting party." Art. V(1). Thus, vessels travelling in international commerce are exempt from customs duties under the GATT.[6/]

IV. Instruments of International Commerce are Generally Excluded from Entry and Duty Requirements Applied to Imported Merchandise

U.S. and international practice have long recognized the distinction between merchandise that is imported for use or consumption in the domestic market and the means of transportation used to carry the merchandise. Accordingly, aircraft, vehicles, and containers used in transporting goods or passengers on international routes -- like vessels -- are considered "instruments of international commerce" excluded from the entry process for "merchandise".

A. Aircraft

Aircraft operated on international routes are considered instruments of international commerce and thus are exempt from the entry and duty requirements applied to imported merchandise. From the earliest days of international airline traffic, Congress recognized the substantially similar position

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6/ Although the European Commission has considered "a trade defensive mechanism for shipbuilding," the Commission recognized the complexity of the problem and the possibility that such a measure would possibly not conform with international commitments. Question No. 60 by Mr. Anastassopoulos (H-233/88), debates of the European Parliament No. 2-366/209 (June 15, 1988).

of vessels and aircraft operated in international commerce and specifically authorized the Secretary of the Treasury to apply to aircraft the same entry and duty laws and regulations that apply to vessels.[7/] As discussed above, vessels used in international commerce are governed by distinct rules for entry and are not subject to entry as merchandise and payment of import duties upon arrival in the United States. Accordingly, the Secretary of the Treasury, through Part 122 of the Customs regulations (governing Air Commerce), has provided for distinct entry procedures for aircraft, like vessels, that are operated in international commerce. In particular, a commercial aircraft of foreign origin that is registered in the United States and operated in international commerce can be admitted to the United States and travel from airport to airport in the United States without formal entry or the payment of duty. 19 C.F.R. § 122.52(c)(1) (1992). If, however, the aircraft is withdrawn from use in international commerce, it must be entered as imported merchandise. 19 C.F.R. § 122.52(c)(2) (1992).

B. Vehicles

Vehicles and other instruments of international traffic,

7/ Section 7(c) of the Air Commerce Act of 1926, formerly codified at 49 U.S.C. § 177(c), authorized the Secretary of the Treasury to apply to civil aircraft the laws and regulations regarding the entry and clearance of vessels. Section 7(c) was reenacted without substantive change as § 1109(c) of the Federal Aviation Act of 1958, 49 U.S.C. § 1509(c) (1988). Section 644(a) of the Tariff Act of 1930 further extended the authority of the Secretary of Treasury under § 7(c) to apply "in like manner" any of the provisions of the Tariff Act of 1930. 19 U.S.C. § 1644(a) (1988).

such as containers, are admitted to the United States without formal entry or payment of duty. 19 U.S.C. § 1322(a) (1988).[8/] For instance, U.S.-based trucks, buses, and taxicabs used in international commerce are admitted, upon their return to the United States, without formal entry or the payment of duty. 19 C.F.R. § 123.16(a) (1992). Similarly, foreign-based trucks, buses, and taxi-cabs are admitted without formal entry or payment of duty if the vehicle is used in international commerce for the transportation of merchandise or passengers. 19 C.F.R. § 123.14(a (1992).

C. Containers

Containers and certain other shipping mechanisms (including lift vans, cargo vans, shipping tanks, skids, pallets, caul boards and cores for textile fabrics) are also excluded from the usual entry and duty requirements applicable to imported merchandise. Containers used in shipping merchandise either to or from the United States are considered "instruments of international traffic" and therefore are not subject to formal entry or payment of duty. 19 C.F.R. § 10.41a(a)(1) (1992).

V. Conclusion

Longstanding U.S. and international practice recognize the special role played by the vehicles that transport goods in international commerce. All such vehicles, including trucks, buses, and taxicabs as well as vessels and airplanes, are considered instruments of international commerce when operated in international trade and are exempted from the entry and duty requirements imposed on articles of commerce imported for domestic consumption. Consequently, the antidumping and countervailing duty laws applicable to imported merchandise do not encompass vehicles operated in international trade.

8/ Section 322(a) of the Tariff Act of 1930, as amended, 19 U.S.C. § 1322(a) (1988), provides:

> Vehicles and other instruments of international traffic, of any class specified by the Secretary of the Treasury, shall be excepted from the application of the customs laws to such extent and subject to such terms and conditions as may be prescribed in regulations or instructions of the Secretary of the Treasury.

AMERICAN INSTITUTE OF MERCHANT SHIPPING

Industry Advocate for 25 Years

March 9, 1994

The Honorable Charles E. Grassley
United States Senate
Washington, D. C. 20510

Dear Senator Grassley:

When I testified before the Trade Subcommittee on November 18, 1993, on "U.S. Shipbuilding Industries--Effect of Foreign Subsidies," you asked two questions which are set out below together with my answers.

Question #1:

What benefit is it to the American shipbuilding industry to penalize and harm their customers for making logical and rational business decisions that every other business would make -- that is, buying the lowest priced product available? In this case, it happens to be vessels.

Answer:

It makes no sense whatsoever for the U.S. shipbuilding industry to penalize its potential customers for making a rational and sound business decision to buy its vessels at the best price and delivery date wherever it can be procured in the world.

I am President of the American Institute of Merchant Shipping (AIMS) which is a national trade association representing 23 U.S.-flag carriers which own or operate approximately eleven million deadweight tons of tankers, dry bulk carriers, containerships, and other oceangoing vessels engaged in the domestic and international trades of the United States. AIMS represents a majority of U.S.-flag tanker and liner tonnage.

I am also Chairman of the Coalition Opposed to Foreign Shipyard Subsidy Legislation. The Coalition and I have been fighting the odious Gibbons bill (H.R. 1402) for three years now. We have been, are, and will be, totally opposed to the basic concept of this legislation since its inception three years ago.

The Breaux and Gibbons bills are punitive in nature and generally directed against the vessel owner. Our members construct and repair (30%) their vessels in foreign yards because they can get them for half the price at least and much quicker than if constructed in inefficient U.S. yards. For example, one of my members considered building a 30,000 DWT product carrier in a U.S. yard. They were quoted a price of approximately $60,000,000. This same vessel can be constructed in a foreign yard for approximately $20,000,000. Also, the delivery time in a U.S. yard is normally about one-quarter longer than in a foreign yard. Recently a U.S.-flag liner operator constructed a small containership in a U.S. yard. They were quoted a price of $125,000,000. When the ship was finally completed the cost had escalated to $167,000,000. This same containership could be constructed in a foreign yard for approximately $80,000,000. In addition, delivery was some four months over schedule. This is why we construct and repair (30%) our vessels in foreign yards when legally able to do so.

The U.S. shipbuilders have lived off artificial military construction for the past twelve years and now that this construction has dried up because of budget constraints they want to move into commercial construction which they are not now constituted to do. Somehow they convinced Sam Gibbons that if the Congress enacts the foolish and punitive Gibbons bill, U.S. yards will be competitive. PURE BUNK! If either H.R. 1402 or S. 990 were enacted tomorrow, U.S. building yards would still be non-competitive. That is because over the last twelve years they have not initiated the

required necessaries to make themselves competitive. They are not competitive because they have archaic and stringent work rules, they have not modernized their yards like their foreign yard competitors, and basically they are low productivity operations. They hide behind the fiction that subsidies to foreign yards are the cause of their non-competitiveness. NONSENSE! First, the alleged foreign yard subsidies are greatly overstated by the U.S. shipbuilders. Secondly, their operations are not constituted to compete for commercial building in the global market and they do not seem to want to do anything to improve their yards to make themselves competitive. They prefer refuge under such fictions and crutches as H.R. 1402, S. 990, and commercial cargo preference.

As you know, they managed to get the House to pass their shipbuilding subsidy legislation, H.R. 2056, in the last Congress. However, thankfully, the Senate Finance Committee refused to move it, where it languished for some eight months until the 102nd Congress expired.

Although the agricultural interests belong to our Coalition and attend the meetings, they have not been very active over the past two years. If the bill passes the House again this year, as expected, and should it move out of the Senate Finance Committee, the agricultural interests will be crucial in attempting to defeat this damaging legislation in the Senate.

Question #2:

Will you support putting the Jones Act, cargo preference, capital construction funds, Operating Differential Subsidies, and the new shipbuilding subsidies recently included in our defense bills on the OECD and GATT negotiating tables so that the United States can get serious about fighting unfair foreign subsidies?

Answer:

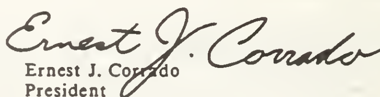
The politics of my organization would not permit me to support including the Jones Act, cargo preference, capital construction funds (CCF) and operating differential subsidies (ODS) in the OECD negotiations in Paris or in GATT negotiations. The real goal of the foreign negotiators is to break the Jones Act. If this were to happen, the U.S.-flag domestic liner and tanker fleets would be destroyed. U.S.-flag vessels simply could not compete with foreign-flag vessels if they were allowed into the Jones Act protected trades. This would be an efficient method of eliminating the U.S.-flag fleet, if anyone wanted to do that.

I would, however, support including the new U.S. shipbuilding subsidies in the OECD negotiations.

While the U.S. shipbuilding industry rails against alleged foreign yard subsidies, it has got some $3 billion from the Congress in the last several years for prepositioned and fast sealift vessel conversion and procurement. In addition, the U.S. shipbuilding industry just wrung from Congress millions of dollars in a direct shipbuilding subsidy program known as Series Transition Payments (STP). In addition, the shipbuilders also got some $50 million for Title XI Mortgage Loan Guarantee Insurance (including coverage for foreign interests constructing in U.S. yards) and some $40 million for MARITECH (a maritime technology program). In addition, for years the U.S. shipbuilders have had the benefit of a 50% ad valorem duty imposed on any repairs by a U.S. operator done in a foreign yard. This is just another subsidy for U.S. builders.

Is it any wonder that the non-U.S. negotiators at the OECD negotiations are reluctant to give up whatever yard subsidies they have. For the life of me, I have not been able to understand how the proponents of H.R. 1402 and S. 990 could expect agreement at OECD in light of the heavy subsidies for U.S. yards set out above.

Sincerely,



Ernest J. Corrado
President

PREPARED STATEMENT OF DUANE D. FITZGERALD

Mr. Chairman and members of the Trade Subcommittee, I am grateful for the opportunity to testify here today on S. 990, representing the 8700 men and women of Bath Iron Works Corporation, Maine's largest employer.

For the last 109 years, our company and its people have contributed to America's defense and economic security. We have produced over 450 ships, including more than 230 naval surface combatants and more than 160 commercial ships. Between 1968 and 1984, BIW built 22 merchant ships—the last of which, FALCON CHAMPION, was the last US merchant ship built under the Construction Differential Subsidy (CDS) program before its termination in 1981.

BIW today is exclusively engaged in the construction and support of the Navy's ARLEIGH BURKE-class AEGIS guided missile destroyer program. Our current backlog of AEGIS destroyers is scheduled for delivery through 1998. We are currently preparing bids for a three-destroyer FY 1994 competitive procurement. Three additional destroyers per year are anticipated through the FY 1995–1999 Five Year Defense plan. Earlier DoD plans, however, contemplated annual procurements of five or more destroyers. The Navy has acknowledged that its two AEGIS shipbuilders, BIW in Maine and Ingalls Shipbuilding in Mississippi, need to gain other shipbuilding work to supplement destroyer production in order to survive. A three-destroyer annual procurement rate is insufficient to maintain production efficiency and program stability, in the absence of other work, at the nation's two experienced, specialized surface combatant building yards.

This year, the number of US Navy ships on order from American yards is at its lowest level in seventeen years. That reality is going to become increasingly severe in the years ahead. Making the transition from our current exclusive dependence on naval shipbuilding to a mix of naval and commercial shipbuilding is imperative if the US shipbuilding industry is to survive. But this is not our challenge alone.

In order to respond to future defense requirements, it is essential that our nation maintain the ability to produce and field the world's most sophisticated naval forces. Making this transition will not be easy. It will not be accomplished overnight. It will involve some costs. The inherent differences between building commercial ships and the world's most technologically advanced surface combatant, the ARLEIGH BURKE-class AEGIS destroyer, are large indeed. We believe, however, that if yards like BIW succeed in supplementing their core naval business through diversification into commercial shipbuilding, the Navy, the taxpayer, and the national economy will benefit in measurable ways.

Several important and encouraging developments this year give us a sense of hope that we can and will be successful in making this critical transition. There appears to be a genuine recognition of the need for more effective partnership between federal policy-makers and our industry. There also appears to be a genuine recognition that important long-term national interests are at stake. This recognition is visible this year in both Executive Branch and Congressional activity, including today's very timely hearing.

On September 29th, President Clinton announced a major multi-agency program to strengthen America's shipyards and improve their ability to compete and win in commercial world markets. The first component of the White House program is a renewed effort to seek the elimination of foreign shipbuilding subsidies through the OECD, and to work with Congress on other actions if those negotiations fail to produce timely and satisfactory remedies. The conference agreement on the FY' 94 Defense Authorization approved key elements of the White House program for commercial shipbuilding: an ARPA-led maritime technology development initiative; and, a joint DoD-DoT loan guarantee program to leverage private investment in commercial ship construction and the modernization of US shipyards for optimal commercial operations.

The House also recently passed H.R. 2151, the Maritime Security and Competitiveness Act, which would, by establishing a temporary series transition payment program, help US shipbuilders to capture their initial commercial ship construction contracts after more than a decade of being effectively shut out of the commercial market.

I mentioned at the outset of my prepared remarks BIW's long legacy of naval combatant and commercial shipbuilding achievement. We are not resting on our laurels or taking any future success for granted.

I was honored to represent BIW and our employees at the White House on October 21st when President Clinton announced the initial group of 41 research projects selected from over 2800 proposals to receive matching funds under the Technology Reinvestment Project. BIW's TRP proposal for a commercial shipbuilding focused development project was submitted in partnership with two US ship companies and

two successful foreign shipbuilding companies—one in Finland, the other in Japan. Additionally, the BIW focused development project on commercial shipbuilding will be overseen by an advisory council including the President of our production employees' national labor union, George Kourpias of the IAM.

Each and every BIW worker has an important role to play in contributing to the success of this transition and towards ensuring the future of our company. The commercial shipbuilding focused development project will include international commercial shipbuilding technology transfer, comprehensive market analysis, development of several efficient commercial ship designs, detailed ship engineering and construction plans, optimized commercial facility modernization plans, and human resources development plans.

How would enactment of S. 990 help make this transition possible? First, let me address the fact that our industry, the Congress, and the Administration, would prefer that this legislation was not necessary. International trade issues are best resolved through negotiation on bilateral or preferably multilateral terms. Unfortunately, our OECD trading partners have yet to tangibly demonstrate that they are committed to eliminating their trade-distorting government shipbuilding subsidy practices.

When he introduced S. 990 on May 19th of this year, Senator Breaux expressed the hope that "this legislation would set the stage for resumption and successful conclusion of multilateral trade negotiations concerning the elimination of shipbuilding subsidies worldwide."

Immense competitive and market share benefits have accrued to foreign shipbuilders since the US terminated its last commercial construction subsidy program in 1981. An immense competitive disadvantage has accrued to the US shipbuilding industry in the commercial market for ships over the last twelve years, and more recently, since 1989 when our government formally initiated negotiations to gain an international agreement to eliminate government shipbuilding subsidy practices.

S. 990 and its counterpart House legislation, H.R. 1402, would provide our government effective mechanisms for identifying those governments which continue to subsidize their shipyards, and for imposing fair but substantial sanctions when other governments fail to commit to eliminating those trade-distorting government subsidy practices. If a listed country does not eliminate its shipbuilding subsidies within 180 days, or sign a trade agreement with the US to do so, then one or more specific sanctions would be imposed against merchant ships owned or otherwise controlled by citizens of the shipyard-subsidizing country.

S. 990 preserves the ability of the United States Trade Representative to conduct multilateral negotiations. It is drafted to allow fair and open administration of its provisions. It establishes reasonable timeframes for action and allows for appropriate discretion by the Secretary of Commerce and the United States Trade Representative in carrying out their duties under the legislation. As currently drafted, S. 990 also attempts to respond to any concerns that imposition of even the scaled-back sanctions of this bill might result in unintended, unfavorable consequences for certain US ports.

Enactment of S. 990 alone will not ensure construction of substantial numbers of commercial ships in American shipyards. Other actions are necessary as well, particularly at the outset of the transition period. However, as Senator Mitchell pointed out in his remarks on the introduction of S. 990 last May, "no US shipyard can compete in a market disrupted by government intervention. The ability of US shipyards to convert to commercial shipbuilding depends upon a free and fair international market for commercial ships."

It is time for comprehensive national action to prevent the loss of this vital industry and the defense capability that it represents. It is, I suggest, in the national long-term economic and security interests that such actions be taken now, not later. Our industry has a defining challenge before it. Much of the responsibility for making the transition a successful one rests on our own performance and degree of commitment. Our success will in large measure depend on how effectively we learn to tap into the world-class capabilities of our workers.

Favorable Senate action on S. 990 is essential. Thank you for affording me the honor to appear before you today.

Response for record from Duane D. Fitzgerald to questions submitted by Senator Grassley at the November 18, 1993 hearing on <u>Foreign Shipyard Subsidies and their Effect on the US Shipbuilding Industry</u>

<u>Note</u> - Mr Fitzgerald did provide an oral answer to Senator Grassley's second question at the hearing November 18, 1993. It was unfortunate that Senator Grassley was unable to remain at the hearing, due to another commitment, to hear the shipyard witnesses respond to his questions.

Question #1, What benefit is it to the American shipbuilding industry to penalize and harm their customers for making logical and rational business decisions that every other business must make - that is, buying the lowest priced product available? In this case, it happens to be vessels.

<u>Answer</u>: The premise of the question is fundamentally misdirected. It appears to interpret our industry's support for S.990 out of context and in a vacuum. American shipbuilders have neither sought to penalize nor harm "our customers" as Senator Grassley's question chooses to suggest. The defense-critical US shipbuilding industry and its workers have been harmed by the commercial shipbuilding subsidy practices of other governments. We have been penalized by our government's inability to convince other governments to end their practices which have substantially distorted competition in the international market for commercial ships for years. The US terminated its only direct commercial shipbuilding subsidy program thirteen years ago.

We have supported since 1989 efforts by US trade negotiators to reach an enforceable, multilateral agreement to discipline government subsidy practices in commercial shipbuilding. It is important to reflect on the fact that the US shipbuilding industry - alone among US industries - enjoys no trade law remedy under US countervailing duty law.

Legislation has never been our preferred option for achieving the desired result. However, after five years of unproductive discussions and the accelerating loss of US shipyard and supplier jobs, the point has been reached where more talk only serves to provide other governments a cynical facade for further delay.

With the dramatically reduced Navy shipbuilding budget, the availability of the defense-critical US shipbuilding industrial base to meet future national security requirements is in grave jeopardy. Our leaders, including Senator Grassley, must seriously weigh the consequences of this reality and decide the proper course for federal policy. Assisting the industry's efforts to re-enter the commercial market would help to preserve elements of this important national capability.

PREPARED STATEMENT OF JEAN C. GODWIN

Mr. Chairman and members of the Subcommittee, my name is Jean Godwin. I am the Vice President of Government Relations for the American Association of Port Authorities (AAPA). Founded in 1912, AAPA represents virtually every U.S. public port agency, as well as the major port agencies in Canada, Central and South America and the Caribbean. My testimony today reflects only the views of the United States delegation of AAPA.

AAPA members are public entities mandated by law to serve public purposes—primarily the facilitation of waterborne commerce and the consequent generation of local and regional economic growth. As public agencies, AAPA members share the public's interest in serving our country's economic, international trade, and national security objectives. Public ports serve as a vital conduit linking the United States to the world marketplace, a critical intersection in the intermodal chain. Ports serve broad hinterlands, connecting farmers, manufacturers and suppliers often thousands of miles inland to international markets thousands of miles from our shores.

International and domestic waterborne trade creates tremendous positive economic impacts at the local, regional and national levels. From the perspective of the port industry, in 1991, the most recent year for which data is available, the U.S. DOT estimates that commercial port activities generated 1.5 million jobs, contributed $70 billion to the gross domestic product, provided personal income of $52 billion, generated federal taxes of $14 billion, state and local taxes of $5.3 billion, and $11 billion in Customs receipts. The importance of ports to local, state and regional economies cannot be overstated. Exports today are increasingly necessary to the health of America's economy, representing one out of six U.S. manufacturing jobs. Additionally, we recognize the significant economic impact created by the shipbuilding and repair industry at ports throughout the United States.

Public ports are keenly interested in the issue of foreign shipbuilding subsidies. In fact, many AAPA members own shipyard facilities which are leased to ship building and repair companies. We support efforts to create a level playing field in international commerce, but also strongly encourage shipyards to enhance their competitiveness through greater efficiencies. However, S. 990, the Shipbuilding Trade Reform Act of 1993, if enacted as currently drafted, would have a devastating impact on U.S. trade and commerce at our nation's ports. *The legislation would result in the imposition of severe, trade-stopping sanctions against up to two-thirds of the world fleet at the same time.*

The ongoing Organization for Economic Cooperation and Development (OECD) multilateral negotiations to eliminate shipbuilding subsidies is the best means of dealing with the problem of foreign shipbuilding subsidies. A legislative "fix" would attempt to benefit a single U.S. industry to the certain detriment of other U.S. industries. It would compound our efforts to open markets by creating a unilateral, sector-specific trade remedy that would increase the cost of using U.S. ports and disrupt international trade.

Specifically, S. 990 would require the Secretary of Commerce to list all countries that subsidize their shipyards and impose severe sanctions against vessels flagged or the controlling interest in which is held by citizens of those countries. The penalties can include limiting 50 percent or more of the vessel's sailing and/or a minimum $500,000 per voyage fee. It also, appropriately, delays the imposition of sanctions for 180 days in order to allow time for countries to enter into trade agreements with the U.S. to eliminate shipbuilding subsidies.

Unfortunately, however, the 180 day deadline is not flexible, minimum penalties are required and not flexible, a country cannot avoid the sanctions except by signing an agreement to immediately eliminate its subsidies, and there is no injury test—a U.S. shipyard does not have to prove that it could compete in the commercial market but for the foreign subsidy. The bill ties the hands of U.S. negotiators and would not make many U.S. shipyards competitive because their problems extend well beyond the existence of foreign subsidies.

The U.S. public port industry is gravely concerned that this legislation would result in *diversion of U.S. origin or destination cargoes,* as well as cruise operations, through non-U.S. ports. All U.S. coastal ranges have been adversely affected by additional taxes on trade, however, they are a particular concern for U.S. seaports bordering Canada. U.S. ports in the North Atlantic, Pacific Northwest, and on the Great Lakes face stiff competition from Canadian ports. Any further increase in the cost of using U.S. ports will result in diversion of cargo through Canadian ports. Cargo originating or destined for points in the U.S. can just as easily move through Canadian ports and over land into or out of this country. The countries that could be listed control nearly 68 percent of the tonnage in the world fleet and nearly 69 percent of the container capacity.

The diversion problem is an extremely serious one for U.S. ports. Although we appreciate the effort to address our concerns about cargo diversion to non-U.S. ports, unfortunately we do not believe the provision currently in the bill is easily enforced. S. 990 would require Customs to stop cargo at the border if it came into a Canadian or Mexican port on a vessel that would be subject to sanctions if it had come into a U.S. port. However, it is our understanding that the documentation accompanying cargo at the border may not include such information.

We strongly support the inclusion of language in the legislation to prevent countries from circumventing the sanctions in the law simply by shipping U.S.-bound cargo through Canadian or Mexican ports. We would be happy to work with the committee to improve on the existing provision in the bill.

Another concern for our member ports with cruise ship operations is the effect the bill will have on the cruise passenger industry. Many cruise ports are situated close to foreign ports which also offer cruise passenger services. If the cruise vessel would be affected by sanctions, the vessel owner could drop the U.S. port of call and embark passengers at the nearby foreign port. For example, cruise passengers that might otherwise use a Florida port would have to fly to a Caribbean port for embarkation. Cruise ports have made significant investments in the physical landside facilities which support cruise calls. As well, passenger cruise business provides significant economic impacts to the local and regional economies, including 450,166 direct and indirect jobs, $6.3 billion in federal, state, and local taxes, and $14.5 billion in wages to U.S. employees according to a recent Price Waterhouse study.

There are changes that could be made to S. 990 that would improve the bill and minimize its negative impacts on U.S. trade and ports. Rather than an automatic listing process, countries should be listed only after an investigation and showing of injury to U.S. commerce. Existing vessels should not be subject to sanctions, only vessels for which construction contracts were entered into after the date of enactment. These types of changes have already been approved by the House Trade Subcommittee to the House version of this bill, H.R. 1402.

In addition, the sanctions that can be imposed on affected vessels should be made more flexible (for example, limit sailings and assess a per voyage fee of up to one million dollars).

The United States is asking other governments to stop subsidizing an industry which our own country has traditionally (and still does) subsidize, without any agreement to eliminate our own subsidies and at a time when the Congress is considering increasing our government subsidies to U.S. shipyards.

Although the construction differential subsidy (which provides payments to carriers to offset the higher cost of using U.S. shipyards) has not been funded since 1981, other subsidies assisting U.S. shipyards still exist. Under Title XI of the Merchant Marine Act of 1936, the U.S. government can guarantee the principal and interest on commercial financing for construction of vessels in U.S. shipyards. Under the Capital Construction Fund Program, U.S. flag carriers can defer taxes on earning deposited into fund accounts for future use in constructing U.S. flag vessels. In addition, U.S. flag operators must pay a 50 percent ad valorem penalty for vessel repair and maintenance work done in foreign shipyards.

In addition to these subsidy programs (which would result in the imposition of penalties under S. 990 if they existed in another country), U.S. shipyards benefit from a number of other U.S. programs and policies. U.S. cabotage laws (the "Jones Act") and cargo preference laws restrict the U.S. coastwise trade and certain percentages of Government impelled cargo to U.S. flag carriers. U.S. fast sealift vessels are constructed exclusively in U.S. shipyards, resulting in billions of dollars of business for U.S. shipyards.

The public port industry has spent nearly $12 billion dollars in the last 40 years to develop transportation facilities. The U.S. Department of Transportation estimates that they will spend an additional $5.5 billion before the year 2000. In 1991, 1.4 billion tons of foreign and domestic waterborne cargo moved through our nation's ports in 1991, including 938 million short tons of import/export cargo worth $461.8 billion. This represents a 25 percent increase compared to 1985 and almost double the volume of 25 years ago.

U.S. ports have made the necessary investment to handle the projected increases in trade in the coming years. It is our hope that the issue of shipbuilding subsidies can be addressed without crippling the competitiveness of U.S. ports, shutting down U.S. vessel owners or increasing the cost of goods to the American consumer.

It remains to be seen to what degree S. 990 would help U.S. shipyards. In an effort not to jeopardize U.S. trade position, the shipyards, maritime industrial sector, and indeed our country needs long-term solutions not short term reactions or signals of dubious efficacy. To that end we encourage the Administration to double its efforts to restart the multilateral negotiations, and ports pledge to cooperate to de-

velop a meaningful and internationally acceptable multilateral compromise. Meanwhile, there needs to be greater communication between ports and shipyards at local and national levels as we strive together to promote our common goal of creating economic activity at U.S. ports.

In summary, the U.S. public port industry opposes S. 990, as drafted, and continues to hope that the problem of foreign shipbuilding subsidies will be resolved in the context of multilateral trade negotiations. We will be happy to work with the Subcommittee in an effort to develop amendments to the bill that will minimize its harmful impact on U.S. trade and U.S. ports. Thank you.

Responses to Questions from Senator Grassley

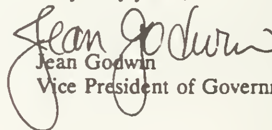
(1) What benefit is it to the American shipbuilding industry to penalize and harm their customers for making logical and rational business decisions that every other business would make - that is, buying the lowest priced product available? In this case, it happens to be vessels.

AAPA does not support the creation of a new, sector-specific trade remedy penalizing ship owners in order to deal with the problem of shipbuilding subsidies. The result would, in effect, harm U.S. shipyards' current and potential customers.

(2) Would you support putting the Jones Act, cargo preference, capital construction funds, Operating Differential Subsidies, and the new shipbuilding subsidies recently included in our defense bills on the OECD and GATT negotiating tables so that the United States can get serious about fighting unfair foreign subsidies?

The United States must recognize that we do not come to the table with "clean hands" on the issue of shipbuilding subsidies, and that we may have to give up some of our own programs. One not listed above is the 50 percent ad valorem tax that U.S. flag operators pay when they have their vessels repaired in a foreign shipyard.

Very truly yours,



Jean Godwin
Vice President of Government Relations

Prepared Statement of Senator Charles E. Grassley

Mr. Chairman, I appreciate this opportunity to address this hearing regarding foreign ship subsidies, and shipbuilding. I will need to leave shortly, so I will incorporate my questions in my opening statement.

I would like each of those testifying today to answer this central question:

> What benefit is it to the American shipbuilding industry to penalize and harm their customers for making logical and rational business decisions that every other business would make, that is, buying the lowest price products available—in this case, vessels?

Retaliating against foreign customers who purchase vessels, can only hurt you. The reason should be obvious to all: American shipbuilders will NEVER recover by selling ONLY to U.S.-flag carriers.

More important to this country, passage of this legislation will destroy hundreds of thousands of jobs put at risk by the inevitable trade war that will result. As we will hear later today, over 2 million jobs will be put at risk.

It is more than just a little ironic that while some continue to rationalize maritime subsidies in the name of assuring the United States enjoys robust international commerce, that it is the maritime industry that pushes legislation that will actually destroy our international trade and the jobs American workers depend upon.

The only acceptable way to resolve the unfair trade subsidies of foreign governments, is to enter into honest negotiation with these governments.

I support multinational maritime negotiations, but while U.S. maritime complains about foreign policies and subsidies, it is the U.S. maritime that insists against truly comprehensive negotiations.

The U.S. maritime industry which refuses to allow its protectionist policies to be put on the GATT table. If anyone read the Journal of Commerce today, they will have seen that America's maritime industry, and its clout with Congress, is at the point of jeopardizing the entire GATT process.

Maritime has negotiated the shipbuilding problem through the Organization for Economic Cooperation and Development (OECD), but it has gone nowhere.

Should that be a surprise? When OECD, and anyone willing to be honest, determined that U.S. protectionist policies such as the Jones Act, cargo preference, and Operating Differential Subsidies, are, in fact, shipbuilding subsidies? In fact, rightly or wrongly, many of our foreign trading partners view Navy sealift construction monies as unfair subsidies that go only to American shipbuilders.

But thanks to the maritime industry, the U.S. negotiators are restrained from putting these protectionist policies on the OECD or GATT tables.

So, my second question, which I would like all those testifying today to answer is this:

> Will you support putting the Jones Act, cargo preference, capital construction funds, ODS, and the new shipbuilding subsidies recently included in our defense bills on the OECD and GATT tables so that the United States can get serious about fighting unfair foreign subsidies?

If the answer is "no," it is an admission that these policies are, indeed, shipbuilding subsidies.

Which leads to the undeniable conclusion that this disastrous foreign shipbuilding legislation should not be given a second thought.

Mr. Chairman, I am also submitting for the record a copy of an OMB report completed in 1982 entitled "U. S. Maritime Programs and Policy."

This report describes how ineffective maritime subsidies have been, including the former Construction Differential Subsidy. This gives us critical perspective relative to today's hearing.

The press may be interested in obtaining copies of this from my office because I was told by the OMB staff who produced this report that the maritime industry exerted its muscle to assure that it was never made public.

So today, may be the first day that the full report is made available.

This report describes a deteriorating maritime industry, which, despite the enormous amounts of subsidies provided by taxpayers, continues to deteriorate.

The report exposed the myth of the national security and economic justifications for all maritime programs, including cargo preference and shipbuilding subsidies.

And it also attacked the credibility of maritime industry and maritime administration studies and claims.

It is well worth your reading, and I will be happy to make it available to anyone who asks.

[Submitted by Senator Charles E. Grassley]

U.S. MARITIME PROGRAMS AND POLICY

AN OMB STAFF REVIEW

MAY 1982

★★★★★★

OFFICE OF MANAGMENT AND BUDGET
SPECIAL STUDIES DIVISION
ECONOMICS AND GOVERNMENT

★★★★★★

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Executive Summary

The purpose of this paper is to review current direct and indirect assistance to the maritime industry and the basic economic and national security rationales traditionally used to justify such assistance.

Since 1936, the Federal Government has spent over $9 billion in direct subsidies for U.S.-flag ship operations and ship construction in U.S. yards to help these industries compete with their foreign counterparts. Fifty-seven percent ($5.2 billion) was spent during the 1970-1980 period under the policies established within the Merchant Marine Act of 1970. In addition, the Federal Government has provided indirect assistance to the maritime industry in the forms of loan guarantees, tax deferments and preference for carrying government impelled cargo at a total cost of approximately $400-500 million a year.

Such assistance is provided to fulfill a number of public policy objectives established in the Merchant Marine Act of 1936, as amended in 1970. This study examines whether or not the public policy objectives set out in the 1970 Act are being met. Further, since many of the public policy objectives are premised on the notion that a U.S.-flag merchant marine industry is required to enhance the national economy and to provide sealift for national security purposes, an in-depth review of the economic and national security rationales traditionally used to justify Federal assistance to the merchant marine industry is also included. The major conclusions are presented below:

Major Conclusions

- The objectives established in the Merchant Marine Act of 1970 of maintaining or increasing the market share for U.S.-flag liner, non-liner and tanker operations have not been achieved. The U.S.-flag share of the non-liner vessel markets continued to decrease through the 1970's. While the U.S. share of liner shipping as a percentage of total liner tons increased over the 70's, the U.S. share of the total value of liner cargo decreased from 28 to 27 percent. Also, during this period the U.S. share of the world liner container fleet tonnage dropped from 45 to 20 percent.

- The objective of stimulating efficiency in the U.S. merchant marine industries has not been achieved. U.S. crew sizes aboard subsidized vessels continue to exceed the crews used by major foreign maritime industries on comparable vessels.

In addition, even after establishing a wage index system in the 1970 Act to bring down crew costs relative to other U.S. workers, U.S. crew wage costs continue to be the highest in the world, often twice as high as the foreign competition. U.S. shipbuilding costs continue to be among the highest in the world, with a cost differential between U.S. and foreign costs exceeding 50 percent for many commercial vessels.

Economic justifications for Federal assistance to the merchant marine industries are weak. Balance of payments, employment and public revenue benefits derived from the subsidy programs are all negligible when viewed in the context of the national economy and contributions to the national economy of non-subsidized industries. While the industry and MARAD have attempted to quantify economic benefits, fundamental flaws of past analyses have not been addressed. Recent analyses fail to distinguish the proportion of the direct and indirect economic benefits that are attributable to the subsidies. In addition, they do not take into account the opportunity costs or potential benefits foregone as a result of resources being utilized in the shipping and shipbuilding industries. When all factors are considered, little evidence is available on economic grounds which would justify the provision of public support to the shipping and shipbuilding industries.

National security arguments provide little justification for provision of public assistance to the merchant marine industries. Navy ship construction, private ship overhaul and repair work are sufficient to maintain the shipbuilding and repair mobilization base determined to be required in case of a national emergency. For the U.S. shipping industry it is somewhat more difficult to translate the National Security findings of this report into specific recommendations regarding public assistance. Most of the major arguments advanced in support of assisting the U.S. merchant marine for national security reasons are seriously flawed. In a short term war, (less than 30 days) the U.S.-flag merchant marine fleet as currently configured is not likely to have an impact on the outcome because vessels do not have the speed nor are they the type of vessels likely to be required. In a longer term conflict, the presence of a U.S.-flag fleet does provide a margin of safety not exactly duplicated in non-U.S. sources of sealift. However, there is no basis for believing that non-U.S. flag sealift resources would not be available for U.S. use in times of war or peace. Much of the world's free world tonnage is controlled by U.S. allies. The

seriousness of the risks the merchant marine may assist the nation to avoid are impossible to measure with accuracy. While there is little evidence that these risks are very great, ultimately, a willingness to assume any national security risk is a question of political judgment.

- There is a need for change in the current structure of Federal assistance to the U.S. maritime industry. It is the recommendation of this study that the Department of Transportation review and redefine national goals and objectives for the U.S. maritime industry. If a direct subsidy program is advisable, approaches to improve the efficacy of the current program must be examined.

Section by Section Summary

Part I - Direct and Indirect Assistance to the Maritime Industry

U.S. public policy on maritime matters was established in the Merchant Marine Act of 1936. The Act reconfirmed the Government's policy of prohibiting foreign vessels in the U.S. domestic trade (cabotage), reserved a substantial portion of government impelled cargo for U.S. bottoms (cargo preference) and established two direct aid programs - operating and construction differential subsidies. In spite of these government programs, the percentage of U.S. foreign commerce carried by the U.S.-flag fleet decreased from 1947 to 1969 as shown below:

PERCENTAGE OF U.S. OCEANBORNE FOREIGN COMMERCE CARRIED IN U.S.-FLAG SHIPS

	1947	1951	1956	1961	1966	1969
By Weight	57.6	39.8	20.7	9.7	6.7	4.8
By Dollar Value	n.a.	n.a.	33.8	25.6	22.5	19.4

n.a. = not available

This decline was attributed to three factors:

1) Higher operating and construction costs of U.S. ships,

2) Federal assistance programs were focused on the liner trade[1] while the growth markets for shipping was in the non-liner bulk trades[2], and

3) The U.S.-flag vessels were shifted by many U.S. owners to "flags of convenience" nations - Panama, Liberia, and Honduras.

1/ Liners serve as common carriers sailing along fixed routes on regular schedules and accepting cargoes from many different shippers for delivery at ports along their routes.

2/ Bulk carriers are not common carriers, the terms of their service to carry bulk material (iron ore, coal, grain, etc.) are fixed by contract between operator and shipper.

In response to the decline, and the inability of the U.S. maritime industry to compete in the international market, in 1970 Congress adopted amendments to the 1936 Act. The objectives of the 1970 amendments were to develop a U.S.-flag fleet to carry a substantial portion of U.S. foreign commerce and to improve productivity and efficiency of the U.S. ship operating and U.S. shipbuilding industries. For the ship building industry the goals established for achieving these objectives included:

1) Domestic construction of 300 ships of standard design by 1980, and

2) Reduction of construction differential subsidies from the authorized level of 50 percent in 1970 to 35 percent by 1976.

For the Operating Differential Subsidy Program, a number of changes were made to control the costs and increase efficiency. As a result of this law, crew sizes for ODS ships are now determined prior to construction of a ship. In addition, a wage index system is used to keep seamen wages in line with the wage rates in the U.S. transportation industry. Finally, non-liner and tanker operations which have been growing faster than the liner trades are now eligible for ODS.

Overall, the U.S. maritime industry entered into the 1970's with a number of direct and indirect aids:

1) Direct aids

Operating Differential Subsidy (ODS) - This program was designed to offset the disparity between the lower cost of operating foreign-flag vessels as compared to the higher cost of the U.S.-flag vessels by making payments directly to ship operators. Eligible cost elements of the program and their proportion of total subsidy include:

- wages - 87 percent.
- maintenance and repairs - 5 percent.
- hull and machinery insurance - 1 per ent.
- protection and indemnity insurance - 6 percent.
- subsistence - 1 percent.

Construction Differential Program (CDS) - This program was to enable U.S. shipyards to construct vessels on parity with foreign competitors. CDS paid the difference in costs up to a maximum of 50 percent.

2) Indirect Aids:

Cargo preference - requirements that 50-100 percent of government impelled cargo be carried in U.S.-flag bottoms.

Tax deferral - the government agreed to defer receipt of taxes on income earned from vessel operations under the condition that funds must be used for reinvestment in U.S. ship construction.

Construction loan and mortgage guarantees - provided shipowners with a method of financing U.S.-flag vessels at more attractive rates and on more reasonable terms than would be provided in the private credit market without government guarantee.

Cabotage laws - reserved all cargo in the domestic trades to U.S.-flag vessels.

Effectiveness of ODS and CDS in maintaining or increasing the U.S. market share

While it was hoped that making ODS and CDS available for non-liner and tanker shipping would stimulate a larger U.S.-flag fleet that could successfully compete with foreign vessels, this objective has not been achieved. The percentage of tanker cargo tonnage carried aboard U.S.-flag ships declined from 1970 through 1979, 4.4 to 3.7 percent. Similarly, the percentage of non-liner bulk cargo carried aboard U.S.-flag vessels declined from 2.2 to 1.25 percent. During this time period U.S. owners continued to register their vessels under "Flags of Convenience" - Panama, Honduras, and Liberia. By 1979, most U.S. flag tankers operated in the protected domestic trades and the U.S.-flag dry bulk fleet consisted of only 20 vessels. Only 3 tankers and 7 bulkers were built using CDS.

In liner operations, the number of U.S.-flag container ships increased over 50 percent and doubled in capacity. However, the U.S. share of world container fleet tonnage dropped from 45 to 20 percent.

Effectiveness of direct subsidy programs in stimulating efficiency

While for ODS the establishment of crew sizes prior to construction has been successful in decreasing the manning levels

of subsidized ships, technological advances in ship design and cargo handling also contributed to the decrease. Moreover, in 1979, U.S. crew sizes continued to exceed those of foreign competitors as shown below:

Ship Type	Country	Crew Size
Containerships:	Japan	25
	Germany	34
	United Kingdom	34
	France	23
	United States	37 - 45
Roll on/Roll off dry bulk cargo vessels (RO/RO)	Norway	18
	United Kingdom	36
	United States	40
Lighter-aboard ship (LASH)	Germany	26
	Norway	30
	United States	32 - 38
Breakbulk:	Japan	34
	Germany	22
	United States	34 - 36

American crew wage costs also continued to be the highest in the world. For example, the monthly crew costs of U.S.-flag ships exceeded Japanese crews by 75 percent and Taiwanese crews aboard Panamanian ships by more than 700 percent.

For CDS, only approximately 80 ships were contracted for through 1979, far short of the 300 goal of the 1970 Act. Increased productivity never materialized and delivery times of U.S. yards sometimes exceeded foreign yards by 2-3 years. By the mid 1970's, the CDS rate stayed in the 48-50 percent range as opposed to the 35 percent goal which had been established for 1976. By the end of the decade, the U.S. Maritime Administration concluded "U.S shipyards, on the average, are using a lower level of technolo[illegible] than foreign shipyards in six of eight categories studied."

Importance of Indirect Aids

Cargo preference and cabotage:

.Laws reserving all cargo in the domestic trades (cabotage) and a percentage of cargo in the foreign trades (cargo preference) for U.S.-flag vessels serve as a primary source of employment for the domestically-built fleet. For example, in 1969 it is estimated

that while preference cargo consisted of only 1-2 percent of total U.S. waterborne foreign commerce, it accounted for 56.8 percent of total tonnage on U.S.-flag ships and 83.1 percent of total tonnage exported on U.S.-flag ships, as shown below:

	U.S. Exports/Imports		Cargo Preference Tonnage			
	Total Tonnage	% U.S.-Flag	% of Tot. Tonnage	% of U.S.-Flag Tot.	% U.S. Flag Exports	% U.S. Flag Imports
1969...	427.9M	4.8	5.4	56.8	83.1	16.9
1979...	823.1M	4.2	1.0-2.0			

It may be concluded that unless major improvements in ship operating costs occur, some mechanism for assuring domestic and foreign cargo for U.S.-flag ships will continue to be required.

Capital Construction Fund (CCF):

The 1970 Act extended tax deferral privileges to non-subsidized operators. Since 1971 over $2 billion has been deposited in CCF accounts and $1.6 billion has been withdrawn for vessel modernization and new construction. This closely approximates the $1.9 billion in government funds expended for the CDS program in the same period, attesting to the importance of the fund for the industry.

Title XI Loan Guarantees:

The loan guarantee program is available for subsidized and unsubsidized construction of vessels to be used in foreign or domestic trades. The 1970 act increased the fund's availability from $1 billion to $3 billion. It has been raised several times since and in 1981, a ceiling of $12 billion was established with $9.75 billion reserved for commercial vessels. The fund currently has over $200 million in assets and an annual income of $42 million. Loan guarantees have been used to construct vessels for the protected domestic trades, inland waterways, and offshore drilling rigs. Of the total $7.2 billion guarantees in force at the end of 1980, $4.2 billion covered tankers, drill rigs, tugs, barges and drill service. The remainder was used to construct ocean-going vessels.

It may be concluded that the Title XI and CCF programs are doing what they were designed to do, but whether it is the government's advantage to continue them depends on government taxing and credit policies as well as other priorities.

Part II - Economic and national security rationales for public assistance

Economic Rationale

The economic arguments used most frequently to justify public assistance to the maritime industries are based on benefits provided by these industries to the nation's balance of payments, employment and public revenue. As demonstrated in the 1975 Brookings Institution study Bread Upon the Waters, the arguments do not stand up to solid analysis, as discussed below.

Assertion: Balance of payments - A strong U.S. maritime industry helps the balance of payments because revenue generated in maritime activities both directly earn and, through import substitution, conserve foreign exchange.

Study Findings:

Neither economic theory nor recent studies demonstrate that assistance to the maritime industries is justified on balance of payments grounds. Estimates of balance of payments benefits are often exaggerated, attributing all maritime export earnings to the subsidy program. Such estimates often do not take into consideration that less than 5% of domestic ship construction is supported by CDS and less than half of U.S. ocean borne cargo is carried aboard subsidized U.S.-flag vessels. In addition, such arguments ignore the possible allocation distortions for the U.S. economy when subsidies postpone comparative advantage adjustments.

Assertions: Employment - Assistance to the maritime industry creates jobs both directly and indirectly through the multiplier effect.

Public revenues - The maritime industry expands the public revenue base, therefore, subsidy programs are not costly because resulting revenues offset a portion of the sums given to the industry.

Study Findings:

The gross direct and indirect employment impact of the subsidy programs affects less than one-tenth of 1 percent of the total

U.S. employed labor force. Employment impact estimates, moreover, make no allowance for the reduction in employment and tax revenues that may occur elsewhere in the economy. For example, a welder on a ship could otherwise be employed working on the framework of a building. In short, there is no evidence the subsidy programs have any positive net employment or tax revenue effect on the nation as a whole. In addition, subsidy programs may have the impact of reducing the magnitude of the nation's employment, if alternative patterns of employment that would exist in the absence of the subsidy program are more efficient.

National Security Rationale

National security arguments are generally used as the principal justification for public assistance to the maritime industry. Both shipping and ship building proved to be valuable assets for the U.S. during World Wars I and II, Korea, and Vietnam. National security was an explicitly stated objective of government assistance to the maritime industry in the 1936 and 1970 Act. During the 70's however, there was a shift in the direction of the subsidy programs toward the objective of providing assistance to facilitate self sufficiency of the industry, on a commercial basis. Given this shift in goals and the rapidly changing perceptions of sealift requirements in the event of a conflict or war, the basic national security justifications were examined to ascertain their current validity. The basic assertions and summary of findings are present below.

Assertion: Military transport security - A strong U.S.-flag merchant marine is required to move large amounts of military supplies in time of war.

Study Findings:

In a short term conflict or in the first 30 days of a longer conflict, the U.S. merchant marine is not likely to have much impact on the outcome. The primary constraints limiting use of the fleet would be the speed of the vessels and the inability of many commercial vessels to carry out-size military equipment. As a result of the limited utility of the commercial fleet for quick supply, the Department of Defense is currently acquiring sealift assets to supplement U.S. commercial ships.

Since in a long term conflict there are numerous uncertainties, it is not possible to estimate exact needs for military shipments with complete accuracy. The U.S. merchant marine, while an important source of sealift in a long war, should be viewed as only one of a number of available resources. Government owned

reserve ships and other sources of sealift such as the effective U.S.-controlled fleet and the fleets of other nations should be viewed as important providers of sealift in time of war. Agreements and tradition argue strongly that the controlled fleet--U.S. citizen-owned vessels registered under the flags of Panama, Liberia, and Honduras--would be available when needed. Similarly, the nations which own and operate most free world shipping are our allies. This fact strongly strengthens the likelihood that this source of sealift will also be available in times of war.

The utility of the U.S. merchant marine fleet should not be over emphasized, since even in a long war a portion of the fleet is not well suited for military purposes. As noted above, public assistance has not been focused primarily on increasing the usefulness of the merchant marine for military purposes. Rather, the thrust has been on commercial viability. Those factors which improve the utility of certain types of ships for commercial purposes often limit their suitability for transporting military supplies.

Assertion: Economic transport security - A strong U.S. merchant marine is required to ensure U.S. access to strategic minerals in times of peace and in times of war to reduce the risk of an interruption in service that could seriously damage the U.S. economy.

Study Findings:

There is no evidence that relying on foreign shipping poses a significant risk to the U.S. in times of peace or war. As noted above, the countries with the largest maritime fleets are U.S. allies. No single country except Liberia controls more than 10% of the total free world tonnage and 23% of the total tonnage of Liberian-flag ships is U.S. owned. In addition, the international merchant shipping industry has historically responded to economic incentives and there is little support for the belief that political interests would overshadow these incentives in the future.

Assertion: Shipbuilding security - A strong national commercial shipbuilding program is required to maintain industrial capacity in the event that it may be necessary to repair and construct Navy ships and commercial sealift ships in an emergency.

Study Findings:

A MARAD/Navy study has estimated the number of shipyards and level of employment required for mobilibization purposes in time of war. As a result of a recent decline in private commercial ship construction, the U.S. Maritime Administration projects that national shipyard utilization will decline below the desired level until 1983.

However, the projected Navy buildup, overhaul and repair work, and alternative non-ship construction are anticipated to cause an employment recovery in the yards by mid-1983 which will lead by the latter part of the eighties to the level estimated to be required for mobilization purposes. Subsidy programs currently account for only 4% of the production employment in yards required for mobilization. Based on MARAD data, elimination of commercial subsidies is estimated to result in approximately one quarter delay in the recovery.

Part III - New Directions

In light of the findings of this study, two broad future policy options for direct assistance to the industry are reviewed. They include terminating direct assistance or revising national goals and objectives and restructuring the direct assistance programs accordingly. The study recommends that the Department of Transportation review and redefine national goals and objectives of the U.S. maritime industry and if a direct subsidy program continues to be required, thoroughly examine alternatives to enhance the efficacy of the program.

PART - I

Direct and Indirect Government Assistance to the Maritime Industry

I. INTRODUCTION

The U.S. Government assists the maritime industry in order to provide competitive parity for the U.S. fleet in the international market. While the Government's maritime policies encompass both domestic and foreign commerce, this report focuses on the U.S.-flag participation in the U.S.-foreign commerce.

Discussed are the direct and indirect forms of U.S. Government assistance to the maritime industry, their legislative bases and objectives. The purpose is to assess whether or not objectives set out in the Merchant Marine Act of 1970 are being met. The development of the U.S.-flag fleet between 1936 and 1970 and changes occurring in the worldwide and domestic shipping environment of the 1970's are addressed as these changes have implications for continued Government assistance to this industry.

Information was obtained from reports of the Maritime Administration, the General Accounting Office, Congressional committees, maritime membership organizations as well as books and articles published on the subject.

II. BACKGROUND

A. The Legislative Base

The Merchant Marine Act of 1936 continues to be viewed as the definitive modern day statement of basic U.S. public policy on maritime matters. It declares that:

> it is necessary for the national defense and development of its foreign and domestic commerce that the United States shall have a merchant marine (a) sufficient to carry its domestic water-borne commerce and a substantial portion of the water-borne export and import foreign commerce at all times, (b) capable of serving as a naval and military auxiliary in time of war or national emergency, (c) owned and operated under the United States flag by citizens of the United States insofar as may be practicable, and (d) composed of the best equipped, safest, and most suitable types of vessels, constructed in the United States and manned with a trained and efficient citizen personnel. It is hereby declared to be the policy of the United States to foster the development and encourage the maintenance of such a merchant marine.

The major provisions of the 1936 act reconfirmed a Government policy of prohibiting foreign-flag or foreign-built vessels from operating in the U.S. domestic trades (cabotage), restated Congress' intent that a substantial portion of government-impelled cargo be shipped on U.S. bottoms (cargo preference) and established two forms of direct financial assistance to the maritime industry: operating differential subsidies and construction differential subsidies.

B. Development of the Fleet

It is difficult to assess the effect of the policies involved in the 1936 Act on the development of the U.S. merchant marine from 1936 to the late 1960's as the more important influences were the buildup and disposal of wartime fleets, technology changes, and geopolitical events.

In 1939 the U.S. fleet was second only to the United Kingdom in carrying capacity and number of oceangoing vessels. During World War II, the U.S. merchant fleet suffered great losses. However, a major shipbuilding effort between 1941 and 1945 resulted in the expansion of the U.S. fleet to the point that by 1946, the U.S. fleet had quadrupled in size and contained one-half of the world's tonnage.

The unusual shipping demands associated with World War II resulted in excess peacetime capacity which the U.S. resolved by selling to foreign nationals and private U.S. citizens close to 2,000 government-owned vessels. By 1948, the number of ships in the U.S. fleet had decreased to 18 percent of the total world fleet and the U.S. ship capacity had decreased to 36 percent of the world tonnage.

From 1948 to 1970, purchase of vessels constructed for use during war, rather than new construction (with or without subsidy) was the method by which the U.S. privately-owned merchant fleet was expanded. Despite the periodic boosts provided the industry by events of the 1950s and 1960s--the Korean War, the closing of the Suez Canal, the Vietnam War, an increasing domestic demand for petroleum, and a strengthening of the cargo preference laws-- the percentage of U.S. foreign oceanborne commerce (imports and exports) carried by the U.S. fleet decreased.

PERCENTAGE OF U.S. OCEANBORNE FOREIGN COMMERCE CARRIED IN U.S. FLAG SHIPS

	1947	1951	1956	1961	1966	1969
By Weight	57.6	39.8	20.7	9.7	6.7	4.8
By Dollar Value	N/A	N/A	33.8	25.6	22.5	19.4

N/A = not available

Because the liner segment of the U.S. fleet led in the adoption of containerization (use of standard size cargo boxes suitable for intermodal transport), it continued to capture a respectable percentage of U.S. oceanborne commerce in the 1960's, from a high of 28.2 percent in 1964 to a low of 21.3 percent in 1969. The nonliner and tanker segments did not fare as well, despite the postwar economic growth requiring vast amounts of raw materials suitable for transport in bulk carrying vessels. During this same period, nonliner (liquid and dry bulk carriers) vessels went from a high of 7.7 percent of U.S. bulk cargo carried in U.S. bottoms in 1960 to 2.1 percent in 1969. A similar decline was evident in the U.S. tanker fleet which carried 6.9 percent of U.S. tonnage in 1960, but only 3.6 percent in 1969. (See Table 1.)

Many factors contributed to the U.S.-flag loss of market share in the 60's:

- operating and construction costs of American ships continued to be higher than those of other major maritime nations, whereas the productivity of American ships remained about the same.
- the ODS and CDS programs focused on liner trade while the growth markets were in bulk trades.
- U.S.-owned ships shifted to registration under "flags-of-convenience" nations-Panama, Liberia, and Honduras.

C. U.S. Fleet Status - 1970

In 1970, U.S. oceanborne foreign trade (import and export of commercial cargo) totalled 473.2 million tons. The U.S.-flag share (that portion carried on ships documented and built in the U.S., manned by U.S.-citizen crews and owned by U.S. citizens) was 25.2 million tons or 5.3 percent, as compared to almost 10 percent in 1961, and an impressive 40 percent in 1951. By general type of cargo, it is segmented as follows:

U.S. OCEANBORNE FOREIGN TRADE/COMMERCIAL CARGO CARRIED - 1970
Tonnage (Millions)

Liner Total Tons	50.4	Non-Liner Total Tons	240.7
Liner U.S.-Flag Tons	11.8	Non-Liner U.S.-Flag Tons	5.4
Liner U.S. Percent	23.5	Non-Liner U.S. Percent	2.2
Tanker Total Tons	182.1	Total Tons	473.2
Tanker U.S.-Flag Tons	8.0	U.S.-Flag Tons	25.2
Tanker U.S. Percent	4.4	U.S. Percent of Total	5.3

The composition and capacity of the U.S. merchant fleet in 1970 is shown below:

---(December 31, 1969)---

Type of service	Number of vessels	Total capacity (DWT)
Non-subsidized U.S. vessels in		
Foreign trade		
General cargo	254	2,914,400
Bulk cargo	27	567,200
Tanker cargo	42	1,276,600
Total	323	4,758,200
Domestic trade		
General cargo	62	681,100
Bulk cargo	11	206,100
Tanker cargo	220	5,048,400
Total	293	5,935,600
Total active foreign and domestic	616	10,693,800
Temporarily inactive or laid-up status		
General cargo/bulk	64	720,700
Tankers	12	222,300
Total inactive or laid-up vessels	76	951,000
Total non-subsidized U.S. vessels	692	11,644,800
Subsidized U.S. vessels in		
Foreign trade		
General cargo	256	3,182,400
Bulk cargo	---	---
Tanker cargo	---	---
Total subsidized U.S. vessels	256	3 182,400
Total U.S.-flag fleet	948	14,827,200

Source: U.S. Department of Commerce, Maritime Administration

D. Redevelopment of U.S. Policies - the 1970 Act

The inability of the U.S. maritime industry to keep pace with the competition in the international market place led to concern for "revitalizing the merchant marine." The Congress responded in 1970 with new legislation consisting of a series of amendments to the Merchant Marine Act of 1936. The Merchant Marine Act of 1970 was basically an update of the 1936 Act; the major philosophical changes are found in the inclusion of domestic and nonliner (bulk and tanker) trades in the scope of maritime policy and the incorporation of objectives to encourage efficiency in shipbuilding and ship operating.

Objectives of the Act were to:

1) develop a balanced U.S. merchant marine capable of carrying a substantial portion of U.S. foreign commerce and providing support in times of emergency, and

2) improve the productivity and competitiveness of the U.S. ship operating and ship building industries.

There was an unsuccessful attempt during consideration of the 1970 Act to separate the elements of building and operating, but the Act continued the link between shipbuilding and ship operating. That is, for an operator to be able to receive the operating differential subsidy (ODS is limited to the foreign commerce), carry preferred cargo or operate in the domestic trades, vessels had to be constructed in the U.S.

The Act also established a goal of constructing 300 ships by 1980 and in an attempt to improve efficiency, established a goal of reducing the construction differential subsidy payment from the authorized level of 50 percent to 35 percent by 1976.

The 1970 Act changed promotion policies to make CDS and ODS available to nonliners as well as liners. Such a change was consistent with the recognition of the increasing importance of the bulk and tanker foreign trades to the U.S. economy and the desire to promote the domestic trade. It also increased the amount of funds available under Title XI to guarantee the repayment of principle and interest on vessels constructed in U.S. yards. The Capital Construction Fund (CCF), previously available to ODS recipients only, was created and opened to U.S.-flag vessel owners/operators in all trades. Using a CCF, owners and operators can defer taxes on income from vessel operations, the gain from the sale of vessels, and on income earned on the investment of deposits in the CCF in return for agreeing to use funds withdrawn for new construction in the U.S.

Other changes were made in an attempt to control costs and increase efficiencies of ODS recipients. For example, the size of the crew which would be subsidized was required to be established prior to construction. This lessened the disagreements between the Government (the Maritime Administration) and contracting owners/operators and assisted operators in union negotiations.

Secondly, a wage indexing system was created. Prior to the 1970 Act, the Government subsidy paid the difference between U.S. seamen's wages and foreign seamen's wages without regard to the reasonableness of U.S. labor costs or the reasonableness of the size of U.S. crews. Under the new system, the Department of Labor developed a wage index, concentrating on the transportation industry. If seamen's wages were less than 90 percent of the index, the operator kept the difference. If they exceeded 110 percent of the index, the operator paid the difference.

III. PROMOTIONAL PROGRAMS

Before assessing the degree to which the objectives of the 1970 Act have been fulfilled, it is worthwhile to examine the benefits it provided to the maritime industry in greater detail.

A. Indirect aids:

- Cargo preference laws benefit subsidized and unsubsidized foreign trade operators by requiring that 50-100 percent of government-impelled cargo be carried on U.S. bottoms. Although some portion of the liner trade relies heavily on preferred cargo, the unsubsidized non-liner and tanker trades are most dependent on these laws for cargo.

- Tax deferral privileges, through the use of Capital Construction Funds, are available to owners and operators in all trades, foreign and domestic, subsidized and unsubsidized.

- The construction loan and mortgage guarantee program is available to any U.S. citizen ship owner or operator. Ships constructed with a Title XI guarantee must remain documented under the laws of the U.S.

- The cabotage laws reserve all cargo carriage in the domestic trades--coastal, intercoastal, and noncontinguous, inland waterways, and Great Lakes-- to U.S.-flag vessels. (Further discussion of cabotage will be limited to contrasts between U.S.-flag participation in the domestic and U.S. foreign trade.)

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B. Direct aids:

- The operating differential subsidy (ODS) is intended to enable US.-flag operators (of vessels built and documented in the U.S. and manned by U.S. citizens) to provide competitive service in essential foreign trades. Originally established under Title VI of the Merchant Marine Act of 1936, it is based on the principle of parity. ODS is paid to offset the disparity between the lower cost of operating foreign-flag vessels as compared to the higher cost of U.S.-flag vessels.

  ODS is paid under a contract entered into by the operator and the Government which cannot exceed 20 years in length. The industry maintains that a long-term contract is necessary to provide a degree of stability to an operator in an industry which has been characterized as "feast or famine." In 1980, there were 7 liner operators and 15 bulk operators holding long-term ODS contracts. These operators and the numbers and types of vessels operated with subsidy are shown in Table 2. Each contract sets forth the obligations of the operator as to the minimum and maximum number of sailings required on designated essential trade routes.

  A recent GAO report contains the following description of the cost elements covered by the ODS program:

  Wages--This subsidy covers the difference in wage costs paid by U.S. operators and wage costs to operate the same vessel under a foreign flag. The wage subsidy accounts for approximately 87 percent of total ODS.

  Maintenance and repairs--This subsidy covers the difference between the costs of obtaining maintenance and repairs in the U.S. and the costs of obtaining them in a foreign country. This subsidy has averaged about 5 percent of ODS.

  Hull and machinery insurance--This subsidy covers the difference in net premium costs of insuring subsidized vessels and the composite premium costs of foreign competitive vessels. This subsidy amonts to less than 1 percent of ODS.

  Protection and indemnity insurance--This subsidy covers the difference in the fair and reasonable net premium costs incurred by U.S. operators and their foreign flag competitors. This subsidy amounts to about 6 percent of ODS.

Subsistence--This subsidy covers the increased costs incurred by U.S. passenger vessel operators over costs incurred to operate the vessel in a foreign-flag service. While there are no longer any U.S.-flag passenger/cargo vessels in foreign service, there are four combination passenger/cargo vessels eligible for subsistence subsidy. This subsidy amounts to less than 1 percent of ODS.

The Soviet Grain program accounted for about 5 percent of total ODS outlays betwen 1973 and 1980. The Soviet grain subsidy program covers stores, supplies, and expendable equipment; fuel; other miscellaneous vessel expenses; vessel depreciation; and certain interest expense.

- Construction differential subsidy (CDS) is provided to build vessels to be used in the foreign commerce of the United States. CDS represents the difference in costs between building a ship in a foreign shipyard and in a U.S. shipyard. The purpose of the CDS program is to enable U.S. shipyards to construct vessels in the U.S. on a parity with foreign competitors.

Applicants for CDS must be U.S. citizens. Vessels built with the aid of CDS must be manned by U.S. citizen crews, and must remain documented under the laws of the U.S. for not less than 25 years (except with respect to tankers and other liquid bulk carriers, which must remain U.S.-documented for not less than 20 years). The current statutory ceiling on CDS rates is 50 percent of the cost of construction or reconstruction of a vessel, excluding the cost of national defense features.

Prior to the enactment of the Merchant Marine Act of 1970, contracting for construction was based on the competitive bid process. The 1970 Act permitted a shipyard and a purchaser to negotiate the price of a ship in the hopes that the yards could develop and market a standardized design and achieve economies of scale.

No construction subsidies are paid for vessels operating exclusively in the domestic trade. However, the Act provides for a temporary transfer of a CDS vessel to the domestic trade for up to six months a year. If permission is granted by the Maritime Administration for the domestic operation of the vessel, the owner is required to repay a proportional amount of the CDS.

IV. ASSESSMENT OF ODS AND CDS IN MEETING OBJECTIVES OF THE 1970 ACT

A. Effectiveness in Maintaining or Increasing Market Share

1. Non-liner and Tanker Operations:

The 1970 act opened ODS and CDS to non-liner and tanker shipping in the U.S. foreign commerce. It was hoped that U.S. building of bulkers would be stimulated and that a larger U.S.-flag bulk carrying fleet would be able to successfully compete with foreign bulkers for the cargo that comprises most of the tonnage in the U.S. foreign trades. These objectives have not been achieved.

From 1970 to 1979, total cargo tonnage in the U.S.-foreign commerce grew from 473.2 million to 823.1 million. Liner tonnage increased somewhat overall from 50.4 million to 57 million but the major growth was in the non-liner and tanker tonnage, with the most dramatic increases occurring in tanker tonnage. As shown in Table 3, tanker cargo tonnage in the U.S. foreign commerce more than doubled, from 182.1 million to 423.4 million, but the percentage carried on U.S.-flag ships declined from 4.4 to 3.7. Similarly, the nonliner share which was only 2.2 percent in 1970 declined even further to about 1.25 percent by the end of the decade.

By 1979, the number of U.S.-flag tankers approached 300, but approximately 14 percent were inactive and fully two thirds of the fleet operated in the protected domestic trades. The dry bulk fleet consisted of less than 20 vessels with approximately 75 percent of those 25-30 years of age.

Despite the 1970 Act, no major subsidy program was developed for the construction or operation of bulkers. Between 1975 and 1980, only three tankers and seven other non-liner type vessels were contracted for using CDS, even though the carryover in unobligated CDS funds averaged $200 million a year during that period. As a percentage of the total subsidized (ODS) fleet, tankers and dry bulkers increased from 5 percent in 1975 to 13 percent in 1979; however, the actual number of subsidized non-liners and dry bulkers increased only from 9 to 21 over those years.

Not only has the U.S.-flag share of the non-liner vessels' market continued to decrease, but the shift of U.S.-owned, foreign-flag non-liners to the U.S.-flag which had been anticipated when the 1970 Act was passed has not been effected. More than 12 times the U.S.-flag dry bulk tonnage and more than 7 times the tanker tonnage is owned by U.S. citizens operating under foreign flags.

2. Liner Operations:

The decade of the 70's saw major technological change worldwide that affected the U.S. liner fleet. Containerization--use of standard size boxes suitable for intermodal transport--came into its own and spurred the replacement of older and smaller general cargo ships with new, larger and more efficient container vessels. The capital investment in these vessels more than tripled between 1970 and 1979. At the same time, crew sizes decreased (despite the increase in capacity) due to design improvements and more efficient cargo handling by dockside equipment.

While U.S.-flag container ships increased from 64 in 1970 to 97 in 1978 and doubled in capacity, the worldwide fleet more than tripled (from 167 to 531). Concomitantly, the U.S. share of world container fleet tonnage dropped from 45 percent to 20 percent.

While the U.S.-flag liner fleet has been able to maintain its share of U.S. foreign commerce, developing nations and the USSR have taken steps to assure their penetration of the liner trades. e.g., bilateral cargo-sharing agreements and pooling agreements.

B. Effectiveness in Stimulating Efficiency

1. ODS Costs:

Other changes in the 1970 Act were made to control costs and increase efficiencies of operators. Establishing crew size prior to construction has, in conjunction with technological advances, contributed to a decrease in the size of U.S.-flag ship crews over the last ten years; however, U.S. crew sizes still exceed those used by other major maritime nations on comparable vessels and, as a result, have contributed to higher ODS costs. The following listing of crew size used on certain ship types by selected maritime nations was recently cited by Congressman Paul McCloskey in support of his amendment to restrict subsidized manning levels to no more than 25 percent above the minimum manning level established for the vessel by the U.S. Coast Guard:

Ship Type	Country	Crew Size
Containerships:	Japan	25
	Germany	34
	United Kingdom	34
	France	23
	United States	37-45
RO/RO:	Norway	18
	United Kingdom	36
	United States	40

LASH:	Germany	26
	Norway	30
	United States	32-38
Breakbulk:	Japan	34
	Germany	22
	United States	34-36

In recent literature, the differences are projected as even greater:
Liberian freighter, 15.-17.
Greek bulk (250,000), 16.
Japanese tanker, 18-20.
Swedish RO/RO, 16-20.

With regard to wages, a recent unpublished GAO report of the relative increase in subsidized seamen wages before and after 1970 concluded that the wage indexing system created by the 1970 Act has been effective in keeping subsidized U.S. seamen wage increases in line with those of other U.S. workers. However, the annual increase has still averaged 9.4 percent and American crew costs are the highest in the world.

Another factor driving up the ODS costs has been the change in foreign competition. Low wage operators from countries with lower standards of living are carrying more of the trade and increasing the differential. Other factors are the use of mixed crews on foreign-flag ships (some low wage cost non-nationals with traditionally high wage cost nationals) and the servicing of U.S. trade by relatively low-cost state-controlled carriers, e.g. Soviets, Polish, Yugoslavs.

Country	Monthly Crew Costs		
	Master	2nd Engineer	Able Seamen
United States	$17,387	$8,212	$3,301
Japan	9,705	4,820	3,643
West Germany	7,401	4,174	2,200
Sweden	8,695	4,813	2,605
Denmark	5,945	2,899	2,428
Korea	2,800	905	644
Taiwan Chinese (Panama Flag)	2,505	1,295	770
Hong Kong Chinese (Liberia Flag)	2,708	1,293	721
Ghana	2,062	1,610	442

New, technologically advanced vessels and establishment of a maximum subsidizable crew size more in line with worldwide manning standards appear to offer the best hope for containing ODS costs under the current system.

2. CDS Costs:

As earlier stated, the Act included a goal of constructing 300 ships by 1980 and reducing the construction differential subsidy to 35 percent by 1976. Since 1970, $2 billion has been spent on new construction of merchant vessels with CDS. Approximately 80 ships were contracted for through 1979. Increased productivity leading to a lower CDS rate never materialized. The CDS rate stayed in the 48-50 percent range and in fact, many builders and potential buyers maintain that the 50 percent rate does not fully cover the difference between U.S. and foreign building. Cost escalation clauses included in U.S. yard contracts, delivery times of two years longer than foreign yards, and vessel costs 2 or 3 times more than foreign yards, all combine to make U.S. building unattractive even with a subsidy. Moreover, a 1978 MarAd study concluded that "U.S. shipyards, on the average, are using a lower level of technology than foreign shipyards in six of the eight major categories studied."

V. IMPORTANCE OF INDIRECT AIDS:

A. Cargo Preference - Cargo preference laws have been enacted at various times since the early 1900's. Although they are not a part of the 1970 act, their importance to the U.S. merchant fleet requires that any discussion of maritime aids include cargo preference. It has long been recognized as the primary Government assistance to the U.S. shipping industry. Protected cargoes have become "base cargoes" for many liner carriers on certain trade routes as well as an important source of employment for U.S.-flag tankers and bulk carriers. Although preference cargoes are a small part of total U.S. oceanborne foreign commerce (imports and exports), they are a major part of outbound cargo carried in U.S.-flag ships.

Consistent historical data illustrating the total impact cargo preference laws have on U.S.-flag shipping are not available. Based on review of the data available, preference cargo accounted for 5.4 percent of total U.S. waterborne foreign commerce tonnage in 1969. In 1979, it probably accounted for only 1-2 percent due to the increase in total tonnage. While preference cargo consisted of only a small proportion of total U.S. waterborne foreign commerce, it accounted for 56.8 percent of total tonnage on U.S.-flag ships and 83.1 percent of total tonnage exported on U.S.-flag ships.

	U.S. Exports/Imports		Cargo Preference Tonnage			
	Total Tonnage	% U.S.-Flag	% of Tot. Tonnage	% of U.S.-Flag Tot.	% U.S. Flag Exports	% U.S. Flag Imports
1969...	427.9M	4.8	5.4	56.8	83.1	16.9
1979...	823.1M	4.2	1.0-2.0	N/A	N/A	N/A

Data reflecting cargo preference as a proportion of total tonnage carried on U.S. flag ships are not available for 1979. However, it is not likely that this pattern would have been drastically altered in the last decade. Individual U.S.-flag carriers on designated trade routes and unsubsidized non-liners and tankers in the world bulk trade (especially petroleum and crude oil carriers) are heavily dependent on this indirect subsidy.

Up to 50 percent of gross freight revenues of subsidized operators may be derived from the carriage of preferred cargo. For the subsidized lines that serve trade routes on which preferred cargo is concentrated, preferred cargo represents a substantial portion of their revenue and tonnage. ODS is reduced in proportion to any excess over the 50 percent permitted.

Unsubsidized U.S.-flag tankers and non-liners are heavily dependent on preferred cargo because they cannot compete with foreign carriers for commercial cargo due to high operating costs.

Is is usually recognized that cargo preference may involve additional costs. Over 50 percent of U.S. foreign trade is related to crude oil and petroleum products. While only 3.3 percent of imported crude is delivered in U.S.-flag ships, the preference provided U.S.-flag ships in the establishment of a strategic petroleum reserve (SPR) is estimated to involve additional costs of about $500 million through 1985.

That there is a cost to the U.S. Government of cargo preference laws is not questioned. The total costs are not known due to incomplete accounting and only partial reporting by the affected agencies. Additional annual average costs of about $54 million attributable to cargo preference laws were associated with the P.L. 480 Food for Peace Program between 1955 and 1971. The additional cost in 1980 was calculated to be $80 million, a 48 percent increase. If one applies the same percentage increase to the annual average costs as estimated by Gerald Jantscher for the four major, not including the SPR, cargo preference programs--Military Sealift Command; P.L. 480, title I, Food for Peace sales program; P.L. 480, title II, Food for Peace donations; and Foreign aid cargoes (AID loans and grants), the additional costs to the Federal Government of cargo preference is $400-500 million a year. This compares to the projected ODS costs in 1982 of $417 million. Together, these subsidies, not including the SPR, cost the U.S. Government about a billion dollars a year.

B. Capital Construction Fund (CCF)

Under the 1970 act, Congress extended to unsubsidized operators in the U.S. foreign, non-contiguous domestic or Great Lakes trade the privilege, which had been limited to subsidized operators, of deferring taxes on income from shipping. In a CCF Agreement between an operator and the Maritime Administration, the Government agrees to defer the receipt of taxes on income earned from vessel operations and the shipowner agrees to use withdrawals from the fund and earnings from investment of the funds for capital reinvestment in U.S. ship construction.

The amount of revenues lost to the Treasury due to the CCF were estimated by the Department of the Treasury to be $10 million in 1969, $70 million in 1975, and $75 million in 1979. Before the 1970 Act, 13 subsidized companies held CCFs; in 1980, 79 unsubsidized and 13 subsidized companies held CCFs.

During 1980, $332 million was deposited in these accounts. Since 1971, the fund holders have deposited $2 billion in CCF accounts and withdrawn $1.6 billion for vessel modernization and new construction. This closely approximates the $1.9 billion in Government funds expended for the CDS program in the same period.

Periodic attempts to extend the CCF provisions to all domestic shipping trade have been defeated on the basis that since these operators are protected from foreign competition by the cabotage laws, preferential tax treatment is not necessary.

C. Loan Guarantees:

Created under Title XI of the Merchant Marine Act of 1936, as amended, the Federal Ship Financing Fund provides for the Government guarantee of obligations issued to construct American-flag vessels, owned and operated by U.S. citizens. The primary goal of the program is to provide shipowners with a method of financing American-flag vessels at more attractive rates and on more reasonable terms that would be provided in the private credit market without the Government guarantee.

Under the Title XI program, the Secretary is authorized to guarantee obligations which do not exceed 87.5 percent of the actual cost of the eligible vessel. All vessels built with CDS receive a guarantee not exceeding 75 percent of the cost after CDS.

Although there is no explicit "Buy American" requirement stipulated under the Title XI program, it is the present policy of the Maritime Administration to exclude from actual cost items of foreign manufacture.

Title XI bonds are issued by the shipowner with the aid of investment bankers. The form of the bonds is similar to that of corporate bonds except the bondholders have the additional protection of the Government guarantee. Title XI obligations, which can vary in form from 180-day rollover notes and serial bonds to long-term (up to 25 years) bonds, are sold at interest rates which, while varying with the length of maturity, are lower than the top-rated utility company (AAA) long-term issues and approximately 25-35 basis points above long-term Treasury rates. The interests of the Government are secured by first preferred mortgages on all Title XI vessels. Upon default, this mortgage gives the Maritime Administration the right to foreclose on the vessel and dispose of the assets to recover its losses.

The total in guarantees that can be outstanding for commercial vessel construction was increased by Congressional action in 1981 from $9.0 billion to $9.5 billion. There were approximately $7.8 billion in Title XI financing commitments at the end of 1981.

The net assets in the Federal Ship Financing Fund as of the end of 1981, totalled approximately $200 million and annual income approximated $42 million. The Maritime Administration has foreclosed on 33 vessels with a foreclosure cost of $172 million. Of this amount, $56 million was recovered through the disposition of assets for a net loss of $116 million.

As the following table demonstrates, Government assistance in the financing of new vessel construction is common among major maritime nations.

Domestic Credit Terms Offered by
Major Maritime Nations

Country	Term Years	Amount %	Interest %	Comment
Belgium	15	90	80% at 1% 10% at 10%	2 year moratorium + operating subsidy
Denmark	14	80	8	4 year moratorium
Germany	12	90	Market rate-2%	12 1/2% price subsidy to owner
Italy	15	70	6-7	Small ships 80%
Netherlands				15% investment premium + 5.5% over 5 years
Norway	12	80	Commercial	3 year moratorium
Spain	12	80	6	2 year moratorium
Sweden	12	70	7	30% balance covered by interest free loan for 5 years
Japan	10	65-90	2%-4%	3 year moratorium
United Kingdom	7	70	7-5	No moratorium

Source: Fairplay International Shipping Weekly

Only recently has the appropriateness of U.S. Government assistance in this regard been questioned. When compared with other loan guarantee programs of the Federal Government, the performance of the Title XI program rates high; however, viewed in combination with all other Government-sponsored credit activity and the role that plays in the private credit markets, it is difficult to justify this particular effort. Further, it is clear that in recent years, the type of construction guaranteed has been primarily for tankers, offshore drill rigs, and inland tugs and barges. Of the total $7.2 billion guarantees in force at the end of 1980, $4.2 billion covered tankers, drill rigs, tugs, barges, and drill service. It is less clear how the guarantee of construction of vessels to be used in the domestic trade can be justified as offsetting to credit terms provided by foreign shipping competitors.

D. Cabotage:

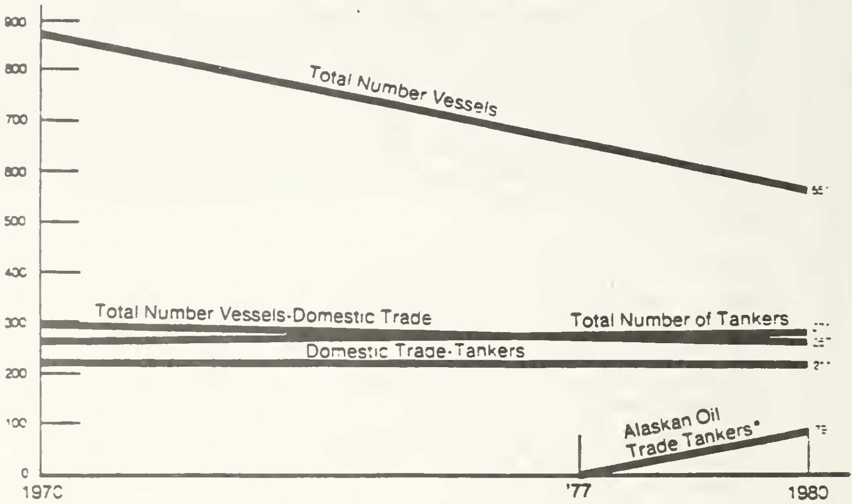
Cabotage laws have been in force in America since 1817. The most recent legislation, Section 27 of the Merchant Marine Act, 1920 ("The Jones Act") stipulates that all domestic waterborne trade (coastal, intercoastal, noncontiguous, inland waterways, and Great Lakes) must be carried in vessels built and registered in the United States, and owned and crewed by U.S. citizens.

Vessels for the domestic trades account for 68 percent of the current merchant ship orderbook of U.S. shipbuilders by number of vessels and 75 percent by tonnage.

With the exception of the shipments of Alaskan North Slope crude oil to the "lower 48" initiated in 1977, domestic waterborne cargo volumes have increased only slightly over the past ten years. However, the volume of this trade in total still exceeds the tonnage carried by U.S.-flag ships in our foreign waterborne trade.

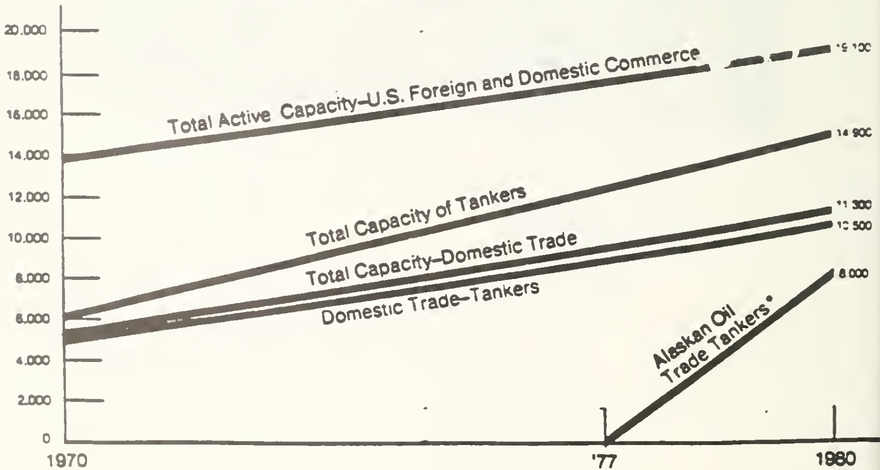
The number of active vessels in the domestic ocean trades (coastwise, intercoastal, and noncontiguous) decreased from 293 vessels or 5.9 million DWTs in 1969 to 257 ships in 1980. However, the deadweight tonnage (DWT) capacity nearly doubled from 5.9 million DWTs to 11.3 million DWTs. Almost 90 percent of the tonnage capacity is in tankers and as noted above, the growth was primarily in the tanker segment of the fleet servicing the protected Alaska North Slope (ANS) oil trade. In 1980, U.S.-flag tankers (the only ones permitted) carried almost 5 times tonnage in this trade as did U.S.-flag tankers in the foreign trades.

TANKERS AS A PROPORTION OF TOTAL ACTIVE VESSELS IN THE U.S. FOREIGN AND DOMESTIC COMMERCE
[Number of Vessels]



*Initiated in 1977

TANKERS AS A PROPORTION OF TOTAL ACTIVE CAPACITY IN THE U.S. FOREIGN AND DOMESTIC COMMERCE
[Number Deadweight Tons (ooo)]



The availability of ANS oil affected the U.S. maritime industry in several ways. Because there was not enough U.S.-built tonnage in the existing domestic trade, operators of tankers built with CDS for the foreign trades sought, and were granted, permission from the Maritime Administration to enter the ANS oil trade. Despite the domestic tanker shortage and the proportionate repayment of CDS required to enter the trade, domestic unsubsidized vessel operators protested and appealed to the U.S. Supreme Court. (The Government's position was upheld.) The fear of unsubsidized domestic operators was that they would be harmed competitively if tankers were built with CDS but permitted to be used in the ANS oil trade.

Recent proposals to lift the ban on export of ANS oil have been met with opposition from U.S.-flag tanker operators and builders. It is assumed that the doubling of U.S.-flag tanker tonnage between 1976 and 1980 was largely attributable to ANS oil availability and laws restricting its carriage to U.S.-built vessels. Similarly, of the 20 ship construction contracts in effect on August 1, 1981, for delivery in 1982-1984, 13 are tankers. As only two of these are being built with CDS, it is assumed that most of these vessels are intended to be used in the domestic trades. That the trade might be opened to foreign-flag vessels and the existing tonnage and additional tonnage under contract become excess is of understandable concern to domestic operators and builders.
On the other hand, lifting the export ban and opening that trade to foreign-flag operators would reduce oil transportation costs and would positively affect the U.S. balance of payments with such nations as Japan. Lifting of the ban would also benefit U.S. owners of foreign-flag tankers who own seven times the tonnage under U.S.-flag.

V. SUMMARY OUTLINE

The purpose of the Merchant Marine Act of 1970 was to revitalize the U.S. merchant marine.

Objectives:

A. CDS

1) the construction of 300 ships of standard design by 1980.

2) the reduction of the construction differential subsidies to 35 percent by 1976.

3) inclusion of non-liner and tanker construction.

B. <u>ODS</u>

1) the control of costs and increase in efficiencies by:

a) establishing subsidized crew size prior to construction.

b) creating a wage indexing system.

2) inclusion of non-liner and tanker operations.

C. Cargo Preference and cabotage, as Government policies. were reaffirmed.

D. Capital Construction Funds were authorized to encourage reinvestment of earnings in domestic shipbuilding.

E. The amount of funds authorized to guarantee the construction loan and mortgage obligations of commercial ships built domestically was increased.

<u>Findings:</u>

A. <u>Constructing Differential Subsidy (CDS)</u>

1) 90 new ships of all types were contracted for between 1970 and 1980.

2) U.S. shipyard prices continued to exceed those of foreign shipyards and by late 1975 it was apparent that the objective of a 35 percent CDS differential was unrealistic. In fact, the 50 percent authorized did not always achieve cost parity, especially when the opportunity costs of construction time in U.S. yards of 2-3 years more than in foreign yards was included.

3) Due to overtonnaging between 1971 and 1975 leading to a depressed market worldwide, the demand for subsidized construction of tankers and non-liners virtually disappeared.

B. <u>Operating Differential Subsidy (ODS)</u>

1a) The establishment of subsidizable crew sizes prior to construction has been successful in decreasing the manning levels on subsidized ships; however, technological advances in ship design and cargo handling contributed to the decrease. U.S. crew sizes still exceed those of foreign competitors.

b) The wage indexing system created has been effective in keeping subsidized U.S. seamen wage increases in line with those of other U.S. workers. However, their annual increase

has still averaged 9.4 percent. Also driving up ODS costs is a trend noted among foreign competitors who are low wage operators from countries with lower standards of living to carry more of the world trade and thereby increase the differential.

2) The inclusion of nonliner and tanker operations in the subsidy program did not generate a demand for ODS, despite the fact that over 90 percent of U.S. foreign trade tonnage is in the bulk commodities. Only 21 of the 159 ships whose operations were subsidized in 1979 or 1980 were tankers (19) or dry bulk carriers (2). Demand for world trade tanker tonnage is not expected to increase and the small U.S. dry bulk fleet is not competitive, especially in a depressed world market.

The "base" cargo for unsubsidized U.S.-flag operations continued to be preferred cargo. Overwhelmingly, U.S. citizen ownership and operations in these trades continued under foreign flags.

C. <u>Cargo Preference and Cabotage</u> - Laws reserving all cargo in the domestic trades (cabotage) and a percentage of cargo in the foreign trades (cargo preference) for U.S. flag vessels serve as a primary source of employment for the domestically-built fleet. Unless major improvements in shipbuilding costs or ship operating costs occur, some mechanism for assuring cargo for U.S.-flag ships will be required. Under current promotional programs, no drastic improvements are predicted.

D. <u>Capital Construction Funds</u> - The availability of these funds has encouraged reinvestment in domestic ship construction--almost equal to the CDS provided. Whether it is to the Government's advantage to defer the receipt of tax revenue in order to assure capital investment in the domestic shipbuilding industry is a question of taxing policy and the relative priority placed on various Government activities.

E. <u>The Title XI</u> loan guarantee program is available for subsidized and unsubsidized construction of vessels to be used in foreign or domestic trades. The 1970 act increased the fund availability from $1 billion to $3 billion. It has been raised several times since and in 1981, a ceiling of $12 billion was established with 9.750 billion reserved for commercial vessels.

Increasingly, the Fund has been used to guarantee construction of vessels to be used in the protected domestic trades, for inland waterways, and for offshore drilling. The justification for increasing the ceiling each time has included the disparity between U.S. rates and terms and those of other maritime nations. Since vessels in the domestic trades do not compete with foreign-built vessels, this rationale seems fallacious.

Conclusions:

The direct subsidy programs have not revitalized the U.S. merchant marine:

1) operating and construction subsidies have not substantially improved the competitive position of either the U.S. shipbuilding or ship operating elements of the maritime industry.

2) cargo preference and cabotage laws, or some form of cargo reservation, are necessary, in the present environment, to maintenance of the existing U.S.-flag domestic and foreign trade fleets.

3) tax subsidies and loan guarantees appear to serve the purposes intended, but should be assessed in the context of Government taxing and credit policies overall.

TABLE 3

U.S OCEANBORNE FOREIGN TRADE/COMMERCIAL CARGO CARRIED
Tonnage (Millions)

Calendar Year	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Total Tons	473.2	457 4	513 6	631 6	628 9	615 6	698 8	775 3	775 6	823 [illegible]
U S -Flag Tons	25.2	24 4	23.8	39.9	40.9	31 4	33 8	34 8	32 1	35 0
U S Percent of Total	5.3	5.3	4.6	6.3	6.5	5 1	4 8	4 5	4 1	4 2
Liner Total Tons	50 4	44.2	44 6	51.3	51 4	44.3	49 8	47 8	56 5	57 0
Liner U S -Flag Tons	11.8	10 1	9.8	13 2	15 3	13 6	15 4	14 4	16 0	15 7
Liner U S Percent	23.5	22.9	21.9	25 8	29 8	30 7	30.9	30 2	28 3	27 5
Non-Liner Total Tons	240 7	220 7	242.6	281.9	282 7	275.3	289 6	289 0	308 8	342 [illegible]
Non-Liner U S -Flag Tons	5 4	4 8	3.8	4.5	5.0	3.8	4.9	5 7	4 5	3 6
Non-Liner U S Percent	2.2	2.1	1.6	1.6	1.8	1.4	1.7	2 0	1 5	[illegible] 0
Tanker Total Tons	182 1	192 5	226 4	298 4	294 8	296 0	359 4	438 6	410 3	423 4
Tanker U S -Flag Tons	8.0	9.5	10.2	22.2	20.5	14 0	13 6	14 6	11 6	15 7
Tanker U S Percent	4 4	4.9	4.5	7.4	7.0	4 7	3 8	3 3	2 8	3 7

Value ($ Billions)

Calendar Year	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Total Value	49.7	50 4	60.5	84.0	124.2	127.5	148 4	171.2	195 8	242 1
U S -Flag Value	10.3	9.9	11.1	15.9	22.0	22.4	26 4	28 0	30 7	35 7
U S Percent of Total	20.7	19.6	18.4	18.9	17.7	17.5	17.8	16 4	15 7	14 7
Liner Total Value	33.5	32 4	37.4	49.6	63 4	64.0	75.8	82.3	99 9	117 6
Liner U S -Flag Value	9.7	9.2	10.3	14 4	19.4	20.0	23.9	25.2	28 6	32 5
Liner U S Percent	28.8	28 4	27.7	29 1	30.6	31.2	31.6	30 7	28 6	27 6
Non-Liner Total Value	12.2	13.2	17.4	25.2	34.7	36.6	38.2	42 7	52.5	62.0
Non-Liner U S -Flag Value	.4	.4	.4	.7	.8	1.0	1.1	1.2	1 0	1 1
Non-Liner U S Percent	3.3	3.1	2.4	2.5	2.3	2.8	2.8	2.8	1 8	1 7
Tanker Total Value	4.0	4.9	5.7	9.2	26.0	26.9	34 4	46.2	43 4	62 5
Tanker U.S -Flag Value	.2	.3	.4	.8	1.8	1 4	1 4	1 6	1 1	2 1
Tanker U S Percent	5.6	5.5	6.2	9.1	6.9	5 1	4.2	3.5	2 7	3 4

Note: Includes Government-sponsored cargo, excludes Department of Defense and U S /Canada transit cargo

Source: Maritime Administration, Annual Report, 1980

Table 1

Tonnage of U.S. Foreign Waterborne Trade, 1959 to 1969
(In millions of tons)

Calendar Year	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968[a]	1969[b]
Total tons	267.0	277.9	272.4	296.8	311.6	332.8	371.3	392.3	387.5	418.6	427.9
U.S.-flag tons	27.1	31.0	25.3	29.6	28.5	30.5	27.7	26.2	20.5	25.0	20.7
U.S. percent of total	20.1	11.2	9.7	10.0	9.1	9.2	7.5	6.7	5.3	6.0	4.8
Liner											
Total tons	48.1	50.7	48.0	48.3	48.9	50.3	49.2	49.9	47.8	46.1	47.2
U.S.-flag tons	13.5	14.5	12.6	12.7	13.5	14.2	11.2	11.4	10.6	11.1	10.0
U.S. percent of total	28.1	28.6	25.8	26.2	27.7	28.2	22.8	22.9	22.2	24.1	21.3
Nonliner											
Total tons	106.9	109.0	106.7	125.2	136.2	161.4	171.6	188.5	190.4	209.5	206.5
U.S.-flag tons	8.2	8.4	7.8	8.3	8.2	9.6	8.2	6.9	5.4	5.4	4.4
U.S. percent of total	7.7	7.7	7.3	6.7	6.0	6.1	4.8	3.8	2.8	2.1	2.1
Tanker											
Total tons	112.0	118.2	116.7	123.3	126.5	121.1	150.5	152.8	149.3	163.1	174.2
U.S.-flag tons	5.4	8.1	5.9	5.8	6.6	6.6	8.2	7.9	4.5	7.5	6.1
U.S. percent of total	4.8	6.9	5.1	5.9	5.4	5.6	5.4	5.2	3.0	4.6	3.6

[a] 1968 data revised May 6, 1970.

[b] Preliminary data, subject to future revision.

Note: Includes government-sponsored cargo; excludes Department of Defense cargo and United States/Canada trans-lake cargo.

Source: U.S., Department of Commerce, Maritime Administration, MARAD 1970: Year of Transition (Washington, D.C.: Department of Commerce, MARAD, 1971), p. 28.

Value of U.S. Foreign Waterborne Trade, 1960 to 1969
(In billions of dollars)

Calendar Year	1960	1961	1962	1963	1964	1965	1966	1967	1968[a]	1969[b]
Total value	24.7	24.7	25.9	27.8	30.0	32.4	34.4	36.6	61.1	42.3
U.S.-flag value	6.6	6.2	6.5	6.9	[illegible]	6.9	8.2	7.9	8.5	8.2
U.S. percent of total	26.3	25.6	25.1	25.1	[illegible]	21.3	23.8	21.6	20.7	19.4
Liner										
Total value	18.6	18.3	18.9	19.8	21.3	22.3	24.8	24.8	26.8	27.8
U.S.-flag value	5.9	5.7	5.8	6.2	7.0	6.2	7.5	7.4	7.8	7.6
U.S. percent of total	31.9	31.1	30.7	31.8	32.9	27.8	30.2	29.6	29.1	27.3
Nonliner										
Total value	3.6	3.7	4.3	5.2	5.9	6.6	8.2	8.5	10.6	10.8
U.S.-flag value	0.3	0.4	0.4	0.5	0.5	0.4	0.4	0.4	0.5	0.5
U.S. percent of total	8.3	10.8	9.3	9.6	8.5	6.1	4.9	4.7	4.6	4.6
Tanker										
Total value	2.6	2.7	2.7	2.8	2.8	2.5	3.4	3.2	3.4	3.6
U.S.-flag value	0.3	0.2	0.3	0.2	0.2	0.3	0.3	0.2	0.2	0.2
U.S. percent of total	11.5	7.4	11.2	7.1	7.1	8.6	8.8	6.3	5.9	6.6

[a] 1968 data revised May 8, 1970.

[b] Preliminary data, subject to future revision.

Note: Includes government-sponsored cargo; excludes Department of Defense cargo and United States/Canada trans-lake cargo.

Source: U.S., Department of Commerce, Maritime Administration, MARAD 1970: Year of Transition (Washington, D.C.: Department of Commerce, MARAD, 1971), p. 28.

Table 2 ODS CONTRACTS IN FORCE—SEPTEMBER 30 1982

A. Liner Trades

Operator and Contract No.	Contract Duration	Number of Subsidized Ships	Service (Trade Route/Area)	Annual Sailings Minimum	Annual Sailings Maximum
American President Lines	1-01-78	22	Transpacific Services[1]		
Ltd	to		California/Far East Line A (TR 29)	50	82
MA/MSB-417	12-31-97		California/Far East Line A Extension (TRs 17 18 29)[2,3]	18	28
			Washington-Oregon/Far East Line B (TR 29)	54	80
			Washington-Oregon/Far East Line B Extension (TRs 28 29)[4]	6	—
Delta Steamship Lines Inc	1-01-76	11	U.S. Gulf/East Coast South America (TR 20)	26	Overall maximum not to exceed 77
MA/MSB 352	to				
	12-31-95		U.S. Gulf/West Africa (TR 14-2)	24	
Delta Steamship Lines Inc	8-17-78	13	U.S. Atlantic/West Coast South America (TR 2)	48	62
MA/MSB-425	to				
	12-31-97		U.S. Atlantic/Caribbean (TR 4)	22	33
			U.S. Pacific/Caribbean East and West Coasts South America Mexico Central America (TRs 23 24 25)	25	42
Farrell Lines Inc	1-01-76	8	U.S. Atlantic/West Africa (TR 14-1)	20	Overall Maximum not to exceed 85
MA/MSB 352	to				
	12-31-95		U.S. Atlantic & Gulf/Australia & New Zealand (TR 16)	16	
			U.S. West Coast/Australia & New Zealand (TR 27)	14	24
Farrell Lines Inc	1-01-80	16	1 U.S. Atlantic/Mediterranean India Service (TRs 10 13 18)	68	95
(American Export Lines	to		a Mediterranean Subservice	50	70
Services)	12-31-80		b India Subservice	18	25
MA/MSB-462			2 U.S. North Atlantic/Western Europe (TR 5-7-8-9)	40	56
Lykes Bros. Steamship Co.	1-01-79	44	U.S. Gulf/U.K.-Continent (TR 21)	36	80[5] (Overall maximum not to exceed 318)
Inc	to		U.S. Gulf/Mediterranean (TR 13)	42	48
MA/MSB-451	12-31-98		U.S. Gulf/Far East (TR 22)	36	80[6,7]
			U.S. Gulf/South & East Africa (TR 15-B)	18	24[8]
			(TR 31)	24	36
			U.S. Pacific/Far East (TR 29)	20	80[9]
			U.S. Pacific/Far East (TR 17/29)	20	
Moore McCormack Lines	1-01-75	13	U.S. Atlantic/East Coast South America (TR 1)	40	70
Inc	to				
MA/MSB-332	12-31-94		U.S. Atlantic/South & East Africa (TR 15-A)	13	20
Prudential Lines Inc	1-01-78	3	U.S. North Atlantic/Mediterranean (TR 10)	24	36
MA/MSB-427	to				
	10-31-97				
Waterman Steamship Corp	8-04-71	5	U.S. Atlantic-Gulf/India Persian Gulf & Red Sea Indonesia Malaysia Singapore	30	40
MA/MSB 115	to				
	8-03-91		Brunei (TRs 18 17)	30	40
Waterman Steamship Corp	10-26-76	1	U.S. Atlantic-Gulf/Far East Indonesia Malaysia Singapore Brunei (TRs 12 22 17)	10	18[9]
MA/MSB-378	to				
	10-25-96				
Waterman Steamship Corp	11-21-78	2	U.S. Gulf/Western Europe (TR 21)	24	35[10]
MA/MSB-450	to				
	11-20-82				
Total Liner Trades		138			

[illegible]

Table 2 (Continued)

B. Bulk Trades:

Operator and Contract No	ODS Agreements		Number of Subsidized Ships 8/30 80	Service	Annual Savings
	Contract Effective Date	Contract Termination Date			Minimum No of Days
Aeron Marine Shipping Co MA/MSB-166	10-10-74	10-09-94	2	Worldwide Bulk Trade	335
American Shipping Inc MA/MSB-272	4-14-76	4-13-96	1	Worldwide Bulk Trade	335
Aquarius Marine Co MA/MSB-309	10-15-75	10-14-95	1	Worldwide Bulk Trade	335
Aries Marine Shipping Co MA/MSB-129	8-09-73	8-08-93	2	Worldwide Bulk Trade	335
Atlas Marine Co MA/MSB-274	12-30-76	12-29-96	1	Worldwide Bulk Trade	335
Chestnut Shipping Co MA/MSB-299	12-01-76	11-30-96	2	Worldwide Bulk Trade	335
Equity Carriers, Inc MA/MSB-439	Not yet effective¹	20 years from effective date	3	Worldwide Bulk Trade	335
Margate Shipping Co MA/MSB-134	12-28-73	12-27-93	3	Worldwide Bulk Trade	335
Moore McCormack Bulk Transport Inc MA/MSB-295	12-10-75	12-09-95	3	Worldwide Bulk Trade	335
Pacific Shipping Inc MA/MSB-273	7-24-76	7-23-96	1	Worldwide Bulk Trade	335
Suwannee River Finance, Inc MA/MSB-440	Not yet effective¹	20 years from effective date	1	Worldwide Bulk Trade	335
Suwannee River Phosphate Finance, Inc MA/MSB-442	Not yet effective¹	20 years from effective date	1	Worldwide Bulk Trade	335
Suwannee River Spa Finance Inc MA/MSB-441	Not yet effective¹	20 years from effective date	1	Worldwide Bulk Trade	335
Worth Oil Transport Co MA/MSB-271	2-20-76	2-19-96	1	Worldwide Bulk Trade	335
Zapata Products Tankers, Inc MA/MSB-167	4-03-76	4-02-96	4	Worldwide Bulk Trade	335
Total Bulk Trades			27		

¹These contracts have been approved subject to delivery of the vessels and start up of the proposed ODS service

Source: Maritime Administration, Annual Report, 1980

TABLE 4

EMPLOYMENT OF U.S.-FLAG OCEANGOING FLEET—SEPTEMBER 30, 1980[1]

Status and Area of Employment	Total		Vessel Type: Combination Pass.-Cargo		Vessel Type: Freighters		Vessel Type: Tankers[2]	
	No.	Deadweight Tons (000)	No.	Deadweight Tons (000)	No.	Deadweight Tons (000)	No.	Deadweight Tons (000)
Grand Total	**863**	**23,979**	**65**	**447**	**488**	**7,425**	**310**	**16,107**
Active Vessels:	**551**	**19,099**	**10**	**84**	**275**	**5,015**	**266**	**14,000**
Foreign Trade	200	5,029	4	37	180	3,617	16	1,375
Nearby Foreign[3]	13	321	1	9	6	52	6	260
Great Lakes-Seaway Foreign	2	29	0	0	2	29	0	0
Overseas Foreign	185	4,679	3	28	172	3,536	10	1,115
Foreign to Foreign	27	1,590	0	0	11	172	16	1,418
Domestic Trade	257	11,259	1	8	45	705	211	10,546
Coastwise	114	3,278	0	0	11	200	103	3,078
Intercoastal	64	3,795	0	0	1	26	63	3,769
Noncontiguous	79	4,186	1	8	33	479	45	3,699
Other U.S. Agency Operations	67	1,221	5	39	39	521	23	661
MSC Charter	48	1,039	0	0	27	399	21	640
Bareboat Charter & Other Custody	19	182	5	39	12	122	2	21
Inactive Vessels	**312**	**4,880**	**55**	**363**	**213**	**2,410**	**44**	**2,107**
Temporarily Inactive	21	807	0	0	6	113	15	694
Laid-Up (Privately Owned)	18	1,217	2	13	8	120	8	1,084
Laid-Up (MarAd-Owned Pending Disposition)[4]	11	151	1	10	9	113	1	28
National Defense Reserve Fleet[5]	256	2,623	52	340	190	2,064	20	301

[1] Excludes vessels operating exclusively on the inland waterways and Great Lakes, those owned by the U.S. Army and Navy, and special types such as tugs, cable ships, etc.
[2] Includes 16 dry-bulk vessels.
[3] Nearby foreign trade includes Canada, Mexico, Central America, West Indies, and North Coast of South America.
[4] Other than vessels in the National Defense Reserve Fleet.
[5] Includes 1 vessel of Pacific Far East Line, Inc. and [illegible] States Steamship Co. [illegible]

Source: Maritime Administration, Annual Report, 1980.

Part II Economic and National Security Rationales for Public Assistance to the Maritime Industry.

Economic Rationale

I. Introduction

Over the years three primary arguments have been used to justify public assistance to the maritime industry on economic grounds:

1. Balance of Payments - A strong U.S. maritime industry helps the balance of payments because revenue generated in maritime activities both directly earn and, through import substitution, conserve foreign exchange.

2. Employment - Assistance to the maritime industry creates jobs both directly and indirectly through the multiplier effect.

3. Public Revenues - The maritime industries expand the public revenue base, therefore, subsidy programs are almost costless because resulting revenues offset a portion of the sums given to the industries.

These arguments received careful review in a 1975 Brookings Institution study "Bread upon the Waters." The study concluded that the economic justifications, as usually formulated, were not credible because of the weak theoretical and methodological assumptions upon which they are based and the scanty facts usually presented to support them. Since the Brookings study, the Maritime Administration has published two studies which attempt to: 1) quantify the economic benefits of public assistance to the maritime industries and, 2) address the theoretical and methodological shortcomings of past analyses.

Both studies utilize complex input-output analyses designed to estimate the direct and indirect economic impacts of the subsidy programs. The studies found that operating and construction differential subsidy programs not only increased the output and employment levels in the ship operating and building industries, but also contributed to a rise in output and employment levels in other industries as well. The most recent MARAD study (January 1981) estimated that between 1970-1978 the ODS program generated $23.3 billion in output and 570,000 person years of employment throughout the nation (when both the direct and indirect effects are considered). For CDS, the study estimated total impact at $5.7 billion in output and 211,000 person years of employment. The findings of the study are summarized below in Table 1.

Table 1
Impact of ODS and CDS on National Output (Revenues)
1971-1978
(billions of dollars)

	Output -ODS	Output-CDS	Total
Direct	$11.6	$3.4	$15.0
Direct and Indirect	$23.2	$5.7	$28.9

Impact of ODS and CDS on Employment
1971-1978 (Man Years)

	Employment-ODS	Employment-CDS	Total
Direct	96,000	136,000	332,000
Direct and Indirect	570,000	211,000	781,000

Source: Economic Impact of Maritime Industries on the U.S. Economy 1971-78; Maritime Administration, January 1981.

The 1978 MARAD study focused on the single year tax generating impact of the subsidy programs. It estimated the increase in taxes to the U.S. Treasury and state and local governments from direct and indirect sources as a result of both the ODS and CDS programs. The findings are shown below in Table 2:

Table 2
Impact of ODS and CDS on Public Revenues 1970
(Millions of dollars)

	ODS	CDS
Federal	126.1	34.5
State and Local	61.0	15.7
Total	187.1	[illegible]0.?

To evaluate the validity of the economic arguments and the studies used to support these arguments, it is necessary to examine both the theoretical underpinnings and the methodologies utilized to obtain estimates of program benefits. In addition, it is useful to place the "benefits" in perspective by examining them in the context of the national economy.

II Balance of Payments

Supporters of public assistance argue that the entire output of the industry represents either foreign exchange earnings or foreign exchange savings. As a result of the industry's extreme efficiency as an earner and conserver of foreign exchange, it is alleged that it contributes greatly to a positive U.S. balance of payments, and supports the exchange rate of the U.S. dollar.

As shown in the following table, the balance of payments benefits said to be attributable to the maritime industry are relatively small. For the time period 1971-1978, the estimated balance of payments impact of ODS and CDS was 2.5 percent of the total volume of exported goods and services and approximately 7.4 percent of the service account.

Balance of Payments 1971-1978 (billions of dollars)

Estimated Direct and Indirect Benefits of ODS and CDS	$ 28.9
Total U.S. Exports - Goods and Services	$1,135.8
Services Account	$ 388.7

This estimate of benefits, moreover, is exaggerated. It assumes that all export earnings resulting from vessels built with CDS or operated with ODS are totally attributable to the subsidy program. That is, if the subsidy did not exist, there would have been a complete loss of these benefits. It has not been demonstrated, however, that all U.S. ship construction and operations would disappear in the absence of a program. In addition, the studies and economic arguments assume that in the absence of such activities the resources now utilized in these two industries would fail to be utilized elsewhere in the economy. Such an assumption is not supportable. It is likely that, given the high skill levels involved, at least a portion of these resources would be employed. While it is not possible to estimate exactly the balance of payments impact of such alternative use, the assumption that the impact is zero is unfounded. The maritime industry does earn and conserve foreign exchange, but, such claims can be made by many other U.S. industries and is not in itself a justification for Federal assistance.

Moreover, the theoretical foundation for assuming an alleged balance of payments benefit has been questioned. In a system of floating exchange rates the value of the dollar is determined by supply and demand. Because the Federal Government currently

does not attempt to defend a particular rate for the dollar, the value of the balance payments benefit provided by the industry is unclear.

The Council of Economic Advisors has recently argued that the provision of export subsidies is often inappropriate and may result in a waste of taxpayers money. They stress that the emphasis on export expansion ignores the importance of imports in making possible welfare increasing expansions of trade.

In addition, claims of balance of payments "benefits" ignore the point that import substitution provided by the maritime industry is not beneficial if foreign producers are more efficient. What arises is a classic case of trade diversion to a higher cost domestic producer which results in allocative distortions for the economy in the long run. When assistance comes through government subsidies, the U.S. as a whole pays for it not only directly but also indirectly by postponing comparative advantage adjustments and consequent expansion of trade.

In short, neither economic theory nor the MARAD studies present sufficient evidence to demonstrate that on balance of payments grounds, assistance to the maritime industries is justified.

III Employment

While the balance of payments argument has usually been the principal economic argument justifying assistance, some supporters of assistance also emphasize the favorable employment impact of the programs. To appreciate the relevance of this argument, the employment impact of the ODS and CDS programs for the 1971-78 period may be compared to the total employed U.S. civilian labor force during the same time period:

Employment 1971-78
(Thousands of man years)

Estimated Direct and Indirect Employment Benefits of ODS-CDS	781
Total U.S. employment base	688,000

As shown, the direct and indirect employment impact of the subsidy programs affected about one tenth of 1 percent of the total employed U.S. labor force. Moreover, as discussed above in the context of the balance of payments, those who claim that

public assistance to the maritime industry has a substantial impact on employment of U.S. workers fail to distinguish between the gross and net employment impact of the programs. By concentrating on the gross employment impact of subsidy to the industries, such arguments make no allowance for a possible reduction in employment that occurs elsewhere as a result of the subsidy drawing resources from other, possibly more productive industries. For example, a welder working on a ship could otherwise be employed working on the framework of a building. Similarly, skilled seafaring workers such as engineers could have been employed in other, possibly more efficient U.S. industries. Few of the job skills required in shipping and shipbuilding are unique to the maritime industry.

The 1981 MARAD study dismissed this issue because of the difficulty of establishing assumptions as to the "best" alternative uses of resources applied to shipping and shipbuilding activities. The study states that "one might wonder about the consequences of withdrawing the subsidies and foregoing the positive economic impacts generated by it." This argument can be turned around by suggesting that the subsidy programs may have reduced the magnitude of the nation's employment, if alternative patterns of production were, in fact, more efficient.

IV. Public Revenues

Supporters of public assistance to the maritime industry argue that assistance to these industries creates and generates tax revenues which partially offset the costs of the subsidy programs. The 1978 MARAD study estimated that the total tax revenues accruing to the U.S. Treasury and State and local governments from all sources as a result of operations of subsidized carriers and subsidized shipbuilders was as much as $237.3 million in 1970. MARAD asserted that this meant that as much as 54 percent of the $234.6 million spent in 197 by the Federal Government for ODS was recovered through Federal taxes.

Arguments discussed earlier of the need to separate out the net impact of the programs on employment and output also apply here. If net employment and output impacts are small, then any associated public revenue increase is also slight. In addition, such public revenue arguments are conceptually flawed because the government is not a profit making enterprise. Therefore, program expenditures should not be reviewed primarily in terms of financial return to the government, but rather on the basis of whether the expenditure of government resources is achieving public objectives in the most efficient and effective manner.

In summary, the basic economic arguments advanced as justification for public subsidies to the maritime industries are weak. While the industry and MARAD have attempted to quantify economic benefits, a review of the two most recent analyses indicates that the fundamental flaws of past analyses have not been addressed. The recent analyses fail to distinguish the proportion of the direct and indirect economic benefits that are attributable to the subsidies. In addition, they do not take into account the opportunity costs or potential benefits foregone as a result of resources being utilized in the shipping and shipbuilding industries. When all factors are considered, little evidence is available on economic grounds that would justify the provision of public support to the shipping and shipbuilding industries.

National Security Rationale

I. Introduction

Historically, national security arguments have been used as the principal justification for providing public assistance to maintain a U.S. flag merchant marine and a strong U.S. shipbuilding industry. Both industries proved to be valuable national defense assets for the U.S. during World Wars I and II, Korea and Vietnam.

During the last decade, as reflected in the Merchant Marine Act of 1970, there has been a shift in emphasis in our subsidy programs away from a concentration on national security and toward a policy of assistance to the industries that is designed to facilitate a movement toward self sufficiency on a commercial basis. In carrying out this policy we have supported ships of a type which are of limited military use, but which are designed to be commercially viable. In short, while the strongest arguments for Federal support for the maritime industry were couched in national security terms, the thrust of the program has been increasingly toward making the industry self sufficient and commercially viable.

This paper reviews the major national security justifications for public assistance to the U.S. shipping and shipbuilding industries. Information contained in this section was derived from a review of public and classified testimony before the House Merchant Marine and Fisheries Committee, public and classified DOD mobilization studies, plans and procedures of the Military Sealift Command, Maritime Administration shipbuilding mobilization base studies, Congressional Research Service mobilization studies, and discussions and interviews with a number of current and former officials within the Maritime Administration and the Department of Defense.

II. Basic Justifications

There are three basic national security arguments offered as justifications for public assistance to U.S. maritime industries:

1) Military transport security: A strong U.S. flag merchant marine is required to move large numbers of military supplies in time of war;

2) Economic transport security: A strong U.S. merchant marine is required to ensure U.S. access to strategic minerals and to reduce the risk of interruption in service that could seriously damage U.S. commerce and economy in times of peace and war;

3) Shipbuilding security: A strong national commercial shipbuilding program is required to maintain industrial capacity in the event that it may be necessary to repair and construct Navy ships and commercial sealift ships in an emergency.

Proponents of a strong U.S. Merchant Marine and U.S shipbuilding industry for national security needs cite a number of facts and assumptions to support their arguments. For example, they assume that foreign flag carriers and foreign shipbuilding industries are unreliable. They believe that dependence upon foreign sources for shipping and ship construction during either peace time or war constitutes an unnecessary national security risk to the United States. They bolster their argument with statistics showing the increasing role played by the merchant marine of the Soviet Union and argue that the U.S. merchant marine is presently incapable of meeting projected wartime demands. They also argue that subsidization of a U.S. flag fleet is required to maintain the necessary seafaring manpower base that would be required to man National Defense Reserve fleet ships, privately owned militarily useful ships, and the new fast sealift ships (SL-7s) being acquired by the Navy.

Opponents to public support for these industries for national security needs often state that it is a waste of national resources to use subsidies to maintain U.S. flag ships and a shipbuilding industry that are not economically self sufficient for the purpose of being able to meet a potential type of conflict or emergency that may not happen. Besides, they argue, even if war or political disruptions short of war occur, U.S. commerce has never been and is not likely to be interrupted by any adverse group action taken by foreign flag vessels. They believe that it is not likely in the foreseeable future that owners of foreign flag vessels will subordinate their economic interests to political interests and attempt to boycott the world's strongest trading nation. They strengthen their argument by noting that a portion of the world's shipping not flying U.S. flags is U.S. controlled in that 23% (276 ships) and 14% (67 ships) of the deadweight tonnage of the fleets of Liberia and Panama, respectively, are owned by U.S. citizens or corporations. Moreover, the major merchant fleets of the world are under flags of U.S. allies and their services would presumably not be

withheld. Finally, it is argued that the U.S. merchant marine is designed with a view towards its commercial viability, rather than for its effectiveness in support of national security objectives. The validity of the forgoing arguments is examined below in the context of a discussion of specific national security demands.

III. Military Transport Security

There is no question that sealift capability is vital to military success overseas, as demonstrated in experiences during World War I and II, Korea, and Vietnam. If future sealift capability falls significantly short of what is required, the nation's security would be in jeopardy. Future requirements for sealift capability to transport supplies and equipment depends upon the nature and duration of a potential conflict or war and the likelihood that a particular scenario will transpire. Because the requirements for sealift capability vary according to the type and length of war envisioned, the following section examines:

- Demands for sealift based on probable war scenarios developed by the Department of Defense,
- resources available to meet these demands and,
- the specific role likely to be played by the U.S. merchant marine.

Current DOD planning basically envisions two types of wars - NATO and non NATO - either of which may be short or long in duration. For analytical purposes we have focused seperately on requirements for short term conflicts (or in some circumstances the initial stage of a long term conflict) and long term conflicts.

Short Term Conflicts

The most recent study of sealift requirements in time of short term emergency is entitled "Congressionally Mandated Mobility Study" (classified - April 1981). It reviews sealift requirements and "strategic mobility" under four scenarios considered to be indicative of the likely trouble spots in the world in the 1980's.

Each scenario is developed assuming the contingency will last 60 days from the day deployment commences and focuses on requirements for sealift during the first 30 days.*

[Details of the short run war scenarios are classified information].

Summary

As currently configured, both the subsidized and non-subsidized portions of the U.S. merchant marine do not play a critical role during the first 30 days in any of the short term scenarios outlined above. The principal reason for this is because to be effective, supplies must be available very quickly after a conflict begins. In spite of subsidization, U.S. flag merchant vessels neither have the speed nor are the proper types of vessels expected to be available in large enough numbers to make a significant difference in resupply capabilities within the first 30 days of a conflict.

DOD planning is currently oriented toward acquisition of vessels for maritime prepositioning of supplies and the use of fast SL-7 Navy supply ships for immediate deployment capabilities, reducing its dependence on privately owned merchant ships.

No attempt was made in this study to second guess DOD assumptions on planning procedures. If DOD assumptions are valid, it seems clear that the present configuration of the U.S. merchant marine sharply limits its usefulness within the first 30 days of short term conflicts, and the present subsidy programs are not likely to change this situation. This strongly suggests alternative ways of providing sealift capacity should be identified and evaluated.

Long Term Conflict

In light of the limited short term impact of the U.S. merchant marine, the major argument used to justify assistance to the U.S. flag fleet has been based on the fleet's usefulness and availability in long term conflicts, and the belief that other sources of sealift would not be reliable in time of war. A number of factors complicate attempts to examine the validity of this justification. First, it is not possible to obtain accurate assessments of sealift demand in a long term conflict.

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*The study assumes, after initial deployment, that air/sealift resources are adequate for resupply of forces. This assumption will be examined in the section dealing with long term conflicts.

Discussions and testimony of military and civilian personnel are very general leaving the overall impression that the more ships we have, the better off we are. Part of the problem in obtaining rigorous estimates of need has been that to military planners charged with sealift responsibilities, the capabilities provided by the U.S. merchant marine were viewed as a free good and, therefore, there has been little incentive for DOD to attempt a quantification of cost/benefit tradeoffs.

Quite apart from this lack of incentive to make tradeoffs, however, there are difficult demand estimation problems caused by such uncertainties as the length and scope of a "long" conflict, its intensity, the degree to which sealanes could be kept open, and the rate of shipping attrition caused by enemy action. It is, therefore, almost impossible to measure the risks that a U.S. flag fleet is intended to forestall. Similarly, there are serious problems in measuring the supply of ships that would be available to meet military demands. Ships differ significantly in their usefulness for military purposes. Some factors which limit their use can be modified if time is available for conversion. Other factors are less amenable to retrofit, but limit usefulness only in given situations. Because a long term military conflict may last from several months to years and take place under a variety of conditions, it is difficult to judge what types of ships in the U.S. fleet or elswhere are militarily useful.

In the face of such uncertainties, this analysis has sought to examine the validity of the national security justification for public support for a U.S. merchant marine through review of the following questions:

(1) What are the types of resources (including those provided by the U.S. merchant marine) that are available to meet long-term U.S. sealift demands? and,

(2) What are the strengths and weaknesses of each class of resources? Are the types of ships militarily useful and are they reliable?

For the purpose of this analysis a "long" term conflict is assumed to be any conflict or war lasting past 30 days.

Current Sealift Assets

The procedures for acquiring sealift resources to support military operations in peacetime and in an emergency are outlined in a June 1981 memorandum of agreement between the Department of Defense and

the Department of Commerce. That memorandum outlines steps to be implemented to acquire needed resources. In keeping with that memorandum, available sealift assets are discussed below in the order they would normally be utilized in the event of an emergency. The discussion is followed by a review of the strengths and weaknesses of each source of sealift.

The U.S. has five primary sources of sealift:

1) The Military Sealift Command Controlled Fleet (MSC) - As a Navy fleet, the MSC's primary mission is to support the sealift requirements of all the armed services in the event of war or non-mobilization contingency, in a timely manner. The current MSC controlled fleet consists of 134 ships, divided into 2 fleets-the MSC nucleus fleet and the MSC controlled commercial fleet. For peacetime shipping of military cargo, MSC charters commercial ships giving priority to U.S.-flag ships. However, if U.S.-flag ships of the desired configuration are not available, MSC has indicated a willingness to spot charter foreign flag ships. In the case of an emergency, MSC assigns its nucleus and controlled cargo and tanker ships against cargo movement requirements. If this is not sufficient, MSC notifies Navy staff of the need to activate the Ready Reserve Force (RRF) ships - a portion of the National Defense Reserve Fleet (NDRF).

2) The National Defense Reserve Fleet (NDRF) - The NDRF is comprised of preserved merchant and ex-U.S. Navy ships maintained by MARAD. Included are 254 ships which would be available in an emergency. Break out time in the event of mobilization is estimated to be 21 days for the first ship, with the last ship becoming available by the 60th day. An element of the NDRF--the Ready Reserve Force (RRF) consists of 27 dry cargo ships which can be activated within 5 to 10 days of notification, if manpower is available.

3) U.S. Flag Merchant Fleet - There are currently 578 ships in the privately owned U.S. ocean going merchant fleet. The composition of the fleet is shown below.

Table 1

	U. S. Privately Owned Oceangoing Merchant Marine Fleet As of July 1, 1981
Combination Passenger/Cargo	7
Freighters	110
Bulk Carriers	17
Tankers	269
Intermodal	151
Tug/Barge	11
LNG	13
Total	578

Of the total private fleet, as of July 1981, 158 (27 percent) received operating differential subsidy.

4) Effective U.S. Controlled Fleet (EUSC)- The ships in this fleet are U.S. owned or U.S. controlled ships of foreign registry (Panama, Honduras, and Liberia) which can reasonably be expected to be available for U.S. use in time of emergency. There are about 343 U.S. owned or controlled ships in the EUSC fleet.

5) Free world shipping -- The fleet of free world ships that are not owned or that are not controlled by the U.S. totals over 20,000 vessels and over 600,000,000 tons. Key maritime nations include Greece, the United Kingdom, Norway, Italy, and Japan. This may be compared to the merchant fleet of the Soviet Union which totals 2,500 ships and 19,000,000 tons.

Strengths and Weaknesses of Available Sealift Assets

The strengths and weaknesses of various sealift may be judged in terms of availability and reliability as well as in terms of suitability for military purposes. No precise answers are available in making judgments of this type, but the principal findings are presented below.

(1) Military Sealift Command controlled fleet (MSC). The MSC fleet is considered to be the first line of shipping assets that would be used in the event of a non mobilization contingency or all-out war. This source is totally controlled by the government and its resources are almost immediately available. It's principle weakness is that it can only carry a small share of the military cargo likely to be needed. Within the fleet it owns or controls, less than three dozen ships are estimated to be ideally suited for sealift of military supplies. The remaining ships are useful for such military purposes as transportation of fuel or undersea surveillance.

(2) The National Defense Reserve Fleet (NDRF) - The availability of the NDRF is limited only by the time required for break out. Questions have been raised, however, regarding its reliability. The fleet is primarily made up of old World War II victory ships. As of October 1981, 130 ships remained in the fleet ranging in age from 30-40 years. The fleet has been critized by some as technically and operationally obsolete. Others state that despite their age, the NDRF ships are in relatively good condition, having been operated only during call up periods in the early 50's and late 60's. MARAD generally replaces older vessels as newer vessels are turned over to the NDRF. In 1980, 32 ships were added to the NDRF and 33 older ships were withdrawn.

The Ready Reserve Fleet RRF), which is a subset of the NDRF, consists of the best ships which could be made available within 10 days of an emergency. Activation tests are periodically carried out in the RRF without advance warning to test their availability. GAO has recently stated that the vessels in the RRF have met readiness tests. In a NATO war, the RRF would provide the initial response capability, and the balance of the NDRF would play an important role in the movement of resupply and as a source of replacements for ships lost to enemy action during the initial phases of deployment. On balance, it appears that the fleet should continue to be viewed as an important part of sealift resources.

(3) U.S. Flag Merchant Fleet - The greatest strength of the U.S. flag merchant marine in time of emergency is its availability. The availability of the fleet is governed by the Merchant Marine Act of 1936 which permits requisitioning, purchase, or charter of any vessel owned by U.S. citizens or under construction within the U.S. whenever the President

declares a national emergency or proclaims that needs of national security make it advisable.

This availability is further assured through the Sealift Readiness Program. As a prerequisite of receiving ODS and CDS subsidies, P.L. 96-459 requires that the participating U.S. flag merchant ships must be offered to the Sealift Readiness Program (SRP) and be made available upon request by the Military Sealift Command. In addition, any company that contracts with the Military Sealift Command to transport military supplies must offer 50 percent of its U.S. flag fleet to the Sealift Readiness Program. From both sources, there are presently 169 dry cargo ships offered by 10 companies and 36 tanker ships offered by 14 companies in the SRP. Ships in the SRP are considered to be third in the normal sequence of sealift resource utilization in the event of an emergency.

While the fleet is available and reliable, only a portion of it is considered ideally suited for the transport of military cargo. Thirty-six percent of the current U.S. privately owned oceangoing merchant fleet is considered by DOD to be directly militarily useful for dry cargo sealift. More merchant marine ships are not considered directly useful for military purposes because, according to DOD, to be ideally suitable for military purposes ships must be fast, able to handle outsized (large) military equipment, and have a shallow enough draft to get into small unimproved port facilities.

During the last 10 years, the design of commercial ships has been increasingly toward containerization and specialization, focusing on increased fuel efficiency rather than speed. These changes which are designed to improve efficiency and commercial viability have limited the ability of the commercial fleet to meet military needs. The extent to which commercial features limit the usefulness of the U.S. fleet depends on the length, location and type of war to be fought. The point to be made is that only a portion of the fleet can be counted on without substantial retrofit to carry military cargo.

(4) Effective U.S. Controlled Fleet (EUSC) - The lack of suitability for transport of military goods is also a disadvantage of a portion of the EUSC. Only about 15 dry cargo and 52 tankers are considered by DOD to be ideally suited for direct military use. The reason for the relatively small number of ships which would be ideally

suited for direct military purposes is as noted earlier, a result of the inconsistency between the types of ships that are beneficial for commercial and military purposes. The bulk of the effective U.S. controlled fleet are tankers. Of the dry cargo ships, many are of a highly sophisticated design requiring complex cargo handling and support facilities, the availability of which would depends upon the location of the conflict.

While suitability for military purposes presents some problem, the major issue regarding the EUSC ships is their availability . While DOD considers them to be a reliable source, MARAD continues to claim that there is a substantial risk in depending upon them for transportation of military supplies.

The idea that the EUSC Fleet could be counted upon as a viable asset to augment U.S. sealift capability has been accepted by the Department of Defense since the early 1960's. This idea is based on four reasons: first, contracts in effect between MARAD and affected shipowners include callup procedures; second, the laws of Honduras, Panama and Liberia contain no restrictions on U.S. use and these countries are likely to remain neutral in time of war; third, there is the precedent of World War II during which Honduran and Panamanian registered vessels were fully assimulated in the U.S. war effort; and finally, EUSC fleet shipowners have obtained war risk insurance indicating their intent to serve when called.

Although these reasons continue to be valid, there continues to be considerable controversy regarding the availability of these ships. Critics of this system say that even though DOD counts on EUSC fleet for support, the risk continues to be great. For example, they believe that foreign crews may be reluctant to expose themselves to risk, hence real manpower shortages could develop in the event of emergency. Or, they assert that the flag of convenience countries may take action that is counter to U.S. policy, as occurred in 1973 when the President of Liberia reaffirmed his country's support of the Arab position by issuing an executive order forbidding all vessels of Liberian registry from delivering supplies to the Middle East for the duration of the conflict (Yom Kippur War). Such critics tend to overlook the fact that the U.S. did not try to requisition or charter ships during that war. Therefore, the order did not interfere with the availability of such ships to the U.S. In addition, 80 percent of the crew personnel of EUSC ships come from NATO countries, and it

is not likely that there would be large defections if the ships revert to U.S. control. Perhaps the most telling point is that as recently as August 1981, the Secretary of Defense stated "we have no basis to believe that most of the ships would not be available when needed."

Free world shipping - It is not possible to obtain an estimate of the number of free world ships suitable for military purposes. The major issue with regard to this fleet, however, relates to its availability and reliability. Is it likely that these ships, which are neither owned or controlled by U.S. citizens, will be made available for U.S. military purposes in time of war?

As discussed earlier, much of the free world shipping is controlled and manned by countries likely to be our allies in a military conflict. In the event of a NATO war, contingency procedures have been established to make non-U.S. NATO shipping available to the U.S. for the reinforcement of Europe. Nearly 650 dry cargo ships are earmarked to satisfy a potential requirement that has been estimated to be 400 bottoms.

There is some concern, however, that NATO ships cannot be counted on in the event of a non-NATO emergency because the country of registry is likely to retain the vessels to prevent their own national interests from becoming threatened during the conflict. Similarly, concern has been raised regarding the possible unwillingness of foreign crews to particiрte in support of U.S. military action.

With regard to the risk of free world nations preventing their ships from being used in support of U.S. military forces, it does not appear likely that such actions would occur in the face of a major confrontation. In a smaller conflict, the elimination of the ships of any single country or small group of countries would not significantly impact on the supply of available sealift resources. A concerted action by all major free world shippers would sharply reduce sealift availability, but there is no precedent for such action. One difficulty in judging the likely response of free world shipping to U.S. military requirements in time of war has been the tendency on the part of the U.S. in the past to maximize the use of the U.S. active fleet in such situations (e.g., Viet Nam). The result of this desire to keep business for U.S. ships has been that ships registered in free world nations have not been requested to provide sealift for military purposes.

not put to the test

with regard to the reliability of foreign crews, contacts with the Navy and Center for Naval Analysis have failed to produce any analysis which would validate the seriousness of this problem. There is little evidence based on post war history which would indicate a likelihood that the international shipping community would substitute politics for economic incentives, but it is not possible to prove this point in any systematic way.

Summary

A number of points are worthy of note:

(1) It is not possible to estimate exact needs for military shipments with complete accuracy as a result of the numerous uncertainties regarding the nature and extent of a conflict.

(2) The U.S. Merchant Marine, while an important source of sealift, should be viewed as only one of a number of available resources. Government owned reserve ships and other sources of sealift such as the EUSC fleet and the fleets of other nations shoud be viewed as important providers of sealift in time of war. Agreements and tradition argue strongly that the EUSC fleet would be available when needed. Similarly, the ownership and crewing of free world shipping provide assurances that this source of sealift will remain available in times of war.

(3) Moreover, the utility of the U.S. merchant fleet should not be over emphasized, since a large portion of the fleet is not ideally suited for military purposes.

(4) Public assistance has not been primarily focused on increasing the usefulness of the merchant marine for military purposes. The thrust has been on commercial viability and those factors which improve the utility of certain types of ships for commercial purposes, often limiting their suitability for transporting military supplies.

There are no simple conclusions that can be drawn from the analysis. Most of the major arguments advanced in support of assisting the U.S. merchant marine for national security reasons are seriously flawed. Nevertheless, the presence of this fleet does provide some margin of safety in terms of availability and

reliability that is not exactly duplicated in non U.S. sources of sealift. The seriousness of the risks the merchant marine may assist the nation to avoid are impossible to measure with accuracy. There is little evidence that these risks are very great, but ultimately a willingness to assume any national security risk is a question of political judgment.

IV. Economic Transport Security

Quite apart from military needs, public assistance has been justified on the basis that a U.S.-flag merchant marine is required for the Nation's economic security to ensure access to materials and supplies essential to the U.S. economy in both peacetime and war. It is claimed that relying on foreign flag ships to handle U.S. commerce and supplies constitutes a large national security risk because these shippers may prove to be unreliable.

Many of the points raised earlier with regard to the use of foreign flag shipping for supplies during a long term conflict apply here. To develop a fuller perspective, a review of the composition of the major fleets of the world and the proportion of U.S. ocean borne commercial cargo carried in both tonnage and value by U.S. flag ships is useful.

As shown in Table 2, 9 of the 10 top major merchant fleets in the world belong to free world countries, 8 are U.S. allies. The first and sixth ranked fleets, belonging to Liberia and Panama are, as discussed above, composed of a large number of U.S.-owned ships. In the foreseeable future it is not likely that there are any circumstances under which our allies would restrict the ships under their registery from U.S. trade. In the event of a war, it would be in the interests of all allied nations to ensure the supply of raw materials and bulk commodities to maintain the U.S. as well as their own domestic economies.

U.S.-flag ships currently carry only 4.2 pecent of total tonnage of U.S. ocean borne commercial tonnage and 14.7 percent of the total dollar value as shown in Tables 3a and 3b. It was not possible to determine the proportions carried aboard subsidized ships, but even the overall data indicate that only a small portion of the Nation's commerce is carried aboard U.S. flag ships. Therefore, such ships provide only a small cushion to support the U.S. economy if foreign suppliers withdraw from the U.S. market. Moreover, there is no reason to believe that such a withdrawal will occur. During the 1970's there were a number of abnormal worldwide events which caused disruptions in shipping

patterns and worldwide shortages in shipping, but U.S. commerce was never seriously interrupted. During such times, the United States possessed the capability to bid away the shipping it needed from other users. It is reasonable to assume that in the future, the international shipping community will continue to respond to economic incentives and the U.S. will be able to obtain sufficient commercial shipping when needed.

In summary, the argument that the U.S. must maintain a U.S. flag fleet for economic security to reduce the U.S. dependence on foreign shippers, does not stand up to scrutiny. While the risks are impossible to measure precisely, there is little reason to believe events will occur which would jeopardize U.S. access to shipping services required to maintain the flow of raw materials and strategic goods needed for the domestic economy.

TABLE 2

MAJOR MERCHANT FLEETS OF THE WORLD - JANUARY 1, 1980

Country	No. of Ships1/	Rank by No. of Ships2/	Deadweight Tons	Rank By Deadweight Tonnage
Liberia	2,380	3	158,702,000	1
Greece	2,876	1	63,542,000	2
Japan	1,751	5	61,192,000	3
United Kingdom	1,110	6	41,937,000	4
Norway	632	9	39,494,000	5
Panama	2,347	4	35,257,000	6
U.S.S.R.	2,512	2	21,590,000	7
United States (Privately Owned)	569	11	20,540,000	8
France	359	17	19,884,000	9
Italy	624	10	18,489,000	10
Spain	506	12	12,656,000	11
Germany (Federal Republic)	502	13	12,485,000	12
Singapore	667	7	12,341,000	13
China (People's Republic of)	645	8	9,372,000	14
India	363	16	9,100,000	15
All Others3/	6,955		114,321,000	
TOTAL	24,798		650,902,000	

Source: Maritime Administration Annual Report, 1980

TABLE 3a

U.S. OCEANBORNE FOREIGN TRADE/COMMERCIAL CARGO CARRIED
Tonnage (Millions)

Calendar Year	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Total Tons	473.2	457 4	513.6	631.6	628.9	615.6	698.8	775.3	775.6	823.1
U.S.-Flag Tons	25.2	24.4	23.8	39.9	40.9	31.4	33.8	34.8	32.1	35.0
U.S. Percent of Total	5.3	5.3	4.6	6.3	6.5	5.1	4.8	4.5	4.1	4.2
Liner Total Tons	50.4	44.2	44.6	51.3	51.4	44.3	49.8	47.8	56.5	57.0
Liner U.S.-Flag Tons	11.8	10.1	9.8	13.2	15.3	13.6	15.4	14.4	16.0	15.7
Liner U.S. Percent	23.5	22.9	21.9	25.8	29.8	30.7	30.9	30.2	28.3	27.5
Non-Liner Total Tons	240.7	220.7	242.6	281.9	282.7	275.3	289.6	289.0	308.8	342.7
Non-Liner U.S.-Flag Tons	5.4	4.8	3.8	4.5	5.0	3.8	4.9	5.7	4.5	3.6
Non-Liner U.S. Percent	2.2	2.1	1.6	1.6	1.8	1.4	1.7	2.0	1.5	1.0
Tanker Total Tons	182.1	192.5	226.4	298.4	294.8	296.0	359.4	438.6	410.3	423.4
Tanker U.S.-Flag Tons	8.0	9.5	10.2	22.2	20.5	14.0	13.6	14.6	11.6	15.7
Tanker U.S. Percent	4.4	4.9	4.5	7.4	7.0	4.7	3.8	3.3	2.8	3.7

Source: Maritime Administration Annual Report, 1980

TABLE 3b

U.S. OCEANBORNE FOREIGN TRADE/COMMERCIAL CARGO CARRIED
Value ($ Billions)

Calendar Year	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Total Value	49.7	50.4	60.5	84.0	124.2	127.5	148.4	171.2	195.8	242.1
U.S.-Flag Value	10.3	9.9	11.1	15.9	22.0	22.4	26.4	28.0	30.7	35.7
U.S. Percent of Total	20.7	19.6	18.4	18.9	17.7	17.5	17.8	16.4	15.7	14.7
Liner Total Value	33.5	32.4	37.4	49.6	63.4	64.0	75.8	82.3	99.9	117.6
Liner U.S.-Flag Value	9.7	9.2	11.1	15.9	22.0	22.4	26.4	28.0	30.7	35.7
Liner U.S. Percent	28.8	28.4	27.7	29.1	30.6	31.2	31.6	30.7	28.6	27.6
Non-Liner Total Value	12.2	13.2	17.4	25.2	34.7	36.6	38.2	42.7	52.5	62.0
Non-Liner U.S.-Flag Value	.4	.4	.4	.7	.8	1.0	1.1	1.2	1.0	1.1
Non-Liner U.S. Percent	3.3	3.1	2.4	2.5	2.3	2.8	2.8	2.8	1.8	1.7
Tanker Total Value	4.0	4.9	5.7	9.2	26.0	26.9	34.4	46.2	43.4	62.5
Tanker U.S.-Flag Value	.2	.3	.4	.8	1.8	1.4	1.4	1.6	1.1	2.1
Tanker U.S. Percent	5.6	5.5	6.2	9.1	6.9	5.1	4.2	3.5	2.7	3.4

Source: Maritime Administration Annual Report, 1980

V. Shipbuilding

National security arguments regarding the granting of public assistance to maintain the U.S. commercial shipbuilding industry require careful review. Supporters of the industry frequently cite as a justification for public assistance a need to maintain a U.S. shipbuilding mobilization capacity to convert, overhaul, repair and construct naval and commercial vessels in time of a national emergency. They argue that without such assistance, the major private U.S. shipyards would be unable to compete with lower cost foreign yards. As a result, at least some U.S. shipyards would close, skilled shipyard labor would find other sources of employment and the active shipyard mobilization base would fall short of that required for national security needs.

Opponents to public assistance counter by citing facts that public assistance currently represents only a small portion of the shipbuilding activity in the shipyards considered to be in the U.S. active shipbuilding base. Further, they argue, the recently announced Navy shipbuilding program and the increased demand for non-ship construction activity are likely to sustain the capacity required in the event of a major national emergency.

This section examines these arguments in greater detail.

- It reviews the requirements for a U.S. shipbuilding and repair mobilization base as defined in the most recent study - a 1978 Maritime Administration/Navy interagency review;

- It reviews the available resources to fulfill these requirements with a particular emphasis on the U.S. shipyards considered to be the active shipbuilding base;

- It illustrates the historical and current roles of private merchant ship construction, Navy ship construction and public assistance in maintaining the base;

- It discusses the projected changes in the demand for shipyard capacity resulting from projected commercial ship construction, the proposed Navy shipbuilding program, and increased demand for non-ship construction and repair and overhaul work; and

- It discusses the implications of the projected changes for the shipyards included in the active shipbuilding base and the overall shipbuilding industry.

A major conclusion of this section is that shipyard production employment in the 24-27 major shipyards defined as the active

shipbuilding base is presently somewhat below the level which has been estimated by MARAD and Navy to be required to maintain the mobilization base. Employment in these yards will decline from present levels through mid-1983 as a result of decreased demand for commercial shipbuilding. However, employment will begin to rise again to the level estimated to be required as the bulk of the Navy shipbuilding contracts are awarded in mid-1983.

Subsidy programs currently account for only 4 percent of the production employment in these yards. Based on MARAD projections it is estimated that elimination of funding for subsidized vessels included in the commercial shipbuilding projections will result in a one quarter delay in the beginning of recovery for the major yards. For the industry as a whole, including both the shipyards in the active shipbuilding base as well as additional yards that would be relied upon in the event of war, it is projected that commercial and Navy repair and overhaul work, and other non ship work such as off-shore oil rig construction will maintain a private sector industry work force which will adequately meet requirements for mobilization purposes throughout the period of the 80's.

Requirements for a Shipbuilding Mobilization Base

The most recent study of U.S. shipbuilding mobilization base requirements -"National Security and National Defense Objectives - Shipbuilding Base," (classified - 1978) was conducted by a MARAD/Navy interagency task force. The study outlines U.S. shipbuilding mobilization requirements assuming short and long term war situations with the former defined as a 90-day intensive NATO/Warsaw pact conflict and the latter as the same 90-day intensive war followed by 33 months of low level hostilities. In the study, shipbuilding capacity requirements were derived based on a number of assumptions regarding such factors as:

(1) The way mobilization needs would be perceived by the U.S. Government at the onset of a major war,

(2) length and extent of hostilities,

(3) commercial and Navy shipbuilding programs in place at the initial stages of a major war,

(4) attrition levels, and

(5) division of the repair and building work load between U.S. and European shipyards.

The specific resource requirements in the study were derived by a MARAD computerized model that took into account the compatability of facilities available in 1978 with the characteristics of ships to be built, activated, converted, or repaired, and the time required for such activities. Because of the staff and time constraints on this study effort, OMB did not attempt to validate the assumptions used in the Navy/MARAD study. Rather, the study's basic estimates of requirements, as modified slightly by more recent analysis efforts undertaken by MARAD, were accepted as given.

Based on the computer model, the 1978 joint MARAD/Navy study concluded that for a short war the current capacity of U.S. shipyards available for mobilization purposes would be adequate to meet mobilization demands and labor availability would also be adequate. With regard to a long war, the study found that the current U.S. shipbuilding capacity would be sufficient for the initial phases of the war, but over the longer term, augmentation would be required to assure a capacity to build all of the ships needed. The study noted that as the war progresses, the availability of shipyard facilities rather than steel or labor availability would represent the primary constraints on meeting shipyard mobilization requirements. The study estimated, however, that the additional capacity needed for a long war could be provided by the expansion of existing shipyards or the use of Great Lakes yards which were determined to be inappropriate for the work required in the event of a short term conflict. The study recommended that to assure that the shipyard mobilization base continued to be adequate, measures should be taken to insure against degradation of existing shipyard capacity.

In terms of specific numbers, the study identified twenty-four shipyards as the major commercial yards which would be relied upon for mobilization purposes. These yards accounted for almost all peacetime construction of Naval and merchant oceangoing ships. The study estimated that the 24 yards had about 82,000 production workers and recommended that this level be maintained for mobilization purposes. In addition, the study indicated that the entire shipyard mobilization base should be viewed as including an additional 30 or so shipyards which, while not actively involved in major commercial construction work, would be required in time of war. The study estimated that including these yards raised the required premobilization work force to between 117,000 and 152,000.

In May 1981, MARAD conducted an update of shipyard mobilization requirements. MARAD estimated a required shipbuilding mobilization base of 54 yards supported by 136,000 workers. Of this, 24 yards and 82,000 workers were required to be engaged in shipbuilding for oceangoing vessels. In short, this most recent estimate agrees with

the 1978 study which is used in this report as a basis for making comparisons regarding shipyard mobilization adequacy in the future.

A few points should be made regarding the basic findings of the Navy/MARAD study and the present study's reliance on these findings. The estimated level of 82,000 production workers determined in the study to be the minimum required in the yards providing construction of ocean going vessels exactly equals the number of those workers that were employed in the yards when the study was done. Moreover, the 1978 production employment level was the highest level of production workers since World War II. The level represented almost a doubling of the number of production workers in the same 24 yards at the beginning of the decade - 44,000 in 1970. In short, the study determined that the highest level of employment achieved in shipyards in the past 30 years was exactly the level needed to be maintained for national security purposes.

While there is no substantive reason to doubt the validity of the Navy/MARAD approach, and the results of the 1978 study are utilized throughout this section, it must be noted that no means of independent varification of the data could be obtained. As noted above, it was not possible to validate the assumptions and methodology of the 1978 study. MARAD analysis done since that time has used the same assumptions and therefore cannot be used as a means of validating the 1978 study.

Current Capacity and Available Shipbuilding Resources

As indicated above, the U.S. shipbuilding base is comprised of two groups. The major group currently consists of 24-27 commercial shipyards which fulfill the Nation's need for oceangoing vessels. These yards, as shown in table 4, are generally referred to as the "active shipbuilding base" because each has the capacity to construct and repair major oceangoing ships. As of July 1981, total employment of production workers in the active shipbuilding base stood at 74,1[illegible]0, somewhat below the 82,000 estimated to be required as an adequate premobilization base. Ten of the yards are considered principal producers by the Navy. The remaining yards include those that are presently doing commercial shipbuilding, concentrating on ship repair, and producing smaller ships, patrol, and service craft.

Historically, these yards have depended upon a combination of subsidized and nonsubsidized private, Navy, Coast Guard constuction

TABLE 4
ACTIVE SHIPBUILDING BASE
PRIVATE YARDS

Company	Location	Total Production Workers (July 1981)
Alabama Drydock & Shipbuilding Co.	Mobile, Alabama	1,581
American Shipbuilding Co.	Lorain, Ohio	--
*Avondale Shipyards Inc.	New Orleans, Louisiana	5,980
*Bath Iron Works Corporation	Bath, Maine	5,644
Bay Shipbuilding, Inc.	Strugeon Bay, Wisconsin	1,241
Bethlehem Steel Corporation	San Francisco, California	197
*Bethlehem Steel Corporation	Sparrows Point, Maryland	1,872
Equitable Shipyards, Inc.	New Orleans, Louisiana	800
*General Dynamics/Electric Boat	Groton, Connecticut	20,347
General Dynamics/Quincy	Quincy, Massachusetts	2,858
Halter Marine, Inc.	New Orleans, Louisiana	2,110
*Ingalls Shipbuilding Division	Pascagoula, Mississippi	9,462
Levingston Shipbuilding Co.	Orange, Texas	1,578
*Lockheed Shipbuilding & Construction Company	Seattle, Washington	--
Marinette Marine Corp.	Marinette, Wisconsin	620
Maryland Shipbuilding & Drydock Corp.	Baltimore, Maryland	1,036
*National Steel and Shipbuilding Company	San Diego, California	5,372
*Newport News Shipbuilding & Dry Dock Company	Newport News, Virginia	17,947
Norfolk Shipbuilding & Drydock Corp.	Norfolk, Virigina	2,571
Peterson Builders, Inc.	Sturgeon Bay, Wisconsin	897
Tacoma Boatbuilding Co., Inc.	Tacoma, Washington	1,781
Tampa Ship Repair & Dry Dock Co.	Tampa, Florida	406
Todd Shipyards Corporation	Galveston, Texas	823
Todd Shipyards Corporation	Houston, Texas	464
*Todd Shipyards Corporation	Los Angeles, California	3,543
*Todd Shipyards Corporation	Seattle, California	3,347
	TOTAL	74,140

*The asterisk denotes those yards where most Navy construction is now focused.

and repair as shown in Table 5. Since 1978, the proportion of ship construction generated by MARAD subsidy has decreased 63 percent while the overall production employment in the active shipbuilding base has decreased by less than 6 percent. As of 1981, MARAD subsidies supported only 4 percent of the production employment in these yards.

Table 5

Average Monthly Employment in the U.S. Active Shipbuilding Base As of May 1981

Ship Construction, Conversion, and Repair (Percent of Total)

Year	Total (Actual)	MARAD*	Navy	Other Fed	Private
1969	50,417	22%	60%	--	18%
1970	43,961	7%	68%	--	25%
1971	44,144	18%	61%	--	21%
1972	49,546	28%	52%	--	20%
1973	54,850	21%	58%	--	21%
1974	60,953	15%	56%	--	29%
1975	62,393	19%	55%	--	26%
1976	67,606	22%	52%	--	26%
1977	78,844	12%	65%	--	23%
1978	81,582	11%	68%	--	21%
1979	80,370	10%	78%	--	12%
1980	74,964	9%	76%	--	15%
1981	76,580	4%	67%	--	29%

* Private commercial ships which received construction differential subsidy.

In addition to the active shipbuilding base, the industry overall consists of an additional approximately 580 shipbuilding and ship repair companies. Of these 93 percent (445) have less than 100 employees and correspondingly have limited facilities. The remaining yards, are primarily engaged in building a blend of smaller boats, barges, or rigs, and other equipment, particularly for the inland and coastal waterways. About 40 of these shipyards are considered to be part of the mobilizatior base which would be of use during a conflict. In addition, to these private yards must be added eight naval shipyards. Four of these yards have not built ships since the 60's. They retain the physical capability to construct naval ships, but a period of planning, facility improvements, and training would be required to return these shipyards to production.

As of May 1981, 180,000 workers were employed in the entire industry. Approximately 87% of the workers (157,000) work in yards considered part of the mobilization base. Therefore, it appears that the current level of employment is within the range deemed to be required in the Navy/MARAD study. Recent employment levels are shown below.

Table 6

Historical Employment in Privately Owned Shipyards

Year	Shipbuilding and Repair
1977	174,100
1978	172,000
1979	171,600
1980	170,400
1981 (Jan.)	173,000
1981 (May)	180,200

Projected Shipyard Activity

This section reviews the types and volume of future activity projected for the shipbuilding industry. As discussed in greater detail below, a number of uncertainties affect these estimates and they should be viewed primarily as orders of magnitude. The impact of these estimates on the activity and employment levels of U.S. shipyards is reviewed in the next section.

Commercial Shipbuilding

As of July 1981, the Maritime Administration anticipated the following merchant ship construction contract awards in the FY 1982-1986 period.

Table 7

Fiscal Years

	1982	1983	1984	1985	1986	Total
Total	8	15	13	19	9	64

These estimates, which include 2 to 7 CDS ships per year, are only tentative because of uncertainties in world shipping conditions,

availability of government subsidy, and possible changes in government regulation. MARAD has informed OMB staff that this estimate is currently under review.

Navy Shipbuilding Program

At the beginning of 1981, 89 Navy ships and submarines and 4 Coast Guard ships were under contract, with an additional 33 Navy ships authorized by Congress not yet under contract. At this writing the FY 82 Navy budget as amended includes 15 new construction projects, 12 conversions including two reactivations, and the acquisition and conversion of three existing ships. The stated Administration goal is that the strength of the overall naval fleet will be raised to 600 ships and 15 battle groups. This will require a program that will build and modernize a mix of approximately 30 ships per year, approximately 20 new and 10 conversions. The FY 82 ships have not been contracted so it is not possible to determine the impact of the program on specific yards. However, it is estimated that the bulk of the program will probably awarded in FY 1983 and later, and the effect on shipyards will only begin to be felt in mid-1983.

Non-ship Construction

During the next couple of years the demand for nonship construction and repair and overhaul work is anticipated to enhance commercial shipyard workload. Rising oil prices have spurred a recovery in demand for offshore rigs constructed in shipyards, especially for new jack up rigs. By the end of 1980, 76 riggs were on order with 10 builders in the U.S. Four of the builders: General Dynamics, Groton; Bethlehem Steel, Sparrows Point; Ingalls, Pascagoula; and Levingston Shipbuilding, Orange; are included in the U.S. active shipbuilding base.

Impact on the Shipbuilding Industry

Figure 1 illustrates the impact of the projected work load on the active shipbuilding base as of July 1, 1981. As shown, because of the lag in the initiation of new Navy construction, employment in the active shipbuilding base is anticipated to drop from the level of 82,000 estimated to be required for mobilization to a level of approximately 67,000. This low level of employment is anticipated to continue for only a short time. As the Navy program picks up,

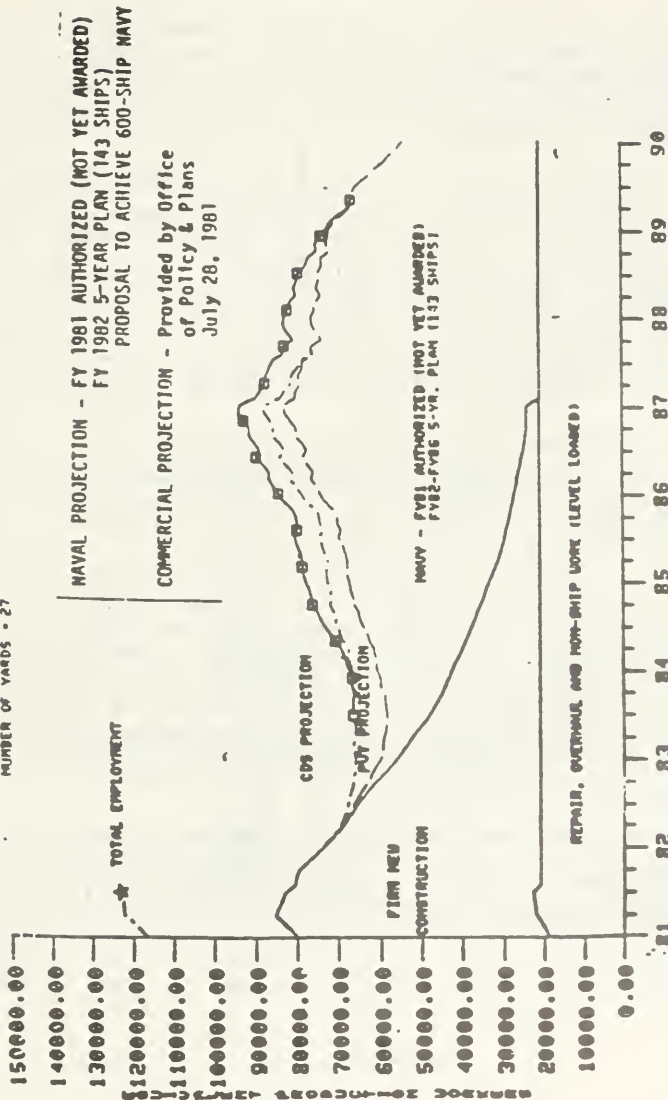


FIGURE I
SHIPBUILDING INDUSTRY WORKLOAD PROJECTION
ACTIVE SHIPBUILDING BASE SUMMATION
NUMBER OF YARDS - 27
NAVAL PROJECTION - FY 1981 AUTHORIZED (NOT YET AWARDED)
FY 1982 5-YEAR PLAN (143 SHIPS)
PROPOSAL TO ACHIEVE 600-SHIP NAVY
COMMERCIAL PROJECTION - Provided by Office
of Policy & Plans
July 28, 1981
TOTAL EMPLOYMENT
CDS PROJECTION
PDT PROJECTION
FIRM NEW
CONSTRUCTION
NAVY - FY81 AUTHORIZED (NOT YET AWARDED)
FY82-FY86 5-YR. PLAN (143 SHIPS)
REPAIR, OVERHAUL AND NON-SHIP WORK (LEVEL LOADED)
150000.00
140000.00
130000.00
120000.00
110000.00
100000.00
90000.00
80000.00
70000.00
60000.00
50000.00
40000.00
30000.00
20000.00
10000.00
0.00
81
82
83
84
85
86
87
88
89
90
JULY 1, 1981

the yards which depend on Navy ship orders will remain active for several years. While it is too early to judge the impact of this program on particular yards, it does appear that overall, the Navy program in concert with private sector maritime activities will assure an adequate level of employment in the active shipbuilding base well into the 1980's.

In the period before 1983 the decline in estimated demand may result in layoffs. The extent of this is not clear because of difficulties in estimating the demand for such projects as construction of specialized vessels for domestic trade, construction of barges; ready reserve fleet deactivations/ activations, construction of offshore drilling rigs and work on Navy auxillary crafts and Navy subcontracts. Even if layoffs occur, however, MARAD staff have indicated that it is not likely that the shipyards in the active shipbuilding base will go out of business or that the physical plant in the active shipbuilding base will disappear, particularly in light of the Administration's commitment to an increased Naval force.

MARAD's foregoing estimates are not greatly affected by the availability of public assistance. OMB has been informed by MARAD staff that if the subsidized vessels were eliminated from the commercial shipbuilding projection, the reduction might possibly delay recovery of the active shipbuilding base to the required mobilization level for one-quarter.

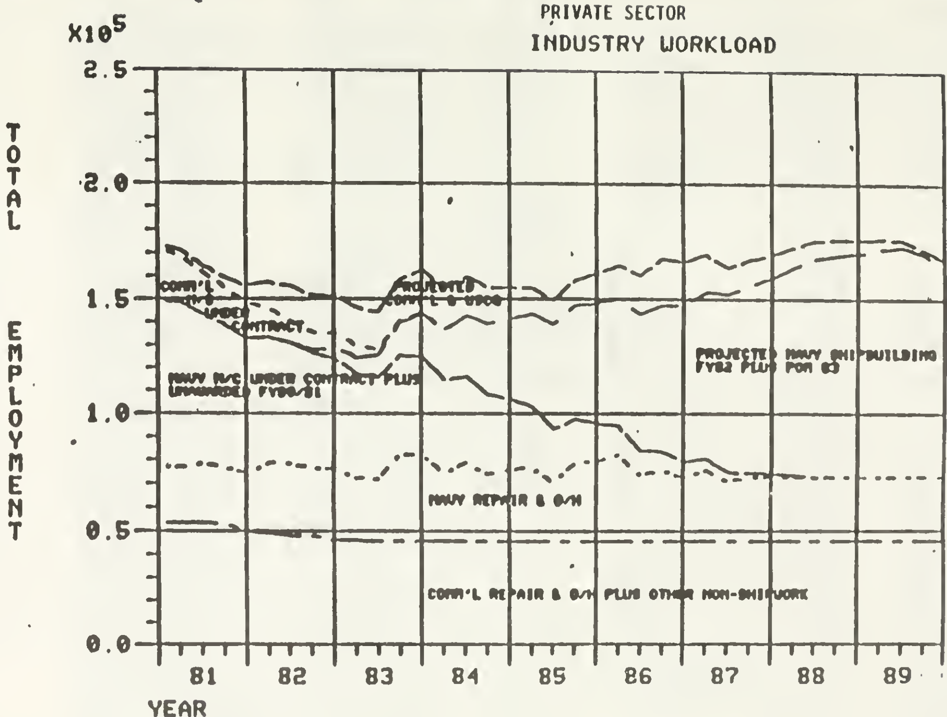
Figure 2 reflects the anticipated employment for the private shipbuilding industry as a whole. It has not been possible to obtain projections of employment levels for just those yards in the mobilization base. However, in 1978, employment in such yards equalled 87 percent of total industry employment. The industry as a whole is estimated to maintain an employment level of over 150,000 workers through 1989. Assuming that the proportion of employment in yards in the mobilization base to all yards has remained constant since 1978, the projections indicate that the level of employment in the mobilization base identified in the MARAD/Navy study will be sustained throughout the decade.

In summary, while there are substantial uncertainties involved in making estimates of this type, it appears that an adequate shipyard mobilization base will be maintained throughout the 80's and that the adequacy of the base will be affected only marginally by the presence or absence of public assistance.

* FOR OFFICIAL USE ONLY *

FIGURE 2

PRIVATE SECTOR
INDUSTRY WORKLOAD



SOURCE: Naval Sea Systems Command

Part III - Conclusions and New Directions

Summarizing, the purpose of this study has been to review the current direct and indirect Federal assistance programs to the maritime industry and the basic economic and national security rationales traditionally used to justify such assistance. The major conclusions of the study include:

- The national goal established in the Merchant Marine Act of 1970 to increase the market share for U.S.-flag liner, non-liner, and tanker operations has not been achieved with the current programs. The share of U.S. foreign cargo carried aboard U.S.-flag ships decreased from 1970 to 1979, falling from 5.3 to 4.2 percent of total tons and from 20.7 to 14.7 percent of total value.

- The direct assistance programs have not stimulated the increased level of efficiency in the U.S. maritime industry envisioned in the 1970 Act. Costs to construct vessels in the U.S. and to operate under a U.S. flag continue to exceed the comparable costs of foreign competitors.

- The economic rationales of balance of payments, employment and public revenue benefits to the nation used to justify Federal assistance to the industry are weak. Overall, economic benefits derived from the subsidy programs are negligible when viewed in the context of the entire national economy and contributions of non-subsidized industries.

- National security arguments provide little justification for assistance to the industry. While the presence of the U.S.-flag fleet does provide a margin of safety not exactly duplicated by foreign-flag fleets, there is no basis for believing that non-U.S.-flag ships would not be available in an emergency. Navy ship construction, overhaul and repair are sufficient to maintain, without a direct subsidy program, the shipbuilding and ship-repair mobilization base required in case of a national emergency.

In light of these findings, it is clear that a continued reliance on the policies and approaches set down in the 1970 Act will bring few positive results for the U.S. maritime industry or the nation as a whole in the 1980's. The failure of the programs to obtain program goals and objectives and the weakness of the economic and national security rationale suggest that the current policy of providing direct assistance to the industry may be outmoded.

To provide a basis for considering needed changes, this section discusses two alternatives for future U.S. maritime policy regarding direct Federal assistance. Both assume the continuation of indirect assistance and implementation of the Administration's recent maritime regulatory policy initiatives. The alternatives are:

1. Termination of direct Federal assistance to the maritime industry.

2. Redefinition of national maritime goals and objectives, and a continuation and restructuring of direct assistance programs.

Termination of direct Federal assistance to the maritime industry would be consistent with the findings and conclusions of this study, and free market principles. Elimination of direct assistance programs would reduce distortions in the market allocation of productive resources. This approach, together with the recent Administration regulatory proposals which allow shipping conferences greater freedom to set rates within certain guidelines without fear of prosecution under Antitrust laws, could create an economic environment conducive to a more competitive U.S.-flag fleet.

This approach is also a logical extension of the recent Administration policy and budget decisions to limit the availability of construction differential subsidies and to fund no new commitments for operating subsidies. The CDS decision recognizes the relatively minor role construction subsidies play in U.S. shipyards and is consistent with a belief that it makes little sense for the Federal government to continue to provide direct assistance that does not contribute to improving the long term viability of the U.S.-shipbuilding industry. Similarly the operating differential subsidy program appears to provide little more than temporary help in covering up the real causes of financial distress afflicting the U.S. shipping industry.

There are factors which limit the Administration's ability to terminate the direct assistance programs. ODS is paid under legally binding contracts entered into by the shipping operators and the Government for up to 20 years. A recent GAO staff legal analysis of the ODS contracts concluded that the contracts create vested rights and are property, and Congress may only terminate ODS contracts if it makes just compensation to the contract holders. GAO noted, however, that there is an exception to the requirement for compensation in that Congress could terminate the

contracts under the power of the Commerce Clause - power to regulate commerce with foreign nations - if it could demonstrate that the U.S.- flag fleet would be in a better competitive position without the contracts or another form of aid or that the program is not fulfilling its national defense objectives.

An alternative approach to termination of the direct assistance programs would be to redefine national goals and objectives for the U.S.-flag fleet and restructure the direct assistance programs accordingly.

The first step would be to redefine national goals and objectives in light of current national priorities and needs. Commercial and national security goals and objectives should be made clear and distinct to facilitate an efficient use of any type of Federal assistance. In the past, because the objectives were not distinguished, subsidy funding decisions to achieve a commercially viable fleet often conflicted with the development of U.S.-flag merchant vessels considered to be ideally suited for national defense sealift purposes. On the other hand, military approvals and constraints have added costs to commercial operations, affecting the competitiveness and economic viability of subsidized vessels. Future maritime policy goals and objectives should reflect the differences in military and commercial needs and expectations.

National security arguments may lead to a continuation of a direct subsidy program. As noted earlier in Part II of this report, the U.S.-flag fleet provides a margin of safety not exactly duplicated by the availability or presence of foreign flag ships. As discussed in the analysis, there is little reason to believe that foreign flag ships would not be available when needed, but there is some risk. The seriousness of the risks that the merchant fleet may assist the nation to avoid are impossible to measure with accuracy, and a willingness to assume any national security risk is a question of political judgment. If we are risk averse, then some form of direct subsidy may be required to maintain a U.S.-flag fleet for sealift purposes.

There are several means available for enhancing the efficiency of the ODS program to fulfill national security objectives. (It is assumed that for reasons noted in the section on shipbuilding that continuation of CDS will not be considered). For example, one method could include defining a large role for the Department of Defense in subsidy decisions, possibly including DOD cost sharing and joint responsibility with the Department of Transportation and the Maritime Administration for choosing the types of vessels to receive operating differential subsidies. A

larger role for DOD would also balance the commercial interests of DOT and MARAD.

If, on the other hand, it is decided that the main objective of assistance should be to improve the commercial viability of the U.S. merchant marine, a number of program changes should be made in the ODS program to enhance the efficacy of the program and to provide incentives for improving the competitiveness of the fleet. The types of program changes presented in the past include:

- Some form of competitive bidding or lump subsidies - this may bring the subsidy level down and improve efficiency by providing incentives to subsidized carriers to use the least cost combination of inputs to provide a given level of service.

- Output-based subsidies - Each operator's subsidy would be calculated on the basis of the amount or value of the cargo carried, providing incentive to implement labor saving techniques.

- Competitive rate of return - Revenues generated and full costs incurred by an operator including return on capital invested would be used as the basis of a subsidy to guarantee a minimum rate of return.

These approaches require further study to determine the degree to which they would enhance the commercial competitiveness and long term development of the U.S.-flag fleet. It is our recommendation that the Department of Transportation review and redefine national goals and objectives of the U.S. maritime industry and if a direct subsidy program continues to be required, thoroughly examine these and other approaches to enhancing the efficacy of the program.

PREPARED STATEMENT OF WILLIAM L. HIGGINS III

Mr. Chairman, distinguished Members of the Committee, McDermott is very pleased to provide the following testimony in support of S. 990—The Shipbuilding Trade Reform Act of 1993. We want to recognize and express our sincere appreciation for the extraordinary leadership of Senator Breaux and, of course, Senator Mitchell, in tirelessly pursuing the interests of the United States shipbuilding industry and, in particular, for sponsoring this important legislation. In addition, we deeply appreciate the strong testimony and support presented by Senators Mikulski and Lott today—two of our industry's stalwart champions.

For the record, McDermott is a worldwide marine and energy services company headquartered in New Orleans. Founded in 1923, the company had gross revenues of $3.17 billion in fiscal year 1993 of which approximately 52 percent was derived from marine construction services, including shipbuilding. McDermott maintains operations in more than 30 countries and employs approximately 28,500 people. About one third of those employees are involved in the marine construction and shipbuilding activities of the company. McDermott operates a medium-sized shipyard in Morgan City, Louisiana, which builds ships up to approximately 700 feet in length.

Mr. Chairman, as you know, McDermott has taken a very active interest in the development of this legislation, and there is a very simple reason for this—WE JUST WANT THE OPPORTUNITY TO COMPETE. We are convinced that this legislation is the key to that opportunity.

As an industry, U.S. shipbuilders were once heavily supported by the United States government—in part through the Construction Differential Subsidy (CDS) program. In 1981, however, we were summarily cut-off from the CDS program with no apparent thought or plan as to how this once vast industry might move forward—how it might make a successful transition from a largely government-dependent industry to one which would be able to stand on its own two feet in a free market environment. At the time, what may have concealed the profound fallacy of the 1981 decision was a temporary surge in Navy activity in response to cold-war demands. But that shot in the arm from the Navy only provided a short-term reprieve from the inevitable crisis our industry now faces.

The crisis is that, during the 12-year void in shipbuilding trade policy that followed the 1981 decision, we were left to the mercy of a literal feeding frenzy by foreign governments to carve up the world's commercial shipbuilding market amongst themselves until today, there is virtually no free market environment left in which the U.S. industry can participate. Each of these foreign governments has purchased a share of the world market with subsidy programs of truly staggering proportions. We are advised that the top six shipbuilding nations provide $9 billion in shipyard subsidies annually, offsetting from 28–40 percent of their yard's costs of production per ship. Such subsidies are nothing more than expensive social programs designed by foreign governments to prop-up and defend their heavy industrial bases and the employment it supports. They have used their subsidies to buy American jobs, and the impact on our industry has been devastating.

What really irks many of us is that these same countries—particularly the basically non-militarized nations of Germany and Japan—could afford those expensive subsidy programs because the United States was spending its money—not on protecting its share of the shipbuilding market—but, instead, on footing the bill for Japan's and Germany's protection during the Cold War. Today, as those and other countries continue to storm forward with their complete domination of the world shipbuilding market, Americans are instead consumed with how to pay for the enormous deficits we incurred in protecting the free world. This is a bitter irony for those 120,000 American victims of foreign shipbuilding subsidies who lost their jobs since 1981.

Nevertheless, McDermott Inc. has a very *positive vision* for its shipbuilding future which we believe is shared by the many in the U.S. shipbuilding industry. Our *vision* is to achieve international market competitiveness in the construction of commercial cargo, passenger and special purpose vessels. Our *optimism* stems in large part from our belief that this Congress is sincerely committed to filling the shipbuilding policy void of the past—and S. 990 represents a centerpiece of this commitment.

The potential before us is enormous—the world shipbuilding market is projected to surge by nearly 10,000 ships—a 40 percent growth—in the next decade. At McDermott, virtually all that stands in our way is access to that opportunity.

Today, the U.S. shipbuilding industry does not have one significant shipbuilding market in which to compete, and this has created a strong disincentive for private capital investment in competitive U.S. shipbuilding facilities, technology and innovation. McDermott is a company with a strong entrepreneurial perspective—we do

not advocate what we feel would be a doomed U.S. policy of attempting to fight foreign subsidies with U.S. government subsidies. Nor are we anxious to return to a heavy, long-term dependence on government construction subsidies which can actually stifle U.S. technological development and competitiveness. Short term defense conversion assistance may be appropriate, and is another key element of a successful U.S. shipbuilding policy, but only for so long as it takes to complete such conversion.

Instead, what we do advocate is the simple business axiom that—with access to a market comes the opportunity for profit; with the opportunity for profit comes capital investment; with capital investment comes technological competitiveness; and, from all of this, will come prosperity. We need your help, Mr. Chairman, and the commitment of this Administration, to put this chain of events into motion by helping us gain access to the international shipbuilding market. To reiterate: the conclusion of a multilateral agreement for a free and fair world shipbuilding market will create a natural business incentive for private capital investment to flow into American shipbuilding facilities, technology and innovation which will, in turn, lead to the competitive construction of commercial vessels. Furthermore, U.S. investment will attract international joint venture partners willing to share technology with U.S. yards in order to capitalize on the upcoming surge in shipbuilding demand. U.S. technological competitiveness will be achieved, in part, through access to a free and fair shipbuilding market.

Mr. Chairman, there are those here today who may oppose the bill, suggesting that even if foreign shipbuilding subsidies are eliminated, the U.S. shipbuilding industry will still never be competitive. Well, Mr. Chairman, I sit before you this afternoon as a real-world example of a U.S. shipyard that does compete—despite outrageously unfair foreign competition—at least in certain specialized areas of construction. Due to our ownership in offshore fabrication yards around the world, McDermott is uniquely positioned in the international construction arena, and is often evaluated with the U.S. Gulf Coast, European and Asian construction markets. I can assure you that we successfully compete against, and win, major construction contracts in these areas and have the ability to evaluate costs on major projects. Our analysis clearly confirms the dockside competitiveness of a commercial vessel built in the Gulf Coast with Europe and Asia. Absent subsidies, the primary barriers to entry are: decades of tooling modernization, marketing exposure and multiple vessel contract philosophy.

As you know, McDermott recently competed in the shipbuilding market to win the contract to build a sulphur carrier to be operated by the Louisiana company "International Shipholding Company" (ISC) to carry cargo for Freeport-MacMoRan. To our knowledge, that ship, which is being constructed at our Morgan City yard, is today the only private sector ocean going ship being built in a U.S. shipyard. We did this against all odds in the subsidized world of shipbuilding that exists today—Can you imagine what we could do tomorrow if only we had a fair shot?

If our competition in the world market today was merely that of other private companies, we would be out there right now. But, we are not competing with other private companies, we are competing against the policies of foreign governments backed by the fiscal assets of entire nations. Those assets help defray the production costs of our foreign competitors by 28 or more ! Mr. Chairman, we are indeed a competitive company—but no amount of technology, productivity or efficiency could ever be expected to overcome that size of a competitive advantage enjoyed by our foreign competition.

At this point it should be self-evident that current trade law is completely inadequate to permit the successful conclusion of a negotiated agreement which would provide U.S. shipbuilders with reasonable access to the international market. Three years of intensive negotiations by the Office of United States Trade Representative (USTR) failed to result in such an agreement. These same negotiations were resumed in September and we are advised that, once again, meaningful progress has been stymied by the key foreign shipbuilding nations. At McDermott, we believe strong yet responsible trade legislation effectively designed to enable the USTR to conclude a multilateral shipbuilding trade agreement is the key element of a successful U.S. policy with respect to shipbuilding. Apparently, President Clinton believes this too—based on his recently announced commitment to work closely with Congress toward the enactment of this legislation.

We believe your bill would provide the necessary impetus for the successful conclusion of multilateral or bilateral trade agreements. In direct support of future efforts by the USTR to achieve an agreement, your bill would create new authority and very specific administrative procedures for the Secretary of Commerce to investigate foreign shipbuilding subsidy practices, to identify which foreign governments are providing shipbuilding subsidies, to monitor and enforce trade agreements for

the elimination of shipbuilding subsidies, and to appropriately sanction those nations which refuse, after a reasonable opportunity, to enter into such trade agreements.

We believe the mechanisms and penalty provisions set forth in your bill would provide a credible threat to bring other nations to the table and into an agreement. At the same time, they provide the necessary degree of flexibility and discretion for our negotiators. The penalty provisions of your bill are clearly not designed to be merely punitive or broadly disruptive to trade, as some might suggest, but are instead designed to target specifically those foreign governments whose subsidy policies must be changed. Sanctions would be applied only against those vessels which are the direct constituents of those governments which, after being given a reasonable opportunity, fail to reach a negotiated agreement for the elimination of their trade-distorting subsidy practices. Such vessels would include those which are registered under the flag of the offending nation and those operated by citizens or corporate entities of such nation. It should be clear that the primary objective of this legislation is nothing less than the conclusion of a negotiated free and fair trade agreement to provide U.S. shipbuilders with fair access to the world shipbuilding market.

Mr. Chairman, we are in full support of your bill and stand ready to be of whatever assistance we can in achieving its enactment. We would like to bring to your attention that, consistent with the President's commitment to work closely with Congress toward the enactment of shipbuilding trade legislation, McDermott and the shipbuilding industry have been fortunate to have had the recent opportunity to work in close cooperation with representatives of the USTR and the Commerce Department in suggesting revisions to the House counterpart to your legislation—H.R. 1402, sponsored by Congressman Gibbons. We believe that the revisions which were reported out from the House Subcommittee on Trade last week will be effective in securing definitive support from the Administration and in relieving some of the concerns expressed by other sectors of the maritime community. To that extent, we simply want to bring those revisions to your attention in the context of your further consideration of this legislation.

Finally, Mr. Chairman, I would like to stress the need for Congress to follow through with their consideration of shipbuilding trade legislation all the way to enactment. While there is no doubt that the mere consideration of such legislation by Congress with the support of the Administration provides strong motivation for foreign countries to begin talking about resolving the shipyard subsidy problem, we believe that it will not be until the President signs such legislation into law that the U.S. will have provided a credible enough threat to actually secure an agreement with these nations. To this point, we urge you to continue to press on with this legislation until it is signed into law.

Mr. Chairman, the outstanding American men and women who build ships are at the very heart of our industrial and military base, yet they have been left virtually defenseless by a lack of strong U.S. policy to combat unfair trading practices in the shipbuilding industry worldwide. We thank you for your commitment to rise in the defense of these Americans and in the defense of an industry so central to our economic and national security. At McDermott, we feel privileged to have worked closely with you and your fine staff in this important endeavor and you can be assured of our continued support for your efforts to see this legislation through to enactment. Thank you for your consideration and this opportunity to present our views.

Responses of Mr. William Higgins, McDermott Inc., to questions asked by Senator Grassley

1. What benefit is it to the American shipbuilding industry to penalize and harm their customers for making logical and rational business decision that every other business would make - that is, buying the lowest priced product available? In this case, it happens to be vessels.

(1) It is our understanding that the purpose of S. 990, The Shipbuilding Trade Reform Act" is to threaten ship operating companies of foreign subsidizing countries with potential sanctions which will encourage them to put pressure on their host governments to negotiate an agreement for the elimination of shipbuilding subsidies. It is our understanding that foreign ship operating companies were selected because it is not possible for the U.S. to impose sanctions directly on the foreign subsidizing governments. It is our further understanding that such sanctions would only be imposed on certain vessels if such host governments refused or otherwise failed to conclude agreements for the elimination of subsidies.

In our opinion, it would be of great benefit to the American shipbuilding industry to have access to an international shipbuilding market which is not distorted by foreign shipbuilding subsidies. Our company firmly believes it will be able to effectively compete in the international commercial shipbuilding market if given a level playing field, and that the only means available to secure such a level playing field is through negotiated agreements with such foreign governments. Since such negotiations through the OECD have for over 4 years failed to produce an agreement, we believe that S. 990, and its companion legislation in the House of Representatives, is necessary to put sufficient pressure on foreign governments to conclude an agreement which will provide U.S. shipbuilding companies with fair access to a level playing field in the international shipbuilding market.

2. Will you support putting the Jones Act, cargo preference, captital construction funds, Operating Differential Subsidies, and the new shipbuilding subsidies recently included in our defense bills on the OECD and GATT negotiating tables so that the United States can get serious about fighting unfair foreign subsidies?

(2) It is our understanding that decisions regarding what specific issues will or should be "put on the table" for negotiating a shipbuilding agreement are the prerogative of the Office of the U.S. Trade Representative. We have and continue to actively support all reasonable efforts of the USTR to conclude an OECD shipbuilding agreement which contains the necessary elements to provide U.S. shipbuilding companies with fair access to a level playing field in the international shipbuilding market.

PREPARED STATEMENT OF SENATOR TRENT LOTT

Mr. Chairman, I am pleased that the International Trade Subcommittee is holding this hearing and I want to thank you for allowing me to testify on S. 990, the Shipbuilding Trade Reform Act of 1993, and the important issue of the United States shipbuilding industry.

This is important to me personally. I grew up on the Gulf Coast of Mississippi in Pascagoula. My Father was a pipefitter at the shipyard there and I know how much the shipbuilding industry added to my hometown while I was growing up.

Furthermore, this issue is important to my State. Mississippi is home to numerous shipyards: Ingalls Shipbuilding, Inc. in Pascagoula; Halter Marine, Inc. in Moss Point; Trinity Marine Group in Gulfport; and other facilities too numerous to name here. My fellow cosponsors of S. 990—Senator Breaux and Senator Mikulski—can testify how much shipyards add to the economic base of their states, as well.

Most of all, Mr. Chairman, I truly believe that this legislation is important for America. Let me tell you why:

First, shipyards provide high paying jobs for skilled workers that actually produce something of value. Shipyards add to the economic base of this Nation—over 100,000 workers are currently employed in the shipbuilding industry. Thousands more are employed in related industries.

Second, shipyards are important for this country's national security. With the end of the cold war the United States Navy is no longer as large as it was just a few years ago, but America is still a maritime nation that relies on trade and the freedom of the seas. The Navy is vital to our national security and the capability to build our own ships is essential to our Navy.

Mr. Chairman, this Nation is in real danger of losing this essential shipbuilding base. In the past eleven years, over fifty shipyards have closed their doors putting more than 44,000 production workers out of jobs. The main reasons for these closures is the very problem S. 990 is designed to address—foreign shipbuilding subsidies.

In 1981 the United States unilaterally ended the Construction Differential Subsidy or CDS program. We expected that the rest of the world would follow our example and dismantle subsidies to their shipbuilding industries. We were wrong. Instead of dismantling their subsidies, other countries increased subsidies to their shipyards to assure increased shares of the world shipbuilding market. Other countries knew how important shipbuilding could be to their economies. Shipbuilding industries abroad expanded; ours started a long, slow decline that has yet to be stopped.

Almost five years ago the Shipbuilders Council of America acted to address the issue of foreign subsidies and end this decline of the U.S. shipbuilding base. The SCA filed a Section 301 petition with the United States Trade Representative. That petition was withdrawn at the USTR's request and negotiations were initiated with other shipbuilding nations under the Organization for Economic Cooperation and Development. Those negotiations are still going on. Our shipyards are being negotiated to death while our negotiating partners continue to subsidize their shipbuilding industries. Here are some examples:

Since 1988, the average annual shipyard subsidies to competitors of U.S. shipyards have included:

$2.4 billion in South Korea;
$2.3 billion in Germany;
$1.9 billion in Japan; and
$940 million in Italy.

Mr. Chairman, subsidies are not the answer. I believe U.S. shipyards can compete if given a level playing field. I believe S. 990 is the best way to encourage other countries to stop subsidizing their yards.

S. 990 provides an incentive for other countries to end their subsidy practices by linking discontinuation of those subsidies to access to U.S. ports for vessels owned by nationals of the subsidizing countries.

Mr. Chairman, we have a great window of opportunity here. Over the next ten years, the world market will require between $300 and $400 billion worth of new vessel construction. We have a choice. Our shipyards can build a fair share of those vessels if we pass legislation this Congress. Thousands of jobs and millions of dollars can be added to the American economy. Or we can do what we have done in the past—we can do nothing. We can continue to allow other nations' shipyards to have an unfair advantage over our shipyards and watch the jobs go elsewhere. I think the choice is clear.

I am encouraged by recent developments. The Administration has shown a strong interest in the U.S. shipbuilding industrial base and proposed a new shipbuilding plan. With my colleagues, I worked in conference to include the National Shipbuilding Initiative (NSI) in the final version of the Department of Defense Authorization bill. The NSI contained a number of provisions (such as a Federal Ship Financing Program for export sales of vessels) that should encourage shipbuilding here in the United States.

I understand that the House Ways and Means Subcommittee on Trade recently reported out an amended version of H.R. 1402, the Shipbuilding Trade Reform Act of 1993, that addressed a number of the Administration's concerns and brought the House bill closer to S. 990. I urge this Committee to seriously consider the House bill and S. 990 and work to enact this legislation this Congress. We need this legislation if other countries are ever going to end their shipyard subsidies and United States shipyards are going to prosper.

PREPARED STATEMENT OF SENATOR BARBARA MIKULSKI

Mr. Chairman, I thank you for the opportunity to speak at your hearing on the Shipbuilding Trade Reform Act of 1993. I am proud to be an original sponsor of this shipbuilding reform bill.

If America's shipbuilding industry is going to survive we must eliminate unfair subsidies by foreign governments to shipbuilding and repair operations within their borders.

This bill will: (1) Promote free and fair trade in international shipbuilding, (2) Support the shipbuilding and ship repair industries that are vital to the United States national defense and economic security, and (3) Prevent the complete disappearance of American commercial shipbuilding.

This legislation would require the Secretary of Commerce to list all countries that subsidize commercial ships. Those countries would be required to sign an International Trade Agreement with the U.S. to stop their unfair trade practices—or the U.S. would impose sanctions.

My hometown of Baltimore, and other great American industrial and maritime centers, are cities of contrasts. They're cities of rebirth and revitalization. Yet, they are also becoming cities of empty shipyards and abandoned steel mills.

In Baltimore, we had two thriving shipyards in 1981. Over ten thousand people made good family wages building ships. Now, only a dozen years later, Baltimore has lost one of those shipyards, and only 1,250 people are actively employed.

From the late sixties to 1981, Baltimore's shipyards built more than fifty ships. Many of them were tanker or container ships for commercial customers. Since 1981, only two ships were built in Baltimore, and those were for the Navy.

With the end of the cold war and the emphasis to decrease the deficit, shipyards will not be able to exist on Navy work alone

The story is the same across the country. In 1981 the U.S. unilaterally ended all shipbuilding subsidies. Now, almost all commercial shipbuilding has moved overseas. In 1981, the U.S. had 49 merchant ships under construction. In 1988-89 we had zero. In the 1980's unfair foreign subsidies cost America over 120,000 shipyard jobs, and half our shipyards.

Enough is enough.

Worldwide demand for commercial ships is expected to triple in the 1990's. American workers want to build those ships. It's time we make certain that no more jobs are lost, and no more shipyards and steel mills closed down because we're not ready to fight against unfair trade subsidies.

I know the administration has pledged to work on an international agreement to end subsidies and unfair trade practices. Because of that pledge they have reopened negotiations at the O.E.C.D. (Organization for Economic Cooperation).

I want these negotiations to succeed. But years of previous negotiations have not ended foreign government subsidies. If we are going to save U.S. shipbuilding capability we can't wait any longer. We must end foreign government shipbuilding subsidies now. There are 2,235 days until the year 2000. We must prepare Maryland and the U.S. for the future. We must ensure a U.S. shipbuilding and repair industry is with us in the 21st century. We must stop foreign subsidies that steal American business. We must give American businesses a level playing field. This bill does not subsidize American workers. They don't need subsidies. Our workers and our companies can compete anywhere in the world. But they can't compete against foreign governments. Our government should be ready to make sure they don't have to.

I am proud to be an original sponsor of this critical legislation.

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PREPARED STATEMENT OF H. GEORGE MILLER

U.S. shippers are universally opposed to passage of S-990. Unilateral action by the United States against the world fleet that moves 96% of U.S. international maritime trade would seriously disrupt the flow of U.S. exports, increase U.S. transportation costs and result in the loss of hundreds of thousands of jobs in the U.S. export industries.

SCOT, Shippers for Competitive Ocean Transportation, is an organization of major U.S. international maritime shippers and associations representing major U.S. industries. The companies represented by SCOT account for over 60% of U.S. liner exports and for substantial volumes of bulk movements, both imports and exports, and for liner imports. We have worked closely with major industries like coal, petroleum and agricultural interests who are not SCOT members and these groups also support the shipper position presented in this testimony.

Shippers do support the intent of this bill, to eliminate the subsidies of shipbuilding and ship repair so that U.S. shipyards can compete fairly in the world commercial shipbuilding market. However, we believe that the solutions proposed in S-990 would be disastrous to the U.S. economy and may offer little, if any, protection for jobs in the U.S. shipbuilding industry.

We urge the Subcommittee on Trade to consider carefully the concerns of U.S. industry on the adverse impact of this proposed bill on U.S. trade and on our balance of international payments.

Maritime Administration statistics confirm that in 1992 the United States relied on the world fleet to move 96% of its international maritime trade volume. U.S. flag vessels moved about 17% of our total liner volume and only 1% of the bulk volume. Table I indicates that approximately 78% of the capacity of the world fleet would be blacklisted under S-990, unless each country agreed to immediately eliminate its shipyard subsidies. The results of this action would be disastrous to the U.S. economy.

S-990 would require the assessment of a fine of a minimum of $500,000 on all vessels owned or flagged in countries who are determined to subsidize shipbuilding. Since economic operation of liner vessels requires that they deliver and pick up cargo in each country, the fine for liner vessels would be $1,000,000 for each round voyage to U.S. ports. Liner operators would have to pass on these tremendous fines to U.S. shippers. Realistically, S-990 will assess these mandatory fines of U.S. importers and exporters not on the owners of blacklisted vessels. Since only the United States would be assessing these draconian fines the rates on U.S. exports would become substantially higher, while rates from all other competitive world producers would remain unchanged. Substantial loss of market would occur.

As an alternative, the Secretary of Commerce would be required to force the owner of the vessel to reduce calls at U.S. ports in half. The owner could not meet any long term contract commitments which he had made to move U.S. cargoes and there would be a shortage of capacity to move U.S. maritime shipments. These actions would be particularly damaging to the charter markets for bulk vessels. A very significant volume of U.S. liner imports move under service contracts that assure U.S. exporters they will have a steady supply of containers and transport capacity at fixed rates to meet commitments to customers around the world. The mandatory action against the blacklisted vessels under S-990 would force the carriers to terminate these critical service contracts. Importers rely on these service commitments of carriers to assure timely delivery of seasonal merchandise.

Disruption of the timely flow of goods, particularly seasonal products, would be severely damaging to U.S. retailers and to U.S. consumers.

Bulk products traditionally move under both short and long term charters with vessels of the world fleet. Many U.S. industries are dependent on charter of a fleet of specialized vessels that carry chemicals, lumber and paper products, coal and grain. Our studies indicate that 75% to 90% of these specialized fleets are owned or flagged in countries likely to be blacklisted under S-990. Without the economic availability of these world bulk fleets, billions of dollars of U.S. exports would be lost.

The United States is dependent on imports to supply between 45 and 50% of its petroleum requirements. The assessments of fines against the world tanker fleet that moves these cargoes and the disruption of long term charter arrangements required under S-990 would be particularly damaging to the oil industry. The cost of fines would be added to the freight cost to move U.S. oil. The restriction of access to the U.S. trades of a substantial part of the world tanker fleet, by fine or by the 50% reduction of voyages for a blacklisted vessel, would significantly increase the cost of oil for all U.S. industry, agriculture, transportation and consumers. It would have a significant inflationary impact on the economy. Since only the U.S. would be applying these fines and restrictions, our energy cost would increase while the cost for the rest of the world remained unchanged.

Unilateral action against the world fleet without which the United States economy cannot function is not an economically feasible way to deal with world shipbuilding subsidies. We should not try to resolve a problem for a special interest group in a manner that severely damages the total U.S. economy. S-990 allows the Secretary of Commerce no flexibility to exercise judgement on what level of penalty is justified by the specific subsidies or to take into account the damage his action may do to the U.S. economy.

Table I indicates the countries that would be subject to blacklisting under S-990, using a 1993 report by the Maritime Administration (MARAD) that summarized world shipyard subsidy practices. That report omitted the former communist countries, the PRC and the countries who were part of the Soviet Union. These countries would certainly be subject to blacklist under the definition of subsidy in S-990. The countries recognized as subsidizing shipbuilding and repair in the MARAD study are listed in Part A of Table I and the communist countries and other countries known to subsidize shipbuilding are listed in Part B. The number of ships owned by each of these countries, based on ownership data from UNCTAD, is listed as well as the deadweight capacity of these vessels. This shows that 78% of the capacity of the world fleet would be subject to blacklisting under S-990.

One can speculate whether a specific country would actually be subject to blacklisting, or that some of the countries may elect to enter into unilateral agreements with the United States to eliminate their subsidies. Some probably would enter into an agreement to eliminate subsidy to avoid blacklisting. The point we wish to emphasize is that a very significant disruption of U.S. maritime trade would occur with removal of even 25% of the fleet. If a substantial percentage of the world fleet were prevented from serving U.S. trades, or if a substantial part of the tanker fleet or specialized bulk fleets were affected, the damage to U.S. commerce would be extremely serious. In the liner trades the severe disruption of any major trade route would be damaging.

It is also very important to recognize that it will be difficult for any country to eliminate subsidies unless they are assured other major shipbuilding and ship repairing countries will follow suit. Although difficult to accomplish, multilateral action is critical to the countries who wish to eliminate shipyard subsidies and to shippers. With multilateral action one can assume that freight rates will increase as ships will cost more. As long as these increases apply to all world shippers, the relative cost to U.S. shippers should not materially change and loss of markets will be minimal. It is unilateral action that will seriously damage U.S. shippers.

It is also important for Congress to recognize that the U.S. has not entered the OECD negotiations with clean hands. From the beginning, the U.S. has refused to place cargo preference and the absolute restriction of foreign construction of Jones Act vessels on the bargaining table. U.S. flag operators, who build U.S. vessels abroad, are restricted from carrying reserved cargoes for several years. While the U.S. is pressing for a multilateral agreement to eliminate subsidies, Congress is considering the enactment of new subsidies for the U.S. yards. Without question many current U.S. practices would be considered subsidies under the definition of subsidy in the OECD shipbuilding drafts and in S-990.

This demand that other countries do as we say, not as we are willing to do ourselves, will increase the probability that many countries will elect to retaliate against U.S. carriers and U.S. commerce rather than be blackmailed into elimination of shipyard subsidies.

The shipbuilders have engaged in a campaign to lead Congress and the public to believe that a very considerable number of jobs have, and in the future, will be lost because of subsidizing of shipbuilding and repair by other countries. Many of these claims are included in the findings section of S-990. As outlined below, an independent study raised serious questions as to the accuracy of these estimates of job loss. It is important that Congress recognize that enactment and implementation of S-990 will place at risk over two million U.S. jobs dependent on U.S. exports.

The following industries have analyzed the impact of S-990 on their exports and export jobs and have determined enactment and implementation of S-990 would place a significant portion of the following export sales and export jobs at risk:

JOBS	EXPORTS BILLION $	ESTIMATED DIRECT EXPORT RELATED	
AUTOMOBILE INDUSTRY	47	940,000	(1)
CHEMICAL INDUSTRY	44	159,000	(2)
COAL INDUSTRY	4	20,000	(2)
FOREST AND PAPER INDUSTRY	17	115,000	(2)
AGRICULTURE	33	825,000	(1)
TOTAL	145	2,059,000	

(1) General estimate of 20,000 jobs per $1 billion exports for higher valued automobiles and 25,000 jobs per $1 billion exports for lower valued agricultural products.

(2) Based on specific data developed by each industry on direct jobs in manufacturing or mining.

The above table projects the number of jobs directly related to production of the products exported. Each of the five industries

move significant volumes of their exports under charter on specialized fleets of vessels. All except coal also move substantial volumes of exports on liner vessels.

The above table does not account for the additional $303 billion of exports in 1992 and the jobs related to marine movement of those cargoes.

The Department of Commerce has analyzed the number of total jobs involved in each billion dollars of exports and published data for the period 1980 to 1987 and updated the estimates for 1990.

For all sectors of the economy the number of jobs per billion dollars of exports declined from 26,900 in 1980 to 23,600 in 1985 to 19,100 in 1990. If we continue the downward trend to 1992 we would estimate 18,000 jobs per billion dollars of exports. Of the $448 billion of exports in 1992, 38.5% or $172 billion moved by vessel. If we assume 18,000 jobs per billion dollars of marine exports, there would be 3,105,000 jobs at risk if S-990 is passed.

Obviously, not all of the above jobs would be a risk as 20 to 30% of the world fleet may not be subject to blacklisting. Some countries may enter into agreements to discontinue subsidies. However, it is apparent that the impact of this bill will be extremely damaging to key industries and to the U.S. economy.

Enactment of S-990 and unilateral action against the world fleet that moves over 96% of our international maritime trade, would materially reduce U.S. exports and would result in the loss of hundreds of thousands of jobs in U.S. basic industries, in transportation and in U.S. ports. It will increase our already unacceptable unfavorable trade balance.

As noted, the U.S. chemical industry accounted for $44 billion of exports in 1992. While the greatest value of maritime exports moved by liner vessel, a very substantial amount moved on highly specialized chemical parcel tankers. The typical chemical cargo ranges from 100 to 1500 tons, is sensitive to contamination and may require specialized piping and pumps, stainless steel tanks and refrigeration or heating in transit. It is estimated that over 75% of the specialized world chemical parcel fleet would be subject to blacklisting under S-990. Without the economic availability of that fleet U.S. chemical producers could not participate in the world markets.

In 1992, the forest and paper industry accounted for $17 billion of exports. Many higher value products move on liner vessels in containers. A large volume of lumber, pulp and other products of the industry move on specialized large open hatch bulk vessels, the majority of which would be blacklisted under S-990. The industry estimates that S-990 would place at risk 1,215,000 jobs related to exports.

In 1992, U.S. coal exports amounted to $4.2 billion. This product moves exclusively on vessels of the world bulk fleet. Freight is a significant part of the delivered cost. Much coal is purchased f.o.b. the U.S. port with the buyer arranging for freight. Countries like Brazil and Japan are major purchasers of coal and use their own flag or owned vessels for movement of U.S. coal. Both of these major countries subsidize shipbuilding and would be blacklisted. They would not pay fines to move U.S. coal when they can secure the coal from other countries. Enactment of S-990 would place at risk 20,000 jobs in the coal mines as well as 140,000 related jobs of truckers, railroad employees, and barge and terminal operators who move the coal to port.

Most vitally affected would be the agriculture industry. Exports of agricultural products amounted to 33 billion in 1992. Many higher value products move on liner vessels, but large volumes of grain move on chartered bulk vessels. Freight is a significant part of the delivered cost. Enactment of S-990 would place at risk 825,000 jobs in agriculture as well as the jobs related to the storage, transportation and handling of the product at inland and waterfront terminals.

Exports of automobiles and parts amounted to $46.6 billion in 1992. Exports of passenger cars and trucks by the three major U.S. based automobile companies from U.S. and Canadian plants increased over 46% from 1990 to 1992. The U.S. automobile industry is dependent on the world fleet of auto carriers for movement of fully assembled automobiles and trucks and on liner vessels for movement of so called "knocked down" units. Enactment of S-990 could restrict automobile export as well as export of parts just as U.S. based companies are expanding their markets.

When the original shipbuilding bill was introduced in the House the Ways and Means Committee requested the International Trade Commission (ITC) to evaluate the impact of the proposed bill on the U.S. economy and on the shipyards. The ITC study noted that there had not been a commercial ship built for export in a United States yard since 1960. One of the findings upon which S-990 is premised is that:

"(5) foreign shipbuilding subsidies have caused, and threaten to cause, material damage to the United States shipbuilding industry, as evidenced by:

(A) the closure of 40 major shipyards and the loss of over 120,000 jobs in shipyards and their supplier base since 1981."

The inference is that there is a direct relationship between the foreign subsidies and the closure of U.S. yards and loss of jobs. Clearly if no ships have been built for the international market since 1960, there were no shipyard jobs in U.S. yards dependent on building commercial vessels for export in 1980. All U.S. shipyard jobs in 1980 were based on military building, on the construction of ships for the fully protected Jones Act trade, or for construction of U.S. flag vessels for U.S. carriers. All of the latter group received CDS subsidies from U.S. taxpayers. It follows that all jobs lost since 1981 resulted from the cutback in military spending, the elimination of U.S. subsidies for U.S. flag vessels, or the reduction in construction of Jones Act vessels.

International subsidies had nothing to do with the claimed loss of 120,000 jobs in U.S. yards <u>and their supplier base</u>.

The Shipbuilding Council of America (SCA) could argue that in the 1980's the U.S. yards could have replaced cutbacks in protected building for U.S. companies and military with vessels for export if foreign governments had not subsidized shipbuilding. Here again the ITC study provides solid data. It notes that the cost of construction of commercial vessels in U.S. yards in the 1980's averaged approximately double the cost of building similar vessels at world market prices. These are not rough estimates, but the detailed calculation of comparative cost by the Maritime Administration (MARAD) to determine the amount of money U.S. taxpayers would pay U.S. carriers to make the cost of U.S. vessels comparable to the cost of vessels built by carriers with whom they had to compete on the various trade lanes. While these CDS subsidies were routinely referred to as subsidies of 50%,

MARAD determined the percent of subsidy by dividing high the cost of U.S. construction into the world market cost. If we reverse this equation the subsidy was 100% of the world market price.

At this time, the typical subsidy did not exceed 25% although some vessels were bid in distress times and higher subsidies paid. It was the clear conclusion of the ITC that the U.S. was not competitive in the world market and, more important, that elimination of subsidies currently averaging 10 to 15% would not permit U.S. yards to compete. The ITC projected the world market price of the last commercial U.S. flag vessel delivered in 1992 and concluded it also cost more than 100% more in the U.S. yard, and that it took over twice the time to construct, as comparable vessels in foreign yards.

This data would also raise serious questions about the accuracy of the finding:

"(B) the potential loss of another 180,000 jobs if foreign subsidies are not eliminated."

First, all of the present 180,000 jobs are not at risk as Congress has budgeted and stepped up the schedule of military construction of warships and of fast vessels for rapid deployment of cargo in an emergency. Equally important, the ITC study concluded that elimination of a 10 to 15% subsidy by major world shipbuilding nations would be unlikely to have any impact on U.S. jobs until the U.S. yards improved productivity and became much more cost competitive.

The SCA ignores this independent study and merely repeats the litany of jobs lost and states, with no substantiation, that U.S. yards are or will be competitive, at least on some categories of specialized vessels.

What shippers want to emphasize is that enactment of S-990 is likely to have a very serious impact on jobs in the U.S. export industries. We urge the Senate to carefully consider the conclusions of the independent study by the ITC and to weigh the real potential loss of jobs in export industries with the claimed loss in shipyards by SCA.

In summary, SCOT speaks for the overwhelming majority of U.S. shippers in requesting that the Senate not enact S-990. Unilateral action will seriously limit U.S. exports, will cost real jobs in export industries and will add to the $1.1 trillion unfavorable balance of merchandise trade that we have incurred since 1981.

TABLE I

ESTIMATE OF PERCENT OF THE WORLD FLEET OWNED BY COUNTRIES THAT WOULD BE BLACKLISTED UNDER S-990 OR HR-1402

A. COUNTRIES IDENTIFIED AS SUBSIDIZING SHIPYARDS IN MARAD "REPORT ON FOREIGN SHIPBUILDING SUBSIDIES" JULY 1993

COUNTRY	NO. OF VESSELS OWNED BY COUNTRY	MILLION DWT OWNED	RANK DWT TONS OWNED
AUSTRALIA	96	2.9	34
BELGIUM	174	5.9	21
BRAZIL	257	9.8	15
DENMARK	630	12.7	11
FINLAND	172	3.6	30
FRANCE	263	6.2	20
GERMANY	1,143	15.5	10
GREECE	2,579	94.4	1
INDIA	435	10.8	14
ITALY	644	11.6	12
JAPAN	2,907	82.8	2
NETHERLANDS	601	5.2	26
NORWAY	1,476	56.8	4
PHILIPPINES	271	3.3	31
POLAND	283	3.7	28
ROMANIA	330	5.6	22
S. KOREA	627	17.8	9
SPAIN	426	5.3	24
TAIWAN	376	11.5	13
TURKEY	380	7.6	18
UNITED KINGDOM	925	23.4	8
SUBTOTAL	14,995	396.4	

B. COMMUNIST AND FORMER COMMUNIST COUNTRIES AND OTHER COUNTRIES LIKELY TO BE BLACKLISTED

COUNTRY	NO. VESSELS OWNED	MILLION DWT OWNED	RANK DWT OWNED
FORMER USSR	4,245	29.8	6
CHINA (PRC)	1,541	25.9	7
HONG KONG	672	32.1	5
SINGAPORE	417	7.0	19
YUGOSLAVIA	256	5.2	
SUBTOTAL	7,131	100.0	
TOTAL A & B	22,126	496.4	
PERCENT OF WORLD FLEET	80%	78%	

Footnotes:

1. These estimates are based on ownership of vessels listed in an UNCTAD Report "Review of Maritime Transport 1991."
2. Under these bills, vessels owned by subsidizing countries or flagged by those countries could be blacklisted. Some additional vessels may be added because of flag
3. The UNCTAD data listed ownership information for the top 35 shipowning countries. Omitted from Table I are 10 countries listed by MARAD for whom comparable ownership data was not available. These are: Bangladesh, Malta, Mexico, Morocco, Nigeria, Peru, Portugal, South Africa, Thailand and Uruguay. These countries had a fleet of vessels flagged in the countries of 593 vessels and 5.5 million DWT, about 0.9% of the world DWT.

REPONSES OF MR. MILLER TO QUESTIONS SUBMITTED BY SENATOR GRASSLEY

1. What benefit is it to the American shipbuilding industry to penalize and harm their customers for making logical and rational business decisions that every other business would make - that is, buying the lowest priced product available? In this case, it happens to be vessels.

Shippers believe that S-990 targets the wrong people, i.e., the owners of vessels that received subsidies, not the shipyards who receive subsidies or the governments who provide the subsidies. To compete in the total world market, owners must purchase their vessels at the lowest cost available. No owner can expect to survive if he unilaterally decides he will not take advantage of the best available price.

Shippers are extremely concerned at any attempt of the U.S. to take unilateral action to remedy world shipbuilding subsidies. All fines assessed against blacklisted vessels calling at U.S. ports will immediately be passed on to U.S. shippers and will increase U.S. rates relative to the rates paid by all competitive producers serving the world markets. In reality, S-990 fines U.S. shippers and U.S. consumers. The alternate severe penalty (or added penalty under S-990) would force owners to reduce voyages of blacklisted vessels that have served the U.S. by 50%. Since up to 75% of the world fleet capacity could be blacklisted under S-990, there is no way the U.S. could handle its international maritime trade if vessels are blacklisted. The U.S. is the largest user of the world bulk fleet. U.S. flag vessels carry only 1% of our international bulk trade and that is all reserved cargo moved at more than double the world market rates.

Implementation of S-990 will place at risk over $100 billion of U.S. marine exports and over 2,000,000 jobs in U.S. industry and agriculture dependent on those exports. Damage to the U.S. economy will be far more severe than damage to subsidized shipyards or governments who subsidize shipbuilding. Unilateral action is not an acceptable method of dealing with this issue.

2. Will you support putting the Jones Act, cargo preference, capital construction funds, Operating Differential Subsidies, and the new shipbuilding subsidies recently included in our defense bills on the OECD and GATT negotiating tables so that the United States can get serious about fighting unfair foreign subsidies?

While SCOT members have not taken a position on repeal of the Jones Act, many of our members are placed at a severe disadvantage as a result of implementation of the Jones Act and members have no objection to placing it or the other forms of subsidy listed above on the bargaining table.

SCOT members feel strongly that the current U.S. negotiating position in the OECD shipbuilding talks is unrealistic and invites retaliation, not cooperation to remove shipbuilding subsidies. Throughout the over 4 years of negotiation, the U.S. had insisted on the right to continue a number of the subsidies defined in the draft OECD Agreement, while insisting that all other countries eliminate those same subsidies. The Jones Act build American requirement, restriction on carriage of cargo preference cargoes on foreign built vessels, present and proposed research aid and capital construction funds are all defined as subsidies under the draft agreement and their retention only by the U.S. are examples of the U.S. refusal to live by the rules we would impose on other countries. It is also important to recognize that the U.S. yards have not built any commercial vessels for the world market (other than a minor amount of oil drilling rigs and supporting equipment) for over 30 years. We insist on setting the rules for a market in which we are not active and then insist on the unilateral right to ignore some of those rules.

We must be willing to put all U.S. subsidies on the table if we are to negotiate in good faith and expect other countries to cooperate. We cannot blame other countries for failure to reach agreement as long as we maintain our present unfair position. SCOT supports placing all of the listed U.S. subsidies on the table.

Prepared Statement of Senator Bob Packwood

Mr. Chairman, I have serious concerns about unfair foreign subsidies. Subsidized industries abroad can injure our own industries and deprive us of jobs. In shipbuilding and ship repair especially, subsidized foreign shipyards should not be permitted to undermine and destroy U.S. shipbuilding and ship repair capability.

The U.S. has been engaged for three years in international negotiations aimed at reversing the growing trend toward shipyard subsidies by our trading partners. Unfortunately, although they are continuing, these negotiations have been unsuccessful to date.

While I believe that a negotiated solution is probably our best long-term course, a legislative solution which forces countries to eliminate subsidies may be the only available option. I am examining the various proposals that have been introduced, in particular the bills that were recently introduced in the House and Senate. I do however, have concerns that any legislation we consider be consistent with our GATT obligations. I am not convinced that any of the legislation which has been introduced meets this criteria.

I would include in the Finance Committee Record, two letters written by the Port of Portland, raising concerns about how the shipbuilding legislation will impact the Port of Portland. The Port of Portland has raised legitimate points which need to be addressed before this legislation is further considered.

Thank you.

Port of Portland

Box 3529, Portland Oregon 97208
503/231-5000

April 22, 1993

Honorable Robert Packwood
United States Senate
259 Russell Building
Washington, DC 20510-3702

Dear Bob:

After reviewing the latest version of H.R. 1402, the anti-shipbuilding subsidy legislation known as the Gibbons Bill, I am writing to express the Port of Portland's opposition to the measure. Shipbuilding interests have discussed a Senate version of the bill, but nothing has been introduced yet.

Sponsors of the bill intend to stop foreign governments from unfairly subsidizing their shipyards. This is a laudable goal. Unfortunately, the impact on Portland and our shippers would be anything but positive.

If implemented as drafted, the penalties in the bill would have a serious impact on international trade through Portland and the Columbia River. Most vessels carrying cargo for Port customers are the very foreign flag vessels targeted by this legislation. Vessel owners and operators, not the governments of offending countries, would pay the fines of between $500,000 to $1 million per voyage. No flexibility is provided in levying these fines.

Several results are likely at the Port of Portland. Most harmful, many shipping lines would simply pass these charges along to their customers. For our low margin commodities, such as grain and pulp, the resulting price increase would mean Northwest products could not remain competitive in the world market for long.

Passage of the Gibbons Bill also would hamper Port efforts to attract new carriers to serve this market. The specter of such large penalties seriously harm our aggressive efforts to attract new lines to the Columbia River. A more limited, but still troubling result, would be the diversion of some cargoes, particularly containers, to Canadian ports.

In each of these instances, the net effect is to reduce exports from the Pacific Northwest, raise costs for U.S. producers, and threaten trade-related jobs.

Another troubling factor in the bill is its unilateral approach. While some U.S. shipyards also are subsidized in one form or another, the bill is silent about U.S. practices. In other words, we press other nations to act while the U.S. does nothing. Such an approach invites other nations to retaliate against the U.S. in return.

This is a particular worry to the Port of Portland because our own ship repair yard may fall within the guidelines of "subsidized" yard under the Gibbons Bill, simply because it is a government-owned facility. Reciprocal penalties established by other nations could make it unattractive for domestic and foreign owners to have their vessels repaired at U.S. yards receiving subsidies, as defined by the Gibbons Bill. Such foreign reprisal could be directed at the Portland Ship Repair Yard.

As you may be aware, this proposal has divided much of the maritime industry. Supporters are correct that U.S. shipyards are at an unfair disadvantage as a result of our unilateral decision in the early 1980s to curtail federal shipbuilding subsidies. Others are rightly concerned about the detrimental impact on trade and skeptical that the measure will cause foreign governments to change their policies. Strong opponents include the AFL-CIO Maritime Committee; American Association of Port Authorities; the American Institute of Merchant Shipping; National Grain and Feed Association; Pacific Northwest Waterways Association; and a number of individual ports.

While I agree that we must find a way to prevent these foreign subsidies from harming U.S. shipyards, I believe the best approach is through tough international negotiations, at a minimum, or amendments to the bill to target the offending governments rather than the shipowners and operators. Otherwise, the Gibbons Bill, if enacted, would have crippling impacts in the Pacific Northwest.

I hope this viewpoint is helpful to you. If you have any questions, or need further information on the perspective from the Port of Portland, I hope you will call on me at once.

Yours very truly,

Mike Thorne
Executive Director

November 17, 1993

Honorable Robert Packwood
United States Senate
259 Russell Building
Washington, DC 20510-3702

Dear Senator Packwood:

Several months ago, the Port of Portland wrote to you regarding legislation aimed at eliminating foreign shipbuilding subsidies, also known as the "Gibbons Bill." This year, a similar bill, S 990, was introduced in the Senate by Senator Breaux. That bill, we understand, will be the subject of a hearing before the Senate Finance Committee this week.

The Port of Portland is opposed to S. 990 as drafted. We agree that the U.S. must find some way to prevent foreign shipbuilding subsidies from harming U.S. yards, but we believe the best way is through tough international negotiations, not unilateral legislative action that would disrupt trade in this and other regions.

In our previous letter, we advised you of our strong opposition to both the House and Senate versions of foreign shipbuilding subsidy legislation. We stated that those bills could substantially injure the ocean carriers who serve the Oregon economy through the Port of Portland, the Oregon exporters who depend upon efficient cost-effective vessels, and as a result, the Port itself. Those bills would establish a harsh and rigid mechanism of fines for virtually all ships built or repaired in many foreign shipyards, without opportunity for appeal or consideration of other U.S. economic and policy interests. A copy of that letter is attached for your reference.

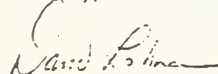
The recent House action incorporated many of the revisions proposed by a coalition of organizations including the U.S. Trade Representative, U.S. flag vessel operators, the American Association of Port Authorities, and importers and exporters. These changes significantly improve the bill by removing its retroactive impact, its arbitrary application of penalties and its troublesome definition of "subsidized" shipyards.

For these reasons, we believe that the House bill is improved, although the Port remains opposed.

We understand that Senator Breaux intends to incorporate many, if not all, the changes made to H.R. 1402 into his legislation. Nonetheless, S. 990 would continue to trouble us as it would limit opportunities for construction of vessels serving the Pacific Northwest exporters who utilize the Port of Portland.

We wanted you to be aware that this legislation still poses problems for the Port and its customers, even in view of the substantial improvements made since our last letter to you.

Sincerely,



David Lohman
Director, Policy and Planning

Prepared Statement of Donald Phillips

Good afternoon, Mr. Chairman and members of the Committee. I am Donald Phillips, Assistant U.S. Trade Representative for Industry. I am pleased to report to you on international shipbuilding issues and more specifically on legislation to deal with the problems facing the U.S. shipbuilding industry due to declining demand, defense downsizing, and especially foreign subsidization of shipyards. I will not address all of the proposed bills affecting this industry, but will present the Administration's views on S. 990, and its revised counterpart in the House, H.R. 1402.

In addition, I would like to give you an update on the status of the negotiations which are now being actively pursued under the auspices of the Organization for Economic Cooperation and Development (OECD) to eliminate shipbuilding subsidies. Finally, I would like to describe briefly the Administration's plan to help the shipbuilding industry recover its international competitiveness as set forth in the proposed National Defense Authorization Act.

Foreign Subsidies

This important industry has encountered serious challenges that have reduced demand for its output and have forced cutbacks in production and employment and reduced profitability. Worldwide demand for ocean going vessels declined sharply from 1974, when the number of ships on order peaked at 2824, to a low of 817 in 1987. This decline forced shipbuilding facilities around the world to be shut down, and competition became extremely intense.

During this period, many shipbuilding industries pressed their governments for assistance. In response, many countries stepped up their aid to shipyards with massive levels of subsidies in virtually every form. In 1981, however, subsidies to the U.S. shipbuilding industry were discontinued. For a time, U.S. yards were sustained by large orders for naval vessels as prices for commercial ships came under pressure from reduced demand and foreign subsidy practices. In recent years, moreover, in the face of military cutbacks and more formidable long-term demand prospects for ships, the industry has recognized the need to re-establish a competitive presence in world commercial shipbuilding.

Recognizing that it cannot compete with foreign government resources made available to foreign shipyards, the Shipbuilders Council of America (SCA) sought relief under Section 301 from foreign subsidy practices. Accordingly, in 1989, the SCA filed a formal petition for an investigation of such practices by Japan, Korea, Germany and Norway. In response, the U.S. Trade Representative, with SCA approval, initiated in 1989 negotiation of a multilateral agreement to eliminate all subsidies to shipbuilders. The European Community (EC), Norway, Finland, Sweden, Japan and Korea, the major shipbuilding nations of the world, are all participating in these negotiations. I would underscore that all interested parties appear to share the view that the conclusion of such a multilateral agreement is the best way to deal with the problems of the world shipbuilding industry. In our view, it would create an economically rational environment in which U.S. shipbuilders can compete fairly.

OECD Shipbuilding Negotiations

At first, a fair degree of progress was made in the negotiations. Within a year a preliminary draft containing basic principles of agreement was prepared and generally approved. In addition, an Annex I was hammered out that defined a comprehensive list of trade distortive measures that would be forbidden under the agreement.

Negotiations became drawn out, however, as talks focused on the few issues that are the most sensitive and complicated--most notably the need to fashion an injurious pricing or anti-dumping discipline. Because ships are unique, in that they carry traded goods to ports for entry into commerce of countries but do not actually enter the commerce of such countries themselves as goods, ships are not regarded as imported goods. Therefore, they are not subject to the traditional countervailing and anti-dumping duty remedies. To develop a remedy for dumping required a long series of technical talks in order to define dumping, ownership and specific sanctions that could be applied if injurious pricing of ships occurred.

However, after several missed deadlines, we found ourselves at a point where we had serious doubts about the interest of other parties in concluding an agreement and, consequently, the prospects for successful conclusion. As a result, at the April 1992 meeting, facing a continued lack of convergence on resolving certain issues, we told the parties that we were not prepared to schedule further meetings until it was clear that all participants were committed to conclude an agreement, and there were reasonable prospects for success. We maintained bilateral contact with other participants, however, and made clear that we would be prepared to resume negotiations if it appeared that there was a serious prospect of bringing them quickly to conclusion.

Resumption of OECD Negotiations

Since the legislative thrust of both S. 990 and H.R. 1402 is to provide an incentive for countries to cease subsidizing shipbuilders and commit themselves to an agreement to eliminate subsidies and other distortive practices, I would like to give you an update on the results of our efforts this year to restart the negotiations for an agreement to eliminate shipbuilding subsidies.

Although formal negotiations were suspended in 1992, we continued bilateral consultations with various parties. We found among the countries a strong preference for a multilateral agreement. In early 1993, a new Chairman was appointed for OECD shipbuilding issues, Staffan Sohlmann, the Swedish Ambassador to the OECD. He called an informal meeting of participants in the negotiations in June, and then undertook to contact all parties to ascertain their views on the draft agreement. Based on their comments and the discussion in the June 1993 meeting, the Chairman set forth a framework for resumption of the negotiations, which called for talks to be completed by yearend and set January 1, 1995 as a deadline for eliminating subsidy programs. He included substantive proposals on several key issues, such as changes in the injurious pricing mechanism.

All parties agreed to resume negotiations on the basis of the Chairman's framework. Subsequently, negotiating sessions were held in the OECD in September and November. There are several outstanding issues, and although we have made recent progress in closing the gaps, important differences still remain. Injurious pricing is the thorniest, but our intensive negotiations have narrowed the gap somewhat. Two other key issues relate to subsidy practices dealing with export credits and indirect support for shipbuilders through home credit schemes. The export

credits issue centers on whether or not such measures will be subject to the binding dispute settlement procedures of the agreement. With regard to home credit schemes, there are differences as to whether, and under what circumstances, such programs provide indirect support to shipbuilders. The Chairman has scheduled a meeting in early December at which he will present revised compromise proposals on these issues, which he anticipates will close the gaps and give shape to the final text of an agreement.

In sum, important differences still stand between us and an agreement, but significant progress has been made in narrowing them, which, in turn, has generated a momentum that could lead to an early conclusion of an agreement. Therefore, we would assess the prospects for bringing the parties together into an agreement as reasonably good.

Legislative Support for Negotiations

Although strongly supportive of an international agreement and the negotiations to that end, Congress has been concerned about the slow pace and uncertainty of a positive result. Several pieces of legislation, therefore, were introduced in previous years that would have imposed sanctions on subsidized ships entering U.S. waters, unless their countries entered into an agreement to eliminate subsidies to their shipbuilding industries.

In the spring of this year, reflecting continuing concerns about this issue and the dormant state of negotiations, S. 990 was introduced, which was much like the newly revised bill introduced by Congressman Gibbons (H.R. 1402) this year. Both bills would provide for investigation of countries that subsidize their shipyards and impose sanctions on the fleets of such countries.

Administration Views

We share the objective of this legislation, namely elimination of shipbuilding subsidies and other distortive practices, although we believe that conclusion of an agreement is by far the best solution to the problems facing the U.S. shipbuilding industry and would largely eliminate the reasons for which the legislation was proposed.

Nonetheless, we are aware of the possibility that an agreement might still elude us, and consequently, as Ambassador Yerxa testified before the House Ways and Means Trade Subcommittee in July of this year, we are prepared to work with Congress to develop remedies for the trade policy problems faced by our shipbuilding industry in ways that would support the long-term objective of eliminating subsidies. We do have concerns about several aspects of S. 990, as we did about H.R. 1402 as it was introduced earlier this year. We would like to work with you so as to ensure that the legislation will not work at cross purposes with our common objective and would be consistent with our overall trade policy and our international obligations.

Some of the areas where we think significant changes are required include the following:

- Investigations should be complaint-driven, i.e., they should be initiated by those who can demonstrate the existence of foreign subsidies or other distortive practices and are affected by them.

- Inclusion of an adverse effects test, whereby a sanction would be applied only where it is determined that injury to U.S. shipbuilders results from the practices being investigated.

- Administrative discretion, so that investigations and sanctions would not be required to be administered in ways that are disproportionate to the subsidies involved or not in the national interest.

- The cargo diversion remedy would pose administrative problems and might be challenged in the GATT.

The recently amended H.R. 1402 seems to address in a largely satisfactory manner all but the last item which remains a serious concern for the Administration but one which we assume can be worked out.

I should point out that although S. 990 does not have this provision, the earlier version of H.R. 1402 introduced this year did have a provision subjecting ships to Anti-dumping/Countervailing Duty (AD/CVD) remedies. Because extending these laws to ships would pose significant administrative, technical and legal difficulties, Commerce believes they would be unworkable and in large part redundant, given the comprehensive remedy in the bill. This provision has been dropped from the amended version of H.R. 1402.

We would look forward to working closely with you and your Senate colleagues and their staffs on the above points as well as other detailed changes that might be beneficial.

Plan of Assistance to Shipbuilders

I would like to add that our concern for the industry is not only to remove the unfair competitive advantage that foreign shipbuilders have been enjoying, but to help the industry make the transition from defense-related to commercial production. To that end, the Administration conducted an intensive study of the industry's needs. On October 1, President Clinton transmitted to Congress the Administration's proposed program of assistance to the industry, significant parts of which are incorporated in the Defense Authorization Act. The program have five major components.

First, the negotiating effort described above, which should lead to an international agreement to eliminate subsidies, is the key to ensuring U.S. shipbuilders access to international markets that are free of governmental distortions and unfair practices. Without this assurance, the other steps aimed at helping the industry regain its competitiveness and capture a share of world markets for commercial vessels are likely to fall short of the mark this industry has set for itself.

Second, it would provide for the establishment of, and an average of $44 million a year in funding for, MARITECH, a new joint effort of the Department of Defense's Advanced Research Projects Agency and the U.S. shipbuilding industry, including builders, owners, suppliers and technologists. The research effort is to focus on manufacturing and information technologies used in ship design and production.

Third, the Title XI loan guarantee program will be extended to provide financing for export sales as well as for domestic buyers. The provision of $150 million over the next four years should support guarantees of up to $3 billion in loans.

The fourth phase of the program involves the reduction of regulatory burdens that needlessly hamper productivity and increase the cost of doing business. The fifth phase involves the expansion of the activities of Executive Branch Agencies in ways that will assist yards in their marketing efforts and facilitate cooperative arrangements between U.S. and foreign yards.

Finally, this five-point program is a transitional program, consistent with federal assistance to other industries seeking to convert from defense to civilian markets. In addition, it seeks to support, not undercut, the negotiations that are currently underway in the OECD. In this regard, we have made clear our intention to modify this program, as appropriate, so that it would be consistent with the provision of a multilateral agreement--if and when such an agreement enters into force.

Thank you Mr. Chairman. I would be happy to answer any questions that you or other members of the committee may have.

EXPORT FINANCE

A Position Paper by the
Industry Sector Advisory Committee on
Small and Minority Business
for Trade Policy Matters

Introduction

This position paper is a follow-up to the Sector Profile originally prepared by the Industry Sector Advisory Committee on Small and Minority Business for Trade Policy Matters (ISAC 14) sponsored by the Secretary of Commerce and the U. S. Trade Representative. It addresses the vital area of export finance as it affects small and minority businesses (SMBs). The purpose of this paper will be to attempt to take some of the mystery out of a subject that is complex, subtle, and incompletely understood by the general public.

We will not deal with the urgency of the international trade situation except to observe that:

1. The trade deficit is soaring out of control.

2. SMBs may be the last ditch trade deficit remedy. The evidence is now overwhelming that big business and government are approaching the end of their traditional remedies, and labor is most likely to proceed toward destructive protectionism.

This paper is an offer of a new perception of SMBs which will be iconoclastic in terms of "what everybody knows," but may be closer to some basic understandings from which new action guidelines may be drawn.

General Limitations

ISAC 14 is a private sector advisory group with a relatively small handful of consistently active members who meet periodically at their own time and expense to review international trade affairs. Internally, there is industrious, serious commitment, and a high level of common agreement on issues. There are some important limits to the potential impact of ISAC 14, however.

With literally hundreds, perhaps thousands, of government personnel active in the policy on operational areas of international trade, it is impossible for ISAC 14 to monitor everything simultaneously. At meetings, important time is dedicated to presentations by relevant government personnel regarding updates and new issues as they emerge, to which ISAC members feed back what they hope will be valuable insights from the firing line. Over the course of ISAC 14 history, some important patterns of thought in government perception of SMBs have taken shape, and it will be the purpose of this paper to reinforce some and challenge many others. It will not be possible to offer a comprehensive critique of all of the past, present, and potential future export finance issues. Rather, by limited examples chosen from these issues we would hope to make some new thought available.

What Makes ISAC 14 Businesses Different?

An important element in the Sector Profile of ISAC 14, cited above, was its offer of the organic morphology of SMBs, rather than statistical description. This matter is so critical to "finding the handle" on small business that it is important to make some of these points again for the purpose of small business as this paper would deal with it.

We will not deal with businesses which are "small" or "minority" by sales, asset size, employment, percentage of racial constitution by ownership or work force, or any of the other traditional statistical approaches. Instead, it is imperative that we look at small businesses as primary cells of capitalism, especially in considering their financing. It is imperative because the subject at hand, exporting, is an important business risk/opportunity to which capitalistic response is being solicited and measured. What special characteristics do SMBs have in their primitive capitalism that will make them different creatures with which to deal than the big businesses which have been America's primary exporters of the past?

Nothing is more important to export finance than the capital structure and the basic business question of a capitalist society: "Who takes the risk, and who gets the return?" Instantaneously, the difference between small and big business is strikingly evident.

The capital bases of small businesses tend to be individual, family, or a very limited group of private investors. They have drawn their equity capital from personal, family, or intimately known financial resources. Their business borrowings are invariably made against owner/manager personal guarantees. Investors also tend to be direct participating members of management.

Big business, by contrast, tends to be run on a publicly held capital base unencumbered by the personally guaranteed debt of its owners. Policy passes through a board of directors which may likely have more or less indirect management participation, or even ownership, in the company. Operational day-to-day management is conducted by hired professionals.

Obviously, there are shades of gray in these interpretations of small and big business, but it is the mass tendencies which have to be dealt with, and these lead to two profoundly different characteristics:

1. Large businesses are managed to yield after-tax per-share earnings directed at producing dividend streams and/or capital gains attractive to public investors.

2. Small businesses are managed primarily to control risk within acceptable levels, then within these levels provide salaries, bonuses, perks, and future personal security to the investors/managers who own/operate them.

The financing of big and small business, including possible successful Federal export financing, must accommodate these differences. The key factor for the SMB looking at any new opportunity, including exporting, is: "Who takes the downside risk, and what are the failure consequences?" This is the acid test, and it is the most consistently misunderstood characteristic of small business by all of the "Bigs" (government, business, and labor). It is the pervasive source of failure of decades of policy in the SMB international trade area.

Why Are Businesses Small?

A close corollary to this misperception of small business is the structure of misperception as to why any business is small. It has become popular in big business to minimize the importance of small business in export trade for obvious self-serving purposes in

competition for the limited resources of government. Two classic examples in circulation at the moment are the "Grace Report" and the Boeing position paper., "The Invisible Exporters," which imply that the SMB component of export business opportunity can be derived from subcontract subservience to large exporters such as Boeing, a sort of "feeding the horses to nourish the birds." Realistically, small business has a vital independent stature in exporting which will not be possible to exploit until some of these popular myths have been dispensed with.

Some small businesses are small only as a matter of timing over which nobody has any control. Every big business started as a small one, and some of the most important, exciting big businesses of America's future will come from products and enterprises which are now at the very beginning of their growth curve. It becomes important, then, that we have programs in position that can offer instant assistance to all small business in exporting, and stop trying to identify future winners with fad expressions like "high tech" for export support programs. Technical and investment analysts are simultaneously trying to identify these future growth companies with skill, experience, and sophistication far beyond that available to any crystal ball owned by any agency of government. The marketplace will very rapidly identify the big winners, at home and abroad, and without export support for SMBs in general, the markets abroad will be sacrificed perhaps before they can ever be reached, among the little companies which might be destined to be big.

Other companies are small simply because they are highly specialized, and the total market demand for their offerings simply won't command the existence of a big company as a supplier. They will never be big within the scope of their existing business, but they may be old, stable, well-managed, and offering top quality products at world competitive prices. With appropriate export support, perhaps thousands of these companies could build an international marketplace for American industry which would stabilize our export strength for decades to come, as opposed to trying to pick out the next IBM, or gambling on nature and politics for a bumper crop of agricultural exports.

Most important, this kind of SMB diversity would be essentially invulnerable to the contemporary common complaint of foreign supplier "targeting" in U.S. and world markets.

Other small businesses may be small by the nature of their products or services which will not bear the cost of transportation. Conceivably these might open foreign branches and grow into big businesses and important overseas earners by small business replication. (The annual sales volume or market area of a McDonald's hamburger stand is a small business by any definition, whether in Philadelphia or Dusseldorf.)

Small businesses are not small because their owners are necessarily unenterprising. It is worth noting that this presumed cause of small business reserve in exporting is almost invariably offered by those who are not operating a small business of their own in these times.

Most important in the area of exporting, however, is the unrelenting, all-pervasive, staggering misconception that management of small businesses is too obtuse. Small business owners supposedly need "information." If they would accept government "education" they would become happy and profitable exporters. Thus, after literally decades of how-to-do-it books, pleadings by all of the agencies of government, seminars, and every conceivable form of communication that can be sent their way, small business operators are still unmoved to enter exporting in the way which reflects their potential, and the nation's need. The easy rationale is "They are too dumb," but would it be possible to test the opposite conclusion,

"They might be too smart"? It is possible that small business operators, with their dedication and sensitivity to risk limitations, have sensed in all of the government's messages to export a far more important subliminal message which persuades them they should not.

The Misguidance of Government Policy and Programs

No matter what the superficial content of the "education" on exporting afforded small business in the past, there have been two clear, unmistakable Federal government messages for small business:

1. With trivial exception, government policy and programs are calculated to isolate government from participating in the business risk of small firms in exporting.

2. The trend of very recent years has been to dramatically escalate the diversion of export business risk away from government to small business, in spite of the escalation of the trade deficit.

There have been fringe cosmetic actions such as export trading company legislation and proposed relaxation of the foreign corrupt practices law, but at the capitalist ground level of business risk-taking the government has relentlessly opened up the maximum possible distance between itself and small business. This has not been lost on the small business community, either consciously or unconsciously, as SMBs consider exporting as a business risk. Although condemned for a lack of astuteness or sensitivity to the government's message that SMBs should be exporting for their own benefit if not for the government's, the average astute, small business operator cannot miss the fact that the government is fleeing full tilt from its own good idea. In the face of this example, what SMB operator can persuade himself to risk a lifetime's investment, savings, income source, and future retirement base?

The examples of government isolation from small business export investment risk appear in a broad variety of forms beyond the scope of this paper, but some examples would be the following:

1. In spite of statistics on numbers of transactions involving small business (which are heavily loaded by inclusion of the Foreign Credit Insurance Association (FCIA) program), the Export-Import Bank does virtually all of its foreign buyer financing to the benefit of big business.

2. The Small Business Administration (SBA) a few years ago heavily publicized the availability of one hundred million dollars in financing for the export activities of small companies. What was not publicized was that this did not increase funding, but merely allowed loan officers to open existing SBA programs to exporting purposes. Characteristically, these loans include security agreements structured to financially crush any business and personally destroy its owners unable to repay as scheduled. (The new revolving export credit line at SBA also has comparable security arrangements.)

3. Commerce has relentlessly withdrawn its financing participation in foreign trade fairs which are programmed principally to the benefit of new and/or small exporters. In those in which they now participate, it is arguably cheaper for participants to buy the services from independent sources than to pay Commerce "user fees."

4. Within the last two to three years, Commerce has introduced astronomical (in some cases multi-hundred percent) increases in fees for export mailing lists, agent-distributor service searches, credit reports, new product publicity, and the other small business support offerings across the spectrum.

5. The Domestic International Sales Corporation (DISC) has been the windfall tax blessing to big exporters, but since it assumes no downside risk (promising only to take away less of what <u>might</u> be earned by a small business that takes the primary risk), only the most unreconciled apologists for DISC can continue to argue its merits. The forthcoming Foreign Sales Corporation (FSC) appears to be more of the same, made slightly more complicated. ISAC 14 is studying the legislation and will recommend amendments for inclusion in the bill.

6. Congress has congratulated itself on the new export trading company legislation, using the choice of a name to equate it to "America's answer to the Japanese model." Actually, it merely eliminates a few uniquely American antitrust and banking legal technicalities, but emergence of the export risk benefits to small business have been far more proposed in theory than realized in practice. The silence in the banking and export community grows more ominous, as the awaited wave of new exporting companies to be formed under this legislation has not yet appeared in functional form. Will it ever?

While it is laudatory to proclaim that the government does not belong in the business risk arena, and that more Yankee Trader spirit is needed by SMBs, it is common knowledge that the government protects the business risk of dairy and tobacco farmers, jet plane manufacturers selling abroad, businesses operating in flood zones, and a whole myriad of manifestations of the personal and business lives of all Americans. This tends only to exaggerate the government's past and increasing present reluctance to support SMBs at the risk level in exporting.

What, then, needs to be done?

<u>The Basis of Federal Responsibility</u>

Actually, one of the most important immediate needs may be one of the most subtle, as well as (fortuitously) earliest to be answered. It is the need for the government to pull <u>itself</u> together. The international trade reorganization proposal, whatever else its merits or drawbacks, may afford the government the chance to speak with a single voice to the export needs of the SMB community, as well as invite some approachable entity toward which SMBs may reach.

The traditional complaint of SMBs is that big government is impenetrable. In international trade, it is virtually unidentifiable. So many agencies and branches of the government proclaim their dedication to the service of small business exporting that bewilderment is universal. Everyone is "coordinating" everyone else, and the buck stops nowhere.

Incidentally, the character of this problem for small business is not limited to the Federal government. At the regional, state, county, municipal, and port authority levels, there are government, quasi-government, and independent agencies of various capability and responsibility all desperately claiming to coordinate the efforts of each other in the essentially nonexistent programs to create a small business exporting front.

It is the feeling of ISAC 14, however, that by its nature international trade is the responsibility of the Federal government as derived from the Constitution. Government is directly responsible for the preservation of the value of the national currency, and there are too many practical as well as legal limitations for lower levels of government to cross American borders and conduct commercial or legal diplomacy. The buck cannot be passed <u>down.</u>

What Are the Financial Needs?

At the export finance level, the SMB exporter needs two basic forms of low-risk support: pre-export and receivables. For the moment, we will leave "low-risk" undefined and address it in more detail later.

In the pre-export scene, there is a need to identify markets, both by geography and product/service demand, adapt products to the markets, participate in demand stimulation activities, establish channels of distribution, build exportable inventories, and provide for and/or train export management. This is the high risk phase of the process where some form of venture capital seed money is needed, rather than hard loan financing.

Beyond the point of actually developing orders for goods to be shipped in export, there is a need for financing which will permit small American exporters to competitively finance these orders at minimal risk to themselves and turn over their own capital as safely and quickly as possible.

It would be impossible to develop within the context of this paper a comprehensive program or series of programs that would answer to all of these needs, but a few examples might be in order: Front-end venture capital, or operational aid for foreign advertising, foreign business development travel, overseas trade fair participation, agent and distributor research, credit information on prospective foreign buyers, product modification to foreign standards, preparation for foreign language advertising and other communications, and training programs for management in exporting. There should also be inventory finance for the buildup of exportable inventory--raw materials, work in process, and finished goods--with security limited to the goods themselves and not the general assets or the personal resources of the small business.

For foreign sales receivables, there is a need for competitive financing to foreign buyers of SMBs comparable to that offered by the Export-Import Bank to big business customers. As a corollary, but not replacement, export credit insurance should be available, without onerous recourse provisions and deductibles, to provide true minimal-risk export financing for small American exporters to their customers.

As cited above, it would be impossible to completely outline the details of what the above program should be, but as an example of what is possible, the attached exhibit describes one British program aimed at the small business market there. Note that government risk exposure is subject to repayment on royalties, rather than secured debt, and that the entire thrust of the program is to create exporters rather than minimize government exposure.

It is vital to emphasize that programs are feasible -- and would undoubtedly be welcomed by SMB new exporters -- that provide government direct participation in the pay-back of success. Actually, the indirect benefits of successful integration of SMB exporting would be far more important in the reduction of unemployment and the trade deficit. However, to those who would turn a blind eye to these benefits and regard any Federal funding of SMB exports as charity, this need not necessarily be the case.

The Administrative question of who gets what among SMBs soliciting government participation in their own export plans is beyond the scope of this paper, but would not appear insurmountable. Research and innovation programs are already being administered to support this kind of endeavor in SMBs, and while they may not be perfect, they do appear functional. And while the British model in the attached exhibit may not be ideal for our purposes, it suggests an important realization.

A psychological threshold has been crossed in the British government, as well as several others in the world, which has not yet been reached in America:

> It is in the interest of the national government to join as true risk partners with the small and minority business entities of the private sector to protect the national business position in international trade. The scope of venture financing is perhaps most important at pre-export levels, but must cover participation through the buyer-payment phase.

The Nature of Government SMB Export Finance Programs

Although the needs are summarized above without detail of programs, in addition to minimal risk any program would require some other important features:

1. They must be available to small business at minimal risk and at reasonable cost, if they are not to be outright grants to the indirect ultimate benefit of the nation. An absolutely vital part of the cost that will make or break any program will be, in modern slang, the "hassle" required to afford small businesses a chance to participate. Blizzards of forms falling from blankets of bureaucrats will spell certain death to anything other than the most certain chance of getting gratuitous charity. Inventory loans must bear reasonable interest rates, or receivables financing must be available at competitive rates--competitive in international trade, not only U. S. money markets.

2. As a corollary of (1) there must be painstaking organization of delivery systems of programs to small business. There is the immediate risk of escalation of bureaucracy because small businesses tend to run in large numbers, they lack massive staffs to conduct government relations, and their business affairs tend to require government speed and decisiveness--often with less comprehensive business decision-making information than might be available from a business giant. A new brand of bureaucrat with a new sensitivity to small business may have to be created in the personnel offices of a new Washington agency to handle this type of thing. In summary, no matter how imaginative the policy or well-conceived and comprehensive the program, a flawed delivery system will negate any other effort.

3. As new programs of the recommended type come into being, there will need to be new techniques for monitoring results, post-auditing the efforts of government and small business involved, and regenerating directive action as well as positive reinforcement. We can no longer afford "more of the same" in the disaster area of financing SMB export efforts. It is time for those of any political persuasion to ask: "If not us, who, and if not now, when?"

Conclusion

SMBs are emerging as the last resort in combating the trade deficit, which is skyrocketing. It would be valuable to determine within classical economics which would be more devastating to the American economy if we reach the end of 1984 and have to choose between a one-hundred-billion-dollar foreign trade deficit and a two-hundred-billion-dollar Federal budget deficit. New and different Federal export financial effort in one form or another is going to be at the heart of any initiative to integrate small and minority businesses into the American exporting community, and this will only work with minimal-risk type financing. The only source of this kind of financing is going to be the Federal government, which in the past has been aloof and is now withdrawing. Export-Import Bank/FCIA Programs, weak and without delivery systems, and SBA prohibitively secured lending, constitute tokenism at best.

Although American small private enterprise people have long been the traditional mainspring of free enterprise coupled with government conservatism, they cannot, unaided and alone, compete effectively in world markets against foreign competitors backed by their foreign governments.

Voiceless and faceless, small and minority businesses bear the stigma of blame for perceived inadequacy in the theater of international trade. If day to day we are haunted by deterioration of our trade balance position, nothing seems to change including the theme that small and minority business is the nation's weakness. Is it possible that the weakness of the nation is the problem of its small and minority businesses?

Respectfully submitted, as
prepared, amended in Committee,
and passed November 17, 1983

Erwin von Allmen
Chairman

Attachment

THE MARKET ENTRY GUARANTEE SCHEME

The Market Entry Guarantee Scheme (MEGS) is designed to help smaller and medium sized firms in manufacturing industry to deal with the financial risk and problems associated with a venture to develop a new export market. In approved cases, the Scheme will contribute 50% of the eligible costs of the market venture in return for a levy on sales receipts which is intended to recover the contributions with a commercial rate of return on the Scheme's investment. If, by the end of the agreed venture period, sales have not materialised as expected, then no further levy payments are required and the firm and the Scheme will share the loss. For this guarantee, the firm pays the Scheme an annual premium.

The scheme is being operated on a trial basis for two years with limited funds. Assistance under the scheme is discretionary and will be offered so as to provide a spread of ventures by size, product and market. Applicants will be expected to put forward a package of proposals which constitute a well-planned marketing programme for the development of an additional export market and to demonstrate their capability to carry this out. Applicants must clearly show that their objective is to obtain a substantial increase in the volume of their exports over the period of the venture and thereafter, to the benefit of the United Kingdom.

Who can apply?

The scheme is open to firms in manufacturing industry. Firms must be exporting a tangible product manufactured in the United Kingdom and the Standard Industrial Classification (prepared by the Central Statistical Office and published by HMSO) will be used as a guide. Orders III to XIX in the SIC will normally be accepted as 'manufacturing'.

Firms mounting a marketing attack on a new overseas market on behalf of either a single manufacturer or group of manufacturers can be considered. Applications from such companies, including export merchants, etc, will have to show that they are acting as the manufacturer's sales organisation and are under firm contract to the manufacturing firm over an acceptable period. In such cases, the manufacturer(s) may also be required to be contractually liable to the scheme for the levy on sales, and satisfactory arrangements to ensure that eligible costs are incurred solely in support of the products on whose sales the levy is charged will have to be agreed.

What projects and costs are eligible?

The scheme is aimed at helping firms with the implementation phase of a new export market entry venture and not with the market research or exploration phase. (Other sources of assistance are available for this phase and potential applicants who have not completed this phase should seek guidance from BOTB offices as detailed at the end of this note.) Proposals for assistance must describe a well planned sales attack based on a substantial examination of the market. Single elements such as a publicity campaign on its own or a visiting programme in isolation will not be eligible. Similarly, the venture must involve the continuity of sales in the new market and not individual sales/projects. The market should be defined in terms of sales area using national or local boundaries and by product; and the eligible costs must relate exclusively to this product and market combination. A new market is one in which the firm has not been selling or in which it has some sales but plans a major increment involving substantial new costs.

To be eligible for support, costs must broadly be overhead costs which are written off as incurred (eg not capital investment) and are largely irrecoverable (except in the sense of recovery from margin on sales). They must *not be directly* related to the manufacture and distribution of the product (eg manufacturing costs, transport costs and agents' commission are not eligible). To be eligible, costs must be incurred solely and directly in relation to the venture and its defined product and market combination. Costs already incurred by a firm in respect of activities prior to the date of application are not eligible, nor can continuing costs for existing facilities be considered.

Costs will normally be considered for eligibility in the following categories:

1. Overseas office accommodation
Rental, property and contents insurance, maintenance, cost of services, local property taxes, office equipment and consumable supplies, purchase and running costs, or rental, of cars. Where premises are purchased not rented, the lesser of interest charges on the capital cost or an imputed rent will be considered for eligibility.

2. Staff costs
For firm's overseas-based administration, sales or warehouse staff: salaries, employment taxes, expenses (excluding entertainment), recruitment and relocation costs. Costs of the firm's technical support staff are only eligible if they are not part of the after-sales service and maintenance requirements and their services are not charged to the customer.

3. Training
Training in the selling and servicing of the product(s) of overseas-based staff including non-company staff (eg agents).

4. Travel and expenses
Travel and subsistence expenses for the firm's overseas-based staff, and for home-based staff when visiting the defined market in connection with the venture. Entertainment costs are not eligible.

5. Sales promotion
Advertising, publicity, sales literature (specific to the defined market), product demonstration.

6. Costs of holding stock
The term stock covers both the product and its spare parts. Costs of showrooms and storage facilities under similar headings to those for office accommodation. Transport costs for the product or spare parts are not eligible. Financing of stock, including interest charges, is not eligible nor is stock loss due to deterioration, obsolescence or other causes.

7. Commercial and legal costs
Legal costs of setting up the overseas operation and external audit costs, costs/fees for patents, licences, trademarks, testing and approval of product to necessary local standards.

A firm's cost of participating in an export marketing activity which has been supported by other sources of public funds will not be eligible. The nature of eligible costs are such that, in most cases, assets are not created. However, the scheme will have a right to a proportion of the proceeds of sale of any assets to whose costs it has contributed (eg office equipment and cars) if the scheme does not recover all contributions with interest.

How does the scheme work?

A proposal put forward by a firm will be studied by the MEGS Unit and, if an offer of assistance is made and accepted, then an agreement will be signed. This agreement will include a definition of the product(s) and market area, the planned eligible costs in each year under agreed headings, the length of the investment period, the subsequent recovery period and the rate of levy on sales receipts. For each year of the investment period, the firm pays the scheme 3% of the scheme's 50% contribution to the planned eligible costs for that year as a premium in respect of the guarantee (ie that the contributions do not have to be repaid if the venture does not succeed). For each year of the investment period, the scheme pays the firm 50% of those eligible costs actually incurred under each heading. The total contribution in each year cannot be more than 50% of the total planned eligible costs. For each year of both the investment period and the recovery period, or until the scheme has recovered its contributions with a commercial rate of interest, the firm pays the scheme the agreed rate of levy on all actual sales receipts for the defined market/product(s) combination. The length of the investment and subsequent recovery periods and the rate of levy will be set so that there is a good expectation that the scheme will recover its contributions with a commercial rate of return before the end of the recovery period. If the end of the recovery period is reached before the scheme has made full recovery on this basis, then no further levy payments are required.

What are the limits to the assistance ?

The scheme's contributions to eligible costs for one venture cannot be more than £100,000 and must be a minimum of £20,000. The investment period cannot be longer than five years and the recovery period will normally be at least as long as the investment period. There are no limits on the size of firm or size of project but the scheme is intended for smaller and medium sized firms and the £100,000 limit on contributions and the fact that the levy is charged on all sales receipts in the defined market makes the scheme less suitable for new market entry programmes with eligible costs over £200,000.

Financial arrangements

The premium for the first year must be paid within one month of the date of agreement and then within three months of the start of each year of the investment period. Contributions to eligible costs will be payable by the scheme in respect of each year of the investment period and will normally be made when the necessary financial statement for the year has been received and evaluated. Interim payments can be considered. The levy due on sales receipts is payable within three months of the end of each year of the investment and recovery periods until it ceases. During the investment period, the levy due will normally be netted off the contributions to eligible costs.

The firm will be required to provide certificated returns of costs incurred and sales receipts for the venture, signed by a responsible officer of the company and validated by an independent accountant. The contributions to eligible costs by the scheme do not create a debt or liability in the normal sense and no security or collateral is required (the firm will be required to give evidence of its financial viability in the proposal). The levy is an agreed rate of levy on sales receipts (normally as invoiced) and is not considered as a direct repayment of the contributions to eligible costs. In respect of each year's trading (or when interim payments are made), the previous balance will be brought forward, the interest calculated for the period and the latest payment of contributions added in, the latest levy payment deducted, and the new outstanding balance carried forward. The interest rate to be used will be 2½% above a weighted average of the clearing banks' base rate rounded to the nearest ⅛% for the period in question.

A firm will be entitled to withdraw from the scheme at the end or middle of any year, having given three months' notice, on condition that it pays at the withdrawal date a levy equal to all contributions to date, less any previous levy payments, with interest. There are no restrictions on firms withdrawing from the venture or any particular element of it but there will be a requirement to give notice of any significant changes of plans.

The levy on sales will continue on the agreed basis even though the venture may effectively have been abandoned. If a firm incurs in any year of the investment period less than 25% of the planned eligible costs for that year, then the Government may at its discretion terminate the agreement at the end of that year, making no further contributions and recovering no further levy.

Both contributions to costs and levy on sales receipts will be planned and dealt with in sterling terms and the agreement will specify the procedure for conversion from foreign currencies.

In general for tax purposes, the scheme's contributions will be treated as reducing the firm's expenditure in respect of which they are paid and the premium for the guarantee and levy payments will be treated as allowable deductions.

Applications

Application forms can be obtained from Export Services and Promotions Division at Export House, 50 Ludgate Hill, London EC4M 7HU or the Export Sections of the Department of Industry's Regional Offices, the Welsh Office Industry Department in Cardiff, the Scottish Office in Glasgow, the Northern Ireland Department of Commerce in Belfast and from British Overseas Trade Board (MEGS Unit), Department of Trade, Room 206, 1 Victoria Street, London SW1H 0ET London

Note: This document is a general guide to the scheme and shall not be regarded as constituting an offer of assistance or of forming part of any contract which may be entered into.

January 1978

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THE MARKET ENTRY GUARANTEE SCHEME

Increased upper limit of guarantee

For applications dated 1 July 1980 or later, an increased upper limit of guarantee applies. References to '£100,000' in the paragraph headed 'What are the limits to the assistance' should be read as '£125,000', and the figure '£200,000' as '£250,000'.

FROM: Donald M. Phillips
Assistant United States Trade Representative
for Industry

RE: Response to Questions on Shipbuilding from
Senator Grassley

B. As stated during this statement, he has two questions that he wants each of those testifying (except for Members of Congress) to answer. To reiterate:

Q 1. What benefit is it to the American shipbuilding industry to penalize and harm their customers for making logical and rational business decision that every other business would make - that is buying the lowest priced product available? In this case, it happens to be vessels.

A. 1. We, too, believe that business should be able to make rational economic decisions in purchasing their products. However, where world markets are distorted and U.S. producers disadvantaged by subsidies and other unfair practices, corrective action is needed. We are seeking in the Multilateral Shipbuilding Negotiations to establish a rational economic framework for the world shipbuilding industry -- with subsidies basically eliminated and adequate protection against injurious pricing practices.

Q 2. Will you support putting the Jones Act, Cargo preference, capital construction funds, Operating Differential Subsidies, and the new shipbuilding subsidies recently included in our defense bills on the OECD and GATT negotiating tables so that the United States can get serious about fighting unfair foreign subsidies?

If those testifying did not answer these two questions during their testimony, please forward them to be answered in writing.

A. 2. With the exception of the Jones Act home build requirement, where we are seeking a permanent derogation, we have offered to modify US programs, as appropriate, to bring them in compliance with the agreed multilateral disciplines on shipbuilding subsidies. Thus, the U.S. has put its programs on table in the interest of dealing effectively with foreign shipped subsidies.

PREPARED STATEMENT OF JOHN J. STOCKER

Mr. Chairman, Members of the Subcommittee, my name is John J. Stocker. I am President of the Shipbuilders Council of America, the national trade association representing American shipyards, marine equipment suppliers, and naval architects. A membership list is attached to my written testimony.

I appreciate this opportunity to express our industry's strong support of The Shipbuilding Trade Reform Act of 1993, S. 990. The enactment of this important bill is a critical ingredient to the survival of the American shipbuilding industry and 180,000 American shipyard and shipyard supplier jobs.

First of all, Mr. Chairman, I want to convey our industry's appreciation of the efforts, represented by this hearing, to bring an end to the foreign shipbuilding and repair subsidies that are threatening to destroy America's shipyards and leave our country without a domestic shipbuilding capability.

It has now been four years since the Shipbuilders Council of America filed a Section 301 petition with the United States Trade Representative, and over 18 months since the first round of the international trade negotiations responding to that petition collapsed. We understand the negotiations have resumed. But, we remain pessimistic regarding a short-term resolution of this issue and we do not believe negotiations can succeed without the impetus of the passage of S. 990. During this period, the situation for American yards has steadily worsened. With the significant downsizing of the naval fleet during the remainder of the 1990s, the U.S. shipbuilding industry is facing massive layoffs and yard closures. From its current status of 100,000 workers, we expect that the defense draw-down will cost the industry 72,000 jobs by 1998. This will mean that there will be only one or two American yards left that can build large ocean-going ships, unless the industry gains access to global commercial ship construction contracts in the next couple of years. But this can only happen in a market that is undistorted by subsidies, and international shipbuilding is a market that is heavily distorted by Government subsidy practices.

American shipyards are an integral part of our country's critical manufacturing industrial base. Ship construction represents one of the most difficult and complex manufacturing processes in the world. Because it requires many kinds and levels of expertise, it provides work for every socio-economic segment in our society, including entry-level jobs for relatively unskilled urban workers, jobs for skilled industrial workers, and high-technology jobs for degreed engineers.

Furthermore, shipbuilding provides a market stimulus for other basic industries. This is because a ship is a small floating city, requiring both large and small sizes of engines, generators, motors, pumps, valves, winches, and electrical control equipment, in addition to electrical cable, electronic navigation equipment, radios, and, of course, very large quantities of steel plate. This is why, for every job in an American shipyard, another three jobs are created elsewhere in the economy. A modest shipbuilding program of 30-50 ships a year would produce approximately 50,000 American jobs in shipyards and shipyard supplier industries.

In other words, America's shipyards are good for the long-term economic wellbeing of the country, as well as essential for ensuring that the United States has the necessary domestic shipbuilding skills and facilities available to meet our country's defense requirements as they arise in the future.

The U.S. shipbuilding industry has gone without subsidies since 1981, when the U.S. government unilaterally ended the Construction Differential Subsidy (CDS) program for U.S.-flag ships built in U.S. yards. Unfortunately, the timing could not have been worse. In 1981, international commercial shipbuilding entered its worst market depression in history and governments in all shipbuilding countries, with the exception of the United States, were escalating aid programs for their yards.

By propping up their shipbuilding industries in the 1980s through subsidies and other means, foreign governments not only drove unsubsidized U.S. yards out of the commercial shipbuilding market, they encouraged the dumping of ships on an unprecedented scale. At the lowest point, Asian and European shipyards were barely covering half their production costs.

The working group on shipbuilding in the Organization for Economic Cooperation and Development, known as the OECD, recognized the anti competitive, market-distorting effects of shipbuilding subsidies over ten years ago. In early 1983, 14 OECD nations signed a document in which they agreed not to introduce any new shipbuilding subsidies and to gradually eliminate the ones they already had. However, because the agreement did not include an enforcement mechanism, it was largely ignored.

A new draft agreement resulting from the subsequent OECD negotiations begun in 1989 contained a more stringent enforcement mechanism. It also contained an antidumping provision. This agreement was never signed. In April 1992, the Euro-

pean Community, Japan, and South Korea scuttled the talks. The United States Government had underestimated the resistance of the European Community to giving up their shipbuilding subsidies and the insistence of the Japanese and South Koreans to retain ship dumping rights. Moreover, the U.S. Government had underestimated its own lack of muscle in the negotiations, because it had given away its only bargaining chip through the unilateral termination of its commercial shipbuilding subsidy program in 1981.

Shipbuilding interests represent powerful political entities in the top shipbuilding subsidizing nations. Currently, foreign shipbuilders are intensifying political pressure on their governments to continue to receive subsidies. The Shipbuilders Council of America has just released a report which states that the top six subsidizing nations in the OECD are budgeting over $9 billion on average each year to help out their shipyards. Of the total amount, South Korea accounts for $2.4 billion, Germany for $2.3 billion, Japan for $1.9 billion, Italy for $940 million, Spain for $897 million, and France for $643 million.

These shipbuilding aid budget figures include, where known, loans and subsidized interest for ships built in the yards of the subsidizing countries; cash grants to shipyards paid as a percentage of the ship construction contract price; cash for shipyard operations, modernization, and rationalization; and ship and shipbuilding-related research and development. What the figures do *not* include are the subsidy values of government guarantees and tax benefits, or the full amounts of ship construction and shipyard loans and research and development aid. In other words, the true value of shipbuilding aid in the six OECD countries is significantly higher than $9 billion.

What we must conclude is that our trading partners will hold on tightly to their shipbuilding and repair subsidies unless they have a strong enough incentive to discontinue them. The goal of S. 990 is to provide that incentive by tying the discontinuation of shipbuilding subsidies and ship dumping practices to U.S. market access for the ships owned by their citizens.

I should note that S. 990 does not contain the extension of U.S. domestic trade laws to cover ships. In particular, U.S. anti-dumping and countervailing duty laws do not cover ships. A principal benefit of anti-dumping and countervailing duty laws is that they apply to those situations where product pricing is affected by direct and indirect government subsidy practices. However, the Commerce Department has consistently opposed the extension of these laws to ships because it does not conform to their lexicon of import definition. As a result, the Shipbuilders Council of America has reluctantly agreed to drop its support for this concept in recognition of the Commerce Department's lack of interest in protecting U.S. shipyards from predatory foreign government behavior. The House of Representative's comparison bill to S. 990, H.R. 1402, no longer contains this provision as well.

It is interesting to note that while some American shipowners oppose anti-dumping and countervailing duty applications for American shipbuilders, the services they provide are protected under unfair foreign competition industry-specific laws under the Foreign Shipping Practices Act of 1988. This act, which is based on the Merchant Marine Act of 1920 and is administered by the Federal Maritime Commission, permits the imposition of fines and closure of U.S. ports to vessels of carriers benefiting from practices that adversely affect the operations of domestic carriers in U.S. oceanborne trade.

Mr. Chairman, I tell you today that we strongly support S. 990. I have attached to my written testimony a list of over 200 companies across the country who have joined 21 labor unions in endorsing this bill. Furthermore, we are confident that the current Administration is much more amenable to the legislation than the last Administration.

S. 990 gets at the specific shipbuilding and repair subsidy practices of foreign governments. Here, too, the bill parallels the draft OECD agreement by generally adopting the OECD's subsidy definitions and by including an enforcement mechanism. The enforcement mechanism in S. 990 is tailored along the lines of the U.S. Foreign Shipping Practices Act.

S. 990 penalties would be applied against ships domiciled or registered in, or owned by citizens of, countries that refuse to terminate their shipbuilding and repair subsidies. The penalty options are those which are contained in the U.S. Foreign Shipping Practices Act, such as placing a financial penalty of not more than $1 million per vessel per voyage, limiting the number of U.S. port calls for affected vessels, or closing off U.S. ports to such vessels.

As I stated before, these provisions have been part of U.S. law to combat unfair foreign shipping practices for years. They have been extremely effective, and they have not cost U.S. ports any business. Foreign shippers targeted by the FMC for

unfair trading practices have stopped the practices rather than divert cargo from U.S. ports to Canadian or Mexican ports.

There is no reason to believe that applying these same provisions to stop shipbuilding subsidies will result in port diversion, simply because it would not make economic sense to switch to Canadian or Mexican ports merely to avoid the U.S. anti-subsidy legislation. If it is more cost-effective to use U.S. ports now, enactment of The Shipbuilding Trade Reform Act will not change that.

Determining the most cost-effective port involves not only the type and capacity of port facilities to handle the cargo—all ports are not alike—but the land transportation links from the port to the customer. Remember, only 20 percent of a carrier's cost is involved in seaborne transportation; 80 percent of the cost comes from what happens to the goods on land.

Nevertheless, to prevent any possibility of cargo diversion from U.S. ports, and to specifically address the stated concerns of some ports last year, S. 990 provides that the Department of Commerce direct the U.S. Customs Service to deny U.S. entry of cargo that has been transported from Canadian or Mexican ports on ships affected by the legislation. Some concerns have been raised as to whether such a provision would be in violation of Article V of the GATT (General Agreement on Tariffs and Trade), which requires goods in transit to move freely through the territory of a party. However, Article V makes an exception in "cases of failure to comply with applicable customs laws and regulations." The authority of the Customs Service to deny entry of cargo into the United States was established under the Foreign Shipping Practices Act, and no complaint has ever been filed, or even raised, with the GATT.

Mr. Chairman, of course we would all prefer that this legislation was not necessary. We believe our international trading problems are best resolved through the negotiation of international trade agreements. However, there comes a time when it is contrary to our economic interests to wait any longer for negotiated settlements to materialize. Clearly, that point has been reached in the matter of foreign shipbuilding and ship repair subsidies.

Our unsubsidized industry is on the brink of destruction. Our yards cannot fight foreign governments. Furthermore, unless our government acts quickly, it will not only be American shipyards and American shipyard workers who will be affected, but also the country's steel mills, marine equipment manufacturing plants, and the more than 1,000 other U.S. shipyard supplier industries. By 1998, we will have another 180,000 Americans in the unemployment lines unless something is done now to enable American shipyards to re-enter the commercial market—a market undistorted by subsidies.

Now is the time for the United States Government to send a message to the world that the United States will no longer tolerate unfair trading practices in the shipbuilding sector that undercut our industry's ability to compete. S. 990 provides the impetus for giving our trading partners a strong incentive to agree to end their shipbuilding and ship repair subsidies once and for all.

Attachment.

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Tel. 703-276-1700 Fax 703-276-1707

November 1993

REGULAR MEMBERS

The American Ship Building Company
Tampa Shipyards, Inc.
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Atlantic Marine, Inc.
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Jacksonville, FL 32226

Avondale Industries, Inc.
Post Office Box 50280
New Orleans, LA 70150

Bath Iron Works Corporation
700 Washington Street
Bath, ME 04530

Bay Shipbuilding Company
605 North Third Avenue
Sturgeon Bay, WI 54235

Bender Shipbuilding &
Repair Company, Inc.
Post Office Box 42
265 S. Water Street
Mobile, AL 36601

Bethlehem Steel Corporation
Bethlehem, PA 18016
Port Arthur, TX
Sparrows Point, MD

Bollinger Machine Shop &
Shipyard, Inc.
Post Office Box 250
Lockport, LA 70374

Cascade General, Inc.
Post Office Box 4367
Portland, OR 97208

Continental Maritime of San Diego, Inc.
1995 Bay Front Street
San Diego, CA 92113-2122

Edison Chouest Offshore
North American Shipbuilding, Inc.
East 118th Street
Galliano, LA 70354

General Dynamics Corporation
3190 Fairview Park Drive
Falls Church, VA 22042
Electric Boat Division, Groton, CT
and Quonset Point, RI

General Ship Corporation
400 Border Street
East Boston, MA 02128

Halter Marine, Inc.
13085 Industrial Seaway Road
Gulfport, MS 39505

Ingalls Shipbuilding, Inc.
Post Office Box 149
Pascagoula, MS 39567

Intermarine U.S.A.
Post Office Box 3045
Savannah, GA 31402

The Jonathan Corporation
Post Office Box 1839
Norfolk, VA 23501

Marine Hydraulics International, Inc.
543 East Indian River Road
Norfolk, VA 23523

Marinette Marine Corporation
Ely Street
Marinette, WI 54143

McDermott Cororation
Post Office Box 60035
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New Orleans, LA 70160

Metro Machine Corporation
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Norfolk, VA 23501

National Steel & Shipbuilding Company
Harbor Drive at 28th Street
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San Diego, CA 92138

Newport News Shipbuilding
4101 Washington Avenue
Newport News, VA 23607

Norfolk Shipbuilding &
Drydock Corporation
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Peterson Builders, Inc.
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Sturgeon Bay, WI 54235

Southwest Marine, Inc.
Foot of Sampson Street
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San Diego, CA 92113
San Francisco & San Pedro, CA

Textron Marine Systems
6800 Plaza Drive
New Orleans, LA 70127

Todd Shipyards Corporation
1102 SW Massachusetts
Seattle, WA 98134

ALLIED INDUSTRIES MEMBERS

Bird-Johnson Company
110 Norfolk Street
Walpole, MA 02081

Centrico, Inc.
100 Fairway Court
Northvale, NJ 07647

Dresser Pump Division
Dresser Industries, Inc.
401 Worthington Avenue
Harrison, NJ 07029

Fairbanks Morse Engine Division
1730 M Street, NW
Washington, DC 20036

General Electric Company
1331 Pennsylvania Avenue, NW
Washington, DC 20004

Hopeman Brothers, Inc.
Post Office Box 820
Waynesboro, VA 22980

IMO Industries, Inc.
3450 Princeton Pike
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Jamestown Metal Marine Sales, Inc.
4710 Northwest Second Avenue
Boca Raton, FL 33431

Jered Brown Brothers, Inc.
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Lake Shore, Inc.
Post Office Box 809
Iron Mountain, MI 49801

Reliance Electric Company
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Cleveland, OH 44117

Sperry Marine, Inc.
Aerospace & Marine Group
Route 29 North
Charlottesville, VA 22907

Teleflex Incorporated
771 First Avenue
King of Prussia, PA 19406

Unisys Government Systems Group
8201 Greensboro Drive
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McLean, VA 22102

Westinghouse Electric Corporation
Hendy Avenue
Sunnyvale, CA 94088

York International Corporation
631 South Richland Avenue
York, PA 17405

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Two Eaton Street - Suite 704
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Fort & Schlefer
1401 New York Avenue, NW
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PacOrd, Inc.
2700 Hoover Avenue
National City, CA 92050

Peterson Consulting L.P.
101 Federal Street
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Poten & Partners, Inc.
711 Third Avenue
New York, NY 10017

NAVAL ARCHITECT MEMBERS

Designers & Planners, Inc.
2120 Washington Boulevard
Arlington, VA 22204

JJH Inc.
5400 Shawnee Road - Suite 300
Alexandria, VA 22312

John J. McMullen Associates, Inc.
One World Trade Center
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Rosenblatt & Son, Inc.
350 Broadway
New York, NY 10013

ASSOCIATION MEMBERS

New York and New Jersey
Dry Dock Association
c/o New York Shipyard
One Beard Street
Brooklyn, NY 11231

South Tidewater Association
of Ship Repairers, Inc.
Post Office Box 2341
Norfolk, VA 23501-2341

SUPPORTERS OF THE SHIPBUILDING TRADE REFORM ACT OF 1993

ORGANIZATIONS

American Iron & Steel Institute
Association of Northern Chesapeake Docking Pilots
Industrial Union Dept., AFL/CIO
International Association of Plumbers and Pipefitters
Int'l. Assoc. of Heat & Frost Insulators & Asbestos Workers
International Association of Machinists and Aerospace Workers
Int'l. Assoc. of Bridge, Structural & Ornamental Iron Workers
Int'l. Brotherhood of Boilermakers, Iron Ship Builders, Blacksmiths, Forgers, and Helpers
International Brotherhood of Carpenters
International Brotherhood of Electrical Workers
International Brotherhood of Painters and Allied Trades
International Brotherhood of Teamsters
International Chemical Workers Union
Int'l. Federation of Professional and Technical Engineers
International Union of Operating Engineers
Laborers International Union of North America
Marine Machinery Association
Metal Trades Department (AFL-CIO)
Molders and Allied Workers Union
Oil, Chemical, and Atomic Workers Union
Pattern Makers League of North America
Sheetmetal Workers International Union
United Auto Workers
United Mine Workers
United Steelworkers of America

MEMBERS OF THE SHIPBUILDERS COUNCIL OF AMERICA (SCA)

American Ship Building - Tampa Shipyards, Inc. *(Tampa, Fla.)*
Atlantic Marine, Inc. *(Jacksonville, Fla.)*
Avondale Industries, Inc. *(New Orleans, La.)*
Bath Iron Works Corp *(Bath, Maine)*
Bender Shipbuilding & Repair Company, Inc. *(Mobile, Ala.)*
Bethlehem Steel Corp *(Bethlehem, Pa.* - BETHSHIP yards *at Sparrows Point, Md and Port Arthur, Tex)*
Bollinger Machine Shop & Shipyard, Inc. *(Lockport, La.)*
Cascade General, Inc *(Portland, Ore.)*
Edison Chouest Offshore - N American Shipbuilding, Inc. *(Galliano, La)*
General Dynamics *(St. Louis, Mo.* - Electric Boat yards *at Groton, Conn , and Quonset Point, R.I.)*
General Ship Corp *(East Boston, Mass.)*
Halter Marine, Inc *(Gulfport, Miss.)*
Intermarine U S.A *(Savannah, Ga.)*
Litton - Ingalls Shipbuilding, Inc. *(Pascagoula, Miss)*
The Jonathan Corp *(Norfolk, Va.)*
Marine Hydraulics Int'l, Inc. *(Norfolk, Va.)*
Marinette Marine Corp. *(Marinette, Wisc.)*
McDermott Corp *(New Orleans, La.)*
Metro Machine Corp *(Norfolk, Va)*
National Steel & Shipbuilding Co. *(San Diego, Calif.)*
Newport News Shipbuilding *(Newport News, Va)*
Norfolk Shipbuilding & Drydock Corp *(Norfolk, Va.)*
Peterson Builders, Inc. *(Sturgeon Bay, Wisc.)*
Robert E Derecktor of Rhode Island, Inc. *(Middletown, R.I.)*
Service Engineering Co. *(San Francisco, Calif.)*
Southwest Marine, Inc. *(San Diego, Calif.)*
Sperry Marine *(Charlottesville, Va.)*
Textron Marine Systems *(New Orleans, La.)*
Todd Shipyards Corp. *(Seattle, Wash.)*
ABB Combustion Engineering Systems *(Windsor, Conn.)*
The Bingham Group *(Arlington, Va.)*
Bird-Johnson Co. *(Walpole, Mass.)*
Centrico, Inc. *(Northvale, N.J.)*
Colton & Co. *(Washington, D.C.)*
Contralytics Corp. *(Hampton, Va)*
Designers and Planners *(Arlington, Va.)*
Dresser Pump Div., Dresser Industries *(Harrison, N.J.)*
Fairbanks Morse Engine Div., Colt Industries *(Beloit, Wisc.)*
General Electric Co. *(Cincinnati, Ohio)*
Hopeman Brothers, Inc. *(Waynesboro, Va.)*
IMO Industries, Inc. *(Lawrenceville, N.J.)*
Jamestown Metal Marine Sales, Inc. *(Boca Raton, Fla.)*
Jered Brown Brothers, Inc. *(Troy, Mich.)*
JJH, Inc. *(Cherry Hill, N.J.)*
John J. McMullen Assoc., Inc. *(N.Y., N.Y.)*
Lake Shore, Inc. *(Iron Mountain, Mich.)*
New York & New Jersey Drydock Assoc. *(Brooklyn, N.Y.)*
PacOrd *(National City, Calif.)*
Peterson Consulting L.P. *(N.Y., N.Y.)*
Reliance Electric Co. *(Cleveland, Ohio)*
M. Rosenblatt & Son *(N.Y., N.Y.)*
S. Tidewater Assoc. of Ship Repairers *(Norfolk, Va)*
Westinghouse Electric Corp. *(Sunnyvale, Calif.)*
York International Corp. *(York, Pa.)*

SHIPYARD SUPPLIERS AND OTHER SUPPORTERS

Abacus
A&E Industries, Inc. *(National City, Calif.)*
A.G.G Enterprises, Inc. *(Portland, Ore.)*
A&J Manufacturing Co
Allied Systems Co. Ameron Marine Coatings Division *(Brea, South Gate, Calif., Miami, Fla.; Belle Chasse and New Orleans, La.)*
Ameron - Marine Coatings Div *(La.)*
Anderson & Rizzo *(La)*
Ansonia Copper & Brass, Inc. *(Waterbury, Conn.)*
Aqua-Chem, Inc. *(Milwaukee, Wisc.)*
Atlantic Ordnance & Gyro, Inc.
Baltimore Hydraulics, Inc.
Bayou Steel Corp *(Laplace, La.)*
Bearings, Inc *(Cleveland, Ohio)*
Belmont Metals, Inc. *(Brooklyn, N.Y.)*
B.F. Goodrich Co. *(Akron, Ohio)*
BMT International, Inc *(Columbia, Md.)*
Bourdon Forge Co., Inc *(Middletown, Conn.)*
BMP *(La)*
Brand-Rex Co *(Chicago, Ill.)*
Brix Maritime Co *(Portland, Ore.)*
Burroughs & Watson
BWC Technologies, Inc.
California Marine Cleaning *(San Diego, Calif.)*
Capitol Finishes, Inc.
Capital Welding & Fabrication *(Houma, La.)*
Carlson & Beauloye *(San Diego, Calif.)*
C.E. Thurston & Sons
Central Radio Co., Inc.
Chestnut Ridge Foam, Inc.
Chicago Bridge & Iron *(Chicago, Ill.)*
Cincinnati Gear Co. *(Cincinnati, Ohio)*
CISCO
Clark-Cooper Corp. *(Cinnaminson, N.J.)*
Coastal Timbers *(La.)*
Consolidated Employment Systems *(La.)*
CON-TECH Power Systems *(La.)*
Cook Brothers *(San Clemente, Calif.)*
Cospolich Refrigerator Co. *(La.)*
Courtaulds Coatings, Inc., International *(La.)*
CP Industries *(McKeesport, Pa.)*
Crane Defense Systems *(Conroe, Texas)*

(Cont'd.)

Crest Steel Corp *(Los Angeles, Calif.)*
Cummins Mid-South, Inc (La.)
Davis Industrial Products Co. *(Portland, Ore.)*
Davis Interiors, Ltd
Design Associates, Inc. *(La.)*
Diagnostic Retrieval Systems *(Oakland, N.J.)*
Dynalec Corp.
El Cajon Valley Welders Supply *(Chula Vista, Escondido, El Cajon, and San Diego, Calif.)*
Electrocatalytic *(Union, N.J.)*
Envirovac, Inc *(Rockford, Ill.)*
Fire Research Laboratory *(Albuquerque, N.M.)*
Flagship Group Ltd
Flexonics, Inc *(Bartlett, Ill.)*
Flowseal *(Long Beach, Calif.)*
Fraser Shipyard *(Superior, Wisc.)*
Fraser's Boiler Service, Inc. *(Oakland, San Diego, and Terminal Island, Calif.; Portland, Ore., Norfolk, Va.; Seattle, Wash.)*
Green Marine & Industrial Equip. Co. *(La.)*
Guyon General Piping, Inc.
Gimpel Corp *(Langhorne, Pa.)*
Gowen Inc.
Gulf States Steel
Hale Fire Pump Co *(Conshohocken, Pa.)*
Harmon Contract W S A , Inc. *(Rcho California, Calif.)*
Haynes Corp *(Jackson, Miss.)*
H E. Green & Assoc
Herbert S Hiller Corp *(La.)*
H I Tullis *(Long Beach, Calif.)*
Henschel *(Newburyport, Mass.)*
Hyde Products, Inc *(Corona del Mar, Calif.; Cleveland, Ohio)*
Indikon Corp. *(Cambridge, Mass.)*
In-Mar Sales, Inc. *(Portland, Ore.)*
International Paint Co., Inc. *(National City, Calif.; Jacksonville and Miami, Fla.; New Orleans, La.; Union, N.J.; Houston, Tex.; Chesapeake, Grafton, Va.; Seattle, Wash.)*
International Transducer Corp. *(Santa Barbara, Calif.)*
ITW Philadelphia Resins Corp. *(Montgomeryville, Pa.)*
J N & N , Inc
Joo M Liss Associates, Inc. *(San Mateo, Calif.)*
Jiggs Floor Inc *(Portland, Ore.)*
Kanak Ltd
Kastalon Inc *(Chicago, Ill.)*
Key Houston *(Jacksonville, Fla.)*
King Engineering Corp *(Ann Arbor, Mich.)*
Kingsbury, Inc *(Philadelphia, Pa.)*
K-S-E Corp
Landry Enterprises *(Houma, La.)*
Larmann & Associates *(La.)*
LAS Enterprises *(La.)*
Leevac Shipyards *(La.)*
L.F Gaubert & Co., Inc. *(New Orleans, La.)*
Liberty Equipment and Supply *(Seattle, Wa.)*
Life Cycle Engineering, Inc.
Lips Propellers *(Oakland, Calif.; Chesapeake, Va.)*
Lukens, Inc *(Coatsville, Pa., with subsidiaries in over 20 states)*
Mackay Communications, Inc. *(Berkeley & Long Beach, Calif.; Harahan, La., Jacksonville, Miami & Tampa, Fla.; Raleigh, N.C., Beaumont & Houston, Tex.; Renton & Vancouver, Wash.)*
Main Industries, Inc.
Marathon Construction Corp. *(San Diego, Calif.)*
Marine Closures, Inc *(Spring Valley, Calif.)*
Marine Engineering, Inc. *(La.)*
Marine Equipment Service *(National City, Calif.)*
Marine Systems
Marine Travelift, Inc *(Sturgeon Bay, Wisc.)*
Maritime Services Corp *(Hood River, Ore.)*
Marlo Coil, Nuclear Cooling, Inc. *(High Ridge, Mo.)*
Martin, Ottaway and Chandler, Inc.
Maryland Diving Services, Inc.
Minerals Research & Recovery *(Houston, Texas)*
Mustang Power Systems *(Texas)*
Nashville Bridge Co. *(Nashville, Tenn.)*
National Ordnance Co. *(San Diego, Calif.)*
NBS Supply *(Los Angeles, Calif.)*
New England Trawler Equip. Co. *(Chelsea, Mass.)*
Newpark Shipbuilding & Repair *(Texas)*
NMP Corp. *(Tulsa, Oklahoma)*
Oarline Marine Sales *(La.)*
Omnibus Technical Services
Omnithruster, Inc. *(Santa Fe Springs, Calif.; Georgetown, Conn.)*
Pacific Marine Sheet Metal Corp. *(San Diego, Calif.)*
Paco Pumps, Inc. *(City of Commerce and Oakland, Calif.; Portland, Ore.; Seattle, Wash.)*
Paige Floor Coverings *(San Diego, Calif.)*
Painters and Allied Trades
Paramount Supply Co. *(Portland, Ore.)*
Parmatic Filter Corp.
PDS, Inc. *(National City, Calif.)*
Paul Munroe Engineering, Inc. *(Orange, Calif.)*
Power Rents *(Tigard, Ore.)*
Production Supply *(El Toro, Calif.; Chesapeake, Va.; Kent, Wa.)*
Pro Line Paints *(Long Beach and San Diego, Calif.)*
Propulsion Controls Engineering *(San Diego, Calif.)*
P & T Insulation Co. *(Mass.)*
Pump Systems, Inc. *(La.)*
Q.E.D Systems, Inc.
RIX Industries *(Oakland, Calif.)*
Robertson Marine Systems, Inc. *(La.)*
Safety West *(Cy of Industry, Calif.)*
San Francisco (Calif.) Board of Supervisors
Scaffold Masters *(San Jose, Calif.)*
Seacoast Electric Co. *(Rye, N.Y.)*
Sea Spike Marine Supply Co. *(Farmingdale, N.Y.)*
Sea Tech *(Texas)*
Sea Trac *(La.)*
Services & Marine, Inc. *(Humble, Texas)*
Son-Zee, Incl *(San Diego, Calif.)*
Sperry Marine *(Nat. City & San Francisco, Calif.; Union, N.J., Cleveland, Ohio; Harvey, La.; Va Beach, Va.; Seattle, Wash.)*
Stardyne, Inc.
Steam Supply *(Seattle, Wa.)*
Tate Andale, Inc. *(Baltimore, Md.)*
Teak Decking Systems *(Sarasota, Fla.)*
Teledyne Crittenden *(Gardena, Calif.)*
Testing Services and Inspection, Inc. *(San Diego, Calif.)*
Thomas A. Short Co. *(Emeryville, Calif.)*
Timothy Graul Marine Design *(Wisc.)*
Titeflex Corp. *(Springfield, Mass.)*
Todco Division Door Corp.
Trus Joist Corp. *(Boise, Idaho)*
Unaflex Rubber Corp. *(Ft. Lauderdale, Fla.)*
Unirule Industries, Inc.
VL Logistics, Inc. *(Miss.)*
Utility Steel Fabrication, Inc. *(La.)*
Washington Aluminum Co. *(Baltimore, Md.)*
Waukesha Bearings *(Waukesha, Wisc.)*
W.H. Linder & Associates *(La.)*
Weksler Instruments Corp. *(Freeport, N.Y.)*
Wilden Pump & Engineering *(Colton, Calif.)*
Young Engineering Co., Inc.
York Power Systems *(Texas)*
Zodiac of North America, Inc. *(Md.)*

REPONSES OF MR. STOCKER TO QUESTIONS SUBMITTED BY SENATOR GRASSLEY

Question 1: What benefit is it to the American shipbuilding industry to penalize and harm their customers for making logical and rational business decisions that every other business must make--that is, buying the lowest-priced product available? In this case, it happens to be vessels.

The intent of the Shipbuilding Trade Reform Act (S. 990 in the Senate) is to provide a strong incentive for foreign governments to withdraw from the commercial ship construction marketplace. It is, frankly, a measure of last resort, because there are no other remedies available to pry open the market, which is dominated and distorted by the government policies and practices of other shipbuilding nations. Unless this is changed, the U.S. shipbuilding industry will not survive the decade.

In June of 1989, the Shipbuilders Council of America (SCA) filed a Section 301 petition requesting U.S. Government action against foreign shipbuilding subsidies. The evidence of massive subsidization of foreign yards was so overwhelming that the Bush Administration decided to pursue an international solution. Given the immediacy of the plight of U.S. shipyards, taking the complaint to the GATT was seen as a waste of time. However, an agreement within the OECD would take only about nine months, then U.S. Trade Representative Carla Hills promised. Well, nine months came and went, as have six more deadlines over nearly five years. Unilateral legislation appears to be the only way to force our trading partners in the OECD to agree to give up their shipyard subsidies.

We believe that is fundamentally unfair and inherently wrong when our domestic industries are forced to compete not just against foreign companies, but against foreign governments in international markets. In applying this rationale, we try to take an evenhanded approach; for example, we supported the case of American oilseed producers versus French oilseed producers who are so heavily subsidized by the French government. In the interest of fair competition, governments may institute tariffs or restrict consumer access to heavily subsidized imports, whether the imports are agricultural commodities or manufactured products. The intent is not to "punish" or "harm" the consumers of these products. Moreover, as many American consumers have sadly discovered, foreign subsidies may result in cheap prices in the short run, but in the long run they can destroy American businesses and American jobs and weaken the American economy.

Question 2: Will you support putting the Jones Act, cargo preference, capital construction funds, Operating Differential Subsidies, and the new shipbuilding subsidies recently included in our defense bills on the OECD and GATT negotiating tables so that the United States can get serious about fighting unfair foreign subsidies?

Ship operations ("services") is a separate and distinct issue from ship construction ("manufacturing"). This is true in the GATT and in the OECD. The OECD negotiations, which are being conducted within Working Party Number Six on Shipbuilding, are concerned with government policies and practices that aid ship construction, not ship operations. In short, if the question implies a desire to end subsidy programs for the U.S. flag fleet (such as cargo preference and operational differential subsidy (ODS)), then it is targeting the wrong parties.

At the very beginning of the OECD negotiations, the U.S. delegation provided a detailed list of all the specific U.S. regulations relating to commercial ship construction which would be deleted or changed. This was done with the full cooperation and support of the SCA. Moreover, the United States is the only party involved in the negotiations to have provided such a list. The following items were put on the table by the U.S. delegation: (The Office of the U.S. Trade Representative has all the appropriate citations in U.S. law.)

- Construction Differential Subsidy (CDS) [Effectively ended in 1981, but still on the books]
- U.S.-build requirements for U.S.-flag vessels eligible for operating differential subsidy
- The 50-percent ad valorem duty on foreign repairs of U.S.-flag ships
- The requirement for non-emergency repairs of ODS vessels to be made in U.S. yards
- Three-year waiting period for U.S. reflagged, foreign-built vessels to become eligible to carry preference cargos

As for the U.S. build and reconstruction requirements in the Capital Construction Fund (CCF), the U.S. delegation felt it was unconscionable to give U.S. flag operators access to tax shelters for ordering from foreign shipyards at the expense of American shipyards and shipyard workers. Ultimately, the issue became moot as the other parties in the OECD weakened the domestic program provisions in the draft agreement. A similar situation was encountered with the Jones Act. Because the U.S. delegation believed it to be grossly unfair to eliminate just the Jones Act domestic-build requirements, the choice was between eliminating the Jones Act altogether or to leave it intact. Both the Bush and Clinton Administrations opted for the latter.

It should be noted that during the nearly five years of OECD negotiations, the Asians and Europeans have carved out exemptions for some of their commercial shipbuilding subsidy programs, either through "grandfathering" or by removing them from the agreement altogether. Their success in doing so has prompted them to try to save even more of their shipyard aid programs from an OECD agreement, such as the substantial financing programs for export ships built in the yards of the nations of the European Union.

Furthermore, it was only recently disclosed that an agreement could not go into effect until the separate legislatures of all of the member nations ratify it. No one knows how long this will take, especially when considering the political opposition to the agreement in France, Spain, Italy, and Germany. Moreover, since only the United States has disclosed its specific shipbuilding-related laws, no one knows what policies, practices, and regulations would have to be repealed through the legislative processes of the other OECD countries. Hence, there will be no checks and balances.

What we do know for certain is that if an OECD agreement should be signed, foreign shipbuilding subsidy practices will continue--and U.S. yards will continue to be denied access o the commercial market--until the ratification process is complete. In the meantime, what are American shipbuilders to do? To ensure the survival of our country's domestic shipbuilding base in the interim, Congress and the Administration have proposed some modest, short-term programs to help our industry get into the commercial market. These programs would be terminated, or brought into compliance with the final OECD agreement, once the agreement is fully ratified--assuming that the final document is not full of loopholes to accommodate only the shipbuilding subsidies of our trading partners.

COMMUNICATIONS

STATEMENT OF THE AMERICAN FOREST & PAPER ASSOCIATION

These comments are submitted on behalf of the American Forest & Paper Association ("AF&PA"), the national organization of the pulp, paper and forest products industry. In 1992, exports of these products constituted $17 billion, and are consistently one of the primary positive contributors to the U.S. trade balance. AF&PA members conduct operations in all states of the Union and are substantial users of ocean common carriers in international transportation. Our industry employs approximately 1.4 million Americans throughout the United States, and ranks among the top 10 manufacturing employers in 46 states, with an annual labor cost of about $46 billion. Therefore, AF&PA and its member companies, as major shippers, have a substantial interest in this legislation.

Our comments address S. 990 as presently drafted, as well as the recent amendments to H.R. 1402, which some are advocating as appropriate for S. 990. Our comments are organized as follows:

- AF&PA OPPOSES S. 990
- INJURY TO THE U.S. FOREST PRODUCTS INDUSTRY
- NO SOLUTION TO FOREIGN SUBSIDIES
- AMENDMENTS TO THE HOUSE VERSION
- SUBSIDIES FOR U.S. SHIPYARDS
- CONCLUSION

AF&PA OPPOSES S. 990

AF&PA is strongly opposed to S. 990 because it would impose severe sanctions on the very vessels which carry our forest products to foreign markets. We support the testimony presented by H. George Miller, Executive Director, Shippers for Competitive Ocean Transportation (SCOT), presented before your Subcommittee on November 18.

The goal of S. 990 is to reduce subsidies to foreign shipyards, a goal that is supported by AF&PA. However, unilaterally imposing draconian penalties on vessels owned or registered in foreign nations that subsidize their shipyards, would be extremely injurious to U.S. exporters, and ineffective in obtaining the desired goal.

AF&PA opposes S. 990 because it would:

- Significantly reduce the ability of U.S. exports to compete by dramatically increasing costs of getting our forest products to world markets.
- Force many vessel operators to abandon U.S. port calls, reducing and possibly eliminating vessel space for U.S. exporters.
- Cause cargo to be diverted (at great cost to U.S. exporters) from nearby U.S. ports to Canadian and Mexican ports.
- Create a tremendous cost disparity between delivery costs for U.S. forest products and foreign forest products.
- Threaten many more jobs in U.S. forest products, agriculture, coal, oil, and shipping industries than it could possibly save in the shipbuilding/repair industry.
- Invite foreign retaliation. The State Department has already warned that the bill would violate U.S. international commitments and invite retaliation by other countries.
- Disrupt timely flow of goods, which would be severely damaging to U.S. retailers and consumers.

INJURY TO THE U.S. FOREST PRODUCTS INDUSTRY

Forest products constitute one of the most important export commodities in U.S. international trade, even in the face of increasing worldwide competition. Foreign producers on virtually all continents produce paper, pulp, liner board, panel products, and softwood and hardwood lumber. The foreign consumers of U.S. forest products constantly balance the quality and price of our products against those of foreign-based suppliers. Often the decision as to sourcing is based primarily on price. In this environment, any significant increase in the delivered price of U.S. forest products will result in a shift of sourcing away from U.S. suppliers. The impact of such cost increases, in terms of lost sales, lost revenue and lost U.S. employment, will be substantial.

Congress must carefully consider the impact of S. 990 not only on the industry it intends to assist directly (U.S. shipbuilders), but also on the wide spectrum of U.S. export industries which will be impacted indirectly, yet severely. In fact, the employment represented by companies which comprise the membership of the American Forest & Paper Association is far greater than that of the U.S. shipbuilding industry. And our industry is only one industry which would be injured by S. 990—there are a number of other industries with U.S. employment comparable to the forest products industry, which would also be injured. Thus, the danger of S. 990 is that in its effort to represent the relatively few Americans who work in shipyards, the employment of millions of Americans in other industries would be threatened.

It is vital to our member companies, who export price-sensitive cargoes in an increasingly competitive global market place, that costs of delivery be kept to reasonable levels. Experience has clearly shown that when ocean transportation costs increase substantially, U.S. forest products exports (and the employment we provide in the U.S.) can decrease dramatically.

It is essential that our ocean transportation costs be similar to that paid by forest product exporters abroad. S. 990 would immediately create a tremendous ocean transportation freight disparity between ourselves and our foreign competitors. The bill requires penalties of not less than $500,000 and not more than $1 million per *voyage* for vessels that carry forest products. Meanwhile, those same vessels could carry Canadian or other countries' forest products without such penalties.

If vessel operators serving the U.S. forest products industry (and other U.S. industries) cannot purchase and operate vessels at a competitive worldwide price, or if they must pay significant penalties in the U.S. for doing so, they will have no alternative but to pass those penalties on to U.S. shippers or to forego calling at U.S. ports. Yet the forest products industry of the United States is already locked in a battle for global marketshare even while dealing with diminishing harvests. This has resulted in price margins which simply will not allow for the absorption of million dollar fines.

Nor will our foreign purchasers be willing to absorb such assessments. Instead, they will simply look to our foreign competitors to supply them with the forest products they need.

NO SOLUTION TO FOREIGN SUBSIDIES

S. 990 is not a solution to the problem of foreign shipbuilding/repair subsidies because it penalizes the wrong parties. Under the legislation, fines ranging from $500,000 to $1 million per voyage would be levied on the ships which carry our cargo, not upon the governments of offending countries. Foreign governments and foreign yards are the parties involved in shipbuilding subsidies, not the U.S. shippers who must have an efficient means of getting our exports to foreign markets.

The International Trade Commission has concluded that even if the foreign shipbuilding subsidies targeted by S. 990 were eliminated, the disparity in shipbuilding costs between the U.S. yards and foreign yards would continue to render U.S. yards uncompetitive. This is evidenced by the fact that U.S. yards have not built a ship in open competition with foreign yards for 33 years.

CHANGES TO THE HOUSE VERSION

As I am sure the Subcommittee is aware, the House Ways & Means Trade Subcommittee amended the House version of this bill, H.R. 1402, to include the following changes:

- Effective date would be date of enactment—only vessels for which a contract for construction was signed after the date of enactment of the legislation would be subject to the imposition of penalties.

- Investigations would be complaint driven, requiring a finding of injury by the U.S. Trade Representative.
- Definition of subsidy will be that used by Commerce Department.

These amendments, if included in S. 990, would only *slightly* mitigate the negative impact of the bill on U.S. exporters, importers, retailers, consumers, etc., by slowing down the process by which investigations would be undertaken and penalties imposed. S. 990 would still severely hamper the timely flow of goods upon which the commerce of this country is dependent.

Even if S. 990 is amended to include the changes listed above, AF&PA will oppose S. 990 because of the unquestionable damage it will do to our industry, and every other industry dependent upon ocean transportation to send or receive finished products and components.

SUBSIDIES FOR U.S. SHIPYARDS

Regardless of the numerous valid arguments against S. 990, it would be hypocritical for the Congress to pursue passage of S. 990 while at the same time considering passage of a bill to subsidize construction of U.S. flag vessels.

AF&PA does not oppose such subsidies for U.S. flag vessels, in fact we take no position at all on this issue. However, pursuing legislation to subsidize our own shipbuilding industry concurrently with legislation that would penalize foreign nations for subsidizing their own shipyards, is clearly contradictory. It creates a double standard which is not likely to be well received by the rest of world, and is likely to invite strong retaliation, thereby adding to the injury S. 990 would heap on our industry and others.

CONCLUSION

AF&PA recognizes that the intent of S. 990 is to stop foreign governments from unfairly subsidizing their shipyards. This is a laudable goal. Unfortunately, the impact on our industry and most other U.S. industries would be anything but positive.

Although AF&PA supports the intent of this legislation, we believe that S. 990 does not appropriately redress this problem. Through draconian penalties on ships calling on U.S. ports, S. 990 would result in the devastation of the U.S. export community which already struggles to remain competitive in the world marketplace, while simultaneously failing to help the U.S. shipbuilding industry it is designed to assist.

AMERICAN MARITIME CONGRESS
Franklin Square, 1300 Eye Street, NW, Suite 250 West, Washington, DC 20005-3314

December 6, 1993

The Honorable Max S. Baucus
Subcommittee on International Trade
Committee of Finance
205 Dirksen Office Building
Washington, D.C. 20510-6200

Dear Chairman Baucus:

The American Maritime Congress appreciates the opportunity to present its views for inclusion in the hearing record of S. 990, the Shipbuilding Trade Reform Act of 1993.

The American Maritime Congress (AMC) is a research and educational group of U.S.-flag shipping companies operating in the domestic and international waterborne commerce of the United States. AMC's comments express the common views of its members, and are not intended in any way to detract from or otherwise attenuate views expressed individually by any of its members.

We would like to begin by commending Senator Breaux for his leadership in attempting to craft legislation to deal with international shipbuilding subsidies which distort the shipbuilding market to the detriment of U.S. shipyards. In this connection, we note that Senator Breaux was the author of the Foreign Shipping Practices Act (FSPA), which became Title X of the Omnibus Trade and Competitiveness Act of 1988. The FSPA addressed the problem of discrimination by foreign governments and/or foreign-flag ocean liners against U.S.-flag liners.

Before addressing S. 990, we would like to make two general observations, as background for our more specific comments:

- Ideally, the best solution to ending foreign shipyard subsidies is by an international agreement. Only after it becomes abundantly clear that such a solution is impossible should unilateral action be taken; and,

- Should Congress decide that legislation along the lines of S. 990 and H.R. 1402, as recently reported, should be enacted, AMC urges that it be drafted as narrowly and as flexibly as possible to minimize the real danger of retaliatory legislation by foreign governments. The United States does not write from a clean slate in this matter. Several of our own laws and pending legislative proposals can be perceived as direct or indirect subsidies to U.S. shipyards.

Turning to S. 990, AMC believes it does not overreach nearly as much as the original version of H.R. 1402; on the other hand, AMC feels that H.R. 1402, as reported by the House Trade Subcommittee, addresses the problem in a less burdensome manner, is more flexible, and therefore would be easier to administer and less likely to invite retaliation. Considered against the general observations made earlier, however, AMC will neither support nor oppose the new version of H.R. 1402, at this time.

Should legislation be deemed necessary, AMC will comment briefly on S. 990 in the context of H.R. 1402, as reported. The current version of H.R. 1402, contains several changes which AMC believes would lessen the risk of adverse impact on U.S. waterborne trade. AMC recommends that they be incorporated in S. 990:

- Existing vessels should not be subject to sanctions, only vessels for which construction contracts are entered into after date of enactment;

- The "injury test" in S. 990, should be broadened along the lines of the amended version of H.R. 1402, so that it focuses on a "burden or restriction on U.S. Commerce" rather than on a condition unfavorable to one sector of U.S. commerce, i.e., shipbuilding;

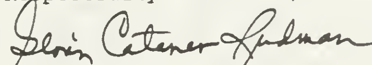
- The "Investigations" process in the reported version of H.R. 1402, involves the United States Trade Representative and the Department of Commerce, whereas S. 990 would only involve the latter. AMC submits that the former strikes a proper balance between the duties and responsibilities of both agencies regarding disciplining of foreign subsidies, and is therefore preferable;

- The reported version of H.R. 1402, provides greater flexibility for the imposition of penalties, and is therefore more likely to achieve its objective -- discipline subsidies paid by foreign governments to their shipbuilders.

- The reported version of H.R. 1402 creates a venue for foreign interests to resolve disputes with the USTR. This may lessen the danger of retaliatory legislation.

The American Maritime Congress wishes to thank the Subcommittee for the opportunity to present its views.

Respectfully submitted,



Gloria Cataneo Rudman
Executive Director

Statement of the Council of European & Japanese National Shipowners' Associations (CENSA)

INTRODUCTION

The Council of European & Japanese National Shipowners' Associations (CENSA) is pleased to submit comments on S. 990 in connection with the hearing before this Committee. CENSA is comprised of the National Shipowners' Associations of Belgium, Denmark, Finland, France, Germany, Greece, Italy, Japan, the Netherlands, Norway, Sweden, and the United Kingdom plus individual liner operators/container consortia from most of those Countries. These countries and their shipowners represent a large majority of the trading partners of the United States.

I.

CENSA'S OPPOSITION TO S. 990

Our Members have asked us to express to your Committee their opposition to this proposed legislation under which the United States would impose unilateral penalties on vessels flagged in or owned by citizens of countries which subsidize their shipyards for construction and repair. In CENSA's view, enactment of this legislation would cause serious and immediate harm to the economy of the United States, its trading partners and CENSA's members.

II.

CENSA SUPPORTS THE OBJECTIVE OF ELIMINATING SUBSIDIES

CENSA's principal objective has always been and continues to be the promotion of an unfettered market with a minimum of governmental regulation and intervention and with resulting benefits for the carriers and the seaborne transport of goods. CENSA has supported policy objectives throughout the world which seek removal of the artificial distortions caused by government intervention in the form of subsidies for shipbuilding and repairs. In CENSA's view, so long as these government subsidies exist, which by their nature encourage excess shipyard capacity and over-ordering, overtonnaging will continue to exist. The problem of phasing out market distortions caused by shipyard subsidies raises difficult issues among nations, and such issues cannot be successfully addressed unilaterally. Only a multilateral approach will permit a resolution which does not disrupt international trade and commerce.

III.

A MULTINATIONAL AGREEMENT IS THE BEST SOLUTION

As the Committee is aware, multinational negotiations to arrive at an international solution of shipbuilding issues have been underway for the past several years under the sponsorship of the OECD and talks are now in progress. Like all multinational negotiations, the issues are complex and a resolution takes time. The United States has been a participant in these talks and has taken a strong lead. A general framework of an OECD draft agreement has been developed dealing with various substantive matters and which is intended to preclude unacceptable measures and practices, such as export schemes, direct and indirect support to shipyards, and set forth measures to resolve disputes as to injurious pricing, among many other items. CENSA is unequivocally in favor of a balanced and effective OECD multilateral agreement which will phase-out all market distortions in the form of subsidies to shipyards and phase in a complaint driven injurious pricing code. In CENSA's view, a positive resolution of the negotiations in this manner best serves the interests of maintaining international trade and

commerce among the nations without the disruption and adverse consequences which unilateral actions could impose. We note that S. 990 agrees that a multilateral agreement among shipbuilding nations is the best means of providing for fair international competition [Section 2(7)].[1]

IV.

S. 990 IS THE WRONG SOLUTION TO BRING ABOUT THE ELIMINATION OF SUBSIDIES

S. 990, entitled the Shipbuilding Trade Reform Act of 1993, sets forth a unilateral legislative scheme which would impose extreme penalties on vessels of countries and their citizens which subsidize construction and repair of vessels. All the countries which have been involved in the OECD multinational negotiations would be statutorily listed as countries whose shipowners would be blocked from U .S. trade unless each country signed an agreement with the United States eliminating any subsidization of shipyards, as defined broadly in the legislation. All other countries would be subject to investigation and placed on the same list, if the Secretary of Commerce reasonably concluded that they engaged in subsidization. The term "subsidy" would be broadly defined, covering essentially any actions which could be deemed to have any impact on U.S. shipbuilders.

CENSA submits that enactment of this legislation and the sanctions contained therein are arbitrary in their application, endanger the possibility of reaching an international agreement, and would be contrary to international law and U.S. obligations. Enactment would be a grievous misstep on the part of the U.S. By this unilateral act the United States would disrupt the worldwide multilateral trading system, bring a virtual stop to U.S. import

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[1]Censa has noted the recent amendments to the Gibbons Bill, H.R. 1402. This Bill, however, still requires unilateral action to be taken administratively. Furthermore, amongst other regrettable provisions:

- it is now similar to S. 990 in that it still discriminates in favor of U.S. shipowners by not retaining any sanctions against their purchase of ships built with subsidies in foreign countries, although vessels flagged or owned in those countries could be subject to U.S. sanctions;

- petitions for the initiation of an investigation as to whether a foreign country is a subsidizing country do not require any proof of harm to the petitioner;

- adverse effects on U.S. commerce are defined in such broad generalizations as in practice to encompass any subsidy in a foreign country regardless of whether it had a perceptible effect on U.S. interests;

- it continues to apply sanctions to vessels connected with subsidizing countries rather than to their shipyards, therefore vessels flagged and beneficially owned in non-subsidizing countries face no sanctions, even if their construction or repair was subsidized.

- the status of vessels (contracted after enactment) beneficially owned or flagged in all foreign shipbuilding countries would be permanently uncertain, as at any time an investigation might be initiated which culminated in the application of sanctions to these vessels.

and export trade, deprive its whole economy of jobs and future growth, and trigger a spiral of retaliation by the trading partners of the United States. S. 990 would be an act of isolation by the United States with consequences not seen since the Smoot-Hawley Tariff Act of 1930, which many consider plunged the United States and the world into a worldwide depression.

Moreover, CENSA must observe that the language of the Bill seems particularly designed in its restrictive language to preclude any solutions. Countries can escape its strictures only by entering into a trade agreement with the United States providing for the "immediate elimination of subsidies for the construction and repair of vessels (including the elimination of continuing benefits from prior subsidy programs)." This language seems designed to make any agreement or solution impossible. Agreements, whether bilateral or multilateral, involve reciprocity.

A. S. 990 does not level the playing field.

- The avowed purpose of S. 990 is to eliminate subsidies for shipbuilding and repairs in foreign shipyards, but it does nothing with respect to U.S. subsidies, and the absence of any restraint on continuing U.S. subsidies, even if the Bill were successful, shows that unilateral action is not the appropriate solution. The United States can hardly demand that other countries totally relinquish their subsidies, including the continuing benefits of past subsidies, while retaining its own shipyard support subsidies, including such provisions as the Capital Construction Fund, Title II, transitional assistance such as that given under ARPA, domestic build requirements of the Jones Act and the benefits received by United States shipowners and shipyards of the past construction differential subsidy program. This would tip the playing field in the opposite direction, and not achieve the free and unfettered market which can best serve international trade and shipowners.

- S. 990 clearly further unfairly discriminates in favor of U.S. shipowners in comparison with their foreign competitors since it permits a U.S. shipowner to buy a vessel built with foreign subsidy and then operate it as long as it is placed either under the U.S. flag or the flag of a nation not on the list.

B. S. 990 is arbitrary in its application.

- The proposed legislation would punish the wrong entities. Although the intent of the legislation would be to address subsidies which are given to shipyards, the burden of this statute would fall not upon the shipyard but on a shipowner of the country which gives the subsidy or on vessels registered in that country. It is the shipowner which loses. The bill thus penalizes the wrong party and in no way redresses the benefits which the shipyard has received.

- The bill exempts shipowners from third flag countries who can enjoy the benefits of the subsidized shipyard construction price. As a consequence, any owner not a citizen of the country which has a subsidized shipyard is free to enjoy the subsidized price and to use the subsidized vessel in U.S. trade under his own or the flag of another country. Thus, a citizen of Singapore (or of any other center of maritime activity where yards are not subsidized) could build a ship in a subsidizing country at the reduced price and sail it without penalty in U.S. trade.

- In further contradiction, S. 990 also punishes shipowners of countries which subsidize shipyards even if their vessels were built in another country. Indeed, a shipowner of a country which subsidized its shipyards would be subject to the penalties even if it built all its vessels in U.S. yards. These arbitrary and capricious results demonstrate that unilateral actions by individual countries neither protect domestic yards from competition nor produce solutions to offset shipbuilding benefits.

C. S. 990 endangers an international solution.

- The provision in S. 990 that each of the countries which have been negotiating as part of the OECD Council Working Group is statutorily placed on the list of countries whose shipowners will be penalized is not conducive to furthering multinational negotiations. To this must be added the bill's restrictive language on the scope of any agreement, which we have already noted. We recognize that international solutions are difficult, but it is fundamental that multilateral agreements provide the only lasting solution.

D. S. 990 is contrary to U.S. and International Law and U.S. Treaty Obligations.

- Essentially the proposed Bill would impose penalties on vessels of shipowners, by either barring the vessel from U.S. ports, reducing its sailings or cargo, or imposing dollar penalties, all because the country of the vessel owner grants a subsidy to its shipyards, a subsidy which the vessel and its owner may or may not have enjoyed. Such action not only is arbitrary, it is a departure from international practice that "instruments of commerce" are to be treated neutrally.

- S. 990 likewise offends the time-honored doctrine of freedom of seas, followed by the world community including the United States, which has recognized open entry to ports, without fines or vessel restrictions, except in time of war or emergency.

- The United States has further with its trading partners entered into Treaties of Friendship, Commerce and Navigation which require that national treatment be afforded the vessels of the other nation. The penalties in S. 990 would deny that national treatment.

- Finally, the Bill's provisions are contrary to the provisions for free passage of vessels granted under Article V of GATT.

E. S. 990 would disrupt and halt U.S. import and export trade, lose jobs and undermine future U.S. economic growth.

- The sanctions and the threat of sanctions in S. 990 applicable within 180 days would severely damage U.S. trade by creating a shortage of tonnage for U.S. exports and imports.[2]

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[2] CENSA sees no difference in practical terms in the impact between those penalties imposed on an "existing affected vessel" or a "new affected vessel".

- Currently over 96% of U.S. total ocean-water-borne commerce is carried in foreign flag vessels. With respect to liner trade, only approximately 18% of the liner trade is carried by U.S. flag vessels.

- S. 990 makes each of the member countries which participate in the OECD Council Working Group subject to the penalties within 180 days of enactment. These "black listed" countries have according to the OECD publication "Maritime Transport 1992," flag shares at mid 1992 as follows:

OECD countries (excluding USA):	28.5%
Korea:	1.7%
Total "black list countries"	30.2%

Adding beneficial ownership, as shown in the forthcoming UNCTAD report "Review of Maritime Transport 1992," the "black listed" countries would account for more than 50% of world tonnage.

- The ability of the U.S. to export (and import) is critical to the growth of the U.S. economy. As the recent U.S. Department of Commerce study shows, Merchandise exports contributed almost all job growth in the U.S. in the manufacturing industry from 1986 to 1990. In 1990, merchandise exports contributed 88% of the Gross Domestic Product (GDP) growth, and from 1986 to 1990 U.S. merchandise exports accounted for 41% of the rise in U.S. GDP (in 1982 dollars).[3/]

- U.S. merchandise exports supported 25% of the growth in U.S. civilian jobs between 1986 and 1990, and in 1990 alone, merchandise exports accounted for 17% of the job growth.

- 19,100 U.S. jobs were supported by each $1 billion of U.S. merchandise exports in 1990, and the loss of jobs in the U.S economy as a result of the disruption of trade would cause severe damage. It would be equally disruptive and damaging to the economies of the trading partners of the United States and disrupt the mutual trade relationships.

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[3] U.S. Jobs supported by Merchandise Exports, U.S. Department of Commerce, Economics and Statistics Administration, Office of the Chief Economist, April 1992, OMA Research Series 1-92.

- In addition to manufacturing jobs, jobs would be lost with respect to workers in ports, mines, farms, forests and chemicals by the reduction of exports of coal, grain, forest products and chemicals by the lack of tonnage. These exports amounted to over 62 billion dollars.

- The interruption in the availability of vessels and resultant decline in trade would clearly result in U.S. consumers paying a higher prices for imports and reduce the standard of living of the whole U.S. economy.

F. S. 990 would trigger retaliation against U.S. vessels.

- It is a fact of international commerce that unilateral attempts by one country to adjust in its favor mutual trade with another country invariably invites retaliation by its trading partner. The United States and that European Community and the United States and Japan have each been repeatedly involved in such actions and counteractions. If S. 990 is enacted, other nations will adopt protective measures for their citizens, including provisions similar to those of S. 990. Existing fleets of U.S. shipowners would be at risk and existing U.S. flag vessels built with past financial assistance such as construction differential subsidy, Title 11 or CCF could become subject to retaliatory and preclusive penalties. Alternatively, other countries might retaliate by imposing restrictions on other industries or commodities. Once unilateral action is taken by one country, the political and economic pressures to respond in kind or by offsetting measures becomes difficult to resist. All such actions hurt trade and impact domestic economies. They do not help the goal of reduction of trade barriers between countries and they emphasize the desirability of a multilateral solution.

CONCLUSION

CENSA has a commitment to the development of international free markets, in which artificial distortions caused by governmental intervention to subsidize, protect or reserve sectors for specific commercial interests are eliminated. In CENSA's view the most effective way forward is through concerted multilateral action, not least with regard to the elimination of subsidies to shipyards. This committee should, therefore, for the reasons set forth herein, not adopt S. 990.

CENSA appreciates this opportunity to present its views on these important issues.

Statement of the Federation of American Controlled Shipping (FACS)

Our organization's membership comprises American companies which own, operate, manage, charter, finance or otherwise utilize open registry vessels. Indeed, one of the primary objects and purposes of FACS, as stated in its Articles of Association, is:

> "To encourage free and open maritime trade throughout the world, to oppose artificial and unreasonable restraints on such trade and to facilitate international maritime trade by stressing that flexible, efficient and dependable shipping arrangements are essential to shippers, cargo owners and receivers."

Thus, unlike organizations concerned solely with the interests of ship operators, we have a broader mandate and must view a legislative proposal such as S. 990 not only from the standpoint of its potential impact on American shipowning companies but also its likely impact on cargo owners as well.

In this regard, we are particularly wary of unilateral efforts which would interfere with the free movement of maritime trade in the international arena, because unilateralism invariably creates barriers to such trade and serves to encourage countervailing measures which in turn give rise to additional barriers. Viewed from this vantage point S. 990 is particularly ill-advised and represents a wrong and indeed counterproductive approach to the problem of achieving international competitiveness for the U.S. shipbuilding industry. In addition, while S. 990 would not directly impact on U.S. vessel operators (for which we commend its sponsors), it would most certainly be burdensome to American cargo owning interests and thus would be harmful to U.S. trade. These points are discussed in the following paragraphs.

I. Unilateral Measures Against Shipbuilding Subsidies Would Be Unrealistic and Counterproductive

As Americans we have empathy and concern for our fellow countrymen engaged in shipbuilding, and genuinely would like to see them become competitive in the international marketplace. We also believe that if the right steps are taken, that goal can be achieved. But we do not believe that continuing on the course of unilaterally seeking to pressure foreign governments to conclude a multilateral agreement which would eliminate subsidies across-the-board over the next few years is realistic, given the present circumstances.

First, the reality in many countries is that there are strong political, economic and social reasons for governments to offer assistance to enable their yards to continue to operate. The former East German yards are a compelling example of this reality. If the German government had not undertaken to commit some $4 billion over a five year period to revitalize the former East German yards, the impact in terms of unemployment, political unrest and human suffering could have been disastrous. Similar but less dramatic pressures exist in various other countries around the globe, such as in Southern Europe. Consequently, it is unlikely that shipyard subsidies could be ended within a matter of a few years by multilateral agreement brought about as the result of unilateral actions or threats of action by the United States.

Second, the U.S. yards presently are in much the same non-competitive position as the former East German yards were prior to the decision made last year by the German government. Candidly, there is no reason to believe that American shipyards could survive without government assistance in an unsubsidized world marketplace any more than the former East German yards could have survived. That reality is well understood by almost every ship

operator familiar with comparative shipbuilding costs throughout the world, and is confirmed by the entirely valid and nonpartisan June 1992 report of the International Trade Commission.

Third, to become internationally competitive in the future the U.S. shipyards must undergo extensive restructuring of their facilities and their ways of doing business. Restructuring can only be achieved by substantial new capital investments and by undertaking research and development leading to the adoption of new technology, creative vessel designs, modern management systems, and programs to increase productivity and to promote commercial sales through sophisticated vessel finance and export promotion. It seems improbable that such investments and programs could be initiated and funded without government assistance in the form of grants and guarantees which in turn would facilitate private investment.

Fourth, at both the federal and state levels efforts are underway to provide such assistance to U.S. shipyards, assistance which in most instances, if granted by a foreign nation to its shipbuilding industry, would constitute clearcut examples of the very types of "subsidies" defined in, and prohibited by, S. 990:

* For instance, H.R. 2151, which was passed by a vote of 347 to 65 in the House (reportedly with Administration acquiescence) earlier this month would establish a new subsidy program providing up to 50% of contract costs for the series construction of two or more vessels.

* The State of Louisiana is presently planning, according to press reports, to pledge up to $160 million in state funds as guarantees to help Avondale Shipyards win a $300 million shipbuilding contract.

* The Administration last month announced its support for a new federal research and development program as well as a Title XI mortgage insurance program to finance some $3 billion in new ship construction by American yards.

* The President just recently signed into law the Defense Appropriations Bill (H.R. 3116) providing in FY 1994 for shipbuilding loan financing guarantees sufficient to underwrite a half billion dollars of new ship construction, along with $47 million in research funds.

Viewed in the context of these various economic and political realities, the basic premise of S. 990 -- that shipyard subsidies must be eliminated over the near term -- is subject to very serious question. It would seem that the United States is now at a policy crossroads, at which it must decide whether to condemn or condone government assistance to shipyards, be they foreign or domestic. We surely cannot have it both ways, demanding in S. 990, with the threat of unilateral action, that foreign governments cease assisting their yards, while at the same time preparing to provide new forms of government assistance to our domestic shipyards.

In the light of these realities, we respectfully submit that S. 990 is the wrong approach. A more realistic and an internationally acceptable solution would be to recognize that at the present time subsidies for shipyards, whether in this country or elsewhere, are a fact of life, and that such subsidies can only be phased out gradually over a period of five or more years, thereby providing ample time for adjustment by both domestic and foreign shipyards to a subsidy-free world. We believe that such a compromise approach could be achieved multilaterally without concurrently moving ahead with the threat of enacting a unilateral measure such as S. 990. Indeed, continuing to trumpet a unilateral approach could "poison the water" in the multilateral negotiations, particularly when the United States, at the same time, is providing new forms of assistance for domestic shipyards.

could trigger retaliatory actions by other nations, to the detriment of U.S. maritime and trading interests.

II. Unilateral Measures Against Shipbuilding Subsidies Would Penalize American Cargo Owners

It is most improbable that S. 990 would directly impact on American companies operating open registry vessels flying the flags of Liberia, Panama, Bahamas and The Marshall Islands, since none of the flag states is a shipbuilding nation. On the other hand, S. 990 would create serious problems for American enterprises which are dependent on the unrestricted, efficient and low cost oceanborne movement of goods and commodities in U.S. foreign commerce. In addition, American ship operating companies could be indirectly impaired if foreign governments were aggrieved by the imposition of seemingly unfair penalties under S. 990 and responded by taking retaliatory action against American controlled and/or registered vessels.

The potential breadth and scope of the intended application of S. 990, as well as its harsh penalty provisions, are quite extraordinary compared to practices and controlling principles of comity which prevail today in international shipping. To appreciate how far-reaching S. 990 appears to be, it must be kept in mind, first of all, that it would impact on countries with shipbuilding or ship repair facilities. The addition of repair yards greatly broadens its reach, because there are repair facilities in many countries which do not have shipbuilding facilities.

Moreover, in view of the virtually all-inclusive definition of proscribed "subsidy" in S. 990, it is reasonable to conclude that almost every country with a shipbuilding or ship repair facility would run afoul of its prohibition -- just as the United States surely would if S. 990 applied to this country as well.

Furthermore, S. 990 would apply not only to vessels flying the flags of the many shipbuilding and ship repair nations, but also to vessels registered under the laws of countries without ship construction or repair facilities, where the beneficial ownership of the vessels was held by citizens or nationals of the offending countries. For example, if Denmark were listed as an offending country (which would seem to be likely given the current government support to Danish yards) then not only would Danish flag vessels be subject to penalties, but also Danish controlled vessels flying the flags of Great Britain, Norway, Singapore, Liberia, Panama, Bahamas, etc. would also be penalized if they traded to U.S. ports -- even if the flag states themselves did not qualify as offending countries.

The scope of S. 990 must also be read in light of the fact that almost half of the tonnage in the world fleet is beneficially owned by non-nationals of the flag states. The following is a sampling (percentages are rounded off) of the OECD statistics showing the widespread absence of the beneficial ownership/flag linkage:

Nationality of Owner	Percentage of Tonnage Under Non-National Flags	Nationality of Owner	Percentage of Tonnage Under Non-National Flags
Greek	56%	German	58%
Japanese	60%	Danish	39%
American	70%	Taiwanese	14%
Norwegian	33%	Swedish	63%
Hong Kong Chinese	88%	French	52%
Chinese	23%	Belgian	97%
British	75%	Dutch	33%
Korean	36%	Swiss	86%

To appreciate further the broad sweep of S. 990, it must also be kept in mind that the provision would for all intents and purposes apply to both new and existing vessels (regardless of where they were built or repaired). Taking the hypothetical example cited earlier, this means that a Danish controlled vessel flying, say, the British flag which was built 15 years earlier in a third country would be subject to penalties even if the vessel had been built or repaired without benefit of any shipyard subsidy and even if the present owner had nothing to do with ordering the vessel or arranging for its repairs.

If the wide scope of application of S. 990 is considered along with the severe and virtually automatic application of such penalties, the conclusion must be that it could seriously impair the U.S. export and import trades, to the immediate detriment of American shippers, cargo owners and ports, and ultimately impact on consumers and the national economy.

To appreciate the complexity of the problems that would be created and would impede normal maritime operations and thus U.S. trade, consider the example of an American steel company which arranges for the transportation of its iron ore imports under term charters. It could suddenly find that vessels it had chartered some years or months earlier were subject to penalties under S. 990 if the ships entered U.S. waters. The American steel company would then be faced with demands for indemnification if it directed its chartered vessels to continue serving its import needs.

Another example would be the American grain company seeking to arrange spot charters to transport American exports of wheat, corn or other agricultural products. The available bulk carriers would fall into essentially two categories -- some "safe" vessels and probably a larger number of "targeted" vessels subject to S. 990 penalties. Under these artificial market conditions the freight rates would presumably be driven upwards as a kind of two-tiered market structure came into being. The "targeted" vessels would demand higher than normal rates to cover the cost of penalties, and the "safe" vessels would seek charter rates that were below the "targeted" vessels' rate levels but above the levels that would otherwise have prevailed under normal conditions.

Presumably this situation would create an upward creep in charter rates as the two tiers in the market continually adjusted to the shifting levels. The clear losers in the above example would be American agricultural exporters and American farmers because the landed costs of the U.S. exports in foreign markets would rise disproportionately above the landed costs of foreign exports.

The ripple effect of the uncertainties created by application of S. 990 could dampen and impair future orders and financing of vessels for the U.S./foreign trades, which in turn would also distort the supply/demand equation and thereby create an upward pressure on rate levels. At the same time, the replacement of older and less environmentally desirable vessels could be impeded.

Clearly S. 990 would conflict with free and open maritime trade by imposing artificial restraints on such trade, and for that reason we submit that it would be very harmful to American interests generally.

CONCLUSION

We respectfully urge that your Subcommittee not lend its support to S. 990.

Statement of the International Council of Cruise Lines

The International Council of Cruise Lines (ICCL) is a non-profit trade organization. Our members are both American and foreign-owned companies engaged in the overnight, oceangoing cruise industry. Our membership accounts for approximately 90% of the worldwide passenger cruise industry capacity. We operate more than seventy-five vessels which this year alone will carry more than four million passengers.

As members of the international cruise industry, we carry on a long tradition of freedom of the seas and freedom of trade. Our members sail on all of the oceans and seas of the world and are substantial contributors to the economies of all the nations with which we come in contact. As members of a truly international industry and with a significant interest in the growth and expansion of the United States economy, we are highly desirous of working constructively with the United States Congress on matters of concern to the United States. In our view, the issue of shipbuilding subsidies is not only economically and politically complex, but it is international in scope. Any action that restricts the freedom of the seas and the freedom of international trade is obviously not in our commercial interests. In our view, the shipbuilding subsidy situation cannot be effectively addressed by reliance on sanctions of the type contemplated by S. 990. Therefore, with all respect, we cannot support this approach in our earnest desire to work with the Congress in developing a solution to this problem.

The proper place to address issues of international trade is through multilateral government-to-government negotiations. International bodies, such as the General Agreement on Trades and Tariffs (GATT) and the Organization for Economic Cooperation and Development (OECD), exist to address the very situations such as that which S. 990 seeks to address. Unilateral attempts by any government to address international trade disputes will weaken the multilateral mechanisms in place and erode, rather than strengthen, international trade. Such a result would impede the growth of the cruise industry and accordingly could have a negative impact on the rapidly growing contribution our industry makes to the U.S. economy.

We are proud of the contribution our industry is currently making to the United States domestic economy and look forward to increasing this contribution in the future. We create employment for hundreds of thousands of Americans and we are responsible for billions of dollars each year in wages and taxes, as well as payments to suppliers, travel agents, and U.S. airlines.

Price Waterhouse, in a recently completed major study, confirmed that the cruise industry will add 134,712 full-time jobs to the U.S. economy in the next four years, on top of the 450,166 U.S. jobs it already provides. Price Waterhouse confirmed that in 1992, our industry generated $14.5 billion in U.S. wages and $6.3 billion in domestic tax revenues. Price Waterhouse projects an additional $4.3 billion in wages and $1.9 billion in taxes by 1996, based on estimated capacity growth of 6.8 percent annually.

This multi-billion dollar impact of wages and taxes is a conservative estimate by Price Waterhouse because it only counts the "value added" component and none of the raw materials—such as fuel and agriculture products—that the industry uses. Among Price Waterhouse's specific findings for 1992:

- The cruise industry created 63,168 core sector jobs and 71,612 supplier sector jobs, for a total direct impact of 134,780 jobs. Expenditure-induced (ripple effect) jobs number 315,386, for a total economic impact of 450,166 jobs.
- The industry created more than $2.2 billion in core sector wages and $2.3 billion in supplier sector wages, for a total direct impact of $4.6 billion in wages. Expenditure-induced wages were an additional $9.9 billion, for a total impact of more than $14.5 billion.
- Cruising generated $519.6 million in state and local taxes and $1.6 billion in federal taxes, for a direct impact of $2.1 billion in taxes. Expenditure-induced taxes were $944.6 million for state and local governments, $3.3 billion for federal coffers. The total tax impact: $6.3 billion in federal, state, and local taxes generated.

Price Waterhouse reported that of the total impact of $20.8 billion in the U.S., seven continental U.S. port cities—Miami, Los Angeles, New York, Port Canaveral, Fort Lauderdale, Seattle, and Tampa—share $2.7 billion ($1.9 billion in wages, $819.6 million in total taxes and fees). The other $18.1 billion economic impact was spread throughout the economy in every industrial sector. Among the industries enumerated: transportation and utilities; services; manufacturing; agriculture; mining and construction; finance, insurance, and real estate; and government.

The cruise industry is a partner in America's economic growth and has been for more than two decades. Our expansion will help continue the growth with more

jobs, more wages, and more tax revenues in the years to come. We want to work hand-in-hand with Congress to assure that this economic impact continues to benefit the U.S. A projected growth estimate of 6.8 percent compounded annually is conservative because it does not include the most recent expansion projects. From 1980 through 1991, the industry has grown 9.8 percent annually, and there is no reason to expect a slowdown now, barring political or economic obstacles.

If, despite the concerns expressed by ourselves and others, it is decided to proceed with the type of legislation contemplated by the current draft of S. 990, we would respectfully submit that amendments should be adopted to make the bill more targeted on the perceived problem and not as punitive to the shipowner. Foreign governments are responsible for shipbuilding subsidies. Foreign shipyards are the primary beneficiaries of shipbuilding subsidies. Subsidies represent a complex domestic situation within a country which spills over into the international trade relations between governments. The shipowner as a purchaser in an international market should not be the target.

Specifically, we have the following comments about certain sections of the bill:

1. In Section 2, subsection 7 of S. 990, it is provided that, ". . . a strong, effective multilateral agreement among shipbuilding nations to eliminate trade-distorting practices in the ship construction industry is the best means of providing for fair international competition . . ." We unequivocally endorse that policy.

2. We disagree, however, with the broad, open-ended definition of subsidies. The bill should provide precise terminology in defining a subsidy. Definitions are needed that are readily identifiable to the shipowner to ensure that any future ship orders do not inadvertently run afoul of the statute. Under the proposed language, it is quite conceivable that a cruise line might enter into a contract for a new vessel only to later learn that the yards failure to follow what are deemed after the fact to be "commercially responsible investment practices" has decimated the investment.

3. The approach used in the concept of listing including the investigation, preliminary determination, emergency listing, final determination, notification, and reconsideration process is basically fair and seems to provide adequate due process. Most importantly, the safeguards for judicial review built into the legislation appear to protect the rights of the parties from hasty bureaucratic action.

4. It should not be the public policy of the United States to penalize owners of vessels who have acted in good faith. Those owners who purchased vessels, or entered into agreements to contract for vessels, while in full compliance with the laws at that time, should not later be penalized. S. 990 should be designed to change future behavior regarding shipbuilding subsidies. It is not, therefore, appropriate to penalize past, lawful behavior as a method to change future action. S. 990 should be amended so that all existing affected vessels and new affected vessels, as defined in the bill, and all vessels under construction agreements at the time of enactment of the bill, regardless of when construction is completed, should be exempt from the bill. As it is the foreign governments that provide the allegedly anti-competitive subsidies, it is the foreign governments that should be penalized, not the lawful purchasers of the ship.

5. It is neither equitable nor realistic to ask a private cruise line owner to investigate the many defined—and some undefined—subsidies a shipyard, bidding for the owner's business, might receive. It is unfair to ask the owner to act as the agent and enforcer of the United States government. The cruise line cannot be expected to be aware of the value, if any, of a particular shipyard bidding for construction or repair of their vessel. We should expect the cruise line owner, when seeking to purchase a multi-million dollar vessel, to act like any responsible business person—to seek the most cost-effective, responsible bid. The responsibility for enforcing free and fair trade agreements, for the evaluation of duties, tariffs and subsidies, is with and between the affected governments. S. 990 *seems* to imply that this is a government-to-government problem, but then in the end punishes the shipowner. The problem lies with the government—not the shipowner. The solution lies with the government—not the shipowner. The level playing field can only be created by the government—not the shipowner. The United States is the dominant economic power in the world. This Congress and our trade representatives have the ability to "speak softly and carry a big stick." Governments have influence; governments have remedies; governments have offsetting areas of economic impact.

6. ICCL would encourage the addition of language to require that there be some demonstrated injury on the part of any person appearing as an interested party in the proceedings.

7. Finally, it would be advisable to address inadequacies in Section 301 Remedies rather than adopt another statutory scheme. It is provided in Section 301(d)(2) of the 1975 Trade Act, as amended:

"An act, policy, or practice of a foreign country that burdens or restricts United States Commerce may include the provision, directly or indirectly, by that foreign country of subsidies for the construction of vessels used in the commercial transportation by water of goods between foreign countries and the United States."

Accordingly, there is a statutory framework to address the U.S. shipbuilding industry unfair trade complaint. If for any sound reason that framework is not working properly, we submit that allegation should be addressed rather than the S. 990 approach of additional investigations, sanctions, appeals, and the cost and bureaucracy associated therewith. Consistent with our view that this is a timely international issue, we urge that a careful analysis and, if necessary, amendments be made to Section 301 procedures. If, for example, it is contended that the Section 301 approach takes too long to reach a formal decision that problem could and should be addressed; or, if the burden of establishing injury to a domestic U.S. industry is too onerous—that could be examined. Any approach short of Section 301 modifications will clearly invite serious international retaliation.

CONCLUSION

The approach adopted in H.R. 1402 as reported out by the House Ways and Means Trade Subcommittee incorporating amendments requested by the Administration and exempting all existing vessels and construction contracts up to date of enactment represents a legislative approach this Committee should consider. In our view, it provides a workable legislative approach. We reiterate, however, that trade matters among sovereign nations can best be resolved through international cooperation and agreement. Multilateral efforts have already resulted in a reduction of shipbuilding subsidies from a maximum of 30% to a maximum of 9% today. Our interest is to work with the Congress and the international community in reaching an agreement that will stimulate international trade and encourage, foster, and expand the economic contribution the international cruise industry makes to the United States.

Thank you for this opportunity to make known our views and to reiterate our willingness to work with you and the international community to reach an international solution in the best interests of all parties.

STATEMENT OF THE INTERNATIONAL PAPER

International Paper strongly opposes the enactment of the Senate Bill—990 bill currently pending before congress. Such unilateral action against the worlds shipping fleet to resolve foreign building subsidiaries would have debilitating effects on International Paper's exports.

The proposed law would require the Secretary of Commerce to assess fines of $500,000 each voyage and/or reduce its U. S. Port of Calls by 50%.

Neither of these actions would be acceptable because the vessel owner would be faced with two alternatives, pass the cost onto the shipper or abandon the service! The later is most likely because the shipper could not absorb such an increase in its' freight costs.

The magnitude of such actions boggles the imagination, which is best illustrated by what it does to International Paper with the following facts:

- Annual exports of Forest Products exceed two million metric tons
- U. S. Flag participation is less than 3%.

As we all know, ocean freight rates are driven by "supply and demand." If you remove a major portion of the worlds' fleet from our shores, rates will rise as we have never seen before.

It is a well known fact that U. S. shipyards have not been competitive for many years and to think such, legislation would revitalize this industry is beyond comprehension.

International Paper competes on a global basis, not only with other U. S. manufacturers, but with many foreign manufactures. Ocean freight cost represents a high percentage of the delivered cost of goods to a foreign land, and to enact such laws would in all probability serve the best interest of our foreign competitors.

Our current administration is fervently pursuing open and free trade around the world. Senate Bill—990 would be the most damaging legislation to trade that has been introduced in a very long time.

It is essential that this bill *not* be enacted into law!

STATEMENT OF THE PORTS OF TACOMA, SEATTLE, ET AL.

Mr. Chairman and Members of the Subcommittee, my name is Don Fleming, and I am the Director of the Marine Division for the Port of Seattle. I testify today on behalf of the Ports of Tacoma and Seattle and other northern coast ports that would be uniquely affected by S. 990. We rely on the American Association of Port Authorities ("AAPA") to convey our general views on S. 990. Today we will confine our testimony to its effect on the diversion of cargo, an issue that has enormous implications for ports in the North Atlantic, North Pacific and Great Lakes.

To summarize, to the extent that this legislation makes it more difficult and more expensive to do business at a port in the United States, foreign shippers will divert cargo to Canadian ports near the U.S. border. Those shippers will then simply transship the goods into the United States by truck or railcar. This would be a most unfortunate result since a key purpose of this legislation is to help protect American jobs in the shipbuilding industry. It makes no sense whatsoever to save U.S. jobs in one industry—shipbullding—and then export them in another—port services.

Several key ports, particularly those located on the northern coasts of the United States, have already experienced the effects of diversion. Some Canadian ports specifically advertise that shippers can avoid American taxes and fees by diverting cargo. This is a result of the cumulative effect of various taxes and policies which discourage vessels from calling in the United States. These include the harbor maintenance tax and the vessel tonnage tax. Together these can add well over $1,000 to the cost of a container shipped into the United States.

The shipbuilding bill you are considering today could add to the problems we are facing with container diversion. A vessel which could not enter the United States would be re-routed to Canada, where its cargo would be loaded on trains and trucks and shipped to United States interior points. This would defeat the purpose of the bill.

We applaud your foresight in including an anti-diversion provision in S. 990. I'm sure you will agree that it is an absurd result if shippers that would be penalized upon entering American ports are allowed to circumvent the law by diverting cargo through Canadian ports and into the U.S. In fact, that is the worst of all worlds—shippers can avoid the law with minimum expense *and* U.S. shoreside jobs are exported to Canadian ports. Your provision hopefully will lessen any diversion problem caused by S. 990.

You may ask why we even raise this issue since both the House bill, H.R. 1402, as amended, and S.990 contain anti-diversion provisions. We are concerned that the United States Trade Representative's Office has argued that it is economically infeasible to divert goods through Canada. While we have great respect for USTR's views on world trade, it is simply wrong on this issue. Every day, because of costs like the harbor maintenance tax, shippers are moving cargo into Canada and transporting it to the United States. S. 990, without a diversion provision, would only make matters worse.

Recently 10 Members of the House of Representatives wrote Deputy Trade Representative Rufus Yerxa in support of a diversion provision. The letter told the story of a Pacific Northwest shipping company forced to choose between continuing its historic practice of transporting goods through the Port of Seattle or transhipping through the Canadian Port of Vancouver, British Columbia. A key issue in this business decision was the harbor maintenance tax in the United States, which costs this company between $300–$1,250 per shipping container. The letter from the 10 Members of Congress summarizes this company's business decision this way:

> Because the company imports about 13,000 containers annually, the savings achieved by diverting these containers to Vancouver could exceed $10 million annually. As a result, this company has begun diverting cargo from the Port of Seattle to the Port of Vancouver. [H.R. 1402/S. 990], without a diversion provision, will just add one more reason for a shipper to divert cargo to Canadian ports.

The Members have requested a meeting with Ambassador Yerxa to discuss the extent of this diversion at northern tier ports.

A typical containership landing in a North Pacific or North Atlantic port might pay $80,000 in harbor maintenance fees and vessel tonnage taxes. The same ship

visiting a Canadian port could pay less than $3,000 in harbor fees. Little wonder that one study in the late 1980's showed that the transshipment of U.S. goods through Canadian ports increased 60% in two years.

The USTR has also raised a concern about the administrative feasibility of stopping cargo at the U.S. border to ensure compliance with S. 990's diversion provision. We believe that your provision *is* administrable. When cargo is diverted to Canada, most of it moves into the United States by railcar. When the container crosses the U.S. border on a railcar, the engineer hands the Customs agent an "in transit" form ("IT"). This form contains the name of the country of origin, the carrier company, and the vessel on which the container entered Canada. That is all the information that a Customs agent would need to identify diverted cargo. If Customs is instructed to prevent diversion, we believe it is within their competence to do so.

For your information, Mr. Chairman, we have drafted alternative anti-diversion that we would be pleased to share with the Committee at the proper time. This replacement language was drafted to address specific concerns raised by USTR in July. In that alternative, the shipping container is defined as a part of the vessel itself. Thus, when an affected container enters the U.S. at any point—either through a U.S. port or by crossing the U.S. border on a railcar—it triggers the penalty provisions. As you many know, there is considerable precedent in maritime law for treating containers as a part of a vessel. Much like the diversion provision you included in S. 990, our alternative would help prevent shippers from circumventing the law with impunity.

This diversion problem will get worse before it gets better. Passing S. 990 or H.R. 1402 *without* a diversion provision would greatly exacerbate this problem. Today our primary concern is diversion to Canada, but it is only a matter of time before our southern ports see similar diversion, particularly to Mexico. The more impediments to trade that we apply at our ports, the more international shippers will look at other countries' gateways to move their products.

Again, Mr. Chairman, we congratulate you on your enlightened approach to the cargo diversion issue. We are available to work with you and your staff on this matter if we can be helpful. Again, thank you for your efforts to keep American ports strong and competitive.

STATEMENT OF STAR SHIPPING A/S [1]

Star Shipping A/S of Bergen, Norway is an international ocean carrier of forestry products, containers and of dry bulk commodities. Star has regularly served United States and Canadian trades since the early 1960s. It operates a worldwide fleet of between 70 and 75 dry cargo vessels under both long and short term charter to Star. This fleet includes 40 specially designed forest product vessels each of about 42,000 tons deadweight. At any given time Star's worldwide fleet utilizes between 30 and 35 conventional dry bulk cargo vessels. Star has a dedicated fleet of 40 long-term chartered vessels which is supplemented to meet peak demand and other special needs by short term charters of vessels obtained on the world charter market.

I. U.S. FOREIGN COMMERCE IS HEAVILY DEPENDENT UPON THE SERVICE PROVIDED BY FOREIGN FLAG VESSELS, PARTICULARLY THOSE TRANSPORTING DRY BULK CARGO

A large portion of United States and Canadian export commerce is dependent upon Star's service and upon the service provided by dry bulk cargo fleets which are similar to Star's. None of these competing bulk vessel fleets, so far as Star is aware, include U.S. vessels or carriers, except for bulk grain preference cargoes given U.S. subsidies in the form of cargo reservation for U.S. vessels. For many bulk commodities U.S. exporters are totally dependent on low cost foreign flag vessels, most of which would be directly affected by S. 990. U.S. exporters have no alternative means available to them for moving their goods in export commerce. Indeed, Star has received many serious expressions of concern from U.S. exporters who ship on its vessels and from U.S. ports served by Star about the adverse consequences which passage of this legislation would have on them.

Star alone last year handled nearly 6,000,000 metric tons of exports moving from U.S. and Canadian ports. Most of this cargo consisted of forest products.

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[1] This material is prepared, edited, issued or circulated by Robins, Kaplan, Miller & Ciresi, 1801 K Street, N.W., Suite 1200, Washington, DC 20006, which has filed a Registration Statement with the Department of Justice, Washington, DC under the Foreign Agents Registration Act as an agent on behalf of Star Shipping A/S, Fortunen 1, P.O. Box 1088, 5001 Bergen Norway. This material is filed with the Department of Justice where the required Registration does not indicate the approval of the contents of the material by the United States Government.

Bulk and other specialized products moving in shipload lots (grains, and other agricultural products, ores, petroleum, coal, fertilizers, metals, forest products, autos, certain chemicals, etc.) constitute a very large portion of U.S. foreign commerce. The movement of this commerce is, in turn, very heavily dependent upon chartered vessels and on the costs of chartered vessels which are obtained on the world market. Most vessels employed in moving these products are obtained by bulk or specialized carriers like Star, or by U.S. exporters and importers themselves, by chartering vessels through brokers on the world vessel charter market.

The movement of most of these commodities is very price and transport-cost sensitive. No country, including the United States, can be successful in its foreign commerce in bulk commodities (or as to products utilizing these commodities) if that country's ocean transport costs are consistently above world market costs experienced by foreign competitors. Star and similar carriers and the world vessel charter market itself presently operate to assure that U.S. exporters and importers of these basic commodities have transport costs that are competitive with those of other countries. This bill will change that, and it will assure that U.S. exporters and importers have costs well above world market levels.

II. S. 990 WILL HAVE A SERIOUS ADVERSE EFFECT ON U.S. FOREIGN COMMERCE

This bill, either as presently worded or if it is amended in accord with the current House version of it, *guarantees:*

(1) that transport costs for bulk and other shipload-lot commodities will be greatly increased for U.S. trades in large part because chartered vessels employable in U.S. trades will come only at a cost well above world market levels which other countries will enjoy; and

(2) that, as a result, U.S. foreign commerce in these basic commodities that depend on charter market vessels will be impaired—severely so in some cases—and will be placed at a significant cost disadvantage in world markets.

Star's own bulk and specialized vessel operations in U.S. trades illustrate why these warnings should be heeded and why ignoring them will cause U.S. exporters and importers to pay a very heavy price.

A. S. 990 Will Dramatically Increase The Cost of Transporting U.S. Exports

Star's fleet consists of about 40 percent of chartered-in vessels obtained on the world market through brokers. About 60 percent of the fleet consists of vessels committed for longer terms to Star by participants of various nationalities, on a profit-sharing basis, but which in turn may have been chartered in from other persons, whose nationality or citizenship is not necessarily known to Star. The company's ability to operate at a profit and its ability to enable U.S. exporter and importer customers to enjoy rates as good or better than their foreign competitors depends on Star's acumen in achieving overall fleet vessel costs that are less than (or that at least do not exceed) world market charter costs. This bill seriously impairs, and ultimately will destroy, Star's ability to provide vessels at or below world market rates in U.S. trades.

This bill provides (a) for imposition of huge penalties upon vessels, (b) for the barring of vessels for which Star may have incurred long-term obligations from U.S. trades, and (c) for limiting their participation in U.S. trades, all based on whether a "controlling interest" in the vessel is held by citizens or nationals of a country *subsequently* determined to provide shipyard subsidies. That is so even though the vessel itself and its owners may have received no subsidies. Indeed the most onerous part of the proposed legislation is the misdirection of penalties. While the bill has as its target subsidized foreign shipbuilders, it imposes severe penalties not on the offending shipbuilders, but rather on independent carriers. And the penalties are so severe they could put many independent ocean carriers out of business, with no effect on the shipbuilders or the countries that subsidize them, but with a major adverse effect on U.S. exporters.

The specific adverse consequences of the bill are clear and direct.

First, companies like Star and its participating vessel owners, who are of varying nationalities, have no way to know, when acquiring vessels for the long term, what countries will later be listed by the U.S. Trade Representative. That makes any vessel *retroactively* subject to penalty or to an inability to use the vessel in U.S. trades. Such future uncertainty translates into substantial costs.

Second, charterers on the world charter market work through brokers and have no present way to assure who has controlling interests in vessels so chartered. Yet as operators of these chartered-in vessels in U.S. trades companies like Star will find themselves fighting legal battles, having penalties assessed or having their chartered-in vessels barred from U.S. trades. Those costs can be huge.

Third, to the extent that it is possible to establish the nationality of controlling interests in vessels on the world charter market, the bill would divide the world charter fleet into "white hat" vessels that are at least claimed to be controlled by interests not associated with countries likely to be listed by the Trade Representative at some future time, and all other vessels. That will greatly increase the charter cost of the "white hat" vessels, safely employable in U.S. trades, and those costs in turn will greatly inflate U.S. export and import costs above world market levels.

Fourth, Star's (and other similar carriers') ability to operate with cost efficiency depends on maximum flexibility to use the vessel that is best positioned to carry particular cargoes. If large portions of Star's or the world charter fleet are at risk of penalties, this efficiency is lost and large costs are imposed.

This is, in short, a bill whose remedies consist of severe penalties whose high price will be paid by U.S. exporters and importers. Moreover, "Grandfathering" vessels constructed prior to the enactment date as would the recently amended Gibbons bill (H.R. 1402) only delays for a few years the costly adverse effects of the bill or, alternatively, assures that, as time goes on, only the oldest, least efficient vessels are the ones to be assigned to U.S. trades.

Indeed, the resultant extended and expanded use of overaged vessels presents an added threat to U.S. environmental interests as well. It would be ironic to pass legislation such as this which encourages the concentrated use in U.S. trades of older, less safe vessels—including tankers along with dry cargo vessels—when the U.S. Congress has moved so decisively in the Oil Pollution Act of 1990 to encourage and provide for the elimination of such vessels from U.S. trades as quickly as possible.

B. The Increased Transportation Costs Created by S. 990 Will Be Borne by U.S. Exporters

It is important, as well, to understand that those who believe this legislation will have little effect on U.S. trades are being wholly unrealistic. They are undoubtedly thinking of container carriers, whose vessels normally are dedicated to regular service over many years to particular trades—such as between the U.S. and Europe. Make no mistake, containership owners will be penalized by this bill which will be reflected in significantly higher freight rates. Container carriers, however, move only a very small portion of the total cargo on which U.S. trades depend. Most U.S. commerce depends on bulk carriers, including tankers as well as dry bulk carriers, whose vessels move all over the world. This bill is a great misfortune for those industries and for U.S. consumers.

It would be a very serious mistake to assume that Star and similar carriers now serving U.S. ports could simply spread the extra costs created by S. 990 to shippers from other countries. Shipping rates are highly competitive. Carriers in trades not burdened with the inefficiencies and costs imposed by S. 990 (for example, carriers serving only Canadian ports) would have far lower costs and would charge corresponding lower rates to foreign exporters. Therefore, Star could not impose the large incremental costs of S. 990 on customers in other trades. Moreover, Star could not and would not itself absorb these extra costs. If, however, Star tried to pass these large extra U.S. trade costs created by S. 990 to U.S. shippers, it would more than double their shipping cost and would render them uncompetitive in world markets. (For example: a typical voyage from the U.S. West Coast to the Far East today would carry 10,000 metric tons of U.S. cargo with the balance loaded in Canada. A penalty of $500,000 would thus increase the freight cost by $50 from approximately $45 to $95 per metric ton. For smaller shippers not exporting such big volumes, the effect could be much worse.) Since their cargo would then not be shipped in world trades, the real effect of measures like S. 990 is to eliminate both significant portions of U.S. export trade and to drive the carriers handling such cargoes out of U.S. trades.

An exporting nation like the United States should not be giving serious consideration to a measure like S. 990. The bill has much too high a probability of being seriously injurious to, if not destructive of, the United States' position in world export markets. That is particularly so given the fact that relatively low value, price sensitive basic "traded" commodities such as forest products make up such a large part of U.S. exports. Even having such proposals seriously aired is a disincentive to investment in shipping and export businesses potentially affected.

S. 990 thus reflects dangerous brinkmanship in which the interests of U.S. exporters would be sacrificed. It is safe to say that the nations at which S. 990 is directed cannot or will not abandon or commit to abandon subsidy measures for a variety of domestic reasons in any kind of time frame that would avoid the penalty consequences. Even if there were only a possibility that these countries will not or realistically cannot withdraw their subsidies, setting S. 990's penalty machinery in motion would involve unreasonable risks for U.S. export commerce.

S. 990 does not even serve as the most effective form of leverage to achieve reductions in the targeted subsidies. Moreover, S. 990 would injure U.S. interests more quickly and drastically than the interests of the many countries at which it is aimed.

C. The Adverse Economic Consequences to U.S. Exporters of S. 990 Could Not Be Avoided Given the Limited Options Open to Carriers Affected by It

S. 990, if enforced as contemplated, gives Star and similar ocean carriers serving the United States the following options:

—(1) dispose of vessels in the fleet that are controlled by citizens or nationals of listed countries and forego chartering such vessels in the future so as to maintain a single versatile fleet that can operate worldwide without restrictions;
—(2) create a segregated sub-set of the fleet consisting of vessels not associated with listed countries and dedicate this sub-set of vessels to serving the U.S. market; or
—(3) cease serving the United States market.

Each of these options produces large adverse effects on U.S. exporters whose shipping rates must reflect the underlying costs.

The first option above (disposing of vessels from listed countries that are in Star's worldwide fleet and acquiring all vessels from non-listed countries) is one that Star could not and would not adopt. It would be financially ruinous, during the expected life of Star's vessels, to dispose of them whenever a country is listed under S. 990 and then to turn around and acquire new or different vessels controlled by nationals of countries not then on the list. A carrier cannot simply acquire and dispose of vessels as if they were Hertz rental cars whenever a governmental listing changes. Carriers can only survive, operate economically and provide service at competitive rates if they are shrewd in making long-term decisions in acquiring, building and disposing of vessels at the right point in market cycles and, similarly, if they pay no more for vessels than their international competitors pay.

The second option above—creating a special fleet of vessels controlled by nationals of non-listed countries and dedicated to U.S. trades—would be extremely costly. Not only would vessel and fleet costs be substantially increased but also the segregation of a fleet operating worldwide into two segments defeats the basic efficiencies in vessel use on which Star's whole operation depends. The resulting shipping costs of this option for U.S. exporters would likely be so high, compared to costs of shipping from third country sources, that there would be insufficient U.S. exports of most major moving export commodities to fill the ships in any event.

The third option—withdrawal from U.S. trades or curtailment of Star's operations in U.S. trades—is not one that Star would welcome after decades of service to the U.S. However, it is likely to be the option that S. 990 would thrust upon Star and upon similar carriers. One example alone demonstrates why this would be so. Star now handles forest products from the west coast of Canada and from the United States often by using the same vessels calling in both Canada and the U.S. However, Star simply could not compete in the Canadian export market using only vessels that were not controlled by nationals of countries that are likely to be on any S. 990 list. Star's competitors serving only Canada would be free of this very costly requirement, would have far lower costs and lower rates from Canada than prevailed from the U.S. Since Star's U.S. exporters would not be able to compete with Canadian exporters by absorbing all these extra costs, and since Canadian exporters will not pay them, the prudent thing for Star would be to curtail or to eliminate its service to the U.S. and concentrate instead on the Canadian market.

III. CONCLUSION

Star's position is not one of support for subsidies of shipbuilders, ship operators or ship repairers. Such subsidies distort the marketplace. Star itself is adversely affected by U.S. subsidies. Star vessels carry bulk grain. Cargo preference measures imposed by the U.S. on grain exports are clearly subsidies for U.S. carriers of such commodities. They vastly increase the cost of shipping the grain, and they exclude Star and other carriers from the competitive market.

S. 990, however, is a remedy for subsidies that would be far more disruptive to the market than the subsidy problem which it addresses. S. 990 will not work. It is far too blunt an instrument, and it risks far too much damage to U.S. and world trade to be a prudent or effective way of achieving a reduction in foreign subsidies. In this regard, it must be strongly emphasized that S. 990 will greatly increase unemployment amongst competitive and prosperous U.S. industries and not help the U.S. Shipbuilding and Shiprepair industry at all. It is naive to think that non-U.S.

owners would flock to U.S. yards considering the prices being offered by these yards today.

The United States has, since World War I, provided enormous subsidies to a U.S. flag merchant marine and to U.S. shipyards in the form of direct operating and construction subsidies, cargo set asides, government guaranteed construction loans, "build American" requirements, tax breaks, etc. Some forms of these subsidies continue to exist. The United States may now be engaged in a commendable process of phasing out its own bad past habits. However, that does not make it appropriate or effective to adopt extreme measures like S. 990 aimed at friendly countries and allies of the U.S. simply because their policies and domestic political considerations are not changing at exactly the same time and pace as changes in U.S. policy or changes forced by U.S. budgetary constraints. If, as in the case of S. 990, these extreme measures will injure the U.S. itself far faster and more drastically than it injures anyone else the measures clearly make no sense from a national interest standpoint.

Finally, as noted above it is most important to understand that the very same problems described herein with respect to S. 990 hold true for the recently amended version of H.R. 1402 (the "Gibbons bill") approved by the International Trade Subcommittee of the House Ways and Means Committee. The essential difference between that bill and S. 990—the elimination of retroactive applicability of H.R. 1402's provisions to existing vessels—merely defers for a year or two the adverse consequences of S. 990. As soon as new vessels are built (in a year or two's timeframe) dry bulk carriers such as Star and their U.S. shippers would be facing the very same problems which they would face from the time of enactment of S. 990 with its present retroactive applicability.

SUPPORTERS OF MISCELLANEOUS TARIFF LEGISLATION

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202/872-8181
Fax 202/872-8696

November 22, 1993

Mr. Wayne Hosier
United States Senate
Committee on Finance
Dirksen 205
Washington, D.C. 20510

Subject: Request for Comments on Uruguay Round of Multilateral Trade Negotiations

Dear Mr. Hosier:

We, the companies and associations listed on the attachment, are submitting this statement in response to your request for comments on the Uruguay Round of multilateral trade negotiations as they affect specific U.S. interests.

We strongly support a Uruguay Round Market Access agreement that would include: (a) the immediate elimination of duties on products that recently have been the subject of noncontroversial duty suspensions and of noncontroversial duty suspension legislation introduced in Congress; and (b) the immediate reduction of duties on products that were the subject of duty reduction legislation considered in conjunction with duty suspensions.

There is widespread support in Congress for the benefits of duty suspensions and reductions. Their inclusion in the Uruguay Round agreement would contribute directly to United States negotiators efforts to reduce foreign trade barriers. Attached is a copy of a letter addressing our concerns that was submitted to U.S. Trade Representative Michael Kantor on August 12.

The elimination, or where appropriate, the reduction of duties on products for which there is no substantial U.S. production would enhance the competitiveness of many different U.S. industry sectors. As stated in the attachment, overall benefits to the United States economy of the elimination, or where appropriate, the reduction of these duties would include the retention or creation of U.S. jobs, maintenance or expansion of U.S. production and/or services; and the control or reduction of costs to U.S. companies and consumers.

Signatories to this Statement are Listed on the Attachment.

SUPPORTERS OF MISCELLANEOUS TARIFF LEGISLATION

818 Connecticut Avenue, N.W.
12th Floor
Washington, D.C. 20006

202/872-8181
Fax 202/872-8696

August 11, 1993

The Honorable Michael Kantor
United States Trade Representative
600 17th Street, N.W.
Washington, D.C. 20506

Dear Mr. Ambassador:

We, the undersigned companies and associations, are writing to request that in the closing months of the Uruguay Round negotiations the United States place a high priority on the negotiation of a Market Access agreement that would include the immediate elimination of duties on products that recently have been the subject of noncontroversial duty suspensions or of noncontroversial duty suspension legislation introduced in Congress. Also in this context, we request that the U.S. place a high priority on the immediate reduction of duties on products that have benefited or would benefit from noncontroversial duty reduction legislation -- the type of legislation that has historically been enacted in a package with duty suspensions.

The immediate elimination or, where applicable, reduction of duties on these products, for which there is no substantial U.S. production, would enhance the competitiveness of a broad spectrum of U.S. industrial and agricultural sectors.

Overall benefits to the United States economy of the elimination or, where applicable, reduction of these duties would include:

-- The retention or creation of jobs in the United States;

-- The maintenance or expansion of production, R & D, warehouse, and services facilities in the United States;

-- The control or reduction of costs for United States companies and consumers.

In addition, as a result of the increases in employment and corporate earnings from expanded production, these duty suspensions and reductions make a direct positive contribution to federal revenues through increased taxes on individuals and corporations.

We are very encouraged by the efforts already made by the Office of the U.S. Trade Representative and the Department of Commerce to develop a package of the recently expired and proposed duty suspensions/reductions for their possible inclusion in U.S. offers of tariff concessions.

We thank you in advance for considering that the immediate elimination or, where applicable, reduction of the duties on these products be a high priority for U.S. negotiators in the Market Access package of Uruguay Round negotiations.

Sincerely,

The 3M Company
Adams-Mellin, Division of Sara Lee Corp.
Agglomerate Stone Tile Importers Association
Albany International/Mt. Vernon
* American Cyanamid Company
American Cycle Systems, Inc.
* American Association of Exporters and Importers
American Electronics Association
American Stone Distributors, Fabricators & Installers Committee
American Tartaric Chemicals, Inc.
Apple Computer Inc.
* Arctco, Inc.
Ares-Serono
Ashton-Drake Galleries, Ltd.
Asten Forming Fabrics, Inc.
Atlanta Wire Works, Inc.
BASF Corporation
Baxter Healthcare Corp.
Belmont Hosiery Mills, Inc.
Bicycle Manufacturers Association of America, Inc.
Biocraft Laboratories, Inc.
Bossong Hosiery, Inc.
Bristol-Myers Squibb Company
Buster Brown Apparel, Inc.
Canned and Cooked Meat Importers Association
Cannondale Corporation
Carolina Cook Industries, Inc.
Century Juvenile Products
Charleston Hosiery, Inc.
Cheminova, Inc.
Ciba
Club Car, Inc.
Compaq Computer Corporation
Computer and Business Equipment Manufacturers Association
ConvaTec
Crompton & Knowles Corporation
* Cytec Industries
Dayco Products, Inc.
D. Klein & Sons
Department 56

* not an original signatory

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Schering Inc.
Shimano American Corporation
Sturmy-Archer Limited
Sun Metal Products, Inc.
Sundstrand
Synthetic Organic Chemical Manufacturers Association
Tennessee Machine and Hosiery Co.
The Kendrick Co.
The Smucker Company
Totes, Inc.
Toy Manufacturers of America, Inc.
Trek Bicycle Corporation
T. W. Garner Food Company
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Uniroyal Chemical Co., Inc.
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