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OCEAN FREIGHT RATES ON MILITARY CARGOES

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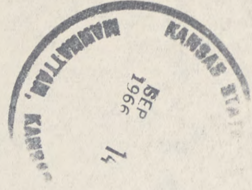

HEARINGS

BEFORE THE

SUBCOMMITTEE ON MERCHANT MARINE AND FISHERIES

OF THE

COMMITTEE ON COMMERCE UNITED STATES SENATE

EIGHTY-NINTH CONGRESS

SECOND SESSION

ON

S. 3297

A BILL TO AUTHORIZE THE CARRIAGE OF MILITARY CARGOES BY UNITED STATES-FLAG VESSELS AT REDUCED RATES WHICH ARE FAIR AND REASONABLE

MAY 9 AND 10, 1966

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CONTENTS

Page

Text of S. 3297 ... 1

Agency comments:

Federal Maritime Commission, dated May 16 and June 1, 1966 ... 2

Comptroller General of the United States, dated June 23, 1966 ... 5

Post Office Department dated July 26, 1966 ... 7

State Department, dated May 10, 1966 ... 7

Treasury Department, dated May 12, 1966 ... 7

Statement of—

Gulick, James W., Deputy Maritime Administrator, Maritime Administration, Department of Commerce, Washington, D.C.; accompanied by Carl Davis, General Counsel; and Carl L. Weir, Office of Program Planning ... 40

Harllee, Rear Adm. John, U.S. Navy (retired), Chairman, Federal Maritime Commission, Washington, D.C.; accompanied by James V. Day, Commissioner; Edward Schmeltzer, Managing Director; and Leroy Fuller, Special Assistant to the Chairman ... 27

Moot, Robert C., Deputy Assistant Secretary for Logistics, Department of Defense, Washington, D.C.; accompanied by Marvin H. Morse, Assistant Counsel, Office of Counsel ... 11

Safir, Marshall P., chairman, Sapphire Steamship Lines, Inc., 375 Park Avenue, New York, N.Y ... 93

Walsh, Cornelius, chairman, Waterman Steamship Corp., 19 Rector St., New York, N.Y.; accompanied by Joseph T. Lykes, Jr., vice chairman, Lykes Bros. Steamship Co., Post Office Box 53068, New Orleans, La.; William B. Rand, president, United States Lines Co., 1 Broadway, New York, N.Y.; Robert G. Stone, president, States Marine Lines, 90 Broad Street, New York, N.Y.; Edwin A. Wester, vice president, Pacific Far East Lines, 141 Battery Street, San Francisco, Calif.; and Warner W. Gardner, counsel, Shea & Gardner, 734 15th Street NW., Washington, D.C ... 47

Miscellaneous information submitted:

Dewey, Ralph B., president, Pacific American Steamship Association, 635 Sacramento Street, San Francisco, Calif., letter dated May 26, 1966 ... 95

Excerpt from the hearings before House Committee on Appropriations, 88th Congress, 1st session ... 96

Haddock, Hoyt S., executive secretary, AFL–CIO Maritime Committee, 100 Indiana Avenue NW., Washington, D.C., letter dated May 17, 1966 ... 97

Hall, Paul, president, Seafarers International Union of North America, 675 Fourth Avenue, Brooklyn, N.Y., telegram dated June 6, 1966 ... 97

Letter from Alan S. Boyd, formerly Chairman, Civil Aeronautics Board, Washington, D.C., addressed to Lawrence E. Hartwig, Chairman, Renegotiation Board, Washington, D.C., dated February 19, 1965 ... 98

OCEAN FREIGHT RATES ON MILITARY CARGOES

MONDAY, MAY 9, 1966

U.S. SENATE,
COMMITTEE ON COMMERCE,
SUBCOMMITTEE ON MERCHANT MARINE AND FISHERIES,
Washington, D.C.

The subcommittee met at 10:10 a.m., in room 5110, New Senate Office Building, the Honorable Daniel B. Brewster presiding.

Senator BREWSTER. The subcommittee will come to order.

The purpose of the hearing today is the consideration of S. 3297, a bill to authorize the carriage of military cargoes by U.S.-flag vessels at reduced rates which are fair and reasonable, introduced by the chairman of this committee, Senator Magnuson, and by me.

(The bill follows:)

[S. 3297, 89th Cong., 2d sess.]

A BILL To authorize the carriage of military cargoes by United States-flag vessels at reduced rates which are fair and reasonable

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Shipping Act, 1916, is amended by redesignating section 45 as section 46 and by inserting before such section a new section as follows:

"SEC. 45. (a) Any carrier or group of carriers subject to this Act may notwithstanding any other provision of this Act negotiate shipping contracts for the carriage of Department of Defense cargoes, in foreign or domestic commerce, at rates less than those prescribed in their commercial tariffs, under the procedures provided in this section.

"(b) The Secretary of Defense may negotiate such contracts as provided in subsection (a) of this section for the ocean transport of goods in foreign or domestic commerce, in vessels of United States registry, with any common carrier or appropriate group of common carriers acting under authority of an agreement approved under section 15 of this Act.

"(c) The rates and charges for the ocean transport of Department of Defense cargoes shall be fair and reasonable and the rates and charges provided in any contract made under subsection (b) hereof shall not exceed those charged in the aggregate for the transport of similar classes of cargoes for private persons.

"(d) The Secretary of Defense and any carrier or group of carriers with which he contracts pursuant to this section shall endeavor to reach agreement upon the rate or rates which shall comply with the requirements of subsection (c) hereof. The Secretary shall have authority to require, for Government use only and not more frequently than annually, the submission by the contracting carrier or group of carriers of such data relating to costs and profits as he may reasonably require.

"(e) If the Secretary of Defense and any carrier or group of carriers cannot reach agreement upon the rate or rates which shall comply with the requirements of subsection (c) hereof, either party may petition the Federal Maritime Commission to determine under the principles followed for domestic offshore ocean rate regulation what may be a fair and reasonable rate or rates. Such rate shall be determined with due regard to the level of commercial tariff rates in the trade. The carrier or carriers, pending such determination by the Com-

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Staff counsel assigned to this hearing: William C. Foster.

mission, shall charge the rate or rates last in effect subject to an obligation by both parties to adjust their accounts retroactive to the date of the petition to reflect the rate ultimately determined.

"(f) In procuring transportation under this section, the Secretary of Defense, in support of the national policy to promote a strong United States merchant marine, shall employ to the maximum practicable extent United States-flag common carrier operators, and shall utilize an equitable system for allocation of cargo among such operators in proportion to their respective services."

(The agency comments follow:)

FEDERAL MARITIME COMMISSION,
OFFICE OF THE CHAIRMAN,
May 16, 1966.

HON. WARREN G. MAGNUSON,
Chairman, Committee on Commerce,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: In reference to your request of May 4, 1966, for the views of the Federal Maritime Commisison with respect to S. 3297, a bill "To authorize the carriage of military cargoes by United States-flag vessels at reduced rates which are fair and reasonable," I am enclosing a copy of my testimony on the proposed bill given before your Committee on May 9, 1966.

In addition, at the request of Senator Brewster, which he made during the course of my testimony, we will be forwarding comments and suggested language for amendment of the proposed bill.

Sincerely yours,

JOHN HARLLEE,
Rear Admiral, U.S. Navy (Retired), Chairman.

FEDERAL MARITIME COMMISSION,
OFFICE OF THE CHAIRMAN,
Washington, D.C., June 1, 1966.

HON. DANIEL B. BREWSTER,
Chairman, Subcommittee on Merchant Marine and Fisheries, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Pursuant to your request we are enclosing herewith with the unanimous concurrence of the Federal Maritime Commission, copies of proposed revisions or additions to S. 3297, incorporating certain answers to questions which I had raised during the course of my testimony concerning the proposed legislation. In addition, the enclosed proposed revisions cover additional matters.

Although my testimony raised the question of whether or not the decisions of the Federal Martime Commission under section 45(e) would be subject to court review the enclosure does not comment thereon. We believe, however, that decisions would be subject to court review as are other orders of the Commission. We would also point out that while in most instances involving disputes under government contracts the Armed Services Board of Contract Appeals is the forum to which the parties first address themselves for redress, under this legislation it would be the Federal Martime Commission on issues involving lawful rates or practices.

Consideration was given to inclusion of a provision clarifying that the provisions of section 6 of the Intercoastal Shipping Act, 1933, not be rescinded as a result of this proposed legislation. While it is our belief that nothing in the Act would conflict with section 6 of the Intercoastal Shipping Act, 1933, the Congress may desire, in order to eliminate any doubt, to include the following language,

"Nothing in this section shall prevent the carriage, storage, or handling of Department of Defense cargoes at free or reduced rates, when otherwise permitted by law."

In our testimony presented on May 9, we raised the question of treatment of subsidies in determining the fair and reasonable rate under section 45(e). We have not determined the effect of subsidy payments to carriers of military cargo space and our files do not include materials which would be necessary to arrive at such a determination. Nevertheless this committee has asked for views on the subject and we, therefore, will make our recommendation in accordance with our understanding of the effect of subsidy on the expense and profit position of American flag carriers who transport military cargoes.

Construction differential subsidy may amount to as much as 55 percent of the cost of constructing an American flag vessel. We think that the construction differential subsidy clearly should not be included in the carrier's rate base. The rate base normally consists of funds which are invested by the carrier itself in the operating capital equipment. We know of no reason which would support allowing a rate of return on the part of the rate base supplied by the government. Logically it would be unthinkable for the government to pay a percentage of the cost of the ship and then pay rates which allow a rate of return not only on the percentage of the vessel cost borne by the operator but also the percentage contributed by the United States. Thus, it seems clear that the rate base of the carrier should not include construction funds contributed by the government.

The problem is not so easily answered concerning treatment of operating subsidy in calcuating the carrier's net profit. Three alternatives would be to (1) deduct operating differential subsidy allocable to military cargo from the expenses attributable to military cargo, (2) treat operating differential subsidy allocable to military cargo as military cargo revenue, or (3) give no effect to operating subsidy in which case the fair and reasonable military rate would be based on the total expenses of running the ship including the portion contributed by the government in the form of operating differential subsidy. We favor the first alternative for the following reasons:

(1) the rate of return should be based only on expenses actually accruing to the operator. The portion of the expense covered by subsidy is paid by the government, of course, and not the operator, and hence a rate based on total expenses of the vessel would result in a windfall to a subsidized operator, and (2) rates based upon total expenses (including those covered by operating differential subsidy) would result in rates higher than a reasonable rate of return for the efficient operator or would tend to promote inefficiency on the part of subsidized operators.

It should be recognized that the subsidized operator gives up certain operating flexibility in return for receipt of subsidy. He must serve the range of ports specified in the subsidy contract even though it might be more efficient to cover only the ports at which a large volume of profitable cargo is tendered. Thus, it is likely that to a certain extent the unsubsidized operator is free to operate more efficiently and have a lower cost per ton on military cargo than the subsidized operator. It might be that this should be recognized in setting a fair and reasonable rate of return, but at this time the Federal Maritime Commission has no facts on which to base a suitable formula. There are other factors in the operation of subsidized versus unsubsidized vessels which also affect this problem. For example, the subsidized operators use more modern vessels which probably would carry cargo at a lower cost if operated only between a limited number of ports; the unsubsidized operator of older ships would have a very low depreciation expense. There may be other factors relating to the operation of subsidized carriers vis-a-vis non-subsidized carriers which we cannot give effect to without the kind of detailed factual study which could not be accomplished in view of the limited data available to us and the limited time we have had to prepare these comments and the attached statutory revisions.

On balance we would favor a determination of fair and reasonable rates on military cargo based on a rate base exclusive of construction differential subsidy and a calculation of net return which deducts operating differential subsidy from the carrier's expenses.

As the next alternative, we would favor the substitution of a determination of net profits based on expenses attributable to military traffic less a reasonable reduction for payment of operating differential subsidy. This would leave the Commission free to subtract from total operating expenses only the portion of operating differential subsidy which the Commission deems to measure the net advantage resulting from the payment of subsidy.

Our testimony of May 9 pointed out that the Federal Maritime Commission has in the domestic offshore trade based rates on varying bases such as (a) cost of a particular carrier, (b) cost of dominant carrier, (c) aggregate cost of all carriers. At this juncture it would be difficult to project which of the above three would be the most appropriate. In some instances there might be only one carrier involved. In another instance there might be no dominant carrier and conceivably in some instances the experience of all carriers in the trade would be meaningless because of changed conditions. We would use the aggregate or average cost of the carriers in the trade, except in extraordinary circumstances such as military exigency or experimental movements.

The following area was not discussed in previous testimony but should, we feel, be brought to the attention of this Committee. This involves section 45(f) of the proposed legislation. We believe that it would be advisable for the Congress to clarify whether the allocation of cargo in proportion to respective services would mean priority of allocation to special services such as vehicle carriers and containerized ships. This would have a bearing on the rate structure and would permit the Department of Defense to take advantage of such specialized services.

We would also suggest that the words "in vessels of United States registry" be inserted after the word "cargoes" in section 45(a) of S. 3297. This would be consistent with the language elsewhere in the bill and would clarify that this applies only to vessels of United States registry.

Finally, I should like to reiterate that the enclosed material is furinshed at your request and should not be construed as any indication by us concerning the desirability of this legislation. As I stated during my oral testimony we would defer to the Department of Defense concerning the substantive merits of the proposed bill and to the Department of Commerce with respect to the potential impact upon the carriers.

In the event that additional clarification or comment is desired we shall be happy to provide such at your request.

Sincerely yours,

JOHN HARLLEE,
Rear Admiral, U.S. Navy (Retired), Chairman.

(e) In the event that the Secretary of Defense and any *common* carrier by water or conference of such carriers cannot reach agreement upon a rate or rate pursuant to negotiation under subsection (b) hereof either party may petition the Federal Maritime Commission to determine what may be a fair and reasonable rate or rates. In the absence of an agreed upon negotiated rate or rates, the carrier or carriers shall charge the rate or rates last in effect subject to an obligation by both parties to adjust their accounts retroactive to the date of the filing of the petition with the Federal Maritime Commission to reflect the rate ultimately determined.

The insertion of the word "common" makes it clear that section 45(e) petitions would be limited to common carriers. (Question 1 in testimony of May 9, 1966.)

In any proceeding under this subsection the burden of proof of establishing what are fair and reasonable rates shall be upon the common carrier by water or conference of such carriers. In determining a fair and reasonable rate the Federal Maritime Commission shall apply those standards followed in determinations made pursuant to the Intercoastal Shipping Act, 1933, but in no event shall the government rate be higher than the applicable commercial rate.

This language imposes the burden of proof upon the carrier, which has available to it all the accounting data and cost data necessary to enable the FMC to reach a finding and is, therefore, in the best position to sustain the burden. (Question 3 in testimony of May 9, 1966.)

The carriers in testimony on May 10, 1965 indicated that this was merely a safeguard. While many commercial rates are meaningless, we would, nevertheless, recommend retention of this language.

In the absence of a petition by either the Secretary of Defense or the common carrier or conference of such carriers who are parties to the contract or pending contract, the Federal Maritime Commission shall not inquire into the reasonablenes of rates negotiated pursuant to section 45.

This language limits the FMC authority to review. It may not, thus initiate investigations under § 22 of the Act. In this area, where both the shipper and carrier are in agreement on the rates no legislative purpose would be served by a § 22 investigation. (Question 8 of the statement.)

Rates established or approved after hearing by the Federal Maritime Commission pursuant to provisions of this section shall not be subject to the Renegotiation Act of 1951, (50 U.S.C. App. 1211, 65 Stat. 7).

This language would not be mandatory for resolution of question No. 5 of the statement. However, it does make clear that after FMC determination of a fair rate the contracts would not be subject to renegotiation. To include the possibility of subsequent renegotiation would be redundant and cause the FMC to engage in what might be a useless exercise in conducting hearings under section 45(e).

(i) The provisions of section 18(b) of this Act shall not apply to the carriage of Department of Defense cargoes upon a determination by the Federal Maritime Commission that the filing of rates for such carriage would serve no regulatory purpose.

This provision is self-explanatory, giving the Federal Maritime Commission authority to waive the filing requirements of the referenced section when the burden and the cost involved thereby would not be commensurate with serving any regulatory purpose.

(f) Add the following:

In determining an equitable system for allocation hereunder the Secretary of Defense may recognize separate categories of service based upon social purpose equipment, such as vehicle carriers or container carriers, as constituting separate allocable pools.

This recognizes that the carriers using special purpose equipment should be treated separately in allocating cargo, in order that the Department of Defense may take advantage of cost savings afforded by the special purpose equipment so that the carrier will reasonably expect utilization of such equipment.

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., June 23, 1966.

B-95832.

Hon. WARREN G. MAGNUSON,
Chairman Committee on Commerce,
U.S. Senate.

DEAR MR. CHAIRMAN: Further reference is made to your letter of May 4, 1966, requesting our comments on S. 3297 which would amend the Shipping Act of 1916, as amended, 46 U.S.C. 801–842, by renumbering the present section 45 and adding a new section 45 to authorize the carriage of military cargoes by United States-flag vessels at reduced rates which are fair and reasonable.

It appears from Senator Magnuson's statement introducing the bill by request (Cong. Rec., Senate, May 3, 1966, Pages 9067–9069) that the intent of the bill is to preclude the Department of Defense carrying into effect, so far as its procurement of ocean transportation on regular berth service other than on bills of lading is concerned, its announcement on April 4, 1966, that by July 1, 1966, it would open to competitive bidding all maritime contracts for carrying defense cargoes overseas. Such transportation service since about 1950 for the most part has been procured under a system of group contract negotiation. The intent of S. 3297 generally is to preserve the Military Sea Transportation Service group contract negotiation procedures in the establishment of rates and allocation of cargoes thus avoiding the possibility of rate wars detrimental to the American Merchant Marine.

The Department of Defense under 49 U.S.C. 65(a) and 10 U.S.C. 2304(a)(10) and 2304(a)(17) already has permissive authority to negotiate such contracts—and as indicated, has exercised such authority for more than 15 years. But such authority of the Department is permissive under 10 U.S.C. 2304(a), if it is administratively determined that advertising is not feasible and practicable—unless such method is otherwise precluded by law—and the Department may require such procurement to be let through competitive bids as it indicates it proposes to do. The bill giving it permissive authority to negotiate such contracts would thus merely give it authority it already has. It would not require the Department to adhere to the system of negotiation of rates or preclude its putting into effect its announced intention to resort to competiive bids for berth liner service. It would thus be ineffective to carry out the primary purpose for which it was introduced.

Also, if the bill were modified to make it mandatory that Defense adopt or continue the system of group negotiation which has been in effect since 1950, its terms would then appear to be too broad in that it would appear to encompass as well the Department's procurement under charter of the use of an entire vessel and of its procurement, by bill of lading, of common carrier transportation available to the public generally at tariff rates.

Furthermore, the bill in requiring that rates be fair and reasonable and not in excess in the aggregate for transportation of similar classes of cargoes for private persons is somewhat vague in that it apparently contemplates fixing the rates on a cost basis (or cost plus a reasonable profit) limited in the aggregate not to exceed charges for similar cargo made the public generally. But it does not spell out whether the cost would be that of the particular owner or operator of the vessel or the most efficient owner or operator in the particular ocean service involved or the fully distributed cost making allowance for periodic replacement of the vessel or merely incremental costs attributable to carriage of the Defense cargo after incurring the costs connection with the carriage of other cargo loaded on a particular vessel. If reasonableness were to be computed on the costs of each operation, there might be a multiplicity of rates, different for each operator or vessel used. If based on the operations of the least-efficient operator used, there would appear to be a windfall to the more efficient operator and higher costs to the United States.

Subsection (e) contains a provision obliging both parties to adjust their accounts to reflect the rate ultimately determined to be fair and reasonable retroactively to the date the Federal Maritime Commission was petitioned to make the determination. We believe that serious audit and accounting problems for our Office might result if many such rates were to be referred to the Commission for determination. In this respect, the records of our Office are not maintained in a manner that would permit a ready identification of those bills or vouchers that have been passed in the audit but which would have to be recalled to adjust the charges to conform to the retroactive application of rates.

Subsection (f) provides that United States-flag common carrier operators shall be employed to the maximum practicable extent and that an equitable system for allocation of cargo among such operators be utilized. Common carrier berth liners have largely confined their activities to carriage of manufactured goods and passengers between regularly scheduled destinations, the rates for which services are fixed in tariffs. Cargo in bulk has largely been carried by tramp operators which generally have no fixed and regularly scheduled destinations and the rates of which are largely determined by competitive conditions. Subsection (f) would therefore operate to give United States common carrier berth line carriers cargo formerly carried by American tramp ships and hence would be discriminatory against such tramps.

The prescribed system for allocation of cargo requires that it be in proportion to the services of the respective operators. It seems that this language could be construed as requiring allocation based on service offered as the only consideration regardless of any difference to rates between the operators. We believe that, if there is a difference in cost to the Government, the lower cost carriers should be used to the extent of their capacity, allocating cargo in proportion to services only when it does not result in higher costs to the Government.

While we recognize the bill concerns policy questions affecting the American Merchant Marine which are for decision by the Congress, in view of the matters set forth above, we do not feel that we can recommend its favorable consideration by your Committee. However, if your Committee decides some legislative action is necessary in the situation in order to better protect the interests of the United States as a shipper and to make it perfectly clear that the Government including the Department of Defense can enter into special contracts and secure reduced rates by competitive bid or otherwise, we recommend enactment as to carriage by vessels in foreign or domestic commerce of a clause similar to those in 49 U.S.C. 22 and the Intercoastal Shipping Act, 1933, 46 U.S.C. 846. Enactment of such a clause seems desirable to preclude possible resort to the Courts by carriers which may be adversely affected by the Department of Defense adoption of competitive bidding procedures. See in this connection, *Slick Airways, Inc.,* v. *United States,* 154 Ct. Cl. 417, 421 (1961) and *United States* v. *Associated Air Transport, Inc.,* 275 F. 2d 827, 838–839 (1960), wherein the Court of Appeals, Fifth Circuit, in considering the Government's assertion of preferential status under the Civil Aeronautics Act stated that the "short of it is that when Congress seeks to give the Government a preferred transportation status, it does so in

plain terms." A similar recommendation was made in our reports to your Committee when it was considering amendment of the Shipping Act, 1916, which culminated in the passage of Public Law 87–346. Such recommendation was adopted by your Committee, see Senate Report 860, 87th Congress, 1st Session, but prior to final enactment the suggested amendment was deleted.

Sincerely yours,

ELMER B. STAATS,
Comptroller General of the United States.

THE GENERAL COUNSEL OF THE TREASURY,
Washington, D.C., May 12, 1966.

Hon. WARREN G. MAGNUSON,
Chairman, Committee on Commerce,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Reference is made to your request for the views of this Department on S. 3297, "To authorize the carriage of military cargoes by United States-flag vessels at reduced rates which are fair and reasonable."

Since the proposed legislation relates to matters primarily within the jurisdiction of the Department of Defense, the Treasury Department defers to the views of that agency on the merits of the bill.

The Department has been advised by the Bureau of the Budget that there is no objection from the standpoint of the Administration's program to the submission of this report to your Committee.

Sincerely yours,

FRED B. SMITH, *General Counsel.*

DEPARTMENT OF STATE,
Washington, May 10, 1966.

Hon. WARREN G. MAGNUSON,
Chairman, Committee on Commerce, U. S. Senate.

DEAR MR. CHAIRMAN: I refer to your letter of May 4, 1966 requesting the comments of the Department of State on S. 3297, a bill "To authorize the carriage of mlitary cargoes by United States-flag vessels at reduced rates which are fair and reasonable."

Since the proposed legislation relates to freight rates on United States military cargoes which are carried on United States-flag ships, the provisions of S. 3297 appear to have no present foreign policy implications. The Department of State therefore defers to the views of the directly interested departments and other agencies of the Government.

The Bureau ofthe Budget advises that from the standpoint of the Administration's program there is no objection to the submission of this report.

Sincerely yours,

DOUGLAS MACARTHUR II,
Assistant Secretary for Congressional Relations
(For the Secretary of State).

THE POSTMASTER GENERAL,
Washington, D.C., July 26, 1966.

Hon. WARREN G. MAGNUSON,
Chairman, Committee on Commerce,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is in reply to your request for our comments on S. 3297, a bill to authorize the carriage of military cargoes by United States-flag vessels at reduced rates.

A review of this measure discloses that it applies only to contracts negotiated with the Secretary of Defense covering military cargoes. It would not affect our contract negotiations for the transportation of mail by water carriers. Accordingly, we have no recommendation to make regarding enactment of S. 3297.

The Bureau of the Budget has advised that from the standpoint of the Administration's program there is no objection to the submission of this report to the Committee.

Sincerely yours,

LAWRENCE F. O'BRIEN.

Senator BREWSTER. As acting chairman of this subcommittee, I would like to make a very brief statement on this measure.

On April 4, the Department of Defense revealed that by July 1 it would open to competitive bidding all contracts for carrying defense cargoes overseas.

Since this announcement, industry representatives have indicated that the implementation of such a policy could be disastrous.

It is my understanding that MSTS cargo now represents nearly half of the cargo carried by U.S.-flag lines on principal MSTS trade routes. Industry states that under a competitive bidding system each line would be forced to bid low enough to insure obtaining at least its share of this military cargo. The resulting rate war could have the most serious consequences for our merchant marine.

The legislation which Senator Magnuson and I have introduced would preserve present arrangements for MSTS procedures in the establishment of rates and allocation of cargoes. It is intended as a vehicle for the thorough discussion and debate of the Defense Department decision, since it would require the Secretary of Defense to cooperate to the maximum practicable extent in the development of a strong American merchant marine through the equitable allocation of military cargo among U.S.-flag carriers on regular berth service operation.

This legislation is not intended to preclude the Secretary of Defense from entering into special contracts for the handling of special cargo, nor is it intended to preclude the making of special rates for the handling of cargo from point of origin to point of destination.

I have long been distressed by the policy paralysis which has recently plagued American maritime affairs. I firmly believe that we must develop a plan for a modern maritime fleet. Until this can be accomplished, we must not allow the independent uncoordinated decisions of a variety of Government agencies, acting without consultation, to determine in a random way what our maritime policy shall be.

The Defense Department announcement reflects this kind of a decision and requires that other agencies of Government and representatives of the industry have an opportunity to be heard. It requires that the appropriate committees of the Congress consider the subject carefully.

If the responsible officials in the administration are incapable of developing a policy to protect American sea power and preserve our vital command of the oceans, the Congress must, and I believe will, assume that responsibility.

A memorandum detailing the rationale behind the bill now under consideration, will be made a part of the record of these hearings.

(The memorandum follows:)

MEMORANDUM IN SUPPORT OF BILL AMENDING SHIPPING ACT TO AUTHORIZE THE CARRIAGE OF MILITARY CARGOES BY U.S.-FLAG VESSELS AT REDUCED RATES WHICH ARE FAIR AND REASONABLE

I

Ever since the close of World War II, defense cargoes have been carried at uniform rates with the cargo allocated among all U.S.-flag berth carriers in the trade. Ever since 1950, the rates have been set by the Military Sea Transport Service as a result of discussions with groups of carriers serving the several trades.

For a year past, the U.S.-flag berth lines and MSTS have been in dispute or uncertainty as to whether rates under the MSTS shipping contracts were fair and reasonable. To help resolve that dispute, the Federal Maritime Commission has carried forward an elaborate investigation, FMC docket 65–13. For their part, the carriers in all the principal trades have produced searching cost studies which broke new ground in steamship accounting. These studies indicate that MSTS rates are substantially less than the commercial rates on comparable goods.

On April 4, 1966, a witness for the Department of Defense announced in FMC docket 65–13 a new policy for the carriage of defense cargoes. This would be done under contracts procured by competitive bidding by the individual lines or, in cases where this was not feasible, by individually negotiated contracts. The commander, Military Sea Transportation Service, has recently declared his intention to open bids and have the system in operation by July 1.

II

The steamship industry believes that any such system spells disaster to the industry and will preclude the Department of Defense traffic agencies from accomplishing their mission. They summarize their position as follows:

1. The effect on the lines: (a) For nearly a century, without known exception, rate competition among ocean steamship berth lines has always produced a rate war in which rates were driven far below costs.

(b) This uniform history is not an accident, but results from the fact that over 75 percent of the costs of a berth operation are fixed, so that any return over the 25 percent of variable costs is better than free-space. In the case of the FIO defense cargoes, about 83 percent of the costs are fixed.

(c) The MSTS cargo represents close to half of the outbound cargoes carried by the U.S.-flag lines on the principal MSTS trade routes. None of the lines on those routes can do without this cargo.

(d) Under a competitive bidding system, each line will in normal times be forced to bid low enough to insure that it obtains at least its share of this indispensable cargo, with the inevitable and classic result of bids below fully distributed costs and approaching the added costs of cargo handling and vessel loading time costs for the MSTS cargoes.

(e) The apparently proposed absence of restriction upon bidders will in all likelihood stimulate the formation of transient steamship lines which will offer low bids for selected routes when vessel charter rates are low and desert the damaged trade when these rates rise.

(f) The unsubsidized lines will be forced to abandon U.S.-flag service almost immediately after the return to a normal period of excess tonnage. The subsidized lines could hang on longer, but with up toward half their cargoes carried at a loss their eventual survival would be equally doubtful.

2. The effect on MSTS: (a) MSTS has often enough indicated its need for berth services and for fast modern ships. There will be no vessel replacement for services conducted at a loss, and MSTS would sooner or later be forced into sole dependence upon its own fleet. The costs, we believe all agree, would greatly exceed those resulting from use of the berth lines.

(b) MTMTS, which is responsible for Department of Defense traffic management and terminals, was opposed last September to any system of competitive rate bidding on the ground that it could not discharge its function if it had to deal with line-by-line routes, rates and priorities. It was not consulted on the Department of Defense policy announced on April 4.

(c) The Department of Defense negotiates with rate bureaus, not individual roads, to obtain railroad rates. It accepts the CAB determinations for fair rates for military cargoes and personnel. The steamship industry, with its unvarying history of destructive rate wars whenever rates are fixed by competition, would seem the last, not the first, transportation industry in which to procure rates by competition.

(d) For 15 years past, the berth lines have felt themselves obliged to meet all MSTS requests, whether or not the voyage would produce a loss and whatever their competing obligations to commercial shippers. One simply cannot expect an MSTS contract holder, who obtained his contract by competitive bidding below the cost of service, to be willing to take on costly obligations beyond the perimeter of his contract. Negotiations and special costs will replace automatic and uncompensated compliance with special requests.

(e) At this moment, something of a rarity in steamship history, the lines are not short of cargoes. In 1966, but not as a rule, we should expect a sharp increase in MSTS freight rates if competitive bids are substituted for continuing contracts.

Senator BREWSTER. We will also include in the record Senator Magnuson's letter to Secretary McNamara of May 4 of this year. For the purposes of clarification, I want to read two paragraphs from the chairman's letter to the Secretary of Defense:

I enclose for your information a copy of S. 3297 which I have just introduced, along with a copy of my explanatory statement which I made on the floor of the Senate. I should hope that the Department of Defense will, at our May 9th and 10th hearings, be prepared to make full comment on this bill and to give full explanation of its proposed competitive bidding procedures.

It seems to me of first importance that the Department delay institution of its new procedures until the Congress has had an opportunity to consider the basic issues of policy which are involved. The system of uniform, Government-fixed rates for defense cargoes has been in use for the past twenty years. Hearings have been expedited so that this system can be continued for another few months while the Congress considers the matter.

(The letter follows:)

MAY 4, 1966.

DEAR MR. SECRETARY: I need not reiterate our concern that this Nation should have as strong and as effective a merchant marine as may be possible. The Congress has for half a century proceeded upon the assumption that this goal could not be achieved, at least for the berth liner or common carriers, if their rates were fixed by unrestrained competition. Accordingly, the Shipping Act, 1916, authorized conference rate making and P.L. 87–346 in 1961 authorized dual rate contracts in order to make conference rate-fixing effective.

The current proposal of the Department of Defense to ship defense cargoes under a competitive bidding system is viewed by the steamship industry with the utmost alarm. I am not at this point prepared to say that the competitive bidding proposal is right or wrong. I am, however, entirely clear that it presents an issue of basic policy which should be considered and evaluated by the Congress.

I enclose for your information a copy of S. 3297 which I have just introduced, along with a copy of my explanatory statement which I made on the floor of the Senate. I should hope that the Department of Defense will, at our May 9th and 10th hearings, be prepared to make full comment on this bill and to give full explanation of its proposed competitive bidding procedures.

It seems to me of first importance that the Department delay institution of its new procedures until the Congress has had an opportunity to consider the basic issues of policy which are involved. The system of uniform, Government-fixed rates for defense cargoes has been in use for the past twenty years. Hearings have been expedited so that this system can be continued for another few months while the Conrgess considers the matter.

I should be very glad to have as prompt advice as may be feasible that the Department will delay inauguration of the proposed competitive bidding system until the Congress has had an opportunity during the present session to carefully consider the matter.

Sincerely yours,

WARREN G. MAGNUSON, *Chairman.*

Senator BREWSTER. Our first witness this morning will be the Honorable Robert C. Moot, Deputy Assistant Secretary for Logistics, Department of Defense.

Mr. Moot, we welcome you here. We are very glad you are able to give us your time. In your remarks, sir, I would appreciate it if you would address yourself to Senator Magnuson's request that your new procedures be withheld until Congress has a chance to look into this. Please go ahead.

STATEMENT OF ROBERT C. MOOT, DEPUTY ASSISTANT SECRETARY OF DEFENSE (LOGISTICS SERVICES), INSTALLATIONS AND LOGISTICS; ACCOMPANIED BY MARVIN H. MORSE, ASSISTANT COUNSEL, OFFICE OF COUNSEL, DEPARTMENT OF DEFENSE

Mr. MOOT. Thank you, Mr. Chairman. I am here today at your request to comment for the Department of Defense on S. 3297, a bill "to authorize the carriage of military cargoes by U.S. flag vessels at reduced rates which are fair and reasonable." In introducing this bill, requested by major carriers, it was recognized that the Department intends to actively seek price competition in the procurement of ocean freight services and the committee was so advised in a letter from the Department dated April 2, 1966. Because our analysis of S. 3297 was made against the background of this decision to seek price competition, I would like to discuss briefly the considerations that led the Department to such a conclusion prior to commenting specifically on the provisions of S. 3297.

The Department of Defense through its operating agency, the Military Sea Transportation Service, is procuring commercial ocean freight services at an annual rate of more than $400 million in shipping costs. Approximately 50 percent of these ocean freight shipments move in berth or liner service. Rates applicable to these shipments for the most part are negotiated between MSTS and carrier organizations which have been granted antitrusts immunity by the Federal Maritime Commission pursuant to section 15 of the Shipping Act of 1916.

Procurement of ocean transportation service to move the above mentioned volume of cargo has been for all practical purposes on a sole source basis. No price competition is involved. Rates have been negotiated with the intent of excluding costs such as brokerage fees and cargo handling expense which are not applicable to the movement of military cargo to the same extent as such expense is involved in the movement of cargo for commercial shippers.

The legislative requirement that the armed services procure transportation services only from U.S. ships stems from the act of April 28, 1904, which, as revised and codified as section 2631 of title 10, United States Code, provides as follows:

> Only vessels of the United States or belonging to the United States may be used in the transportation by sea of supplies bought for the Army, Navy, Air Force, or Marine Corps. However, if the President finds that the freight charged by those vessels is excessive or otherwise unreasonable, contracts for transportation may be made as otherwise provided by law. Charges made for the transportation of those supplies by those vessels may not be higher than the charges made for transporting like goods for private persons.

The contract law in force at the time of the passage of the Cargo Preference Act of 1904 made it mandatory for the Army and Navy to utilize the transportation provided by the company submitting the lowest bid. The effect of the 1904 law was to restrict bidding to U.S. shipowners. Therefore, the opening of competition to foreign shipowners is not at issue in connection with the newly announced change in Department of Defense procurement practice; neither is the question of world conference of United States and foreign flag carriers directly involved.

Overall armed services purchasing techniques were revised as a result of the Armed Services Procurement Act of 1947 which provides that all Department of Defense procurements shall be by formal advertising with the exception of 17 numbered instances where negotiation is permitted. In procuring ocean contract carriage services by negotiation, the Military Sea Transportation Service has been utilizing exception No. 10 which permits other than formal advertising when "the purchase or contract is for property or services for which it is impracticable to obtain competition." MSTS has traditionally negotiated for ocean common carriage under exception No. 17 which permits other than formal advertising when authorized by law; the law relied on by MSTS is 49 U.S.C. 65(a), as interpreted by the Comptroller General. It is clear that the exceptions which permit negotiation are permissive and not mandatory. Regardless of such exceptions, the major intent of the Armed Services Procurement Act of 1947 was that procurement be conducted on a competitive basis to the maximum practicable extent.

The policy of the Armed Services Procurement Act was outlined by the President in his statement to the Secretary of Defense upon the signing of that bill. He stated, in part, at that time:

> This bill grants unprecedented freedom from specific procurement restrictions during peacetime. That freedom is given to permit the flexibility and latitude needed in present day national defense activities. The basic need, however, remains to assure favorable price and adequate service to the Government. To the degree that restrictions have been diminished, therefore, responsibility upon the defense establishment has been increased. There is danger that the natural desire for flexibility and speed in procurement will lead to excessive placement of contracts by negotiation and undue reliance upon large concerns, and this must not occur.

Directly pertinent to the procurement of transportation services are the objectives outlined in the 1962 Presidential message to the Congress relative to the transportation system of the United States wherein the President stated—

> The basic objective of our Nation's transportation system must be to assure the availability of fast, safe, economical transportation services needed in a growing and changing economy to move people and goods, without waste or discrimination, in response to private and public demands at the lowest cost consistent with health, convenience, national security, and other broad public objectives * * *. This basic objective can and must be achieved * * * under the incentives of private profit and checks of competition to the maximum extent practicable.

In keeping with the legislative intent of Congress the Defense Department, for all goods and services, has since 1961 been steadily increasing the proportion of procurement contracts awarded on a competitive basis in contrast with what is for all practical purposes a sole source basis. Since the beginning of fiscal year 1961 the percentage of price competitive contracts has been increased from 33 percent in 1961 to over 43 percent of the total value of awards. Savings accrued through the first half of fiscal year 1966 from this shift in more than $4 billion in annual procurement funds are estimated to amount to now $1 billion per year. As related to commercial maritime operations, Secretary McNamara, in 1962, expressed himself as feeling very strongly that the fundamental premise on which we develop our transportation programs must be that the incentives of private profit and

the checks of competition be used to the maximum extent practicable. The decision to seek price competition in the acquisition of ocean freight services, is therefore, consistent with the overall objectives of the Department.

Early in 1965 a new steamship line initiated service between the U.S. east and gulf coast and Europe/United Kingdom at rates substantially below shipping contract rates then in effect. Other steamship lines—subsidized and non-subsidized—met the competition of this new line. The effect of the rate reduction on MSTS ship space cost was significant. In the case of MSTS general cargo the space rate was reduced by more than 25 percent.

This successful experience with price competition in the acquisition of ocean freight service occurred during a period when the Department was reviewing its procurement practice in this area. August the background of clear legislative intent and a positive management objective to secure maximum competition in procurement, the Department's review of all available data led to the inescapable conclusion that the introduction of price competitive procurement was timely, feasible, and potentially beneficial to all parties.

In the implementation of this revised practice for procurement of ocean freight services, it is important to understand that the Department of Defense considers it is in a unique customer relationship with the shipping industry. By law, all military cargo must move on U.S.-flag ships when they are available which means that the world's largest volume shipper has constraints under national policy as to the scope of carriers it can use. It is against this background of a single, large volume shipper dealing exclusively with U.S.-flag operators that competitive price procurement procedures will be developed.

These are the considerations which led the Department to the conclusion that price competition should be actively sought. The provisions of S. 3297 have been analyzed with these considerations in mind, As a result of this analysis, the Department of Defense is opposed to the enactment of this bill for the following reasons.

PROPOSED SECTION 45

Subsection (f) would establish a mandatory preference for common carrier berth operators over other American-flag operators. The result would be to deny Department of Defense cargoes to a substantial segment of the American-flag shipping industry. The Department of Defense needs all segments of the U.S. merchant marine and all segments should be given fair opportunities to carry defense cargoes. In addtion, this section would require the Department of Defense to use the most costly method of transporting military cargoes.

Subsection (f) calls for establishment of a mandatory allocation system which would eliminate the operational flexibility of the Department to employ prudent management in its operations.

Subsection (a) would authorize carriers to negotiate rates for carriage of defense cargoes which are less than those prescribed in their commercial tariffs. Nothing in existing law prevents the Department of Defense from obtaining lower rates and it has been the exception rather than the rule for the Department of Defense to pay commercial tariff rates.

66-769—66——2

Subsection (b) would authorize the negotiation of contracts with groups of carriers and when considered in conjunction with the mandatory allocation system prescribed under subsection (f), it appears as though the purpose of the bill is to establish a pool of common carrier operators who will negotiate contracts and share proportionately in the allocation of defense business. The Department does not believe that such a pool arrangement would be economical and equitable to other segments of the shipping industry or that it would be in the national interest. Further, the implied restriction on the power of the Department of Defense to negotiate contracts with other than common carriers narrows existing authority under title 10, United States Code, section 2631 and appears to be inconsistent with the authority contained in title 10, United States Code, section 2304.

Subsection (c) which would establish a "fair and reasonable" test for negotiated rates seems ambiguous in the absence of any standards for reasonableness of rates charged either to commercial or Government shippers. In subsection (a) authority is granted to negotiate rates at lower levels than those charged commercial shippers and this further complicates the question of determining fair and reasonable rates.

Subsection (d) which would entitle the Secretary of Defense to require submission of financial data annually is unnecessary in view of title 10, United States Code, section 2306(f) which requires submission of comprehensive certified cost data in procurement in excess of $100,000 and undesirable in that it would limit the authority of the Department to secure data necessary for prudent management.

Subsection (e) would require that any adjudication of rate differences give due regard to the level of commercial tariff rates in the trade. Military cargo rates should not be priced on the basis of the economic demand or the market value of the cargo being transported. Commercial ocean freight rates tend to follow or correlate to the value of material being shipped in that value generally equates to profit and willingness to pay higher costs. Military cargo must move regardless of the marketplace value of the material and transportation rates should be established on other than a commodity basis. The requirement for retroactive application of rates ultimately determined by the Commission is novel so far as liability of the customer to additional charges is concerned; it introduces uncertainty into budgeting and limits management discretion in its choices among the various transportation modes and facilities.

It is for these reasons that the Department of Defense opposes enactment of this bill. The Department feels strongly its obligation to obtain the ocean freight services it requires at the lowest overall cost to the Government. It believes just as strongly that the program for procurement which is being adopted by the Department is consistent with our national procurement policy; that it is consistent with the basic objectives of national policy as they relate to the transportation system of the United States; and that it will prove beneficial to the U.S. merchant marine.

Mr. Chairman, this completes my prepared statement. This statement is also intended with your permission to serve as the report of the Department of Defense on S. 3297. With me today is Mr. Marvin Morse from our Office of General Counsel.

Prior to offering to answer questions, if you would like, I will try to answer questions concerning Chairman Magnuson's letter to Mr. McNamara, about which you asked earlier. Mr. Chairman, the letter is in the Pentagon. The Secretary is aware of the hope expressed by Senator Magnuson that the Department will delay its implementation during this session for review. It is his present feeling that the normal procedural leadtime required to develop implementing procedures, which we have not yet developed, to review them, to have them approved, to discuss them with other agencies of the Government, as will most probably be required, and to then institute an implementing bid procedure, will provide sufficient time for concurrent review by the Congress.

Senator BREWSTER. Has the Secretary answered the chairman's letter formally?

Mr. MOOT. He has not yet answered it, sir, but he will answer it. I will convey to him, when I go back, the comments you have put in the record and in your opening statement.

Senator PROUTY. Mr. Chairman, may I ask what was the date of the letter?

Senator BREWSTER. May 4, 1966.

Mr. MOOT. Yes. I saw the letter on Saturday for the first time, Mr. Chairman.

(The letter mentioned above follows:)

ASSISTANT SECRETARY OF DEFENSE,
INSTALLATIONS AND LOGISTICS,
Washington, D.C., May 13, 1966.

Hon. WARREN G. MAGNUSON,
Chairman, Committee on Commerce,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This has reference to your letter to the Secretary of Defense concerning Department of Defense procurement of ocean transportation services and Senate Bill, S. 3297, dated May 4, 1966.

As you know, Mr. Robert C. Moot, Deputy Assistant Secretary of Defense (Logistics Services), testified for the Department of Defense before the Senate Subcommittee on Merchant Marine and Fisheries on May 9, 1966. His prepared statement sets forth clearly the department's position on S. 3297 and explains the decision to seek greater price competition in the procurement of ocean transportation services.

The Congressional and industry concern over unrestrained competition and the possible effects thereof is certainly appreciated, but in the view of the Department of Defense is unfounded. Rather than having adverse effects on the U.S. Merchant Marine, the Department of Defense firmly believes that its new ocean transportation procurement practices will produce salutary results. The fact that contracts will be let for a period of a year will in itself have a stabilizing effect on rates. Also we do not believe that the conditions which have led to rate wars in the commercial trade in the past will exist insofar as the movement of military traffic is concerned. The Department of Defense is a single shipper and is dealing only with U.S.-flag carriers. There are no outside competitive forces involved.

As you know, the provisions of the Shipping Act of 1916 as amended which permit conference rate making are designed to protect the competitive position of the U.S. Merchant Marine in world trade. The problems of foreign-flag competition, or the question of world shipping conferences are not at issue in this case.

We expect carriers to make a reasonable profit on our traffic and will not permit "buying in" by a carrier. "Buying in" is a term used to describe a situation where a bidder submits a below cost bid for the purpose of securing a contract with the intention of recouping his loss through later contract price escalation.

We have every reason to believe that our new procurement practices will stimulate carriers to improve the overall cost effectiveness of their operations and

expand their commercial operations. Success on either of these points will certainly be beneficial to the merchant marine industry.

The normal leadtime in developing and implementing the new procurement practices is such that the program will not be operational until early in FY 1967. This will afford time for a concurrent review of the basic issues involved.

Sincerely,

PAUL R. IGNATIUS,
Assistant Secretary of Defense (Installations and Logistics).

Senator BREWSTER. It is my understanding that present plans are for the Department of Defense to implement their present plan, but parenthetically you add that under the present plans, Congress will still have time, if they wish to change the procedures, by statute.

Mr. MOOT. That is right, sir.

Senator BREWSTER. Thank you, Mr. Moot. I have a series of questions. But first I will defer to Senator Prouty.

Senator PROUTY. Thank you, Mr. Chairman.

Mr. Secretary, I have just one or two questions. It is my understanding that the Federal Maritime Commission has conducted an investigation during the past year on common carrier berth line rates for Military Sea Transportation Service cargo. It is also my understanding that elaborate cost studies have shown that berth lines have shipped MSTS cargoes at rates substantially below comparable commercial cargo. Do you know whether that is correct or not?

Mr. MOOT. Insofar as the first part of your question is concerned, Senator, the Federal Maritime Commission is conducting extensive hearings in which we have testified. So this is correct.

Insofar as the second aspect of your question is concerned, it needs to be put in perspective, the question of military rates for defense cargo in ocean freight movement and comercial tariff rates.

The two are not comparable to begin with. In the first place, for all military lift, the ship comes to the military terminal. The loading, the cargo expense, is incurred by the Department of Defense, in loading the vessel. There is in addition no brokerage fee, there is usually no wharfage fee.

The movement of the cargo to the terminal at the other end is likewise at that end handled for the most part by the military. So in determining comparability of rates between the movement of military cargo for ocean freight tariffs, it is first necessary to determine what part of the commercial tariff rate involved in these is either not applicable to the Defense Department or not required by Defense such as brokerage and cargo expense.

We have likewise examined the data as submitted by the carriers to the Federal Maritime Commission, in its docket hearing 65–13. It would be our conclusion, Senator, that on a comparable basis, we would believe that for what the Defense Department needs, namely, the occupancy of space, the comparable rates indicate that the Department of Defense is paying somewhat higher than commercial rates. We would likewise believe that the financial statements in terms of the profit or loss indicate that the carriers are making somewhat more profit on military cargo than they are on commercial cargo.

So to that extent I would qualify the latter half of your question.

Senator PROUTY. If the Federal Maritime Commission is charged with the responsibility of establishing a fair and reasonable rate, why is it necessary to induce bidding procedures? It seems to me they are

far better qualified to determine what is a fair rate than the Defense Department.

Mr. MOOT. I think that is a good question, Senator. Perhaps the technicality of the Commission's mission can best be answered by Admiral Harllee, who I believe follows me. But from the Department of Defense's point of view, the issue in the investigation order of the Commission is to determine whether or not the rates charged the military were discriminatory.

It was not the intent of the Commission to establish rates. The Commission can deem a rate unreasonably high or unreasonably low. The purpose of the hearing is to determine whether the rates are discriminatory insofar as being unfair in their charge against military cargo. So I see nothing inconsistent in the Defense Department's view and desire to determine that it is in the national interest to seek competitive rates, with the Commission's hearing.

Senator PROUTY. Do you foresee the danger of competitive rates perhaps leading to a rate war, which would weaken our flagship systems dangerously?

Mr. MOOT. We have given long and careful consideration to the position that we play in securing ocean freight service and we have recognized the industry position concerning the dangers of rate war and we have reviewed the history.

On balance, we believe that there should be no danger of rate war for the following reasons: First of all, again as I stated in my statement, we are talking about one customer, not in international competition between foreign-flag shippers and U.S.-flag shippers, but one large volume shipper, dealing with one segment of the world's shipping industry, namely, U.S.-flag operators.

It is our intent to establish rates through annual contracts and not to open up bidding to daily changes at the whim of someone who wants to become more competitive. It would be our intent to seek proposals, cost proposals, which we would intend and expect to be compensatory to the bidders, on a basis of annual contracts, probably for the first time with both a request including a guaranteed minimum amount of lift for the year, as well as a comparable bid, without a guaranteed minimum. It is our basic policy in the Department of Defense not to accept that we call "buy in" bids, which are artificially or subnormally low at the time of the initial contract, for the purpose of securing the business and then subsequently raising the price.

This is against Defense Department policy. So against that framework and with our intent to establish contracts on an annual basis, and with the fact that we are dealing with one segment, our own U.S. flag shippers, with one customer, we feel that we will bring stability rather than instability to the price structure.

Furthermore, I might point out that the other 50 percent of our lift that we are not talking about today is now on price competition as a basis. The contract carriage that we secure is price competitive. We have not experienced rate wars in this particular area. I would also like to point out that in our review of the history of this problem, when we leave 100 years ago or 50 years ago, and come up to modern times, it appears to us that most of the world conferences of today engaged in U.S. cargo movement in foreign commerce, have independent competition. Most of them have independent competition

which results in a rate difference which ranges anywhere from 10 to 25 or 30 percent. It is not our understanding that there have been disastrous rate wars in recent years. We do not consider that our own experience of the past year is a disastrous rate war experience. Taking all of this evidence into account, Senator, it is our belief that we can bring stability to the industry, we can offer them a certain assured amount of lift, we can create a competitive situation where the more effective operators are stimulated and the less effective operators will be stimulated, and we believe that we can comply with the legislative intent of the Congress, which is to secure Defense requirements at the lowest overall practical extent possible by price competition.

Senator PROUTY. Mr. Secretary, who presently sets the rate at which cargo is carried for the Military Sea Transportation Service?

Mr. MOOT. The rate, Senator, insofar as the area we are talking about today, which are berth liner service rates, are established through negotiation between the Military Sea Transportation Service and group associations of the carriers. There are two basic groups, the Atlantic and Gulf Coast, American-flag berth operators, and the counterpart for the west coast. The rates are negotiated between the Military Sea Transportation Service and these associations. The contracts are signed with the individual operators and not with the associations, which is different than your 3297 bill would propose. It proposes contracts being signed with groups of carriers.

Senator PROUTY. In other words, the lines do not set the rates now?

Mr. MOOT. Associations set the rates, sir. The lines are the individual members and in the aggregate of course form the associations.

Senator PROUTY. Thank you, Mr. Chairman.

Senator BREWSTER. Mr. Moot, are any military cargoes being veered to South Vietnam in non-U.S. ships now?

Mr. MOOT. Over the past year, Mr. Chairman, about 4½ percent of our military cargoes have moved in foreign-flag vessels to South Vietnam. This compares with what is normal in a peacetime year, nonemergency year, of 3 to 4 percent. So that foreign-flag lift is within the spectrum of what we would call the normal spot shortages of lift. As you know, we use foreign-flag vessels when U.S.-flag vessels are not available, we use them by and large on a one-voyage, outbound only, and turn them loose at the other end. The prevalence of our use of foreign-flag vessels is just a shade above normal.

Senator BREWSTER. Is this percentage applicable throughout all of military shipments, throughout the world, or is this percentage just applicable to South Vietnam?

Mr. MOOT. The 3 to 4 percent I mentioned is a worldwide normal type of percentage, talking about a nonemergency situation.

The 4½ percent is South Vietnam.

Senator BREWSTER. Does the Department of Defense consider a strong U.S. merchant marine necessary for our national security?

Mr. MOOT. The Secretary of Defense has testified very emphatically that he is dependent upon a strong U.S. merchant marine.

Senator BREWSTER. At the end of World War II it is my understanding our merchant marine fleet ranked first in the world. Do you know where it ranks now?

Mr. Moot. Yes, sir. Would you like to ask me in what terms specifically?

Senator Brewster. In tonnage, I presume, or ships.

Mr. Moot. In terms of numbers of ships, I believe that we still have, or at least did have in the last maritime statistics I saw, the greatest number of ships. In terms of active ships, which is the difference between total ships and the reserve fleet ships, it seems to me that we were probably about eighth or ninth, to the best of my knowledge. And I do have it specifically here, if you would care for me to put it in the record.

Senator Brewster. You might get the exact information for the record.

Mr. Moot. Yes, sir.

(The information referred to follows:)

U.S. Position in the World—Merchant Marine

For dry cargo freighters of 1,000 gross tons or over the U.S. Merchant Marine stood first in the world as of June 30, 1965 according to figures published by the Maritime Administration. Considering only the privately owned part of the fleet, the U.S. stood second in deadweight tonnage, a good measure of the carrying capability of the fleet, and seventh in numbers of ships. The specific data are shown below:

Country	Deadweight tonnage (thousands)	Number of ships
United States	18,406	1,753
Privately owned	6,537	567
Government owned	11,869	1,186
United Kingdom	8,985	1,049
Japan	6,171	826
Greece	5,572	624
Liberia	4,905	480
Norway	4,870	623
West Germany	4,046	639
U.S.S.R.[1]	3,909	709

[1] Source material limited and unreliable.

Source: Marad Report No. MAR-560-20, Oct. 26, 1965.

Senator Brewster. In terms of shipbuilding, do you know where the United States now stands?

Mr. Moot. I do not know exactly, sir. I would like to correct this for the record, but I believe it is about 12th, to the best of my knowledge.

Senator Brewster. Would the generalization be correct that U.S. merchant marine is falling behind, is becoming obsolescent, if not obsolete?

Mr. Moot. Well, there is no question but that the U.S. merchant marine fleet is aging. The better vessels of the U.S. merchant marine fleet are I think the best in the world. The total quantity is probably comparable with the total quantity. Without evading the tenor of your question, sir, I would like to make the point that Secretary McNamara feels very strongly that this course of action he is embarking upon is the type of action or the course of action which will stimulate and help the effective national growth of the U.S. merchant marine.

So I believe his strong statement as to the dependency of the Defense Department in its posture on a strong merchant marine and his desires to secure his ocean freight service by competitive price competition are perfectly consistent.

Senator BREWSTER. Should the United States become involved in two situations, one in South Vietnam and one elsewhere, which is certainly not beyond the realm of possibility, would our existing merchant marine fleet be sufficient for the needs of the military?

Mr. MOOT. I have testified in classified hearings, Mr. Chairman, where we have compared the total availability of sealift that we consider in our plannings, against our requirements under the contingency requirements, and while I can't elaborate upon that discussion here, my answer would be yes.

Senator BREWSTER. I presume that you would expect to cut expenses by your competitive procedures. What saving would you expect to realize at the present rate of sealift?

Mr. MOOT. Well, I think the best way I can answer that is by saying that where we have—and in my statement I mentioned since 1961 some $4 billion of defense annual procurement has been shifted from noncompetitive, sole source procurement to price competition—in that area we have secured in excess of a 25-percent reduction. In the experience we have had in the last year with price competition, in the North Atlantic, the rate differential from existing shipping contract rates has approximated 28 percent.

We would expect, therefore, on the basis of the available data to us, as we are looking at it, that we would reduce our total overall costs of shipping by something comparable to that which has been our experience in other areas.

Senator BREWSTER. Have you analyzed the financial statements of U.S.-flag berth lines to see what effect on their earnings a 25-percent cut in MSTS cargo would have?

Mr. MOOT. Yes, sir, we have to the extent that they have become available to us, we have analyzed the financial statements of at least a fair share of the U.S. shipping industry, 12 to 15 companies.

Senator BREWSTER. Both subsidized and unsubsidized carriers?

Mr. MOOT. Both subsidized and unsubsidized.

Senator BREWSTER. What do you believe would be the effect of a substantial cut in the rates on the earnings of the companies?

Mr. MOOT. Our position, or our belief would be somewhat as follows: Current rates are the same for all members of the industry, whether they are very cost effective or whether they are marginal operators. We believe, and the Secretary has made this very clear, that industries doing business with the Department of Defense should make a profit. It is good for the Department of Defense, as well as for the country. It assures prompt delivery and quality performance. On the other hand, the Department of Defense does not believe, and the Secretary has so stated, that all members of all industries doing business with the Department of Defense, despite their range of effectiveness in operating at low cost, should be making a profit.

He therefore believes that the defense business should encourage the more effective operators, and by encouraging the more effective operators, allow them to expand their business to become more effective in the commercial areas, particularly in this ocean freight service.

We are and have been examining many proposals both from subsidized and nonsubsidized operators in the Department of Defense whereby the proposals that are submitted for new, imaginative, creative ocean cargo lifting offer both the Department of Defense and the operators, as well as of course the public, distinct advantages, lower cost to defense, more effective lift, better use of national resources and of course the combination resulting in the public taxpayer interest. We believe that what we are proposing will result in a more profitable industry and in a more effective industry to the advantage of all parties concerned.

Senator BREWSTER. If we accept the proposition that the American merchant marine is necessary to U.S. security, and we subsidize it, which we do, because this is the only way under present economic conditions we can keep it going, then if we cut the rate or tariff that the MSTS pays, will not the United States have to pick up the tab out of the other pocket, on an increased subsidy for the subsidized lines?

Mr. MOOT. Again I am a little out of my depth, Mr. Chairman, but I believe you will find the operating differential subsidy is not based on total revenue. It is based on cost differentials of wages, maintenance, insurance, et cetera. So I would not expect the absolute amount of subsidy would be affected by what we are proposing.

Senator BREWSTER. Will not this new policy have an adverse affect on the nonsubsidized lines, insofar as their income will certainly be cut and they will not pick up any subsidy to help them, as the subsidized lines do?

Mr. MOOT. In a certain respect, nonsubsidized lines have a distinct advantage over the subsidized lines. Here I am talking about berth line service. They have much greater flexibility in changing trade routes. We would expect that what we are doing here might result in aggressive management among the nonsubsidized lines seeking undertonnage trade routes, rather than staying with overtonnage trade routes, which they have the absolute right to do, of course.

I am sure you also appreciate that the 50 percent of our lift is without reference to any operating subsidy whatsoever. All of our contract lift does not include any operating differential subsidy. So that the combination of flexibility of nonsubsidized lines, the new techniques that are available to the nonsubsidized lines, and, as I mentioned before, we are receiving proposals from such lines, as well as the contract carriage available to such lines, leads us to believe that, while on the surface you have to accept the fact that a nonsubsidized line is in a less competitive position than a subsidized line, we would expect it would not necessarily react to their financial detriment.

Senator BREWSTER. Sir, on the top of page 6 of your statement, you refer to a new steamship line. Will you tell us what you refer to? Is this the Sapphire Line?

Mr. MOOT. This is the Sapphire line, sir.

Senator BREWSTER. Have you been into their financial statement? Is it true they lost about $500,000 a year in their first 6 months of operation?

Mr. MOOT. I have not personally examined their financial statement. It is my understanding, as a result of my specific question, that they are making a profit these days.

Senator BREWSTER. Is this one particular line being given special or favored treatment by MSTS?

Mr. MOOT. If by that you mean are we giving them cargo preference, the answer is decidedly "Yes," and we would so intend, under our proposal, to provide cargo preference to the bidder who offers the best overall price, with other factors being considered, to the Government.

Senator BREWSTER. Then is it very surprising to you that you would get a lower rate quoted, if you give one carrier its pick of the cargo and allow it to serve only a few ports?

Mr. MOOT. Well, I think perhaps one of the basic intents in what we are proposing, Mr. Chairman, is to adjust the allocation of defense business, so it does become something that can be bid for on a cost compensatory basis by those carriers on those trade routes who are best capable of handling that business. So we would expect the cargo preference would follow as the advantage the more effective operator would naturally receive.

This is consistent with our approach, sir.

Senator BREWSTER. If you establish one carrier as the most-favored carrier, then don't you necessarily weaken the competitive and economic and maritime strength of other U.S. shipping lines?

Mr. MOOT. We think not, sir; because we would not expect that we would have a uniform rate. And, again, I am prejudging the development of the procedures, but it is not my belief that we would come out with a uniform rate. We would come out with a level of rates which means that, on a trade route, the carrier who offered the most favorable rate, all other factors being equal, would get that share of business that he could use or he could handle in the frequency of sailing on that route.

But that is by no means to say that all our defense cargo would move by one carrier. This is manifestly impossible. So we would then move to the carrier who had the next most favorable rate, assuming they would both be compensatory. It is only at the far end of the spectrum, Mr. Chairman, that the military cargo would get thin, insofar as the marginal operators are concerned. And this is the intent of the Secretary.

Senator BREWSTER. I may be badgering you on this general point, but I would like you to address yourself to it again. You see no inconsistency in U.S. policy, where we subsidize our merchant marine industry to the tune of $200 million a year, believing it necessary, and then, in another facet of U.S. policy, we cut the tariff or rate that the military pays to transport cargoes on subsidized lines?

Mr. MOOT. No, sir. We don't. I would like—and you are not badgering me, by the way, because it is a point we have considered carefully and sincerely. I think you will find with the more expert witnesses that follow me that the basic purpose of both the construction and the operating differential subsidy is to place our U.S. merchant marine in competition, or at least in a competitive status, with foreign merchant marine lift.

What we are talking about in the Defense Department, does not consider foreign competion. You will note I mentioned in my statement that we are not concerned with world conferences which set rates for the mixed foreign and U.S.-flag lift of commerical cargo. We are

talking about the establishment of rates between one customer, the Defense Department, and U.S.-flag shippers.

We do not believe that this is inconsistent with our subsidy program. We do not believe it will affect the amount of the subsidy. We believe it will improve and encourage the U.S. merchant marine to become more competitive in their world movement of commercial cargo.

Senator BREWSTER. Now, sir, let me direct your attention to page 7 of your testimony, where you discuss the proposed subsection F.

You indicate that the continuation of present procedures would deny DOD cargoes to a substantial segment of the American-flag industry. What segment would be denied MSTS business by the passage of this legislation?

Mr. MOOT. The wording of subsection F, Mr. Chairman, states that:

> To the maximum practical extent, U.S.-flag common carrier operators will be used by the Defense Department.

Currently, 50 percent of our lift is by contract carriage. If we went to the maximum practical extent on common carriers, under the wording of this bill, presumably, it would be to deny the 50-percent contract carriage operators the business they now have.

Senator BREWSTER. So the bill would be improved, if the wording were just generally U.S.-flag ships?

Mr. MOOT. In this respect, yes, sir.

Senator BREWSTER. In the last paragraph of the same page, you state that operational flexibility would be eliminated. Well, hasn't DOD operated under this system of allocations for all of these last 20 years rather successfully?

Mr. MOOT. Well, it is in this very area, sir, that we were discussing the cargo preference given the competitive operator; namely, Sapphire, a few minutes ago. The Department of Defense now has the management flexibility to allocate its cargo in that manner which it deems best in the public interest and in the national defense.

The wording, the mandatory wording, of subsection F means that we would have to take total lift and proportionately divide it up, which to us means there is hardly any stimulation for operators to become more cost effective, when you are assured or guaranteed a certain amount of U.S. defense lift. This is not the case today.

Senator BREWSTER. One final and very general question. Is the establishment and maintenance of a strong and powerful U.S. merchant marine necessary to the maintenance of U.S. power—economic and military—throughout the world?

Mr. MOOT. Again, sir, Secretary McNamara has testified that he does not ever see the day where a great deal of defense cargo will not move by sea, which is about as far as I can go without getting into and discussing deployment strategy, or classified matters. There is no question but that Secretary McNamara is on record before this Congress as being very emphatic concerning his dependency upon an adequate merchant marine.

Senator BREWSTER. I do have another line of questioning that I want to go into, but, before I do, I will see if Senator Prouty has anything else.

Senator PROUTY. I have just one question. Mr. Secretary, has the proposed Defense Department policy on competitive bids been dis-

cussed with the Maritime Administration and the Federal Maritime Commission?

Mr. MOOT. The statement that we are looking at today, and the position of the Department of Defense, Senator, has been discussed with the Bureau of the Budget, in the company of the Department of Commerce, including the Federal Maritime Commission, and in addition, we have, of course, testified extensively at the previously mentioned Federal Maritime Commission hearing, which is docket No. 65–13.

So the answer is yes.

Senator PROUTY. We will hear from representatives of those agencies later, I assume. But I have gathered, from what I have heard, that they do not concur fully, at least in the position which is being taken by the Department of Defense?

Mr. MOOT. Well, I should not speak for them, because you will hear from them. I will say that the position of the Department of Defense has been submitted to the Bureau of the Budget and the Bureau of the Budget has no objection to its being transmitted to this committee.

Senator PROUTY. Well, I am not sure the Bureau of the Budget is qualified to express an opinion on a matter of this kind, as well as in many other fields.

Thank you, Mr. Chairman.

Senator BREWSTER. These next few questions, sir, will pertain to general policies of our transportation laws. When military cargoes move by rail, which, of course, is within the United States, does not ICC set the rates?

Mr. MOOT. The ICC sets rates, except for section 22, Mr. Chairman, which allows rates to be offered the Defense Department below existing rates.

In other words, it is perfectly feasible for a carrier or a group of carriers to offer a free rate to the Defense Department, if they want to, and it is perfectly possible for the Defense Department to negotiate for rates below tariff rates, which we do to a considerable extent.

Senator BREWSTER. Do you have the open competitive procedures which you now propose to adopt in the maritime industry, within the rail industry?

Mr. MOOT. No, sir; we do not.

Senator BREWSTER. Would you recommend opening the rail industry to open competitive bidding on military cargoes?

Mr. MOOT. Here we have a completely regulated industry, sir, so I would be loath to say. We have not approached our domestic railroad lift and studied the question of how to procure. We will be reviewing it as we are constantly reviewing our commercial airlift.

So what we will recommend is yet to be determined. But, it is a different situation, as I am sure you appreciate better than I do, because of the regulatory body, the ICC relationship, in contrast to the FMC relationship.

Senator BREWSTER. Let me direct your attention to the airlift, commercial airlines. Does not the CAB set a floor for the airlift of military cargoes, that you cannot go under?

Mr. MOOT. Here again, if you will bear with me, we are talking about moving internationally, outside of the country. So the question is largely affected or impacted by foreign competition, and this, of

course, largely explains the different roles of the ICC, the CAB, and the FMC.

In the case of the CAB, they do not have the authority to set rates for international traffic. Our history of commercial airlift has been varied. There has been open price competition up until 1960. In 1960, we went to a system of CAB-recommended rates, based on the CAB's authority to set routes, which, in effect, gets down to the approval of the airport, the terminal port, together with an understanding that CAB would set rates.

Since 1964, we have used a different approach, whereby we have requested complete cost data from all of the carriers, have analyzed it, picked and determined through our analysis the rate which would be compensatory to the effective, cost effective, carriers, and have recommended that rate to CAB.

CAB, in turn, has acted as a catalyst between the Defense Department and the carriers for the determination of airlift rates. This method, again, is subject to our review. There is no reason, for example, there is no legal reason why we can't use the cost data secured from the carriers to determine the cost spectrum of the industry and which carriers are the most cost effective, and determine reasonable rates based on the most cost effective, and then negotiate with the carriers for that rate prior to submitting those rates to CAB. There is nothing to stop that procedure.

Again, everything doesn't happen at once in the Pentagon. Things get to be evolutionary. And we have still not the final answer on either the airlift or our domestic rail and road traffic.

Senator BREWSTER. Do you think it proper to negotiate noncompensatory rates on the sealift?

Mr. MOOT. Again, I think this stems back to the philosophy of what we think is both the legislative intent of the Congress and the Department of Defense policies. We generally believe that rates and prices should be compensatory. This is Mr. McNamara's philosophy, and this, of course, is our national philosophy.

On the other hand, the legislative intent of Congress is for us to secure competition. The Department of Defense policy is not to support marginal operators, but to encourage the most effective segment of each industry. So our answer to you would be that, while we would expect the people who did business with us to make a profit, we would not expect that every rate would be compensatory to every carrier. This would be to assume that all carriers were equally cost effective, or that rates were set high enough so that the least effective of all of the operators would still be making a profit, and this would not be our intent.

Senator BREWSTER. In some areas, then, you would be perfectly willing to pay noncompensatory rates?

Mr. MOOT. If the rate, as it was offered to us, was noncompensatory under what we are proposing we would have to be looking at it very carefully. It would depend upon other factors.

As you know, the Defense Department has fairly elaborate procedures in its procurement regulations for determining responsibility of carriers. It also has a prohibition or preclusion against buying in.

If we felt that a noncompensatory offered rate would result in our ultimately paying a higher cost, the rate would not be accepted. I

have testified previously that the Defense Department does not or would not reject a noncompensatory rate solely on the basis that it was noncompensatory. There would have to be other considerations.

The most important thing, I think, however, Mr. Chairman, is that, under what I expect will be our procedure, we would expect that the rates would be at varying levels by the bidders, depending upon their cost of operation and what their prudent management dictated their offer should be.

From our point of view, we would in turn accept those rates and use those carriers to move our cargo in sequence, with cargo preference going to the most favorable bid. Carriers who deal with the Defense Department can, with exactitude, with very definite or finite precision, determine the cost of doing that business.

It is unlike cargo going over commercial piers, where it is mixed cargo. The carrier in our case brings his ship to our pier. He knows the cost of the ship; he knows the cost of his crew; he knows the cost of his daily overhead; he knows the cost of his depreciation. He therefore exclusively for military cargo can, with accurate precision, determine the cost of doing business with us. We therefore expect that he is in a very good position to predicate a bid on a compensatory rate, and we would expect that he would so do.

Senator BREWSTER. Well now, sir, comment on this charge: If MSTS establishes a most favored carrier over the best routes and accepts rates that may be noncompensatory, and you are a giant shipper, do you not unfairly discriminate against the other carriers? And will you not drive out some people that we want to keep in business?

Mr. MOOT. Again, we would not expect, Mr. Chairman, that rates would be noncompensatory. We would expect that there would be, and, as a matter of fact, we would probably encourage—we think it would be healthy, that there would be some adjustment of tonnage between trade routes.

On the other hand, we do not expect that there would be a carrier who would move all of our cargo. And if I may add just once again, the Department of Defense policy is against buying in by underbidding on initial work for the purpose of later raising the price for an overall higher cost. All of these screening regulations, during source selection, would come into play, and you will again recall that I mentioned—we were talking about annual contracts. We are not talking about a man coming in with a more competitive bid each and every month of the year and securing business.

Senator BREWSTER. Would you expect there would be a possibility that you could drive the rates on U.S.-flag ships down to rates of foreign-flag ships?

Mr. MOOT. I don't think it would be our desire, and I don't think we would, sir. There are many procurement techniques that will keep stability of rates.

Senator BREWSTER. Do you believe your new procedures will either reduce or increase the size of the U.S.-flag fleet?

Mr. MOOT. We believe very sincerely that it will increase the size of the U.S.-flag fleet, sir.

Senator BREWSTER. By paying less money, you are going to enhance the position of the U.S. merchant marine?

Mr. Moot. We wouldn't say it like that, Mr. Chairman. We would say we would be encouraging the more effective operators of the U.S. merchant marine to become still more effective and encourage them to seek, through their effectiveness, a greater share of the world market.

Senator Brewster. You argue then the more effective carriers will grow in stature and size and number of ships?

Mr. Moot. Yes, sir. This does not mean necessarily that new operators won't be attracted to this business. As I mentioned before, we have proposals frequently, and have them in hand now, which indicate that this is an area where American enterprise, believing in the workings of the marketplace and competition, are perfectly willing to enter this area and become competitive.

Senator Brewster. Mr. Foster, of our staff, would like to ask one question.

Mr. Foster. Thank you, Mr. Chairman. There is one line of questioning I would like to pursue in respect to the proposed program as it relates to the domestic offshore area. Is your competitive bid procedure applicable there, in terms of your proposal?

Mr. Moot. I believe the domestic offshore area we have not included in the scope of the coverage of our procedures, Mr. Foster. Here you have a different regulator effect. And whether it will or not ultimately be included is something we haven't considered yet.

Mr. Foster. That is not a part of the proposal today?

Mr. Moot. It is not at the present time.

Mr. Foster. Thank you.

Senator Brewster. Mr. Moot, we have kept you here for a long time, but your testimony has been very helpful to the subcommittee at this time and we thank you very much, sir.

Mr. Moot. We appreciate it, sir.

Senator Brewster. We would now like to call Rear Adm. John Harllee, U.S. Navy, retired, Chairman of the Federal Maritime Commission.

STATEMENT OF REAR ADM. JOHN HARLLEE, U.S. NAVY (RETIRED), CHAIRMAN, FEDERAL MARITIME COMMISSION; ACCOMPANIED BY JAMES V. DAY, COMMISSIONER, FEDERAL MARITIME COMMISSION; EDWARD SCHMELTZER, MANAGING DIRECTOR, AND LEROY FULLER, SPECIAL ASSISTANT TO THE CHAIRMAN, FEDERAL MARITIME COMMISSION, WASHINGTON, D.C.

Senator Brewster. Admiral, I see you have a prepared statement. You may proceed as you desire.

Admiral Harllee. Thank you, Mr. Chairman. Mr. Chairman and Senator Prouty, Mr. Foster, I have with me today Commissioner James V. Day, our Managing Director, Mr. Edward Schmeltzer, and my special assistant, Mr. Leroy Fuller. I appreciate the opportunity to testify before your committee regarding S. 3297, a bill to authorize the carriage of military cargoes by U.S.-flag vessels at reduced rates which are fair and reasonable.

Briefly, the bill would amend the Shipping Act of 1916, by adding a new section 45.

It would permit any carrier of U.S. registry, or group of such carriers, to negotiate shipping contracts with the Department of Defense, for the movement of U.S. military cargoes in foreign and domestic commerce at rates less than applicable commercial rates.

Section 45(c) provides that such rates be fair and reasonable and no higher than the aggregate of commercial rates for similar cargoes.

I would like to add to my prepared statement, Mr. Chairman, that on considering this bill, I ran into a little trouble in getting the exact definition of the term "aggregate," although it is in the statutory phraseology, title X, United States Code, section 2631, and it is in the AGAFBO agreements. We don't know exactly what it means, but presumably the Department of Defense does.

Section 45(d) authorizes the Secretary of Defense to require annual submission of required cost data from the carriers.

Section 45(e) provides that if agreement on negotiated rates cannot be reached, either the carriers of the Secretary of Defense may petition the Federal Maritime Commission to determine fair and reasonable rates. Such rate determination shall be based upon the principles followed by the Commission in domestic offshore ocean rate regulation, and shall be determined with due regard to the commercial tariff rates in the trade.

Section 45(f) provides that the Secretary of Defense, in support of the national policy of promoting a strong merchant marine, shall use U.S. common carrier vessels to the maximum extent practicable, and shall allocate cargo equitably among such operators.

We consider the Department of Defense to be the best to speak on the overall purpose of this bill, and the question as to whether it will provide the most efficient and best method for the movement of military cargoes by ocean vessels. For many years they have been directly and intimately concerned with negotiation of ocean freight rates on military cargoes and we, therefore, defer to that Department for an analysis of the merits of this bill. This of course to a great extent has just been done.

Section 45(e) of the act would vest in the Federal Maritime Commission responsibility for determining, upon petition of either party, what may be a "fair and reasonable rate or rates." This raises serious considerations as to whether these standards set forth in the bill provide in their present form a workable formula by which the Federal Maritime Commission can adequately determine whether rates for military cargoes are fair and reasonable. These considerations are the direct concern of the Federal Maritime Commission; and I will, therefore, limit my remarks to the adequacy of these standards.

There are certain problems and ambiguities in the statutory standards of the bill which should be clarified if this legislation is favorably considered by the Congress. I will discuss these in what I consider to be their order of importance.

Section 45(e) sets forth two ratemaking principles which appear to be contradictory. The Commission is asked to determine what may be fair and reasonable rates "under the principles followed for domestic offshore ocean rate regulation." Under the Intercoastal Shipping Act of 1933, the reasonableness of domestic offshore ocean rates is tested basically on a cost basis. The carrier is allowed a level of rates which will yield net profits not in excess of a fair and reasonable

rate of return under the capital invested in the trade (rate base). A second standard in section 45(e), however, requires that rates "shall be determined with due regard to the level of commercial tariff rates in the trade." These ocean freight rates in the foreign trade are generally not set on a rate-of-return theory. They are fixed by conferences of carriers on the basis of combined business judgments, involving consideration of as many as 28 or 29 factors, and the Federal Maritime Commission is empowered to disapprove only those rates which it finds after notice and hearing to be so unreasonably high or low as to be detrimental to the commerce of the United States. Rates which might be unreasonable under a rate of return test might pass muster when compared "to the level of commercial tariff rates in the trade," and vice versa. Furthermore, many of the so-called commercial rates, in conference tariffs are "paper rates" under which little or no commercial cargo moves, although this situation is being improved all the time, and comparison of the military rates with such paper rates would be meaningless. In addition, the commercial tariff rates criterion is imprecise in another way; these could be rates of an individual carrier, nonconference carriers, the contract rates of conference carriers, or the noncontract rates of conference carriers.

Another problem is that the bill gives the Federal Maritime Commission no specific authority to require the carriers to furnish uniform financial reports or to inspect the books and records of the carriers involved. Under its domestic offshore ratemaking responsibility, the Commission has authority to require the submission of financial data relating to revenues, expenses, and rate-base data and to inspect underlying accounts and records. Under the provisions of S. 3297, authority of this kind is given only to the Secretary of Defense. In order for the Commission to adequately carry out its responsibilities for determining fair and reasonable rates, in the case of the option of section 45(e), it would be essential that the Commission have this authority. Indeed, it would be essential for the Commission to examine the expenses, revenues, and investment in all related trades served b the carriers in order to make necessary allocations to carry out our responsibilities under the bill.

Congress should also clarify the cost principles which it intends the Commission to use in carrying out its ratemaking responsibilities under the bill. In the domestic offshore trades, which vary widely in nature, the Commission has at various times based rates on (*a*) the cost of the particular carrier under investigation, (*b*) the dominant carrier in the trade, and (*c*) the aggregate cost of all carriers in the trade. Under the proposed bill, we might be urged by the carriers or the Secretary of Defense to use even additional standards, such as (*a*) the cost experience of the most efficient operator, (*b*) the least efficient operator, or (*c*) the median operator. These, of course, are questions which the Commission could answer on an individual case-by-case basis, but this would be time consuming—in fact in terms of years—and inefficient, and might be intolerable in the field of defense transportation. It would be helpful if Congress would solve this problem at the outset by specifying its intent.

An important problem with respect to ratemaking standards under the bill is the manner in which the Commission should treat operating and construction differential subsidy payments made to carriers

pursuant to the Merchant Marine Act, 1936, by the Maritime Administration, Department of Commerce. As you know, these payments are made in order that contracting U.S.-flag lines may compete with foreign-flag lines, which normally have lower construction and operating costs. The alternatives are (1) to base rates on the actual cost of the American-flag operators or (2) to treat operating subsidy allocated to military cargoes either as income or reduction of expense. The first alternative would appear to result in a windfall to subsidized carriers to the extent they carry military traffic. The second alternative might make it difficult for nonsubsidized carriers to compete; or it might, during periods when there is a surplus of commercial cargo, cause subsidized carriers to lose interest in handling military traffic.

Another principal concern is whether by sections 45(a) and 45(b) Congress intends in any way to change the standards under section 15, Shipping Act, 1916, by which the Federal Maritime Commission approves or disapproves ratemaking conferences. At this time the Commission is hearing docket No. 65–13 to determine, among other things, whether the Atlantic and Gulf American Flag Berth Operators Association (AGAFBO), the West Coast American Flag Berth Operators Association (WCAFBO), and the Trans-Pacific American Flag Berth Operators (TPAFBO) should continue as approved conferences. As we read sections 45(a) and 45(b), they do not imply that Congress intends to change the Commission's power or responsibility to approve or disapprove agreements under the standards of section 15.

Congress should also make clear whether the bill applies to transportation of military cargo between foreign ports, for example, from Japan to Vietnam. Section 45(a) speaks of "in foreign or domestic commerce." This appears to mean the foreign or domestic commerce of the United States which does not include foreign-to-foreign movements. The Commission has no jurisdiction over foreign-to-foreign cargo movements at the present time.

In addition to the foregoing considerations, the following questions should be clarified:

1. Is the rate review provided for in section 45(e) limited to transportation on common carrier vessels?
2. Will the decisions of the Federal Maritime Commission under section 45(e) be subject to court review?
3. Which of the parties in rate determinations under section 45(e) would have the burden of proof?
4. Would section 45 supersede section 6 of the Intercoastal Shipping Act, 1933, which permits movement of Government cargo in the intercoastal or coastwise trades at free or reduced rates?
5. Would rates negotiated under section 45(b), or the rates determined by the Commission under section 45(e), be subject to the Renegotiation Act of 1951?
6. Would the rate review under section 45(e), be independent of standards for rate negotiation in other sections of the bill, e.g., section 45(c) "the rates and charges * * * shall not exceed those charged in the aggregate for the transport of similar classes of cargoes for private persons," and section 45(a) "less than those prescribed in their commercial tariffs"?

7. Do other sections of the Shipping Act apply to the rates negotiated under section 45(b), or determined by the Commission under section 45(e)?

8. May the Commission initiate investigation into the reasonableness of rates on its own motion under section 22 of the Shipping Act of 1916, or is it limited only to review on petition under section 45(e) of the proposed bill?

The Federal Maritime Commission would, of course, carry out whatever responsibilities the Congress sees fit to vest in it under section 45(e), but we do point out that this would require additional personnel.

There is one other question I would like to add at this point, and that is, does the term "such operators," as contained in section 45(f), mean only those operators signatory to the agreements established under this bill, or will the bill permit the military, Department of Defense, to allocate cargo to independent lines, not parties to such agreements?

Now, Mr. Chairman, I would like to say that there are a lot of questions in this statement which I would feel it would be presumptuous for us to attempt to answer for the Congress.

However, if now or at a later time for the record, or now orally, or in a later hearing, you would like a recommendation from the Commission as to what its answers would be to these questions, of course we would naturally be glad to give it. Some of these questions are quite easy, and some are very basic and are a little difficult. But I don't mean to appear with a statement that does nothing but throw questions.

I did mean to appear with a statement that brings up anything and everything about the bill which should be carefully considered before the Congress moves on it. This completes my prepared statement and the remarks I would like to make at this time.

With me today is Mr. Edward Schmeltzer, Managing Director of the Federal Maritime Commission who has a great deal of experience in the field of ocean rates. We will be happy to answer questions to the extent of our ability.

Of course, we have Commissioner Day here and all three of us will be happy to answer questions.

Senator BREWSTER. Admiral, thank you sir. I might comment you must be clairvoyant because my first proposal would be to ask you, Mr. Chairman, or the Commission to provide us with recommendations or suggested answers to the questions you propound on pages 7, 8, and 9 of your statement. Do you or you staff have such recommendations available at this time?

Admiral HARLLEE. Yes, I can make them right now if you would like me to.

Senator BREWSTER. I would like that very much. Proceed.

Admiral HARLLEE. On page 7, question 1. Is the rate review provided for in section 45(e) limited to transportation on common carrier vessels? We believe that it should be limited to such transportation, because there has not been historically, nor has there been a need for, such a rate review in the case of contract carriage. So the answer to that is that we would think it should be limited to transportation on common carrier vessels. We believe this is probably the intent of the bill.

Question No. 2, page 8. Will the decisions of the Federal Maritime Commission under section 45(e) be subject to court review? We believe they should be subject to court review, as in the other actions that we take.

Question 3. Which of the parties in rate determiniations under section 45(e) would have the burden of proof?

We believe that the party that should have the burden of proof is the party with the best access to the information which is required for proof, and this would be the carriers. This may be controversial. It may well be the carriers feel that whoever appeals to the Commission should have the burden of proof, in consonance with many other legal principles. But in this particular case, we think it is a question of who has the most and best records and therefore it should be the carriers.

Question 4. Would section 45 supersede sections 6 of the Inter-Coastal Shipping Act of 1933, which permits the movements of Government cargo in the intercoastal or coastwise trades at free or reduced rates?

We believe for obvious reasons that it should not supersede section 6 of the Inter-Coastal Shipping Act.

Question 5. Would rates negotiated under sections 45(b), or the rates determined by the Commission under section 45(e) be subject to the Renegotiation Act of 1951? We believe in the case of rates negotiated under 45(b), that if the carriers or the Secretary of Defense wish to go to the Renegotiation Board they probably should be so allowed. If they desire to do so. But we think that if the rates are determined by the Commission under section 45(e), that this would replace the action of the Renegotiation Board and they should not go to it in that event.

Question 6. Would the rate review under section 45(e) be independent of standards for rate negotiation in other sections of the bill? For example section 45(e), which provides that the rates and charges shall not exceed those charged in the aggregate for the transport of similar class of cargoes for private persons, and section 45(a), which provides that the rates shall not be less than those prescribed in commercial tariffs. We think the rate review under section 45(e) should be independent of these standards.

Question 7. Do other sections of the Shipping Act apply to the rates negotiated under section 45(b), or determined by the Commission under section 45(e)?

Now in the case of 45(b), simply negotiations between the Department of Defense and the carriers, we do not think that the other sections of the Shipping Act would apply to these negotiated rates. This has been historically the case. And we think it is proper.

But if they are determined by the Commission, under section 45(e), there are certain sections of the Shipping Act, primarily the procedural sections, such as powers of subpena, gathering of information by section 21 orders, general rulemaking, that should be applicable. But there are other sections of the Shipping Act of 1916 which obviously cannot be applied, such as the filing of tariffs in advance, and determination as to whether a rate is so unreasonably high or low as to be detrimental to the commerce of the United States, because that wouldn't be the criterion by which we would be judging this thing.

So on question 7, we will have to furnish for the record a detailed analysis of which sections we think would be applicable and which would not.

Question 8. May the Commission initiate investigation into the reasonableness of rates on its own motion under section 22 of the Shipping Rct, 1916, or is it limited only to review on petition under section 45(e) of the proposed bill?

Now we do not see the necessity at this time for the Commission to have the power to initiate investigation. We think that it is adequate for the purposes of the bill, if it were passed, to do it on petition of the Secretary of Defense or the carriers. That takes care of these eight questions that you asked me about.

Of course the earlier questions are somewhat more difficult. I would be glad to go into those. But they are the type that the subcommittee may wish to give its own consideration to, although I will discuss them if you wish me to.

Senator BREWSTER. Admiral, Chairman Magnuson is deeply concerned about U.S. maritime policy, and proposes to go into this in great detail and at length. It would be helpful, therefore, to this committee if your staff would prepare, if this would be possible, suggested amendments to the bill that is now pending before the committee that will carry out the recommendations of the Maritime Commission.

Admiral HARLLEE. We would be glad to do that, Mr. Chairman. Of course not only would the staff prepare it, but of course the Commissioners would pass on it by vote and submit it under those circumstances.

Senator BREWSTER. This would be very helpful to us. At your convenience, but in the reasonably near future, if suggested amendments and reasoning to the recommendations or the objections you raised earlier in your statement could be submitted it would be of great help.

Admiral HARLLEE. We will be glad to do that and give it a top priority, concomitant with our other obligations before Senator Sparkman's committee, a week from now, we will do it as rapidly as possible.

Senator BREWSTER. Thank you.

Senator Prouty.

Senator PROUTY. Admiral, does your statement represent the unanimous views of the Federal Maritime Commission?

Admiral HARLLEE. There was not; it was not practical to get a vote on the type of detailed questions that I have gone into, Senator. But the answers that I have given and the statements I have made are not so much policy as interpretations of laws and problems that we have brought up. We brought up ambiguities, points that need clarification. These matters, the answers stem more from the law and from the past history than they do from a policy decision which would require a vote. In direct answer to your question, "No," we have not taken a vote on it.

Senator PROUTY. But I gather it is probably representative of a consensus of the thinking.

Admiral HARLLEE. Oh, yes, there is no question about that.

Senator PROUTY. To what extent has the Department of Defense consulted with you with respect to their proposal? Or with the Commission?

Admiral HARLLEE. They have consulted with us to the extent that they have been involved in the biggest formal proceeding in our history, it contains 1,630 pages and has been going on about a year now. That is docket No. 65–13. They have been working closely with members of our staff in this. Information has flowed from that, which constitutes an interchange of information.

The proposal, we have not discussed directly with the Department of Defense, this particular legislative proposal, however.

Senator PROUTY. I rather gather that from the questions which you raised, and which will be most helpful to the committee.

Admiral HARLLEE. Let me supplement the statement, Senator. As a matter of fact, on the staff level, which has been coordinated, there was a meeting held by the Bureau of the Budget, which included representatives of the Department of Defense as well as the other parts of the Government involved in this.

So on the staff level, there was that coordination.

Senator PROUTY. Do you know how much time was devoted to this by the Bureau of the Budget, with your staff people?

Admiral HARLLEE. It was a matter of a couple of days. Of course we just got this bill last Wednesday.

Senator PROUTY. Yes. I can understand that. It seems to me that the Maritime Commission certainly has to give a lot of thought to this proposal, and it certainly will be of great help to the members of this committee to have your views when you have had a chance to go over the matter thoroughly. I have no further questions, Mr. Chairman.

Senator BREWSTER. Admiral, I addressed certain very general questions to Mr. Moot, that did not pertain to the exact provisions of this bill, but to overall merchant marine policy. Would you comment generally on your opinion as to whether or not a first-class U.S. merchant marine is necessary to maintain our economic, political, and military status in the world?

Admiral HARLLEE. Yes, sir, Mr. Chairman, I would be glad to. There is no question what so ever in my mind that it is essential that this country have the best possible merchant marine, a strong merchant marine, which is capable of meeting any defense and commercial commitments that have any likelihood of arising.

This stems from not only my contact with the merchant marine in these matters and my present status, but also from a lifetime in the Navy.

I would like to say that although we, the Federal Maritime Commission, are not charged, as I am sure you realize, with the direct promotion of the American merchant marine, I would like to say we believe and we are convinced that we indirectly do help strengthen the American merchant marine, in five different ways.

The export and import commerce of this country has increased during the last 2 or 3 years at a rate higher than it has ever increased before. Now this has meant more cargo for American ships.

We have insured that American-flag carriers are given fair treatment by the conferences. This is more of a historic problem than a new problem, but it does arise once in a great while.

We have protected them in the cast of foreign countries discriminating against the American merchant marine, there has been a recent case in Uruguay, and I was asked only this morning to go into a matter

involving a problem in Venezuela, in which our help has been requested.

In the matter of rebates abroad, unfair practices abroad, which the foreign steamship lines are able to take advantage better of course than American steamship lines, we have helped our ocean commerce. We do not make the claim that these have been eliminated, but we do claim these have been reduced. They have been reduced by approval of pools by the Commission for the inbound trades, to reduce the effect of rebates. They have been reduced by direct action and fines on foreign steamship lines for rebating. Most noticeably they have been reduced somewhat by self-policing systems and should be reduced a great deal more by self-policing systems as a result of docket 1095, issued by the Commission 3 weeks ago, in which we gave much, more powers to self-policing bodies.

These self-policing bodies have been advocated by the leaders of the industry, such as Mr. Rand of U.S. Lines, for a long time, but only recently have they been given a tremendous amount of power, so industry can deal itself with these unfair practices.

The 10 major maritime nations of Western Europe and Japan, joined in an agreement on December 1, 1963, in which they proscribed many of the unfair practices that our shipping act proscribes.

And we believe, and we are convinced, that although this effort started back in 1955, that our more intensive regulation prompted this, and brought it to a head.

We also have regulated the freight forwarding industry, under a law passed by the Congress in 1961, and the terminal industry, in a manner that the carrier's interests were properly looked out for. So I think in five different ways, with increases in cargo, the conferences, with the foreign countries' unfair practices, and with the terminal and freight forwarders, we have been of indirect assistance to the merchant marine. And I think this can be borne out—it is true you can prove anything by statistics—but we have pretty good statistics of all of the earnings that we can find, that are publicized on American lines, which indicate during the past 2 years, they have made more money than before.

Their profits, except for the strike period which lasted 78 days on the east coast and the gulf, in 1965, have been better than ever during the last 2 or 3 years of regulation. I must say in all candor that the steamship industry people or any other industry people don't like to be regulated and they don't like to spend a few hundred dollars or a couple of thousand dollars to make reports or spend a few thousand dollars or a few hundred dollars for lawyers.

But the facts remain, that they are making more money than ever, and the part of the merchant marine that is being regulated by us is the part, and you know this, Mr. Chairman, is the part which has somewhat held its own. We don't claim this is because we regulated it, subsidy has something to do with it, but it is the part that we haven't regulated, the bulk carriers, the tramps, and that part of the merchant marine which is in a terrible plight. I am sorry to make such a lengthy answer, but I have strong feelings about it and I agree it is essential to have a strong merchant marine and I think we are playing our role.

Senator BREWSTER. As a former naval officer, from your military experience you know a merchant marine is essential to military activity.

Admiral HARLLEE. I know it from personal practical experience in two wars, and in one war college.

Senator BREWSTER. This may be difficult to answer, but do you believe the congressional intent as expressed in the Merchant Marine Act of 1936, is now being carried out?

Admiral HARLLEE. Mr. Chairman, under Reorganization Plan No. 7, approved by Congress, the only sections of the 1936 act which apply to the Federal Maritime Commission are Sections 204, 208, 214. I think they are being carried out, yes.

Senator BREWSTER. I meant in the broader sense, the main purpose of the act.

Admiral HARLLEE. The main purpose, I think that you have an excellent witness who can testify very well to that, following me, the Deputy Maritime Administrator.

Senator BREWSTER. We would be interested in your personal opinion, Admiral, if you are willing to give it.

Admiral HARLLEE. My personal opinion is that there has been a monumental, a tremendous effort being made to inject the element of competition into the American merchant marine. In the case of the domestic offshore merchant marine, we have seen competition work. We have seen the Bull Line go out of the business in Puerto Rico. We have seen a great competitor, Sea-Land, go in there and do a good job.

We have seen what competition has done up in Alaska. We think that the incentive of competition is to strengthen—I shouldn't say "we," you asked me for a personal opinion and this is a personal opinion. I think the good old American spirit of competition is what made this country great and what can make the merchant marine great.

I think you have a situation now where Sea-Land is offering to render a trans-Atlantic containerized service without subsidy. You have a situation where Matson is planning to do the same thing trans-Pacific.

You have a situation where Matson has a couple of years ago reduced rates as a result of the economy of new technology. I think a sincere, honest, strong effort is being made to utilize the American spirit of competition to strengthen the American merchant marine. It is a long-range thing, not a short-range thing. That is my personal opinion, since you asked it, Mr. Chairman.

May I have your indulgence in adding a couple of other things. I must say the recent turmoil of the last year or so about merchant marine policy, in my opinion, has been partially responsible for the evoking of new ideas in which I think the future of the American merchant marine lies. For example, there was an article in the New York Times only 3 or 4 days ago, by Mr. George Horne, about Mr. Ted De Smedt, who suggested as a solution to the congestion in Vietnam, that helicopters pull containers off the ships, so you don't have to worry about docks or longshoremen or anything like that. I think you have a situation where people have been pushed into the business of going to containers. Not just Sea-land and Matson, but the other great Ameri-

can steamship lines, U.S. Lines, Export-Isbrandtsen, Grace, Moore-McCormack, and the rest of them, are changing to containers.

I think there is a revitalization going on, a process of ferment, and I think the best judge as to whether this is going just right or not is the Congress and other appropriate parts of the Government.

But I can see progress is being made. I have named specific examples. I could name others.

Senator BREWSTER. In your judgment, are construction and operating subsidies necessary to maintain a U.S. merchant marine fleet at this time?

Admiral HARLLEE. In my judgment, they are absolutely necessary, and I don't think there is anybody in the U.S. Government, in the executive branch or the legislative branch, that would possibly, for one moment, deny that the subsidies are necessary. There is a question about whether subsidies should be increased, many people argue this, and certainly they have a case when they talk about huge sums of money being spent for vehicles to be used on the moon, exceeding by far construction subsidies for vessels.

You can certainly make an argument that way. You can also argue along the lines that efforts should be made to reduce subsidy, if it can be done, and still strengthen the merchant marine through these forces of competition, which I mentioned earlier. There is no question that everybody agrees at this time that for the foreseeable future subsidies will be needed. The question is how much.

Senator BREWSTER. Do you see any inconsistency in total U.S. policy, where you pay subsidies to maintain a fleet and then you cut rates that the Government pays on U.S. cargoes?

Admiral HARLLEE. I think that there is certainly an apparent superficial short-range inconsistency, there is no question about that, Mr. Chairman.

But from the long-range point of view, I think Mr. Moot, who preceded me, made what I thought was a fairly good exposition of the Department of Defense's belief and I think it is an honest and sincere belief, in the ultimate result of the competitive bidding system.

Senator BREWSTER. Is it the policy of our shipping laws that you have all shippers pay fair rates without the big shipper getting a competitive advantage? In other words, you heard Mr. Moot testify, I believe, and he stated that the practice might be to establish a most favored carrier with the best routes and at times pay noncompensatory rates. Is this policy or procedure inconsistent with the general policy of our transportation laws which is to pay fair and reasonable rates that are compensatory for the carriers?

Admiral HARLLEE. Yes; there is some inconsistency between that and the general policy, but I think he explained the reasons for it.

Senator BREWSTER. Is 65–13 the Sapphire case?

Admiral HARLLEE. Yes; it is, Mr. Chairman.

Senator BREWSTER. I imagine, since it is pending before the Commission, you would not want to comment on that?

Admiral HARLLEE. I can make some limited comments on it. However, that is the reason I have Mr. Schmeltzer with me, as managing director. In order to avoid any possible attempt to disqualify me, he is here and is prepared to answer detailed questions on it.

Senator BREWSTER. No. 65–13 would seem to go right to the heart of the discussion we were having with Mr. Moot. Generally, and to the extent you can, and in view of the pending case, would you comment on what MSTS's policy with reference to Sapphire has done to general U.S. shipping in the Atlantic, and the economic status of the other companies?

Admiral HARLLEE. Since there has already been one attempt to disqualify me on another case for talking about these matters, I hate to pass the buck, but I will pass it to Mr. Schmeltzer.

Senator BREWSTER. Mr. Schmeltzer, did you understand what I was getting at?

Mr. SCHMELTZER. I think I understood the question.

Senator BREWSTER. Would you comment on it.

Mr. SCHMELTZER. The question in that case, or one of the main questions, is, have the rates charged by Sapphire, and which the other lines, the AGAFBO and other conference lines, came down to so reasonably high or low as to be detrimental to the United States. The conference lines claimed they were too low. Well, there have been contentions by the military that the rates are too high.

The proof has gone in in that case, the case has been completed, and if I were to testify on which side I would take, it would be like a lawyer arguing a court case before the newspapers or somewhere else. That is a question for the examiner and Commission to determine.

It is, however, the central issue in the Sapphire case.

Senator BREWSTER. I thank you. I will not pursue that, because I fully understand the chairman's position. Mr. Chairman, do you think it is detrimental to commerce if rates are cut noncompensatory levels in general?

Admiral HARLLEE. There is no question in the world but that it is detrimental to commerce, in general, if rates are cut to noncompensatory levels, and this Commission, our Commission, has repeatedly disapproved and suspended rates which are noncompensatory, because if they remain noncompensatory for any length of time and the carriers are driven out of the trade, this is not in the public interest or conducive to the commerce of the United States. In addition there is the situation where they offer rates that are noncompensatory in order to drive someone else out and plan to raise them later. This is not conducive to U.S. commerce either.

So as a general statement, there is no question that noncompensatory rates should be disapproved.

Senator BREWSTER. Is it generally true if noncompensatory rates are paid to a large established carrier, with favored business, it will tend to drive out or wreck other companies that are not being so favored?

Admiral HARLLEE. As a general statement, there is no question that that is correct. However, if the background of these questions relates to the Department of Defense and Mr. Moot's remarks, let me say I do not believe personally that the Department of Defense would leave in effect for any length of time, if they utilize this bidding. Incidentally, I would like to mention something else, Mr. Chairman, that has a bearing on this, that you may want to go into during the hearings, and I am surprised Mr. Moot didn't mention it. That is, on this proposal of the Department of Defense for competitive bidding, there has been an advisory board set up by the Under Secretary of the Navy, which

is comprised of people with considerable expertise, Mr. Clarence Morse, who was Maritime Administrator and Chairman of the Federal Maritime Board for about 5 years, Mr. Carl McDowell, a maritime insurance expert, and Mr. Alex Cooke, an excellent representative of the steamship lines with long experience with Lykes.

So they will be giving an opinion to the Navy and Department of Defense on how to avoid such things as you are talking about noncompensatory rates and harmful effects that accrue therefrom.

Senator BREWSTER. Will the implementation of the proposed MSTS procedures run the possibility of setting off what is generally called a rate war between various carriers?

Admiral HARLLEE. Of course there is that possibility, but again I think that the Department of Defense would see that the rate wars are not harmful.

Rate wars are not always harmful. There have been a lot of wars between Macy's and Gimbels that have been pretty good for the American people. So I think that having any kind of a rate war anywhere, any time, any place is not always harmful. But on the other hand, having a rate war that results in damage to the carriers, and therefore to our public interest, is certainly something that should be avoided and I am sure it would be avoided.

Senator BREWSTER. Do you see a reasonable parallel in the situation where CAB to some degree, protects the airlift, ICC protects the railroads, and the proposed situation that the sealift carriers should also be protected in the matter of rates?

Admiral HARLLEE. Well, I think the ICC doesn't protect the trucks, as far as that is concerned, and there is a lot of goods that move by truck. There is some comparison to be sure, but I don't think it is a controlling one.

Also, you have the situation that was brought up with relation to foreign carriers, that the CAB has to consider.

Senator BREWSTER. Admiral, thank you very much for your excellent statement and complete knowledge of the facts. We would sincerely appreciate it if you could provide the committee with the information we asked for earlier.

Admiral HARLLEE. We will do that promptly. I would like to ask Commissioner Day if he cares to make a statement.

Mr. DAY. Thank you, Mr. Chairman. I am not here with a prepared statement. I subscribe to the remarks made by the chairman, and it didn't surprise me as a member of the Commission that he was well prepared, because he does his homework. I want to compliment you, sir, on your concern for the American-flag ships. Under reorganization plan 7, Senator, you know of course that we have nothing to do with the promotion of the merchant marine. However, as an individual, and one who has been privileged to sit on the Commission for some 5 years, let me say this for the record, sir.

I think that the management of our flagships has not only been progressive, it has been fair. The lines are fighting a hard battle to maintain our flag on the seven seas of this world. And although we have nothing to do with the amount of cargo moved, it is discouraging to me as an individual to see the lack of the increase which I think this country deserves.

It is so difficult to compete with our foreign friends in the matter of transportation costs. And I would like to say for the record that I think that our own flagships, and the Committee of American Steamship Lines, an important segment of our industry, have done much to promote and to help the balance of payments. And I think this committee is doing a fine service by having these hearings and those of us who are concerned have here an opportunity to compliment the managements of our flagship lines in their effort to stay afloat, so to speak.

And be assured that as a member of the Commission, the fine service of this committee as I perform the duties assigned to us.

Senator BREWSTER. Thank you Commissioner Day. Thank you, Admiral Harllee.

If there is no objection from Mr. Gulick, I propose to continue this morning's hearing for another hour. Our next witness will be Mr. James W. Gulick, Deputy Maritime Administrator, Maritime Administration.

STATEMENT OF JAMES W. GULICK, DEPUTY MARITIME ADMINISTRATOR, MARITIME ADMINISTRATION; ACCOMPANIED BY CARL L. WEIR AND CARL DAVIS, GENERAL COUNSEL

Mr. GULICK. Thank you, Mr. Chairman, we will be delighted to continue. I have with me Mr. Carl Davis, General Counsel, and Mr. Carl Weir of our Office of Program Planning.

Mr. Chairman, I should like to express the extreme regret of the Administrator that an out-of-town engagement set up for the last 9 months makes it impossible for him to be here this morning. So I am in the position of substituting for him.

I appreciate, sir; this opportunity to appear before you to present the view of the Maritime Administration and the Department of Commerce with respect to S. 3297, a bill to authorize certain changes in arrangements for the carriage of Department of Defense cargoes in U.S.-flag ships.

The bill would authorize the continuance of the present system of negotiation of shipping contracts by groups of berth carriers with the Military Sea Transportation Service for carriage of Department of Defense cargoes. It would prescribe the maximum utilization of common carriers practicable and the allocation of defense cargoes among these carriers. It would also authorize the Federal Maritime Commission to fix fair and reasonable rates for the carriage of such cargo if the parties are unable to agree.

The reason for the introduction of the bill evidently was the announcement by the Department of Defense on April 4 that beginning July 1 it would procure shipping services by competitive bids.

The present system of group contract negotiation has been used since about 1950. We understand that there are two reasons for the Defense Department's desire to change the system. First, the Department in general has been steadily increasing the number of procurement contracts awarded on a competitive bid basis. Second, in 1965 a new steamship line initiated service at substantially lower rates than the shipping contracts then in effect. Other steamship lines met this competition, thus reducing the Military Sea Transportation Service general cargo space rate by about 25 percent. The purpose of the

change in the view of the Defense Department is to obtain its commercial shipping services at the lowest possible rate.

We believe the Department of Defense should be permitted to use this method of procuring shipping services. The Department of Defense last Friday reiterated its plans to proceed with the proposed procurement practice.

The Department of Commerce supports the objectives of the Department of Defense which are to seek price competition to the maximum extent practicable, and in the absence of such price competition, to negotiate on the basis of total applicable costs. As we have pointed out the bill would authorize the continuance of the present system of procuring military sea lift. It would also by implication require the Department of Defense to use this system in procuring future sea lift requirements, thus denying Defense the opportunity to institute new methods by which it might obtain its lift requirements at a lower cost.

It goes without saying that the Federal Government, consistent with overall national policies, should where feasible follow the most desirable economic practices in procuring any services. National policy has been consistently one of fostering commercial competition and to the extent that competitive factors are significant, a big procedure serves this policy.

The Department of Commerce therefore supports the general concept of procurement through competitive bidding procedures. The new proposed procedures have been espoused in concept only and specific details have not as yet been developed. It therefore is not possible to evaluate the probable effects of the proposed system.

Problems would of course arise in gearing the consequences of the bid procedure to the overall maritime promotional policies administered by the Department of Commerce. Specifically, subsidized ships having a lower cost base, can bid at a lower level and therefore may be at an economic advantage as compared with unsubsidized ships. The unsubsidized operators, whose major source of business has traditionally been Department of Defense cargoes may find themselves without a significant source of revenue. This would threaten their continued existence. These unsubsidized vessels, having complete operational flexibility, are a most important segment of the merchant marine for Defense usage, as they can quickly respond to military requests that they re-route and diversity their services. Their loss would not only jeopardize our ability to meet the shipping requirements of the Department of Defense, but would result in an even heavier military commitment on the remaining subsidized fleet, thus further reducing its capacity to participate in commercial trade and to respond to additional military requirements.

Furthermore we cannot tell whether the present trade route restirctions of the subsidized fleet would be a benefit or a hinderance in serving areas over which military cargo would move under a bid procedure. This factor would reduce the bidding field which in turn may not fully achieve the desired effects of true market competition.

It is our view that Department of Defense should be permitted, indeed encouraged, to explore alternate means of shipping space procurement to fully develop and ascertain the potential advantages as well as the disadvantages. Enactment of S. 3297 would preclude the

Department of Defense from doing this. We therefore believe that S. 3297 is premature and do not favor its enactment.

When the Navy Department has developed the procedures and guidelines to carry out the competitive bidding policy in sufficient detail to be evaluated, the Maritime Administration and the Department of Commerce will look at them closely from the viewpoint of insuring that the objectives of maritime promotion are met in accordance with our responsibilities under the Merchant Marine Act, 1936.

This concludes my statement, sir. I would like to add that it has been approved by the Bureau of the Budget.

Senator BREWSTER. Mr. Gulick, do you believe that both construction and operating subsidies are necessary in the continuation of the U.S. merchant marine?

Mr. GULICK. At the present time we have every reason to believe that both of these aids are necessary, but at the same moment we would certainly expect that the Merchant Marine Act of 1936, because of its emphasis on the most efficient and economical means of transportation, mandates us to explore other means of improving our merchant marine posture.

Senator BREWSTER. Do you see any way that the United States can build ships in U.S. yards in open free competition with Japan and England or Germany or other countries, without some type of U.S. subsidy at the present time?

Mr. GULICK. At the present time it would not appear that this is feasible. I would agree.

Senator BREWSTER. Generally speaking, percentagewise, how much more expensive is it to build a major vessel in a U.S. yard as compared to a Japanese yard?

Mr. GULICK. At the present time, the rate is over 50 percent. We are authorized to pay up to 55 percent.

Senator BREWSTER. On page 3 of your statement, in the last paragraph, you make this statement:

> This would threaten their continued existence if the procedures suggested by the Department of Defense are immediately implemented.

Do you believe they will, in fact, jeopardize the existence of certain carriers at this time?

That is what you say.

Mr. GULICK. We are only pointing out here, Mr. Chairman, one of the many problems which will be involved in developing and proving out a system of competitive bidding, as is desired by the Department of Defense. It would seem to us at the moment—and, of course, this may be subject to change as the system develops—that there is quite a possibility of the unsubsidized carrier, who has no Government support, being at a disadvantage on a competitive bid system with a carrier who does have Government support. We expect that the system finally developed will take this into account. But exactly how, we are not, of course, prepared to even guess at this particular moment.

The whole problem is one of the Department of Defense, and while we will be glad to work with them, we are not charged with the development of the system.

Senator BREWSTER. But you do see a real practical danger?

Mr. GULICK. Yes, sir.

Senator BREWSTER. Agreeing with the general proposition that competitive bidding is a very helpful thing in Government procurement, and also agreeing that sole source procurement has many dangerous implications, is not the merchant marine a very peculiar problem, and when you are buying U.S. merchant marine service, is it not far different than merely buying ammunition or bombs, in so much as we subsidize the merchant marine and we consider it a military and economic arm of the power of the United States?

Mr. GULICK. It is a special problem, all to itself. It has many difficulties to face. I suppose in the final analysis it comes down to this question: Are we subsidizing in order to provide ships for the carriage of defense cargoes, as a primary aim, or are we subsidizing to put our ships into competition in the commercial field with the foreign carriers?

Under the Merchant Marine Act of course, we are required to take both aspects into consideration.

Senator BREWSTER. Do you see any inconsistency in the payment of subsidies by the U.S. Government and on the other hand the cutting of rates by a major branch of the U.S. Government?

Mr. GULICK. I see no inconsistency because to me these are two separate problems. We are paying subsidy under the Merchant Marine Act of 1936 in an effort to provide us with the most efficient and economic merchant marine that can be developed, with the aid of good management, labor, and government coopertaion. On the other hand, the Department of Defense as a shipper and as a spokesman for the American taxpayer is obviously attempting to gain the transportation of its merchandise at the lowest possible rates.

Senator BREWSTER. Have we required our subsidized lines over the past years to invest rather heavily in American-built ships?

Mr. GULICK. Yes, sir.

Senator BREWSTER. What effect do you think a 25-percent cut overall in MSTS cargo rates would have on our subsidized lines?

Mr. GULICK. I am not prepared to give a final answer, and I believe that the best answer would have to await the development of a system. But if our carriers are to fulfill their obligations under the Merchant Marine Act, the carriage of Government cargoes from the carrier's point of view alone, not the Department of Defense at the moment, the carriers themselves are mandated to get into the field of commercial transportation. It would seem to me that one effect is the possibility of, if I may use the term, freeing up the carriers to engage in commercial competition. To this extent, I am not at the moment prepared to say that a 25-percent rate cut or any other rate cut would be disastrous as far as the subsidized lines are concerned.

Senator BREWSTER. Would you argue, as Mr. Moot did, that a rate cut of 25 percent would help expand the merchant marine fleet?

Mr. GULICK. To the extent that it would help expand the commercial carriage of our merchant marine fleet, yes. Of course, this would not mean that we would have a greater number of ships in the fleet by this action alone.

Senator BREWSTER. Since World War II the international competitive position of the U.S. merchant marine has seemed to continually deteriorate. By this I mean that our international competitors now carry far greater tonnages than we do, and are building at the present time more ships than we are building.

Do you see any very fundamental danger to U.S. policy and security because of this situation?

Mr. GULICK. No, sir. I may be violating all of the tenets of good judgment and reason, but I for one fail to find that our merchant marine is in a disastrous situation. I feel that under the Merchant Marine Act of 1936 the ground work has been laid to provide us with a solid fleet of some of the best ships in the world.

We have those ships today. After World War II, we were practically the only country in the world with a fleet of ships. Our national effort was to assist other countries in building up their business and commercial activities. This we have done.

And in the process other countries have developed merchant fleets of their own. We have fostered this competition ourselves. As the years have gone by, we have seen our fleet gradually drop down—and I do not mean this at the moment critically— drop down to the natural level of our carrying capability, with the type of ships and with the type of business operations that we have had.

We are now in the position of looking back over the last 20 years and looking forward over the next 20 to come. We believe that our fleet has grown in the last few years in one aspect which is tremendously important. We have grown in efficiency and in productivity. Our effort now is to encourage this, to do what ever possible to gain even more in this regard. You asked a question a little bit ago about what was our place in the world merchant marine. In terms of active ships in our fleet, as a result of the past year's activities, we are in fifth place.

We were in seventh place until quite recently. As to total ships available, both active and in our reserve fleets, we are in second place.

Senator BREWSTER. May I interrupt there? How obsolescent is our reserve fleet? Are these World War II Liberty ships?

Mr. GULICK. Our fleet is composed of both the older war-built ships such as the Liberties and as the newer ships are constructed and go into the active fleet, slightly more modern ships of the Victory or C–2 class. None of these are ideal ships. These ships are a pantry that puts us in to throw ships into service if needed.

Senator BREWSTER. How many more years would you consider it practical or feasible to rehabilitate a Liberty or a Victory?

Mr. GULICK. This will probably be answered within the next 2 or 3 years.

Senator BREWSTER. By that do you mean in 3 years we will no longer ever want to use a Liberty or a Victory again?

Mr. GULICK. This is quite possible. We are engaged in a study in this connection right now. We have not come to conclusions. I can say, however, that a Liberty ship is not quite the fastest thing in the world, she doesn't have too much cargo capacity. As the speed of our modern fleet increases, it would probably be evident or it will be evident within the next very few years that a Liberty ship is not going to be able to keep up with the fleet.

Senator BREWSTER. You were addressing yourself to our rank in international shipping and you said we were now fifth in active ships, and second when you take in the reserve fleet. Then we discussed how good the reserve fleet was. How much of the reserve fleet is made up of Liberties and Victories?

Mr. GULICK. My recollection, while I run through to see whether I have the exact figure here and if I do not, I will be glad to furnish it for the record, sir, is that we have probably about 600 Liberties in the fleet. Only a few of these are on the so-called priority list, that is, they are in good enough condition to warrant the expense of breakout and entry into service. Others we are endeavoring to sell as scrap as rapidly as we can to clear out the fleet. Does this answer your question for the moment?

I will be glad to verify these figures and expand on them.

Senator BREWSTER. What you might do is provide for the record, to the extent it is unclassified, exactly what is in our reserve fleet?

Mr. GULICK. I will be glad to do this.

Senator BREWSTER. The number of ships, the make, and the age.

(The document referred to follows:)

Number of ships in NDRF, May 11, 1966

Preserved ships	841
Scrap candidates (mostly Liberty ships)	524
Total	1,365

Types of preserved ships and number of each

Type	*Number*
Dry cargo	341
Passenger and cargo	56
Tankers	21
Reefers	13
Tugs	44
Naval auxiliaries	366
Total	841

Breakdown of preserved dry cargo ships and ages

Design	No.	Average age
Victory ship:		
VC2	79	21
C3	5	21
C2	16	20
C1	50	22
C1MAV1	38	22
Liberty ship: EC2	153	22
Total	341	

Senator BREWSTER. Now would you address yourself to the U.S. rank in the field of shipbuilding, new construction?

Mr. GULICK. In the field of shipbuilding, I hate to say it, but in the commercial field we were 15th as of October 1, 1965. We are in last place among the major maritime nations. [NOTES.—Mr. Gulick advised later that the United States was 14th as of December 3, 1965.]

Senator BREWSTER. I find that very distressing.

Mr. GULICK. Were you asking, Mr. Chairman, also about defense building? I have no information on this, although there is a sizable activity in our shipyards of course in the defense area.

Senator BREWSTER. I was discussing only commercial building. That is really all we are addressing ourselves to.

I understand that the new insurance rate levy on ships caused serious concern to our active merchant marine because of the age of many

of our active ships. Is there any truth in this concern that was expressed to me, that insurance rates were going to go up very substantially on our active U.S. merchant marine, in many cases because of their age?

Mr. GULICK. I am very glad to comment on this, Mr. Chairman. This came up within the last few months at a meeting of the insurance underwriters in Europe, London I believe. And as I understand the situation, because of the age and condition of anything in the world below a mariner type, an effort was made to adopt the rule that insurance could be purchased on those ships only at a rather exorbitant rate. This may be true, as far as the rest of the world is concerned. We deny that this is true with respect to the ships in our American merchant marine. We have made such representations to the insurance underwriters. Part of the subsidy support is for the maintenance and repair of our ships in service. And we maintain that those ships are in better condition than any other ships of their class in the world.

For this reason, we have every intention of pursuing this matter further and urging an exemption for the U.S. ships.

Senator BREWSTER. Have the underwriters accepted your argument?

Mr. GULICK. We believe they are favorably inclined; yes, sir.

Senator BREWSTER. Well, we have continued this hearing for a long time this morning, but we have developed a lot of helpful information and certainly your statement and the answers to our questions has been very, very helpful. I thank you and your associates for being here this morning.

Mr. GULICK. Thank you, Mr. Chairman.

Senator BREWSTER. We will recess this hearing until tomorrow morning at 10 a.m.

(Whereupon, at 12:45 p.m., the subcommittee was adjourned, to reconvene at 10 a.m., Tuesday, May 10, 1966.)

OCEAN FREIGHT RATES ON MILITARY CARGOES

TUESDAY, MAY 10, 1966

U.S. SENATE
COMMITTEE OF COMMERCE,
SUBCOMMITTEE ON MERCHANT MARINE AND FISHERIES,
Washington, D.C.

The subcommittee met at 10:10 a.m. in room 5110, New Senate Office Building, Hon. Daniel B. Brewster presiding.

Senator BREWSTER. The committee will come to order.

This will be a continuation of yesterday's hearing on S. 3297, and other matters of great interest to the Senate Commerce Committee.

It is my understanding that we have as witnesses this morning Mr. Neil Walsh of the Waterman Steamship Corp., who will act as spokesman; is that correct?

Mr. WALSH. Yes, sir.

Senator BREWSTER. And also Mr. Joseph T. Lykes, Lykes Bros. Steamship Co.; Bill Rand of United States Lines; Bob Stone of the States Marine Lines; and Edwin Wester of the Pacific Far East Lines; is that correct, gentlemen?

Mr. WALSH. That is correct, Senator.

Senator BREWSTER. Mr. Walsh, will you please take over now and present the point of view of the industry?

STATEMENT OF CORNELIUS WALSH, WATERMAN STEAMSHIP CORP.; ACCOMPANIED BY JOSEPH T. LYKES, JR., LYKES BROS. STEAMSHIP CO.; WILLIAM B. RAND, UNITED STATES LINES CO.; ROBERT G. STONE, STATES MARINE LINES; EDWIN A. WESTER, PACIFIC FAR EAST LINES; AND WARNER GARDNER, COUNSEL

Mr. WALSH. Thank you, Mr. Chairman. We appear here this morning as a committee representing various segments of the steamship industry in the common carrier service in our foreign commerce. And I would like, with your permission, to read a prepared statement of the committee.

Senator BREWSTER. Please proceed.

Mr. WALSH. The committee having asked me to be the spokesman. We would later try to respond as fully as possible to any questions which you might want to ask, and with your permission we would like to perhaps have more than one member of the committee respond to your questions in order to give you the fullest possible answers.

I am Cornelius Walsh, chairman of Waterman Steamship Corp. Joining me in this testimony are Joseph T. Lykes, Jr., vice chairman of Lykes Bros. Steamship Co.; William B. Rand, president of United

States Lines; Robert G. Stone, president of States Marine Lines; and Edwin A. Wester, vice president of the Pacific Far East Lines.

We appear in support of S. 3297. We speak for the Atlantic and Gulf American Flag Berth Operators. These groups, formed under agreements approved by the Federal Maritime Commission, for 16 years have been negotiating rates with Military Sea Transportation Service for defense cargoes, and handle for the individual lines the great number of day-to-day problems which arise in connection with the ocean transport of defense cargoes.

S. 3297 is supported by virtually the entire American-flag ocean liner industry serving the foreign trade: east coast, gulf coast, west coast, and Great Lakes, subsidized and unsubsidized.

This unaccustomed unanimity reflects the gravity of the threat to our continued operations or even to our existence which arises from the Department of Defense proposal to move its ocean cargoes under a system of competitive bidding.

A. THE PROVISIONS OF S. 3297

The bill is intended to solve a complex and urgent problem. It is, however, a rather simple bill. It is intended to accomplish five things.

First. It would in subsection (a) give the common carrier steamship lines and MSTS legal authority to apply to MSTS cargo shipped abroad rates which are below the lines' commercial tariff rates. When the Shipping Act was amended in 1961 the Comptroller General correctly said this statutory authority was necessary. The Senate added such a provision to the bill which became Public Law 87-346, but for some reason it was dropped in conference.

We don't know why Mr. Moot, with this record of congressional action and in the face of court decisions saying plain language was necessary to grant the Government reduced rates, felt that they now have this power.

Yesterday Mr. Moot explained that the Department's competitive bidding procedures would not, at least at this time, apply to the domestic trades. With this new advice, we should recommend excluding, from subsections (a) and (b), the domestic trades.

Second. The bill in subsection (c) enacts two requirements for rates on defense cargoes: They shall be fair and reasonable and they shall not exceed those charged for similar classes of cargoes for private persons.

Third. MSTS has for the past year, until recent months, complained that it has not received adequate cost data from the lines to permit a judgment as to whether MSTS rates were fair and reasonable.

It is true that Admiral Donaho also testified that the lines had never failed to give him any data which MSTS requested, but we are prepared to agree that MSTS is entitled to statutory authority to get all the cost information which it can reasonably want, and subsection (d) so provides.

Admiral Harllee said yesterday that the Federal Maritime Commission should also have these powers to get data.

If they feel that they can't get the information from MSTS, we have no objection to granting these powers to FMC only.

Fourth. The berth lines have, with enormous effort and cost, recently broken new ground in steamship accounting and have produced cost studies which go far beyond anything hitherto available.

We would expect that with these new tools rate negotiations with MSTS would be greatly simplified and, once the ground rules are established, would become largely noncontroversial.

The bill, however, guards against an impasse by providing in subsection (e) that if agreement cannot be reached either party may petition the Federal Maritime Commission to determine the fair and reasonable rates.

The Commission has considerable rate regulation experience in the domestic off-short trades, and is directed to apply these established principles here.

It may be noted that this rate regulation, in the event of disagreement, although applied in foreign commerce relates only to U.S.-flag lines and thus is not affected by the international considerations which otherwise preclude rate regulation in foreign commerce.

Both Mr. Moot and Admiral Harllee yesterday found difficulty in the provision of subsection (e) that the Commission should give "due regard to the level of commercial tariff rates in the trade." We had thought this only another guarantee that MSTS rates would not exceed commercial, and have not the slightest objection to deletion of this sentence.

Fifth. S. 3297 offers only one thing to the carriers. It authorizes in subsections (b) and (d) the continued negotiation of MSTS rates with individual carriers as well as with groups representing the carriers and in subsection (f) provides for the continuation of the very fair system of allocating cargo among the carriers serving the trade which MSTS has developed and applied for many years past.

This one requirement is, however, of critical importance to the health and, possibly indeed, to the survival of the American merchant marine.

To insure this, we are prepared to support the many concessions to MSTS made by S. 3297, which represent a statutory grant of everything MSTS had requested except only the making of rates by competitive bidding.

The following discussion explains why competitive bidding for MSTS cargo cannot be reconciled with either the welfare of the merchant marine or the policies of the Congress as enacted over the past half century.

Admiral Harllee yesterday raised seven questions about the interpretation of S. 3297, and gave the Commission's answers to these questions. I am happy to say that the industry agrees with each of his answers.

Some question was also raised yesterday by Mr. Moot as to whether subsection (f) would restrict the Department's power to arrange its needs with contract carriers. We believe he overstated the difficulties, and ignores the fact that the MSTS shipping contract cargo is predominantly liner-type cargo, while he seems to have been referring to chartered tonnage.

We are willing to amend subsection (f) to confine it to "procuring transportation on regular berth service operations under this section * * *."

B. THE HISTORY OF DEFENSE CARGO RATES

Commercial shipping resumed after World War II in 1946. A very large volume of military cargoes had to be moved by the commercial berth lines. This was done under almost identical Army and Navy contracts by which a uniform rate was paid all carriers.

This rate was derived by computing the cost per cubic foot of vessel space on Liberty vessels at 1946 costs. Both the services and the industry were sufficiently satisfied with this rate that it continued without change until MSTS was formed in 1950.

MSTS wanted to get away from a rate based on vessel space. At the same time it could not use the ordinary berth term basis of ratemaking, which includes the costs of loading and discharging cargo, because the military services wished to continue the use of their own terminals and their own stevedores.

The space rates in the Army and Navy contracts were accordingly translated into rates per cubic foot of the cargo as measured on the dock, using an assumed 20 percent broken stowage factor.

MSTS and the lines each found it impossible to work out the details of the shipping contracts, to negotiate the rate, or to handle day-to-day problems, when MSTS had to deal with a score or more of individual lines.

The lines could not agree among themselves, and meetings between MSTS and industry were more like unruly conventions than a forum for orderly discussion.

In result there developed first an informal system of committees, and then, in 1956, formal organization under approved section 15 agreements of the two groups known as Atlantic and Gulf American Flag Berth Operators and the West Coast American Flag Berth Operators.

MSTS at an early date developed a system for the allocation of cargo among the lines serving a given trade. In essence it works like this: Cargo is given only to lines with an advertised berth service, and which have a 3-month record of sailings at least once a month. It is allocated among these lines according to their average number of monthly sailings.

Thus, if a given line makes three sailings a month out of a U.S.-flag total of 20 sailings, it gets 15 percent of the cargo shipped during the month. The system has worked very fairly and very smoothly, and subsection (f) of S. 3297 would continue it in force.

Steamship costs have, of course, increased markedly since 1950. This has been reflected in MSTS rates by the following procedure: When the lines feel that an increase is necessary, they submit individual requests to MSTS.

The two groups then organize a very full and detailed presentation of changes in steamship costs which have occurred since the rate was last fixed. MSTS goes over this with a critical eye and a fine-toothed comb, and a period of close negotiation follows.

When the cost increases have been established to the satisfaction of MSTS they usually allow about two-thirds of the indicated rate increase. The one-third discount is because the lines have not, until their recent cost studies, included overhead and depreciation in their cost presentation.

Before the Department of Defense in 1963 started machine coding their transportation documents, the manifest would show the com-

modities shipped and it was possible to determine the rates which the MSTS commodities would bear if shipped under commercial tariffs.

A considerable variety of studies by the industry on both coasts and by MSTS itself were in substantial harmony, indicating a substantial discount to MSTS (after allowance for Government stevedoring) of as much as 40 percent under the commercial rates for similar commodities.

Last winter the steamship lines completed what we believe to be the most elaborate and difficult job ever done in steamship accounting. This was done in connection with the pending Federal Maritime Commission investigation of rates on Government cargoes, docket 65–13, and in order to satisfy the MSTS desire for full cost data.

This is not the place, nor are we the witnesses, to give a full accounting explanation of these elaborate studies. It is, we believe, sufficient to show the final results in terms of profit or loss per cubic foot of vessel space occupied by MSTS and comparable commercial cargoes.

Those for the four major MSTS trades averaged 4.4 cents for MSTS and 6.2 cents for comparable commercial, indicating a MSTS discount of about 30 percent.

Senator BREWSTER. Let me stop you here. Do you mind an interruption?

Mr. WALSH. Not at all.

Senator BREWSTER. We heard yesterday that the competitive bidding system that is proposed by DOD would result in a 25-percent saving, more or less. Already MSTS is getting a 30-percent discount.

Mr. WALSH. Yes, compared to commercial cargo.

Senator BREWSTER. Please proceed.

Mr. WALSH. The study covered about $25 million of MSTS freight revenue in the last quarter of 1964. The annual volume of about $100 million would thus have cost MSTS about $140 million had they shipped under the rates applicable to comparable commercial goods.

The commander, MSTS, on March 31, 1965, advised the Renegotiation Board that he could not recommend an exemption for the steamship industry from renegotiation of its Government freight revenues for 1964.

After an exhaustive investigation, including a close examination of our cost studies, the Renegotiation Board on April 5, 1966, exempted the industry from renegotiation for that year.

Our conclusion that MSTS rates were low had seemed to us confirmed when in February and March of this year two foreign-flag vessels, with low Norwegian and Dutch costs, refused an offer of MSTS transatlantic cargo because the rates were too low.

Senator BREWSTER. Why were foreign-flag vessels offered military cargo?

Mr. WALSH. Presumably because there wasn't sufficient U.S.-flag space immediately available in the prompt position that MSTS wanted for that particular cargo.

Senator BREWSTER. Were there U.S.-flag ships available for the cargo?

Mr. WALSH. Yes, there was, I think in a little later position, but they didn't want to hold the cargo for the later vessel. That is my understanding.

Senator BREWSTER. Go ahead.

Mr. WALSH. We had thought MSTS was getting a pretty good deal, and had hoped that the cost studies would lead MSTS to the same conclusion. Instead, while MSTS is still in the course of its audit and examination of those studies, the Department of Defense announced that competitive bidding would be introduced for MSTS cargo.

C. THE COMPETITIVE BIDDING INNOVATION

On September 24, 1965, Admiral Donaho, commander of MSTS, requested the views of the industry about formulating a new policy of ratemaking for MSTS cargoes which would involve jointly developed contract terms followed by "competitively negotiated contracts."

The many steamship lines replied individually but, so far as we are advised, were overwhelmingly of the view that any form of competitive bidding would be disastrous to the American merchant marine and would not accomplish the objectives sought by MSTS.

We were encouraged when Admiral Donaho, testifying in FMC docket 65–13 on October 13 and 14, 1965, viewed competitive bidding as an alternative to be adopted only if MSTS was unable to obtain "fair costing data."

Admiral Donaho then successively postponed from December to January to February, and ultimately never held, a meeting with the industry to obtain their views upon an unstated new system.

As it subsequently developed, MSTS in September 1965 had not solicited the views of the Military Traffic Management and Terminal Service (hereafter "MTMTS"), which is the agency responsible for the logistics of military movements.

An exhibit in FMC docket 65–13 shows that on October 18, 1965, Rear Admiral Sutherling, deputy commander of MTMTS wrote Admiral Donaho requesting further consideration of his competitive bidding proposal, in that it would create serious problems for MTMTS and adversely affect its operations.

It was accordingly with much surprise that we heard the testimony of Deputy Assistant Secretary of Defense Moot on April 4, 1966, in FMC docket 65–13. The salient features of his testimony were:

1. That in future the Department of Defense would, to the maximum extent possible, procure ocean transportation from U.S.-flag carriers by competitive bidding, awarding contracts to the lowest suitable bidder.
2. That the Department of Defense, other things being equal, would accept the lowest price set by competitive bidding, and would not reject a rate because it was noncompensatory.
3. That it was contemplated that the adoption of the new policy would result in a 25-percent or greater rate cut, which Mr. Moot recognized might result in some lines going out of business.
4. That the Department of Defense contemplated annual contracts in which a "fixed buy" of cargo space would be made from the lowest bidder.
5. That rates among U.S.-flag cariers would no longer be uniform as a result of the new policy.
6. That the Department of Defense in formulating the new policy would give no consideration to differences in costs between subsidized and unsubsidized carriers.

7. That the new procurement policy is intended to become effective by July 1, 1966.

Senator BREWSTER. Let me interrupt again. Are the Sapphire Lines able to carry cargo cheaper than you gentlemen are?

Mr. WALSH. No, Mr. Chairman, they are not. And still be in a position to build new vessels for the future of the American merchant marine.

Senator BREWSTER. Are they building any vessels?

Mr. WALSH. Not as far as we know. As a matter of fact, there have been no new vessels built in the last 20 years, except by the presently subsidized American merchant marine lines. There are quite a few unsubsidized American-flag lines that have had subsidy applications pending before the Federal Maritime Board for some years past, but, unfortunately, no action has been taken by the Federal Maritime Board to sign contracts with those lines which will permit them to accumulate funds for the building of new vessels to perpetuate their war-built vessels, which are now rapidly approaching obsolescence.

Senator BREWSTER. Please go ahead.

Mr. WALSH. Mr. Moot stated that MTMTS, the agency that must do the logistics job, had not been consulted, and that MSTS itself had been advised of the new policy only a few days earlier.

So far as we can know the inner workings of the Government's largest Department, we are forced to the conclusion that the policy was hastily conceived without what we should have thought the necessary consultation with the operating agencies. Certainly there was no consultation with the industry which must live and do its work under the new plan.

Senator BREWSTER. Let me interrupt again. As far as you know, the new policy was just presented to you without any previous conference or consultation?

Mr. WALSH. That is correct, Mr. Chairman. It was announced, I believe, on a Saturday, as having been decided upon as a defense policy, and to go into effect at what we thought was really very short notice, particularly after we had lived with MSTS for so many years under the provisions of the shipping contracts and in a very satisfactory relationship, really, except that we haven't been able to agree for the last year or so on what is the proper measure of rates, primarily in the Atlantic trade, as a result, we think, of the competition of Sapphire, which is not a proper comparison from a rate standard basis with the service provided by the lines under the shipping contracts.

Senator BREWSTER. For how many years had the present working relationship continued?

Mr. WALSH. Well, in one form or another, we have been working with the MSTS since its inception in 1950, and as I said, the day-to-day problems of moving military cargo have been worked out with the utmost cooperation, I think, on both sides.

The lines have been able to provide to MSTS the flexibility which is so important to them, because as you know, our accent on the shipment of military cargoes changes as far as the destination may be concerned, from month to month, and sometimes from week to week.

We have been in a position where our merchant marine has been able to answer their needs on relatively short notice, and adjust the quantities of cargo shipped to Europe and the Far East respectively, and be able to do a good job, in our opinion, for our country.

Senator BREWSTER. Please go ahead.

Mr. WALSH. So far as we are aware there has not yet been formulated any precise plan as to how the competitive bidding system would operate. An advisory committee to the Navy Department, appointed to study and recommend workable procedures for competitive bidding, is still taking and considering views on this matter.

Yet Admiral Donaho, only 3 weeks ago, advised the Chairman of the Federal Maritime Commission that he hoped to issue invitations for competitive bidding in May.

The steamship industry has not the slightest idea how the Navy Department will solve such basic issues as how should routes be fixed—by MSTS or by each individual bidding line; should there be a "floor" established by the Government to prevent ruinous rate cutting and how and by whom should it be determined; should relatively inexperienced newcomers unfamiliar with the route be encouraged or discouraged; what, if any, allowances should be made for speed and characteristics of vessels; what sort of minimum-maximum quantity guarantees should be required; for what periods must MSTS be required to hold cargo in its terminals awaiting a vessel of the favored bidder?

Senator LONG. Might I interrupt you there? I don't have the familiarity with this that Senator Brewster and Senator Magnuson have, but what you say here brings home something that has been on my mind for a long time.

The point of view of the maritime industry, as I understand it, is that building these ships with so much speed might actually be increasing your costs, but on the other hand, this is a defense requirement, so that in wartime you can keep up with a convoy. Isn't that the reason that some of these ships were built as big and fast as they were?

Mr. WALSH. That is correct, Senator.

Senator LONG. After they make you build a ship that from your point of view has a higher operating cost than some of the older ones you have on hand, particularly when you consider the high cash investment and the depreciation of that investment, then it puts you in such a position that you can't compete with someone who has not modernized his fleet, and who is just using a bunch of old junk he has left lying around.

Mr. WALSH. That is quite the case. I think you have stated it very correctly.

Senator LONG. Now, in the event that an enemy started using submarines against us, for example, to cut off cargo that we have going to Vietnam you would then have to discontinue the use of all of the old junk, because those ships couldn't keep up in convoy, and you would have to rely entirely on the ones they forced you to buy at the very great increased cost?

Mr. WALSH. Quite so. The military, as a matter of fact, have acknowledged the importance of the new ships in the merchant marine to the job they have to do in, well, let's say, war or semiwar, undeclared war, and they are very anxious to have the use of as many of that type ship as necessary.

I think, in a national emergency, an all-out war, those ships would be of great value to our Government. There is no question about it. But we have been in a vacuum, as far as our American merchant ma-

rine policy, really has been concerned, for a long time, because we built relatively few ships to perpetuate the American merchant marine.

The subsidized lines are the only ones that have been in a position to do it. As you say, they have committed themselves to substantial capital requirements and large investments, and their returns, as I understand it, are restricted. In other words, they are only permitted to earn a certain amount of money and there are safeguards built around the subsidy contracts.

Our own particular company, we are unsubsidized, and we have been asking the Maritime Administration and the Federal Maritime Board for a number of years to clear subsidy contracts so we could have the availability of tax-deferred reserve funds and begin to accumulate money to build these ships which are very expensive.

We just don't seem to be able to get coordination among the Government departments, and implementation of the policy that Congress has spelled out over and over again, and in the Merchant Marine Act of 1936, it presented, I think, all of the bases that are required for the administrative departments to implement that policy.

Senator LONG. Yes; I am familiar with the fact that the Defense Department has been requiring subsidized lines to replace old ships with these fast big new ships, and that in many instances this has greatly increased costs.

In other words, the putting in of all of the power it takes to move these ships as fast as they want them to go has been at extra cost to the shipowners. But after the Defense Department requires them to build these big ships and put the extra power into them, then it should see to it, having made the shipowners acquire such a ship, that they can make enough money to stay in business.

As I understand it, that has not been your problem. But if you are going to modernize your fleet, that is what you are going to have to think about.

Mr. WALSH. That is right. Our problem at the moment is how to keep alive, particularly under a system proposed like this, and it then becomes the same problem as the already subsidized lines.

I think all you have said is particularly pertinent and applicable to the present situation. I think Mr. Rand would like to add something to what I have said.

Mr. RAND. I would like to say one thing at this point. In all fairness to the Department of Defense, they have not insisted, or the reason we have built the new fast ships is not primarily due to their wishes and directives. We have found ourselves, as a commercial operator, that these larger faster ships from a commercial point of view are very good for our company.

In other words, we have found, and we have done it, we can replace six of the older ships on a given service in the North Atlantic with five new ships, thereby somehow, in some way, more or less counteracting the additional expense.

So, although we have put some features in these ships which have been required by the Department of Defense, it is not entirely a one-way street.

Senator BREWSTER. Please go ahead with your statement, sir.

Mr. WALSH. Thank you.

For what periods must MTMTS be required to hold cargo in its terminals awaiting a vessel of the favored bidder? We sincerely hope that they will not be resolved, as the program itself seems to have been conceived, in haste and with a minimum of attention to matters of practical concern.

But even with the wisest possible implementation of the program, it cannot fail to be a disaster, certainly to the industry and to the future of the American merchant marine, and probably to the Department's transportation agencies as well.

D. COMPETITIVE BIDDING IS DISASTROUS IN OCEAN LINER TRANSPORTATION

The proposal for competitive bidding is advanced in total disregard of nearly a century's history of ocean transportation. That history shows that, without exception known either to us or Mr. Moot, competitive bidding for an important movement of liner cargo inevitably drives rates down below cost and approaching the out-of-pocket costs of cargo handling and added vessel time.

As early as 1875, when several lines were serving the Calcutta/Europe trade, they discovered that rate competition was quite literally ruinous to each. Out of that costly discovery developed the first steamship conference. The same forces are at work in modern times.

Senator BREWSTER. Are you subject to the Sherman Act or the Clayton Act?

Mr. WALSH. No; Mr. Chairman. The conference under which common carrier berth liners operate have been exempted from the antitrust laws provided certain requirements are complied with, primarily filing with the Federal Maritime Commission agreements among themselves which must be approved by the Federal Maritime Commission, before they can become effective.

Senator BREWSTER. We wanted that statement in the record. Please go ahead.

Mr. WALSH. From 1954 to 1958, the Japan to United States trades were in turmoil; rates were driven by competition far below cost and in some instances were below cargo-handling costs.

Again, in 1961, the conference from Italy to the U.S. Atlantic ports was forced to open its rates; competition among the individual lines, as usual, drove rates down toward the costs of handling the cargo, with little or nothing over for the costs of operating the vessel or manning the steamship line.

The examples could be multiplied. It is sufficient that there is no known exception to the rule that competitive bidding between ocean liners, if long continued, inevitably injures all lines and forces the withdrawal of some lines to escape insolvency which reduces frequency of sailings and availability of space.

In 1914, the Alexander Committee, whose report led to the Shipping Act, 1916, phrased its conclusions vividly. It said:

> The entire history of steamship agreements shows that in ocean commerce there is no happy medium between war and peace when several lines engage in the same trade. * * * To terminate existing agreements would necessarily bring about one of two results: the lines would either engage in rate wars which would mean the elimination of the weak and the survival of the strong, or, to avoid a costly struggle they would consolidate through common ownership.

There is nothing mysterious about this inevitable consequence of competitive bidding in the liner trades. It follows, with the ocean liner just as with the competing railroads or electric light companies, inexorably from the nature of their business.

The great majority of the costs of a liner service are fixed in advance of the voyage. Not only depreciation, overhead, and insurance, but the entire vessel cost of wages, subsistence, fuel and repairs, are incurred once the ship is put on berth for its voyage. Whether much or little cargo is carried, these costs are fixed. Only cargo handling costs, and the additional vessel time for loading and discharging, are incurred for any lot of cargo. Our recent cost studies show that 75 percent of the total cost of the voyage is fixed in advance. For MSTS cargo, where straight-time stevedoring is paid by the Government, the ratio of fixed costs is about 85 percent. It inevitably follows that any rate over these variable costs is often preferable to sailing with empty space.

This is not a novel theory invented by the industry. It was, as we have indicated, recognized by the Alexander committee in 1914. It was very explicitly and very clearly spelled out by this committee itself in 1961. In reporting the bill which amended the Shipping Act to legalize dual rate contracts it said:

> The history of ocean shipping proves beyond peradventure that these competitive rigors are so potentially violent that when unleashed almost invariably they destroy the requisite dependability, regularity and non-discriminatory nature of ocean common carriage.
>
> Whether a liner vessel sails full and down or three-quarters empty, it costs about the same to make the scheduled voyage. Fuel, maintenance of the vessel, depreciation, officers' and crews' wages and subsistence, fresh water and insurance—these costs and others are affected only slightly by the amount of cargo carried. And so it is, when a trade becomes overtonnaged, that the normal independent self-interest of each carrier in the trade is to get more cargo, by cutting rates, if necessary, to the point where they return at least the cost of handling, for example, the cost of loading and discharging the cargo.
>
> Thus, in ocean shipping there is no floor to rates, which a distressed carrier, or one which must make the voyage for other considerations than immediate profit, may charge.

The Congress has for half a century acted in clear recognition of these elementary truths. In 1916 the same Congress which enacted the Clayton Antitrust Act passed the Shipping Act. Section 15 of that act permits the ocean carriers to fix rates in combination.

Ever since 1916 conference ratemaking, in place of competitive bidding, has been the cornerstone of the regulation of ocean shipping, When *Maritime Board* v. *Isbrandtsen Co.* in 1958 threatened the efficacy of the conference rate system by condemning the dual rate contracts, the Congress promptly gave interim relief and in 1961 legalized the dual rate systems precisely because they were necessary to make conference ratemaking effective.

There is not any magic which will avoid this result for the MSTS cargoes. In the last quarter of 1964, before the Vietnam buildup, defense cargoes ranged from 26 to 42 percent of the outbound cargoes in the trades covered by our cost study. This is cargo so important that no line in these trades can forego it without serious consequences.

Mr. Moot yesterday considered that MSTS competitive bidding would not produce disastrous rate wars because in many conference trades there was independent competition. We fear that this is the

same sort of superficial analysis which has led to the present proposal. It is one thing to have one or even two independents and a dozen united lines, supported by dual rate contracts, and quite another to have each of a good number of lines in a dogfight with each of the others. In the latter case, which is what MSTS proposes, rate wars have never been avoided.

Senator BREWSTER. Comment, if you will on the charge that Senator Douglas has made that your industry charges U.S. shippers one rate for outbound cargoes and rigs the deal to give a much cheaper rate for inbound cargoes to foreign shippers.

Mr. WALSH. Let me put it this way: There are good reasons why this situation has prevailed over the centuries. In our foreign trade, the outbound volume, particularly of liner-type traffic, exceeds the inbound volume. In recent years the inbound has been increasing. But, nevertheless, the outbound volume is greater. And, therefore, the service that is projected on the trade routes is geared to the outbound volume.

When a ship is returning from abroad and competing with many other ships and all flags for what may be available to come back, and which is not sufficient to go around, then the play of competition inevitably brings those rates down below what they would be on the outbound trade, where there is more cargo to be divided up among the lines.

So I think it a natural economic phenomenon that takes place there, and it is not the result of rigging or anything except the play of natural forces.

This is usually a pretty sound reason for everything that takes place in business and, in this particular case, I think that is the reason for it.

Senator BREWSTER. Should the U.S. Government attempt to invoke any type of economy or shipping sanctions against foreign shippers who utilize rebates, types of monopoly, and utilize types of activity that restrains free trade and hampers U.S. merchant marine activities?

Mr. WALSH. I think our Government should do whatever it can to try to adjust those unfair situations. Of course, under our shipping laws, rebates are illegal, and they are not illegal under the shipping laws of, I think, most of the other countries in the world. So, while I think foreign lines, foreign-flag lines, may, and undoubtedly do, observe our laws in connection with their trades to and from this country, as far as we know, nevertheless, it is a situation that is different here than any place else. I don't think that I would want to say that we should necessarily legalize rebates.

I think we would have to proceed on the basis that it may be a factor that is very difficult to deal with, but it has been one that has been prevalent in our steamship industtry for quite a long time.

Senator BREWSTER. I do not suggest that we legalize any type of rebates. I do suggest that maybe the U.S. Government could do more to help the shipping industry in the United States, and I am asking your opinion as to what the U.S. Government can do more to help the U.S. merchant marine.

Mr. WALSH. Well, I think, presumably, for the future of the American merchant marine, I think the Government should try to protect

a more effective policy of subsidizing the presently unsubsidized liner companies and making it possible for them to perpetuate their fleets, to build new ships, and, beyond that, I think it would have to take whatever action they can in connection with the distribution of cargo and other means to prevail upon other countries not to allow discriminatory practices in the movement of cargo to and from countries and cargo that those governments control.

I think maybe other members of the committee might want to amplify what I said.

Mr. RAND. Mr. Chairman, as a representative of a subsidized company, that is a very good question, I think, and it brings up things that bear on the present lack of appropriations for replacements of vessels within the subsidized segment of the American merchant marine, and we have had an average of something like 17 ships a year, which is grossly inadequate.

And the reduction in appropriations for fiscal 1967 makes it quite apparent that probably no more than 11 can be built. And we find this at a time when we have about 125 new ships in the subsidized segment. We have possibly 25 Mariners, which were built in 1952, 1954, all of the rest are war-built ships. And the total in the subsidized segment is 308. So we are placed in the position here that, in order to promote the commercial interests of the United States, the American-flag merchant marine, it is all very well to say, "Ship American," and all this, but nothing is being done on the other hand to provide the funds which are essential to bring this fleet up to snuff.

I can see nothing but chaos. These ships are getting older, the war-built ships. We still have very many in our fleet, as the other subsidized operators. We can't operate them forever, and, in fact, we are getting indications that they are not going to be subsidized forever, yet, they will not make it possible for us to build additional units.

It goes far beyond that, actually, to take it away from the commercial aspect of the merchant marine, I think it has a profound effect, or can have, or, if something is not done, will have on the national security of this country, because we have these ships becoming rapidly obsolete and very little is being done to replace them, not only to maintain our commercial services, which, I think, is essential, balance of payments, and various other considerations, but, from a national security standpoint, we are going to wake up one morning and find ourselves very, very short of essential vessels regarding speed, space, special handling equipment, everything else, which we now are being deprived of building. That is all I have to say.

Senator BREWSTER. How much longer will your Liberties and Victories last?

Mr. RAND. I think you should discount the Liberties entirely. They operate at about 9 knots. I don't know if they have broken any Liberties out of the layup fleet. I don't think they are in operation.

Senator BREWSTER. But they are still in the reserve fleet?

Mr. RAND. There are many in the reserve fleet. Mr. Gulick testified yesterday many are being taken out for scrap. They are a 9-knot ship. Very small. I think they are useless in the context of this discussion. There are, in the reserve fleets at the present time, 214 ships of Victory-type or better. Better, would be C-2's, C-3's, C-4's. There are 214 of those. But these are rapidly becoming obsolescent by our

standards. And they are old ships. They have had a lot of use, before they were put in the layup fleet, a lot of hard usage. And I don't think, Mr. Chairman, that, from a realistic practical point of view, that we can afford to depend on those ships for the—maybe possible for the immediate future, but not the long range.

Senator BREWSTER. As president of the United States Lines, would you say our reserve fleet could appropriately be characterized as a "scrap fleet"?

Mr. RAND. I could certainly say that; yes. I will qualify that. We are using some units out of the reserve fleet right now in the Vietnam situation. They have been broken out at great expense, an average of $34,000. They are serving a purpose now.

Now I will qualify the statement I just made about the scrap fleet, that, 5 years hence, I think that statement would certainly apply.

Senator BREWSTER. We heard that it would not be reasonable in 2 or 3 years to attempt to rehabilitate any one of the Victories, Liberties, or C–2's.

Mr. RAND. That, more of less, bears out what I say. I said 5 years. Maybe I am being a little generous; I don't know.

Senator BREWSTER. Senator Dominick or Senator Long, would you like to ask a question?

Senator LONG. A thought that occurs to me is that we have decided, as a matter of national policy, that we must keep certain industries strong. I come from Louisiana, where we produce a lot of sugar, and where we have costs that are greater than for sugar produced in the Caribbean. But the United States has seen what it is to be caught without sugar in wartime, and when there are bad crops around the world. We found we had to be able to provide a certain amount of sugar to meet our own needs, so we passed a Sugar Act and thereby we have maintained a healthy sugar industry to get this Nation by in an emergency.

And certain other industries are also regarded as essential. For example, we enacted legislation under the so-called defense amendment to the tariff bill, which would protect the domestic oil industry.

Also, just this last year, we passed some additional protection and relief to protect the footwear industry of the United States. I have in mind the rubber-sole footwear, tennis shoes, overshoes, things of that sort.

So we have, as a matter of national policy, recognized that sometimes some things might cost a little more but we ought to have certain industries that are basic American industries of long standing available to us. I think the merchant marine is such an industry.

People say you never miss the water until the well runs dry. If you find yourself in an emergency and you need these ships—and this is the main argument for the American merchant marine—there is no substitute for having ships that are American owned, that can see this Nation through the kind of emergencies that could confront us around the world. And this fleet is deteriorating to where it is not going to exist if we keep cutting it down.

As I understand what you are talking about here, this so-called policy of competitive bidding is going to do nothing more than just run a lot of operators out of business. Now, perhaps, after you run enough of them out of business, the few that are left might be able to operate with less competition. And, perhaps, by consolidating and merging

into one another, they might eventually get sufficiently small in number that the survivors could continue in business. But this is a matter of cutting down and reducing our merchant fleet, when, in truth and in fact, the merchant fleet that we have is far too small—at least the modern merchant fleet that can meet the needs of a big defense effort is too small. For example, what percentage of your capacity is the Defense Department calling on right now for the Vietnam situation?

Mr. WALSH. Well, just about everything we can make available, and it still is really inadequate to meet their needs with as fully as they would like to have them met, I think.

Senator LONG. Now you say——

Mr. WALSH. Mr. Wester would like to add something to that.

Mr. WESTER. Senator, I will illustrate that point. In February of 1965, prior to the buildup in Vietnam, the west coast lines to the Far East were averaging about 30,000 measurement tons of military cargo per week. And, with the escalation of the effort in Vietnam, we were exhorted by MSTS to provide more and more space. We did that. And, in fact, we went up as high as, during August of last year, we were carrying 90,000 tons a week. Now, that figure has fluctuated somewhat, but I think it is averaging somewhere around 70,000 tons a week.

So you can see it has doubled and tripled what the berth line capacity has been for military cargo. And, as a matter of fact, a recent study of berth liners out of the west coast indicated that, on an average, we were carrying between 60 and 70 percent military carrying outbound at the expense of what cargo we used to carry commercially.

Senator LONG. Here is the thought that occurs to me: Compared to what we have done in a big war, such as World War II, this is still a relatively small effort. Now, what position would the merchant marine be in if it had to carry this and take on an additional load somewhere else?

Suppose a fire broke out in Brazil and we needed a great deal of support in that area? Where would we go for the shipping to support an effort there, if we had to maintain six divisions in Vietnam?

Mr. WALSH. I think all of us as American citizens worry about that. I think Mr. Rand would like to comment on that specifically.

Mr. RAND. Senator Long, I just got a release yesterday from Mr. McNamara, the Secretary of Defense, which informed the congressional appropriations subcommitee, "I have yet to find any evidence that supports the conclusion that the present subsidy program for the merchant marine should be expanded for defense purposes."

And so he carries on with having an adequate merchant marine at this time. But your question, if we have another brush fire somewhere, possibly of the same magnitude as Vietnam it would pose a very very great problem. I personally don't think that we have the ships, the proper ships to be able to conduct another logistic program similar to the one we have in Vietnam at the same time. I just don't think we can do it.

I have got some figures here. The military now have, outside of layup, plus from the subsidized operators, plus from the nonsubsidized operators, plus from the tramps, they have a total of 224 vessels. That does not include their nuclear fleet, which is their own military controlled fleet. I don't know how many they have in that, but I know most of them are on the Vietnam run. In addition to that, what Mr.

66-769—66——5

Wester just said, they are providing a lot of space, weekly space, without providing the ships themselves. They are providing weekly space for the military in the Far East. And we, as a company, from the east coast, on a weekly service to the Far East, have assured the military that, in addition to the ships we have given them already, we will provide them with 200,000 cubic feet of space for their military requirements a week, the east coast to the Far East.

So it is not only the units which we have turned over to them and which they have found in other places, but it is the space in the existing comercial services which we have also turned over to them.

Mr. Wester says they have turned over increasing amounts of space on their weekly services, which we have done also, as I explained. So, if you get into another war at the same time, you have got to take into consideration the space which we are now providing, as well as the units. And I don't think we can do it.

Senator LONG. Yes. That is just the thought that occurs to me. You are pushing capacity with what is a relatively small war. And if you had a real big war forced on you, it would seem to me that we don't have the capacity we would need the way it stands now. We don't have it, and we ought to be acquiring it, because it takes several years to acquire all the ships we would need.

The Air Force might not appreciate this view, because they seem to think that if we have another war, the whole thing will be over in 24 hours, because both sides will have exterminated one another.

I think the probabilities are more likely, however, that when human beings think about it, they will say to one another, "Let's not use the atomic weapons, because, if we use them, they will use them on us." The Europeans are thinking that way now very strongly. They don't want this thing put on such a basis that the moment a war breaks out, the moment troops move in their direction, automatically the missiles go up and the bombs go off. They realize no one can win that kind of war, and it would be far more costly than if you fought it by conventional means.

So, while we talk about these fantastic weapons, the probability is these are not the weapons we are going to fight with. It is more likely the fighting will occur with the same type of equipment that has been used in the past. We have had these fantastic weapons for many years and we have been in wars, but we haven't used them. There have been many wars since World War II and no one used them, and they may never be used. So, if you look at what we need, we shouldn't be sacrificing the merchant marine, when we are going to need a bigger and greater merchant marine.

Mr. RAND. Senator, it takes about 7 years to build a ship from the start of drawing the plans, approval, building, actual construction. Some people might accuse us at this table of being interested only in self-interest. But I think it goes much deeper than that. And I think that, from a national security point of view, as I mentioned before, we have got to have more ships.

I agree with you that we are not going to have these atomic wars, as they say, and we will need to land a million troops somewhere, and they have to have equipment, as well. And the only thing that can get the job done is ships, which we are rapidly running out of.

Senator LONG. We are trying to get nations now to agree to nonproliferation of these atomic weapons. We have them, but we know what they can do to us, as well as what they can do to others.

As we pressure for nonproliferation of nuclear weapons, all of the smaller countries are going to put the pressure on us in the nuclear club to agree that we won't use nuclear weapons, and, one day, we will find nuclear weapons outlawed. And when that happens, we will be confronted with the same situation all over again; that is if we are fighting a war, we need great tonnage capacity to haul the men and supplies to wherever the fighting is.

Mr. RAND. Yes, sir.

Mr. WESTER. Senator, back to the point of the adequacy of the merchant marine, it should be borne in mind that, under the current brushfire-type war, so-called, in Vietnam, we are having no casualties to our vessels. Now that may not be the case if a conflagration should break out in some other area. We may be faced with the loss of vessels, and, obviously, that would further impair our ability to land our goods and men.

Mr. WALSH. Mr. Lykes, I think, would like to say something.

Mr. LYKES. Mr. Chairman, I fully agree with Mr. Rand's statement that, of course, we do need more ships. That is along the line of one point he mentioned earlier, of requiring appropriations.

There is another side, I think, as to the needing of more ships and that is to create and maintain a climate in which those ships can be effectively utilized through their life.

My own company, in proceedings before the Maritime Administration, and in our notice and statements to our stockholders, has outlined two broad areas which, at this time, have given us, as an individual company, pause in progressing further with a shipbuilding program. One is the very uncertain, clouded, much studied, much speculated on future shape of the national maritime policies.

What kind of an overall Government policy will this industry have to live with in the next generation of ships?

Secondly, we have seen a very unsettled labor condition, and we have felt, as a company, that we couldn't prudently proceed until we could see the good prospects of a stable labor management relationship future in our industry. The point which we are discussing here today, the competitive bidding procedures with MSTS cargoes, in my own mind this brings up a third major problem, which we, as an individual company, would want to see the future shape of before we would proceed with an extensive shipbuilding program. And, as an individual company, we must decide between now and December 31 whether or not we will proceed and commit ourselves to build 17 more ships, when funds may be available.

But our company perhaps gets 20 or 25 percent of its business through the handling of MSTS space contract berth business. However, over recent years, MSTS total revenue has amounted to only some 10 to 15 percent of our overall fleet operations.

In the context of Mr. Moot's aim and objective, which presumably he feels competent to accomplish, that of saving 25 percent of his shipping costs, I frankly don't think we, as a company, would want to handle the same volume of some business we have in the past for MSTS at 25 percent lower rates.

I don't know whether the Defense Department thinks they need our capability. They may not, but, certainly, this whole area of competitive building and the shape and the future of what and how the Department of Defense traffic is to be handled, poses a problem of the

most serious magnitude on where lines go in the future on replacing fleets.

Senator BREWSTER. On this very point, has your industry recently met with the Department of Defense on their additional requirements in the immediate future for shipments to Vietnam?

Mr. WESTER. Yes, Mr. Chairman, we received an invitation from Secretary Connors to the Committee of American Steamship Lines, which comprises the subsidized lines, generally, and a request was made for additional ships to be turned over to MSTS under a charter basis, ostensibly to fight inflation, because it was pointed out that it was costing the Government about $500,000—that is their figure—to break out ships remaining in the reserve fleet. And they felt that was an inflationary move.

Instead, they preferred to take existing liner ships, preferably the newer, faster type that the subsidized operators are operating.

Senator BREWSTER. How many new ships did they ask for?

Mr. WESTER. They are asking for an additional 23. They have 27 presently from the subsidized operators. And they are asking for a total of 50.

Senator BREWSTER. Do you know where they are going to come from?

Mr. WESTER. They obviously have to come out from out of our liner trades. And we posed quite a number of questions to them, as to how we were going to retain what little measure of commercial traffic we still have.

Senator BREWSTER. You anticipated my question. Address yourself to that. If MSTS takes these liners out of our subsidized fleet, how are we, the United States, going to maintain our position in international commerce?

Mr. WESTER. It is impossible, as we pointed out to Secretary Connors, the balance-of-payments situation would be adversely affected, but, apparently, that has no consideration, because, in his words, the Department of Defense consideration prevails even though we pointed out that these liner vessels—I am speaking now from the west coast—may go out 70 percent military, we are at the same time carrying the nucleus of commercial cargo on each of them, say, 25, or 30, or 40 percent.

And we have cut back drastically the amount of commercial cargo we have been carrying, in order to meet this military effort, which is a one-way movement outbound.

Senator BREWSTER. And your return on the military cargo is now 30 percent less than on the commercial cargoes?

Mr. WESTER. Actually, our studies have shown somewhere around 39 to 40 percent from the west coast. But the important thing that we tried to stress to them was the fact that taking the units away from us deprived us from bringing those ships in the homebound trades, where we are carrying substantial cargoes.

Take, for example, a ship that goes out with 70 percent military, and you take into account the interport carriage, the homebound carriage, the percentage of the commercial to military is sharply reduced.

In other words, we carry on a voyage 66 percent, approximately, of commercial, and only 34 percent military, when you take the total round voyage.

Here we are contributing substantially to the military effort. As we pointed out, for every ship they take from us, they are not getting a full ship; they are only getting 30 to 40 percent of a ship, because we are carrying 60 to 70 percent military already on these ships.

Mr. WALSH. Mr. Rand, I think, also wanted to comment.

Mr. RAND. Just one comment on that. As we give more ships to this effort in Vietnam—and I think we should—I think that is part of the service that should be provided by the American merchant marine. We already have given a fair number.

Now, they are asking for more, but, in our particular case, U.S. lines. If we have to give a sizable number, say, four or five, this is going to mean the abandonment of one of our trade routes, as I see it, and the abandonment of one of our trade routes represents a tremendous investment which we have put in over the years, in setting up offices, agencies, establishing ourselves as a common carrier with regular sailings.

If we have to give that up, I don't think we will ever get it back. And, yet, on the other hand, the other side of the coin, here we are being asked to make these sacrifices, which, I said before and I repeat, I think it is certainly a duty—we are dutifully bound and obligated to do, but nothing is being done the other way to help us replace our fleets. This is an aspect which I think is grossly unfair.

That is all.

Mr. WALSH. Mr. Stone?

Mr. STONE. Mr. Chairman, I just wanted to add one other point following Mr. Wester, which he didn't mention, and that is the fact that, as more and more space is turned over to the military, and each line at this table carries less and less commercial, after this current emergency is over, it becomes increasingly difficult for us to recapture that commercial cargo. We lose it to foreign lines, and it is for the most part a good percentage of it is gone.

So, following Senator Brewster's question, the military engagement, such as we are in today, does nothing but lessen the commercial participation of U.S.-flag carriers in our foreign commerce.

Senator LONG. I have been thinking about the items that we have to worry about on our balance of payments. I have the impression that, if we carried about half of the foreign trade that this country has in American bottoms, it would almost completely wipe out the balance-of-payments deficit.

But I notice now that our trade surplus has gone down very drastically. I think it is a matter of foreign countries shipping more to us, rather than our shipping less to them. This is going to cause an even greater problem in the future than we've had in the past. This being the case, we need to have even more trade routes for American lines.

So our failure to go back and reestablish these trade routes after the Vietnam fighting subsides would be very harmful. One of you, Mr. Rand, perhaps, said that he doubted we would be able to get this business back.

Mr. RAND. A lot of it is gone forever.

Mr. LONG. I hope very much that won't be the case, because we are very much going to need a certain part of this merchant marine trade, if we are going to ever solve these balance-of-payments problems.

Mr. Rand. Senator, if my memory serves me correctly, in 1964 I think the contribution of the American-flag, American merchant marine to the balance of payments, by keeping dollars in this country, rather than having them go out on foreign-flag vessels, was in the neighborhood of $1 million.

Mr. Lykes. Mr. Chairman, a direct parallel of that, in the industrial field, I had the head of a large manufacturing concern mention only a week or two ago in connection with some very heavy capacity mobile cranes, which were being produced—this was not a production line item, but a customer item on a very large export order—the military had some similiar-type cranes, and an emergency need for Vietnam preempted these derricks, just coming out of production and this foreign customer, according to my informant, went elsewhere.

This business was lost to the American producer, just like this business to us will be lost with the preemption of additional ships to the war effort. The commercial business is a very hard thing to get back.

Senator Long. Maybe we can pass some laws to help you get it back. I have a few ideas I won't discuss here, but first must have a decision whether we are really going to have an adequate merchant marine.

Mr. Walsh. Senator, before I proceed, I would like to say that we here in industry are American citizens, we are interested in the future of our country, we are patriotic, we want to do the best we can as citizens and as businessman. And we feel that what our industry thinks should be taken into consideration in what is going to be done, what is decided upon by the departments here. We really are talking in what we have been saying about fundamentals, the policy for the American merchant marine, which has been spelled out by Congress, but is not being implemented by the Government Departments, and the question of whether, instead of proceeding along those lines, we are living on a basis of day-to-day expediency.

And that is what we think requires a lot of thought. Then, in connection with the present proposal for competitive bids, as we have said, we fell if it does go into effect that it will not only result in putting some of the lines out of business, but it will also impair the ability of the remaining lines to carry out the purposes of the Merchant Marine Act of 1936. So that is the reason for our deep concern about this particular projected system.

Now to resume our statement, if I may, putting aside the present moment, when ocean shipping space is at a premium because of the Vietnam demands, what will any berth line do when forced to submit a bid for a year's supply of defense cargo? It might compute its costs, but no line will put in a bid on this simple arithmetic. He would say to himself that he must have this cargo to live and will then consider what his competitors will bid. Where the outguessing process will stop is beyond the second sight of any man in this room. What is quite certain is that, in ordinary times, the bids will be noncompensatory.

We emphasize "in ordinary times" because of a temporary paradox. At the present moment MSTS rates are low, costs are rising rapidly, and MSTS cannot do without our vessel space, which is also in heavy commercial demand. It is possible that many lines would, in these circumstances, bid substantially higher than the present contract rates. What would actually happen we don't know, and certainly none of us would disclose his thinking to his competitor. But one does wonder

why the Department of Defense has chosen the one year in the last decade when it might get high bids in order to try to save money by competitive bidding. This is, however, a temporary abnormality. We agree that 9 out of 10 years competitive bidding would, until service had been curtailed, produce lower freight rates. That, to the Department of Defense, seems to end the matter. We, to the contrary, believe it only starts the inquiry. There is no gain from lower freight rates if there is no American merchant marine left to carry the cargo at these low rates.

E. THE EFFECT UPON THE UNSUBSIDIZED LINES

The American liner fleet serving foreign commerce is operated by 14 subsidized lines and half a dozen unsubsidized lines. Four of the unsubsidized lines—SML, Isthmian, Waterman, and Central Gulf—are major factors in our foreign commerce and in the carriage of defense cargo. In all, they operate about 100 ships, or about a quarter of our total liner fleet in foreign commerce. So far as the Vietnam crisis is concerned, they are, because of their greater operating flexibility, contributing somewhere near half of the total liner calls in southeast Asia.

Their ships are, it is true, old. Without subsidy, and without a tax-deferred construction fund, they simply cannot be replaced. But old or not, the unsubsidized fleet is indispensable to the MSTS mission.

Yet the Department of Defense seems indifferent to their survival. The unsubsidized lines pay American crew and other costs, and must compete with the foreign lines bearing only a fraction of their operating costs. They contribute heavily to the MSTS mission. At present commercial and MSTS rates the lines can survive, but only so long as their war-built ships last. They cannot earn profits sufficient, especially without the tax-deferred reserves open to a subsidized line, to replace their vessels.

What would happen if rate competition for MSTS cargoes should drive rates below cost? The answer is clear and indisputable. The unsubsidized lines would within a very short period be forced out of business or into foreign-flag operations.

Mr. Moot yesterday seemed to dispose of the unsubsidized lines' problem by saying that they could move to other trades. What other trades? The lines have experimented with a variety of trades and have found the only ones they can live in. If driven out of these they have nowhere else to turn under the U.S. flag.

We see no gain to MSTS in a freight rate saving achieved at such a cost. We see no gain to the American merchant marine or to the defense capability of our Nation if a fractional reduction of freight rates brought about by competitive bidding is obtained at the cost of eliminating a quarter of our merchant liner fleet.

F. THE EFFECT UPON THE SUBSIDIZED LINES

The competitive bidding policy proposed by the Department of Defense will not, it is true, result in the immediate elimination of the subsidized lines. Their financial position is stronger, and their commitment to U.S.-flag operations is as a practical matter inextricable and irrevocable. But the difference is simply that between a prompt and a lingering death.

The subsidized lines operate about 300 vessels. Something less than half of these are new, fast vessels with the most technologically advanced equipment to be found afloat. We have, by virtue of the Merchant Marine Act, 1936, the world's largest liner fleet of fast, new vessels.

MSTS and the Navy Department have repeatedly expressed their gratification at the quality and efficiency of these liners. They have repeatedly called for even more efficient performance, even more modernization of our liner fleet. Yet the present proposal for competitive bidding would be likely to freeze the liner fleet in its tracks, and over the years lead to its gradual disappearance.

The reason is simple. Even with subsidy, the berth operator derives an exceedingly low profit. The subsidized steamship lines according to a 1964 study rank at the absolute bottom of the 50 major industries in terms of their rate of return. Their stockholders would be greater if the assets of this risky business could be converted into Government securities. There is, in short, no fat with which the lines can absorb losses on a major part of their cargoes.

If, as we consider inevitable, competitive bidding results in carrying MSTS cargoes at a loss, the entire operation of the subsidized lines is likely to move from the profit to the loss side of the line. If the steamship service is operating at a loss, there will be no vessel replacement. If vessels are not replaced, the liner fleet will wither away.

There have been raised questions relating to an unfair advantage of the subsidized over the unsubsidized lines, whether under uniform rates or under competitive bidding. The industry, both subsidized and unsubsidized, believes that uniform rates are the only solution. In the first place, the high cost of their new vessels, the restrictions and the controls placed upon subsidized lines, the effect of recapture and the possibility of renegotiation, all tend to make their advantage somewhat less than appears. In the second place, disuniform rates would be a cure which is worse than the disease. The unsubsidized lines certainly don't want to have a second-class position in the booking of cargo because their rates might necessarily be higher.

G. THE EFFECT ON LABOR

We are not going to develop the probable effect of competitive bidding in producing a sweeping loss of seagoing jobs. That is not because this is unimportant but because the committee would presumably rather hear from the representatives of the seagoing unions. We shall leave to them the development of the human cost of this new program.

H. THE OVERALL EFFECT ON THE MERCHANT MARINE

Deputy Assistant Secretary Moot, when testifying in FMC Docket 65–13, estimated that the competitive bidding program might save 25 percent of the ocean freight bill of MSTS. This would be somewhat less than $50 million a year.

The Nation is now spending about $350 million a year in direct support of its merchant marine, in construction-differential and operating-differential subsidies, and in support of cargo preference for civilian cargoes. It seems to us, even as a matter of "cost-effective" arithmetic,

very shortsighted to scuttle or at least jeopardize a $350 million investment in order to save one-seventh of its amount.

The consequences of the competitive bidding proposal are still more alarming when we look at nation objectives rather than the dollars and cents. These objectives have been many times enacted by the Congress. Each is impaired or contradicted by this proposal.

The Shipping Act, 1916, was enacted, according to its preamble, "for the purpose of encouraging, developing, and creating a naval auxiliary and naval reserve and a merchant marine to meet the requirements of the commerce of the United States." To that end, it authorized conference ratemaking and granted exemption from the antitrust laws. The Department of Defense would as to its cargoes substitute competitive bidding without regard to its devastating effect on the merchant marine.

The Merchant Marine Act, 1920, stated the national policy even more clearly, and enacted—

> That it is necessary for the national defense and for the proper growth of its foreign and domestic commerce that the United States shall have a merchant marine of the best equipped and most suitable types of vessels sufficient to carry the greater portion of its commerce and serve as a naval or military auxiliary in time of war or national emergency, * * * and it is hereby declared to be the policy of the United States to do whatever may be necessary to develop and encourage the maintenance of such a merchant marine * * *.

It seems that the Congress was not sure of executive department attachment to congressional policy, for the 1920 act went on to declare that the officials shall "in the administration of the shipping laws keep always in view this purpose and object as the primary end to be obtained." That direction is still the law.

The Merchant Marine Act, 1928, reconfirmed the policy of the 1920 act.

The Merchant Marine Act, 1936, in its declaration of policy substantially reenacted the objectives of the 1920 act, and inaugurated the subsidy system under which the U.S.-flag liner fleet has grown, as we have noted, into the world's best. It recognized that the ocean liner trade rested on conference ratemaking, and insured in section 810 that no carrier agreement should discriminate against U.S.-flag vessels.

The Merchant Ship Sales Act of 1946 in substance repeated the policy of the 1936 act, and declared it to be the policy of the Congress "To foster the development and encourage the maintenance of such a merchant marine."

As we have already noted, when the Supreme Court endangered the conference ratemaking system by invalidating dual-rate contracts, the Congress moved promptly to prevent the disastrous effects of rate competition which was threatened by a weakening of the conference ties to the shippers.

For a full 50 years, then, the Congress has maintained a consistent policy: The American merchant marine must in the national interest be maintained and promoted, and this in turn requires both Government support and rate procedures which avoid the disruption of ocean service which has always followed upon competitive bidding.

Senator LONG. All of these acts to which you refer are still on the books, I take it?

Mr. WALSH. That is correct.

Senator LONG. May I say it amazes and astounds me how some people in the executive branch—it is bad enough for the President to do it, but for someone down the line in the executive branch it's even worse—just ignore the law, and say that no matter what the law says, they are going to take the bit in their teeth and do things a different way.

It would seem to me the law would clearly preclude what is being done by the Department of Defense here. Isn't that about the way you read it?

Mr. WALSH. We feel that way too. We feel there is a definite need for reiteration, really, to all concerned, of the policy of the Congress, and to call upon them to carry out that policy.

Senator LONG. Yes. Because if the policy of the Congress is to maintain an adequate merchant marine, as the 1920 act says it is, it would seem to me that these people in the executive branch should realize that the unsubsidized lines can't afford to abide by their policy.

Mr. WALSH. Yes. Their ability to carry out, really, the policy and to effectuate what Congress has laid down for the future of the American merchant marine will definitely be impaired, there is no question about it.

We believe the Department of Defense is obliged by law to carry out the policies of the Congress even though it stands to one side of the agencies with statutory merchant marine responsibilities. As the Supreme Court, in *Southern S.S. Co.* v. *Labor Board*, once said of another agency:

> It is sufficient for this case to observe that the Board has not been commissioned to effectuate the policies of the Labor Relations Act so single-mindedly that it may wholly ignore other and equally important Congressional objectives. Frequently the entire scope of Congressional purpose calls for careful accommodation of one statutory scheme to another, and it is not too much to demand of an administrative body that it undertake this accommodation without excessive emphasis upon is immediate task.

We believe it to be in the Department's own interest to support and not to injure the merchant marine, and should have thought that the urgent need of MSTS for liner space to Vietnam—which, incidentally, we are meeting—would have put the matter beyond debate.

This Nation has not yet decided that it cannot afford a merchant marine. In one form or another ocean liner subsidies have been in effect for a century and a quarter. We have fought and won several wars which we would probably have lost without a merchant marine. We have built our foreign commerce to an extent, and with a solidity, which would have been impossible had we been dependent upon foreign-flag vessels alone.

We doubt that the proposal for competitive bidding was intended to shrink the merchant marine to minimal proportions and effectiveness. It is true that 3 or 4 years ago the Secretary of Defense considered that air transport would displace most of the needs for ocean shipping, that the passenger vessel had no military utility and the freighter not much. Since then, of course, there has been a near-war, and airfields have been found to be difficult and aircraft to be small. About 95 percent of the cargo and about ⅔ of the personnel is moving to Vietnam by ship. We believe, accordingly, that the Department of Defense no longer regards the merchant marine as a readily dispensable luxury. On that premise we conclude that the Department is not

deliberately, but only inadvertently, moving toward the possible demise of our indispensable merchant marine.

I. THE EFFECT UPON DEFENSE TRANSPORTATION

We mention with hesitation our doubts that the proposed system could accomplish the transportation mission of the armed services. This is primarily the business of the Department of Defense. We nevertheless wonder if the Department has really given mature consideration and study to all the implications of its new proposal. The matters which we believe should be of concern to the Department include:

Senator LONG. May I stop you for a moment, although I know that by asking these questions, I am delaying what you want to present here. But as a new member on the committee I didn't know about some of these matters before, and I find your statement especially interesting.

Am I to understand that the Secretary of Defense estimated 3 or 4 years ago that air transportation would displace most of the need for ocean shipping?

Mr. WALSH. That is our understanding, yes.

Senator LONG. May I say that I was in the amphibious force during World War II and we carried a lot of stuff. I saw what we could carry on amphibious craft, such as an LC–2, and I saw what we could carry by air. I gained the impression that what you can take by air, compared to what you can take even on a relatively small amphibious craft, would be like moving from one home to another and trying to do it with an automobile, by carrying the drawers out of a piece of furniture.

Let me say that once in moving from one apartment to another, with only a few boxes, I tried that, and it just wouldn't work. I finally had to call a truck. It was one van load, but I suppose that if I had continued to try to do the job by taking the automobile back and forth—by trying to fit drawers and pieces of furniture and bedsteads into my passenger automobile—we would have been at it for 4 or 5 weeks.

But I took one big van load, and the job was done. What is the capacity of the larger, cargo planes that we have, do you know?

Mr. WALSH. I really don't know. Perhaps one of the other members of the group may. I don't.

Mr. RAND. The present ones are well under a hundred tons.

Senator LONG. That is a lot of cargo to be carrying in a plane. I didn't know they carried that much.

Mr. RAND. No. I think it is well under that. The present planes apparently are capable of carrying 30 tons of cargo.

Senator LONG. About 30 tons of cargo. Now that uses a fantastic amount of gasoline to get overseas; a fantastic expenditure of gasoline.

Mr. WALSH. Senator, that was one of the things we worried about in the last war, whether we could keep our planes flying with the petroleum supplies.

Senator LONG. That is true. When a plane goes overseas, someone has to have fuel on the other end. And the fuel it would take to get him back to the United States would compare very substantially with the weight of the cargo he delivers on the other end, I suspect.

Mr. WALSH. Yes; and the supply of aviation fuel during an all-out war becomes a worry some times.

Senator BREWSTER. By contrast, how many tons of fuel does a big, modern merchant ship take?

Mr. WALSH. I think I ought to ask one who has one of them. We haven't been able to acquire one, unfortunately.

Mr. LYKES. Ten to twelve thousand tons.

Senator LONG. So as you can see, it is one thing to say you can get there faster with airlift, to get something there you need in a hurry, but if you are talking about a quantity of something, you have to carry it by some other means.

Now then, the Secretary of Defense was estimating 3 or 4 years ago that airlifting is what we would be doing. We have had a great expenditure to build up the airlift capacity. However, I understand that 98 percent of our cargo going into Vietnam is going by ship.

Mr. WALSH. Yes.

Senator LONG. So even though we have been working on increasing our airlift capacity for a good while, and even though it has cost us a great deal of money, it still represents only a small contribution to the fulfillment of our transport needs.

What would you estimate is the difference in cost between carrying bulk cargo, such as fuel or ammunition, by air and by ship over a distance of about 3,000 miles?

Mr. WALSH. There would be a fantastic difference. I can't think of it.

Mr. RAND. We can get that for the record, Senator.

Senator LONG. I would like it for the record.

Mr. LYKES. I think there was a study some years ago in the framework of the then existing large cargo planes and the marine class ships and if I remember correctly, it was determined that there would be more ships needed for the airlift to carry fuel than there would be marine ships to carry the cargo by sea in the first place. But I think we can find that for the record.

Senator LONG. If you get the costs, I am sure they will be shocking. It would certainly be more than 10 to 1.

Mr. RAND. Much more.

Mr. WESTER. As an example, we had an example of where one of our ships happened to overcarry a little bit of cargo from one port to the next, and it was urgently required at the first port and we were trying to arrange to get it out by air and we were talking about 15 cartons and the cost of getting those 15 cartons out by air was $800.

Senator LONG. When you get the figure, it is going to be a lot more than 10 for 1. However, the Defense people had the idea 3 or 4 years ago that we would move cargo by air, when it would be many times more expensive than to move it by ship. Now, as I understand it, they want the shipping people to more or less try to exist by doing business below cost, so that it would save them money, when their own proposal would have caused us to spend about 10 to 50 times as much.

Mr. RAND. While you are on the subject of airlift, I am told the C–5A, in 1970, will be able to carry 55 tons on a long trip and 100 tons on a short trip. In other words, 100 tons going to Europe, or 55 tons going to the Far East, presumably.

The C–5A in research and development will represent a cost of at least $2 billion. I thought it was more than that, but I am told it is

$2 billion. The merchant marine never has received anything like this in the way of research and development, to try and improve the ships that we produce. The appropriations for research in the Maritime Administration is very, very small.

Mr. WALSH. I think, Senator, as you mentioned a while ago, it is possible there might be an atomic war and certain things we have had in the past and up to now may not be needed, but the Vietnam situation has indicated that there is also the possibility that the other type of situation may continue for a long time. So I think we have to have all of the means available to back up whatever we may need to meet all developments.

Senator LONG. Yes, I agree with you. I regret I have to go to a meeting which I have agreed to attend. But I will read every word of your statement—I think it is a very fine statement—and I will certainly support your bill.

Mr. WALSH. Thank you very much. Shall I proceed, Mr. Chairman?

Senator BREWSTER. Please go ahead, sir.

Mr. WALSH. The matters which we believe should be of concern to the Department include:

1. We have already mentioned the probable disappearance of the unsubsidized fleet and the reduction or elimination of vessel replacement by the subsidized lines.

2. We do not know how MSTS can efficiently and expeditiously route cargo if the applicable rate, the available routes, and the quantity of shipment—each fixed by contract with the individual lines—will vary according to which ship happens to be on berth when the cargo is ready to move.

3. If the military terminals must hold cargo for the operator with the lowest rate, or for the ship which has contracted to serve the desired destination, a most costly terminal congestion is inevitable.

4. As we all know, much lower rates can be offered for a one-port to one-port or two-port to two-port operation with full balanced loads than for a multiport liner service. With awards based upon competitive bidding, it seems to us inevitable that the cargo must go to the lines which bid low for just that sort of limited service. MSTS will have, in that case, a series of agents or contract carriers offering a limited range service for full loads of MSTS cargo. Terminals and warehouses, cut to the minimum because of the almost daily arrival of liners for parcel lots of MSTS, will have to be expanded.

5. Under a competitive bidding procedure it would appear that the various steamship lines would have different rates except as they might happen by chance to be the same. Under these circumstances the various field commands of MSTS would be required, under regulations, to utilize those ships with the lowest rate. This would mean the tonnage would have to be accumulated to meet the requirements of the low bidder and valuable space on other ships would not be utilized. The necessity of accumulating tonnage for the lower rated ships would increase the inventory in the supply pipeline which is contrary to the current Milstrip procedure which is designed to minimize the tonnage in the pipeline and effect overall savings for the Government. Additionally, this would necessitate costly expansion of the number and size of terminals at both the loading and discharging ports. Unless these terminal facilities are expanded the

resulting congestion would delay cargo and result in increased terminal handling costs.

6. MSTS has, as I believe it would agree, outstandingly good service from the liner companies in its heavy movements to Vietnam. All of us have had our schedules torn apart by long delays of 30, 40, and even 90 or 100 days in southeast Asia.

Senator BREWSTER. What is the current turn-around time at Saigon or Cam Ranh Bay?

Mr. WALSH. It is better than it was. Perhaps Mr. Wester can be more specific.

Mr. WESTER. Generally speaking, it is about 30 days.

Mr. STONE. Thirty days waiting time I would say.

Senator BREWSTER. Thirty days waiting, and then how long to discharge the cargo?

Mr. WESTER. That depends on how congested the warehouses are and how urgently they require the cargo. In most cases the warehouses are badly congested.

Senator BREWSTER. The point I am trying to get at is, How long is your ship tied up either waiting or at the pier or wharf?

Mr. WALSH. It depends on the type of cargo in the ship. If it is urgent priority cargo, the ship moves in and discharges rapidly, so it varies. On many types of cargoes the ships are at the buoys anywhere from 10 to 30 days to discharge. So it is hard to give a generality on it. The military cargo is moving in faster than it did and I think fairly well, don't you think so?

Mr. WESTER. Better than it was.

Mr. WALSH. Yes, conditions have improved considerably in that respect. Shall I proceed?

Senator BREWSTER. Yes, please.

Mr. WALSH. All of us have willingly done whatever was asked of us to deliver what is needed in Vietnam. We should suppose the Department would want to give long and careful consideration to insure that a competitive bidding system did not produce low rates for the easy traffic and high rates and low tonnage availability for the indispensable but costly steamship service to the theater of war.

7. It is worth emphasizing that MSTS has, under its present shipping contract system, a willing partner in the liner industry. A year ago we established, on the west coast, an express service to Saigon on 2 days' notice. We have always accepted the fact that MSTS cannot know the consistency of its cargo in advance, and often is forced to change its destination. Restowage of cargo, vessel deviation, and rearrangement after vessel stowage of the discharge ports, are routine aspects of the MSTS traffic. We are not entering a complaint, for there are compensating advantages and we have on balance been treated fairly. Our point is rather that we have no idea how this tradition of cooperation, without regard to the costs of the voyage, can be fitted in with a cost-effective approach which gives the cargo to the line with the lowest bid, which would presumably be forced to insist on rigid adherence to its bid terms.

J. RAIL AND AIR TRANSPORT

The Department of Defense is, of course, heavily engaged with transportation other than ocean shipping of which the railroads and

the airlines are the most comparable. It does not use competitive bidding procedures with either.

1. Under section 22 of the Interstate Commerce Act the railroads are authorized to offer reduced rates for Government property. The practice of the Defense Department, when more than one road can move the traffic, is to negotiate the rates with the railroad rate bureaus. When only one road can move the traffic, it deals with that road alone. In 1957 a Federal district court held that collective action by the rate bureaus was not authorized by the statute. The Department took emergency action and induced the Congress to amend a pending bill to overcome this situation. The conference committee explained:

> In urging this amendment the Department of Defense stated that the effect of the above decision would be that unless the Reed-Bulwinkle amendment is clearly applicable to section 22 rates a chaotic situation may well exist with respect to the rendering of transportation services to the United States Government under reduced rates as authorized by section 22. The Department represented that if the carriers are restrained from acting in concert in any manner in the establishment of section 22 rates, either (1) the carriers would refrain in the future from making section 22 quotations to the Department and thus in effect repeal section 22, with a consequent increased cost to the military of over $100 million annually, or (2) individual carriers might continue to make individual quotations but under circumstances under which cutthroat competion would be inevitable.

2. Some years ago the Department of Defense moved air cargo under a system which allowed competitive tenders. The situation rapidly became chaotic and with the cooperation of the Civil Aeronautics Board a noncompetitive system was developed and has been in successful use. The Military Air Command now makes 1- to 3-year contracts with carriers. The rate is fixed by the CAB. While it has no rate-fixing authority in foreign commerce, it will exempt from its economic regulations (requiring inter alia a certificate of public convenience and necessity) only those carriers who agree to abide by its defense cargo rates. In result, defense air cargo moves under a system of regulated rates which is essentially similar to that proposed in subsection (e) of S. 3297.

It is to all of us a profound mystery why the Department of Defense should choose ocean shipping as the place to experiment with competitive bidding. We have a century of unvarying history to teach that ocean liners cannot survive rate competition among themselves. We are, we like to think, doing an outstanding job in meeting what is at this time a crucial national need. It is quite beyond our comprehension why the rail and air industries should, quite properly, be protected against the chaos of competitive bidding and the ocean liner trade subjected to it.

K. SECRET, NONCOMPETITIVE NEGOTIATIONS

We are quite unable to understand the closed negotiations which MSTS is conducting with one or two favored lines in order to establish a new trans-Pacific service. At precisely the same moment that the Department of Defense is insisting upon the virtues of open, competitive bidding, MSTS seems to be making exclusive or sole-source arrangements with one or both of two lines, newcomers to our foreign offshore trades, to establish a new containerized service based solely

on military cargo from the west coast to Okinawa. These lines do not now serve the trade and their contracts undoubtedly will permit them to raid the inbound commercial service.

The trans-Pacific lines, with a large container capacity in existence and more on the way, are not allowed even to know the terms of the proposed arrangements. The Commander, MSTS, has advised that these lines were selected after an evaluation of expressions of interest.

Senator BREWSTER. You say they are not allowed to even know the terms of the proposed arrangements? Isn't that a public expenditure of the taxpayer's money? Aren't these public facts that should be easily and readily available to everybody?

Mr. WESTER. That is right, sir. The thing is they are still under negotiation with these two lines as we understand it. We have not been privy to the arrangement that they are trying to set up with them and under what terms and conditions they propose to set up this new service. Even though we have stated frequently, at monthly meetings we have had with Admiral Donaho and Mr. Nicholas Johnson that the better liner fleet has a tremendous capability for handling container cargo. Yet, despite that, we are advised that they have gone outside and now they want to deal with lines that can offer solely full containerized ship operations, even though we could carry the same cargo in our own containers.

Senator BREWSTER. Please go ahead.

Mr. WALSH. The existing lines have never had an orderly opportunity, as by public request for proposals, to submit an expression of interest to be evaluated. Some of them were asked some months ago to express an interest, upon short notice, in a containerized service to Vietnam. The service now being privately negotiated with a sole, or perhas a dual, source is to Okinawa.

MSTS may consider that private negotiation with one or two lines, and the exclusion of the existing carriers from any opportunity to bid, is compatible with the open, competitive bidding which it is simultaneously seeking to force on the rest of the industry. We do not, and we fear for our industry if so divergent treatment is to be accorded the favored and the disfavored.

Would it not be better to request proposals from the industry and negotiate on a basis whereby container service would be supplied by the entire group of lines? Participation in the trade certainly is open to all, and ground rules for such participation in the military traffic have been compiled with by all the existing lines. Why scrap the ground rules and deliberately bring in new lines inexperienced in the foreign trade on a guaranteed tonnage basis by the Government when the present lines have container capability without minimum guarantees and with utmost flexibility as to ports and frequency?

Why not allow all to participate in the container traffic including any new lines who wish to operate there by spreading the volume over all the carriers in the trade, in fairness to all concerned, in accordance with the ground rules MSTS devised so long ago?

Senator BREWSTER. I see now on page 28 of your statement that you begin your summary. Our time is running out; unless you object, sir, I will direct our clerk to include your summary as a part of your statement as though it were read, and I would like to proceed now and ask you and your colleagues certain questions.

Mr. WALSH. Yes; that will be fine, Mr. Chairman.

L. IN SUMMARY

We feel we would be remiss in our responsibilities to our country if we failed, respectfully but firmly, to question the wisdom of the announced intention of the Department of Defense to introduce a system of competitive bidding into the procurement of ocean shipping space for military cargoes.

It is the unanimous feeling of the experienced common carrier berth lines in our foreign trades that such a system would have a seriously damaging effect on the earnings of the lines and, consequently, their ability to build new vessels which will, in turn, have a seriously detrimental effect on the future of the American merchant marine.

We think it is safe to say that our feeling is shared by virtually the entire steamship industry and by the great majority of the knowledgeable people who have had experience with ocean transportation in our foreign commerce.

We do not question the fact that those in Government who are advocating this procedure are dedicated to serving our Government in the best possible way. Unfortunately, they have had no merchant shipping background, and felt it unnecessary to consult the industry before the policy was decided upon.

Its current consultation with the industry is being done through the Navy Department advisory committee, and our views are supposed to be directed to advising, hurriedly, how such a system can be implemented. This we find difficult to do in view of our conviction that in any form the competitive bidding system is inevitably destructive.

It is the sincere and unanimous conviction of our steamship common carriers in foreign commerce that our Government has had the benefit of reasonable rates and good service for many years under the present shipping contracts.

These contracts do not commit the Government to any minimum quantities of cargo; they provide frequent regular service from a complete range of loading ports to a complete range of discharging ports for any quantity of cargo, without dead freight penalties and with substantial discounts for larger parcels shipped in any one vessel.

Space and service have been increased whenever requested by the Government, and all of the many operating problems can be worked out in comparative harmony.

Freight costs have been lower than on comparable cargo under commercial tariffs.

The Government already has the benefit of competitive factors in the way the shipping contract rates are related to the commercial tariff rates, because the commercial tariffs are themselves subject to very powerful competitive factors in the world shipping markets, which ordinarily could not at this early stage even have a judgment on the effect of the competitive bidding procedures until the proposal took form.

M. WHAT IS PROPOSED BY S. 3297

We want, in conclusion, to return to S. 3297. This is a good bill. It avoids the catastrophic effect of competitive bidding for very important cargo and offers instead an orderly and fair solution of a problem which has plagued the Government and the industry alike for a year past. It does these things:

1. It legalizes below-commercial rates for defense cargoes, and affirmatively requires that defense cargo rates not be higher than commercial.

2. It requires that rates for defense cargoes be fair and reasonable, and provides that the carriers must submit the cost data necessary for determination of such rates.

3. It provides for a Federal Maritime Commission determination of a fair and reasonable rate if the carrier groups and MSTS cannot agree. This in effect combines the rail and air systems: group negotiation, as with the railroad rate bureaus, and regulatory rate fixing, as by the CAB, if the negotiation are not mutually acceptable.

Mr. Moot yesterday explained that competitive bidding would not now be applied to the domestic trades because they were subject to rate regulation. That is precisely what we here propose for the MSTS movements in foreign commerce. It should equally make competitive bidding unnecessary there.

4. It provides for continuation of the system of fair and equitable allocation of cargo among the U.S.-flag lines and should prevent the sort of closed negotiation and apparent favoritism now in progress with respect to Okinawa.

5. It will insure that the administration of defense traffic by MSTS is designed to preserve the existing American merchant marine, and not to drive major parts of our liner fleet out of U.S.-flag service.

6. It will, so far as defense traffic is concerned, help provide a foundation for the continuation of the spectacular advances in ship technology and cargo handling which is now remaking modern ship design.

7. More tangibly, but perhaps of at least equal importance, the bill would go far to preserve the ready partnership of the merchant marine and MSTS which has, we believe, been of great value to MSTS and thus to our Nation.

We urge that S. 3297 be enacted.

Senator BREWSTER. Mr. Walsh, you may wish to refer the questions to your associates.

Mr. WALSH. Yes. More than one may want to comment to give you a complete answer.

Senator BREWSTER. Please get in the act, gentlemen.

Now in part I will refer to yesterday's testimony. We heard the associations fix the rates for berth liner services.

Is this true?

Mr. WESTER. Mr. Chairman, I would like to comment on that.

I think Mr. Moot was misinformed, because such is not the case. I personally have participated in numerous rate negotiations with MSTS in the past, and these negotiations have been carried on under a formula that was devised by MSTS.

For example, in February of 1957 Vice Admiral Will wrote to the secretary of the West Coast American Flag Berth Operators as well as the secretary of the Atlantic and Gulf Berth Operators, stating that it was necessary to come to some uniform approach in rate negotiations. So they set forth a formula which was followed and has been indeed followed up until just recently. There has been no change in this formula to date, until the suggested implementation of the competitive bidding situation.

This formula was based on average cost. You took for example total wages, on a per diem basis, subsistence, repairs and maintenance, stores, supplies and equipment, insurance, fuel, and other vessel expense. In other words, each line would compile cost data relating to these individual items. And they would relate them back to the previous negotiation and come up with a percentage increase in cost.

We would then sit down in negotiation with MSTS and go over these items one by one and in many cases we would feel that we had demonstrated the fact that our costs were of a certain amount; however, in many cases MSTS would not agree, and would in fact set aside and would grant us a certain lower amount.

In any event, the resulting percentage increase that was demonstrated, even after the cutting done by MSTS, we were not then allowed to have the full benefit of the percentage increase that we demonstrated, but rather, MSTS instituted an arbitrary formula, wherein they granted us 75 percent of our demonstrated cost increase.

Now this 75- or 25-percent reduction was ostensibly to take care of certain items that were not included in the formula such as overhead and depreciation. And even though over the years, as we all know, overhead and depreciation has increased substantially, nevertheless there was no allowance made for those items.

So we got two-thirds of whatever final result was of our cost study. And we never arbitrarily set the rates. We would sit down and finally have to agree to what they would consider our costs really were, rather than what we estimated them to be.

And the rate then would be fixed on that basis.

Senator BREWSTER. Now yesterday we heard that the domestic offshore carriers were not going to be brought under the competitive bidding system, because they were subject to FMC rate regulation.

Is there a similarity between the form of rate regulation to which the domestic offshore carriers are subjected and the system they now advocate?

Mr. WALSH. Yes, Mr. Chairman, there is. In the domestic offshore trade, the Federal Maritime Commission has the authority to determine if a carrier's rates are just and reasonable, and we are proposing, in order to avoid controversy, that a similar system could be put into effect in connection with the MSTS cargo rate negotiations.

And I would be glad to have a brief résumé written up of just how that system works, if you would like us to put that in the record, rather than to go over it here and take more time, since we are getting near the end of the period.

Senator BREWSTER. As I stated yesterday, Senator Magnuson has a very genuine and sincere interest in this and proposes to go into maritime policy in very great depth. So I would very much like to have a detailed statement submitted on this point.

Mr. WALSH. Thank you. We shall do that.

(The statement follows:)

AUGUST 5, 1966.

Re S. 3297.

Senator DANIEL BREWSTER,
Chairman, Subcommittee on Merchant Marine and Fisheries, Senate Commerce Committee, U.S. Senate, Washington, D.C.

DEAR SENATOR BREWSTER: During our appearance before your subcommittee on May 10, 1966, on behalf of the American flag ocean berth operators who support S. 3297, you asked that we supply for the record the cargo-carrying

capacity of an aircraft used to deliver military cargo. I am advised that the Boeing 707s operated by Pan American can carry a cargo payload of 76,400 pounds.

Further you have asked what the cost of carrying military cargo by aircraft would be. According to the schedule of minimum rates adopted by the Civil Aeronautics Board on March 29, 1966, and appearing in the Federal Register on Wednesday, April 6, 1966, volume 31, No. 66, pages 5408–5422, the CAB approved a minimum rate for cargo per ton mile for B–707 aircraft of 11.9 cents for a round trip or 22.4 cents for a one-way trip.

Further, we stated we would supply for the record a comparison of the provisions of S. 3297 with the provisions of the Intercoastal Shipping Act, 1933, applicable to the rates of domestic offshore operators.

In the domestic offshore trade under the Intercoastal Shipping Act, 1933, the Federal Maritime Commission is given the authority to determine if a carrier's rates are unjust or unreasonable. A carrier seeking to raise its rates must file the increased rates with the Federal Maritime Commission 30 days before their effective date. If it elects to do so, the Commission may hold a hearing to determine the lawfulness of such rates and may also suspend the effective date of such rate for a period 120 days. In such proceedings the Commission will determine whether the rates are just and reasonable and, if not, what would be just and reasonable rates. The Commission in determining whether the rates are just and reasonable will do so by determining what the carriers rate based (in general terms, its investment) is and what its return will be under the proposed new rates after considering all the carriers costs.

S. 3297 will give the Commission the same function the Federal Maritime Commission has under the Intercoastal Shipping Act, 1933, when particular rates are brought before them to determine if they are fair and reasonable. The Commission would apply the same criteria as they do under the Intercoastal Shipping Act. This would be made clear by deletion of the words from section 45(E), "such rate shall be determined with due regard to the level of commercial tariff rates in the trade". To which we are agreeable, thus leaving the Commission to pass upon the rates solely on the criteria of their being fair and reasonable. While S. 3297 does not give the Commission the power to suspend rates for a period of 120 days, such a suspension provision is unnecessary because the bill provides that when the Commission decides rates are fair and reasonable both parties shall "adjust their accounts retroactive on the date of the petition to reflect the date ultimately determined." In the meantime, the carriers would continue to charge the rates previously agreed to by the Department of Defense.

Very truly yours,

Kirlin, Campbell & Keating,
By Elmer C. Maddy.

Senator Brewster. I have a whole series of questions here, which we prepared as a result of yesterday's testimony, and I would like to keep you gentlemen here for another good half hour or maybe longer, if that is agreeable.

Mr. Walsh. We will be quite happy to, thank you.

Senator Brewster. We heard yesterday from DOD that our present U.S. merchant marine fleet is entirely adequate to the needs of the Nation if we had two situations such as Vietnam on our hands.

I would like a comment from the industry whether we could handle two such situations. I would like to know the number of vessels that are now being taken out of commerce by MSTS, and the number of vessels that would be needed if we had a second situation.

Mr. Rand. Mr. Chairman, I commented on this before when more or less the same question was brought up by Senator Long.

The conclusion was that in spite of Secretary of Defense McNamara's statement to the Appropriations Subcommittee the other day that the merchant marine was adequate to handle all defense needs, there was no need for further appropriations from a defense point of view, I think this committee before you must take exception to

those remarks, because we don't feel it is so. And they now have a total of 224 ships, 88 breakout, 50 to be from the subsidized lines, 25 from the nonsubsidized lines, and 61 from the tramps, for a total of 224 vessels, not including what they have in their nuclear fleet, which is their so-called MSTS controlled fleet.

The total of subsidized liners is 308. They will have removed 50. That will leave 258. Many of these are old ships, the old C–2's, C–3's, C–4's, and a few Victories.

As we said before, within 3 years, I think Mr. Gulick said, they would probably be obsolete. So we have approximately 125 new ships, of which they will have, well, say 25. So we will have 100 new ships left. Plus about 25 Mariners, which were built in 1952 or 1954. That is a total of around 125 new ships available over the next 2 or 3 years for any other conflict which might erupt around the world.

How one can reconcile a statement like that to the facts in the future, I cannot understand, because those ships just are not going to be available. They are not going to be there, because they are becoming obsolete for the most part.

The ones they have broken out of the reserve fleet now at great expense are certainly becoming obsolete as well. They can't be relied on for very many more years.

Mr. RAND. It is very important, essential.

Senator BREWSTER. Should this situation arise, what commercial shipping capacity would we have left?

Mr. RAND. We have left in the reserve fleet, Victory vessels or better, 214. That is the latest count as of this morning. We will have approximately 250 subsidized vessels. We will have approximately 78 vessels belonging to unsubsidized operators and the tramp operators.

So what we have left is the total of 214, plus 78, plus about 150, mostly overaged ships.

As I said before, 100 of that total, approximately, will be in ships, will be comprised of ships built since 1954. One hundred of them.

Mr. WESTER. Mr. Chairman, back to your remarks there as to what would happen to the commercial liftings of the liner vessels, obviously when we are required to give up these ships, which undoubtedly would have to be the case in the event of any conflict anyplace else, it means you just will not have any commercial service whatsoever.

And in addition to what Mr. Rand has been pointing out, although there are certain additional ships that they can take under complete charter, you have to bear in mind that those ships that are presently operating commercially are still carrying substantial quantities of military cargo, so you are not getting a ship-for-ship replacement, as I mentioned earlier in response to Senator Long's question.

Senator BREWSTER. If you withdraw berth liner vessels in a two-war operation situation, what effect would this have upon the level of bids that might be submitted under a competitive bidding system?

Mr. RAND. I think that is a very good question to ask.

If you withdraw commercial vessels from the present commercial fleets, and therefore reduce the number of vessels which would qualify for competitive bidding—that is what you are saying, is it not—I think you would find a situation which could be intolerable for the Department of Defense, in that every one of the operators with a reduced

number of ships would say "We are going to get cargo regardless of what we bid, because there aren't enough of us to go around," and I can see very easily where the bidding rates might go up through the roof, because they know full well that regardless of what they bid, they have the only ships that are available and they will get the cargo.

So I think it would have the opposite effect there, or could have the opposite effect there.

Senator BREWSTER. As an aside to this, Mr. Rand, what do you think of the Navy Department's proposal to build fast deployment logistic ships?

Mr. RAND. I was told that was out of the field of my expertise the other day.

Senator BREWSTER. I would think you would know something about it.

Mr. RAND. Over in the Pentagon. But I can't help but feel very strongly that these ships, I believe they are to cost something in the neighborhood of $40 million each, will, because of their expense and the capital investment involved, not be used for the purpose presently asserted, as deployment ships carrying cargo over the seven seas in the event of an emergency somewhere, but I think they are going to be used to replace the present MSTS nuclear fleet and be used as point-to-point carriers of military cargo.

And that is my deep-felt, or my sincere belief. I don't think there is much question about it. I don't think they can afford to operate these ships haphazardly around the seven seas, at $40 million each.

Now if you want to carry that a step further——

Senator BREWSTER. Please do.

Mr. RAND. I think that the total, $40 million each, 18 ships, would be $720 million, for 18 vessels. We could build commercially something like 110 $10 million or $12 million ships, with the Government participating—I am not sure of these figures here—the Government participating as they do now, 50 percent, about $6 or $7 million, and industry participating in the balance. We could build, instead of the 18, we could build something like 110 of these great big fast ships presently in use, or even improved, for the same price.

And although it is outside—I was accused of being outside of the field of my expertise, I still feel very strongly that what I say can very very easily happen.

Senator BREWSTER. It has been suggested that the Department of Defense recognizes the need for a sealift and therefore the Department of the Navy has recommended the building of these faster deployment logistic ships.

If they proceed with this, it would seem obvious that MSTS cargoes would then be carried on DOD Navy ships, which might well end in the extermination of the U.S. merchant marine entirely.

Mr. RAND. That is my feeling. We have not discussed that within this committee. But those are my personal views. And I think it is a gimmick, what-have-you, to replace the MSTS nuclear fleet. I think it is as simple as that.

Mr. WESTER. I could add to that that the reason we have as many ships as we do now have in operation is because we have had a combination of commercial and military cargoes.

If we did not have the military cargoes to be utilized, we wouldn't have as many ships in operation at the present time as we do.

So any reduction in the military cargo tonnage available is obviously going to have some effect on the number of ships.

Mr. Walsh. Mr. Chairman, may I add—excuse me. Go ahead, Mr. Stone.

Mr. Stone. I wanted to add one thing, Mr. Chairman. It doesn't make sense to any of us here, when the Government is subsidizing one large segment of our merchant marine, to get into situations where the Government is also competing with what they are subsidizing.

And we have always taken a position, as a group, that the Government should make maximum utilization of all of the commercial available space that is in these ships, whether they be unsubsidized or subsidized.

I can see what Mr. Rand is getting at. When we do get into difficult shipping times and can't fill out our ships, all of us, that Government-sponsored cargo, the military, is not only useful to us but it enables all of us to come out. And if we don't have that, and they are competing against use with that cargo, the Government is putting out money in one hand and throwing it away in the other hand.

That is just in effect the way it works.

Mr. Walsh. I think Mr. Chairman, it highlights the need for coordinated guidance of the Government departments in carrying out the wishes of Congress so often expressed.

We seem to be off the track and in a vacuum as far as the future of the American merchant marine may be concerned.

Senator Brewster. Let me get you back to the rather technical business of rates.

Yesterday Mr. Moot testified that the rates in these bidding procedures would be stabilized on an anual basis. I frankly didn't understand that. What does this mean?

Mr. Walsh. Mr. Chairman, we don't understand it either. It seems quite apparent that if the proposed system is carried out, that instead of having stabilized rates, we are going to have a great many rates, in every one of the trade areas where the ships are operating.

So in our opinion the system leads inevitably to instability of rates, quite a conglomeration of rates everywhere. Therefore we can't understand how Mr. Moot could make such a statement. It is just hard for us to comprehend it.

Senator Brewster. So it wouldn't work? There could be no annual stablization?

Mr. Walsh. It wouldn't have that effect. It would create instability, just the reverse.

Senator Brewster. He also testified that the suggested procedures would encourage your respective companies to become more competitive, and perhaps enhance your financial structure and profit-making ability.

I know what you answer will be, but I would like to hear it.

Mr. Walsh. Well, Mr. Chairman, this on the face doesn't make sense or at least it doesn't make sense to businessmen.

There is no question in our minds but that such a system would put some of the liner operators out of business, and would impair the ability of the remaining operators to carry out what Congress laid down in the Merchant Marine Act of 1936, to perpetuate the American merchant marine into the future, because it would impair their

ability to earn and to put money aside, with which to build expensive new ships.

Mr. LYKES. Mr. Chairman, on that, I had the greatest difficulty in following the mental exercise or line of reasoning that Mr. Moot apparently adopted. I think the normal interpretation of the words or the phrase more competitive means you can perhaps design a better product, perhaps devise ways to sell it more cheaply, and thus enhance your earning position.

Now, how in the world the reduced rate on a large part of the business that you secure can lead to the lessening of costs on another segment of business, the commercial business, I can't see any logical bridge between those two precepts.

I think to the contrary, rather than making us more competitive in commercial business, it could reduce our effectiveness, by increasing our costs. If we are going to be running less than full ships or ships less full in the future than we have in the past, it is certainly going to increase the cost per ton of handling this business. I think it flies right in the face of increasing our competitiveness.

If he means by that we might be more anxious to get commercial business, I don't think that logically follows at all. The lines represented on this committee have hundreds of offices in many parts of the world, thousands of people and they are spending millions of dollars trying to secure commercial business today, and we are certainly doing the utmost we can to reduce our costs and thus become more competitive as it is.

Senator BREWSTER. Mr. Walsh, do you have a general figure on the total capital investment of the companies sitting at this table and the total number of employees?

Mr. WALSH. I don't think we can give one now, but we can submit such data to you and would be happy to do so.

Senator BREWSTER. Do you know what your joint operations mean to the balance of payments and the gold situation of the United States?

Mr. RAND. My recollection is, Mr. Chairman, from serving on the Presidential Maritime Advisory Committee, that this question came up and if my memory serves me correctly, in 1964 the combined operation of these lines before you represented a savings in the balance of payments of $1 billion.

Senator BREWSTER. I don't want to pick on——

Mr. RAND. I think that does include the tramp operations as well and they are not represented here.

Senator BREWSTER. I don't want to pick on the Sapphire operation—just parenthetically I might note that they serve the port of Baltimore, in which I have a great interest. But would you say that Sapphire was a berth liner service?

Mr. RAND. No, sir. May I respond to that?

Mr. WALSH. Would you, please?

Mr. RAND. I would like to quote Mr. Moot in his testimony yesterday, his prepared statement, at the top of page 6.

He refers to this operation by saying:

Early in 1965, a new steamship line initiated service between U.S. east and gulf coasts and Europe/United Kingdom at rates substantially below shipping contract rates then in effect. Other steamship lines subsidized and nonsubsidized

met the competition of this new line. The effect of the rate reduction on MSTS space cost was significant. In the case of MSTS general cargo, the space rate was reduced by more than 25 percent. This successful experience with price competition in the acquisition of ocean freight service occurred during a period when the Department was reviewing its procurement practice in this area against the background of clear legislative intent and a positive management objective to secure maximum competition in procurement. The Department's review of all available data led to the inescapable conclusion that the introduction of price competitive procurement was timely, feasible, and potentially beneficial to all parties.

Now I am happy you asked that question, because I picked this up yesterday and I made some notes on it.

Incidentally, we heard last night a report, and I can't tell you whether it is an accurate report or not, that one of Sapphire's ships had been held up in Germany pending payment of certain bills. As I say, that is only a report. But if there is any degree of accuracy there, I think it is extremely significant, because Mr. Moot describes this as a successful experience.

Well, he mentions at the beginning there that a new steamship line initiated service between U.S. east and gulf ports and Europe/United Kingdom. I made some notes here about that very statement. Very soon after Sapphire announced this service, gulf and east coast to United Kingdom and Europe, it became necessary for him to curtail his service; first service was eliminated from the gulf, then service was eliminated to Southhampton, and now every effort is being made to furnish this carrier with full loads on a one-port-load, one-port-discharge basis, to make it appear that a 40-cent-per-cubic-foot rate is a reasonable rate, and then to conclude that all military cargo on the full range of ports should obtain benefit of this low rate.

Thus the Sapphire service has not been a normal berth service. It has not served the full range of ports. It has not produced revenue on a self-sustaining basis. It has not served the commerce of the United States. And in fact it is not a berth service at all, but a full cargo charter service, and has survived only by reason of a conscious effort by MSTS to reduce its costs, the line's costs, by providing it with balanced loads from and to a restricted range of ports.

Now commenting further on that, Mr. Chairman, Sapphire Line is now operating from one port to one port, insofar as possible, and I think that is generally the case. Sapphire Line is getting favored treatment by MSTS, getting full loads, they are holding cargo, so they can fill the ship, trying to score this point that they can do it for 40 cents a cubic foot. Sapphire Line is now going from New York to Bremerhaven, practically exclusively which makes a much cheaper operation as you can imagine than going down the coast, to Norfolk, and coming up to Baltimore, Philadelphia, and New York.

Senator Brewster. What is the situation between bidding on a full cargo from port to port and general competitive bidding against berth liner vessels?

Mr. Rand. The military cargo is really a liner operation. It is not a port-to-port operation. There are many right favorable ports, such as Baltimore, Norfolk, New York. The military have consolidation points inland, which are favorable to shipping their cargo to Norfolk, Philadelphia, rather than New York. So it does become pretty much of a liner service, or should be, as a commercial liner service is.

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In fact, the military, 2 or 3 years ago, said:

We are very interested in establishing a pipeline. We want to obtain cooperation from the operators to furnish ships at regular times, have regular sailings, call at regular ports, regularly. In other words, call at Norfolk, Baltimore, Philadelphia, and New York. We need all that. We want to establish a pipeline of this cargo moving to Europe and thereby reduce our inventory, which is extremely expensive. And we can only reduce our inventory by trying to establish the pipeline which I just described.

At that time we cooperated with the military, in fact we cooperated to the extent that we asked them to sit in while we were planning our new ships. And in our new ships we have incorporated various features which would not ordinarily be there had it not been for the military's requests. We did it at our expense. We put in a 75-ton heavy lift boom, serving two hatches, for their 65- and 70-ton tanks. We would not normally have done that. We put in structurally stronger decks for the carriage of their heavy equipment, which we would not have done. We put in a lot of speed in these ships, and we put in a lot of reserve speed in these ships for the military operations. We put in a lot of reefer space to accommodate the military, and in fact they have been very happy with these ships and these ships have been calling at all of the outports to pick up not only commercial cargo but military, as well.

The military, MTMTS, who is in charge of logistics, has been extremely pleased with this. MTMTS is the agency in the Government that has come out four-square against the competitive bidding, because I am sure they are afraid of what I have been describing here, that it is going to gradually degenerate into a port-to-port movement and their pipeline is going to be severely affected. Their inventories are going to go up. And if this side of it, the expense side, could only be examined, I am sure what I am saying would be corroborated. It would have to be.

To get back to Sapphire for just a moment, the return cargo, military cargo, which they refer to as retrograde, it doesn't move in any great quantity, but it does move, and we have always gotten a fair proportion of that, because of our service, but a great deal of that is now being held for Sapphire, on the theory, apparently, that they want to do everything possible to try and justify this 40-cent rate. And, therefore, they are helping, as I see it, Sapphire in every possible way to prove this point.

We can't live with those rates on a liner operation. We simply can't live at 40 cents. We did go down to 40 cents once and we suffered greatly as a result of it. We are now back to what the rate was before, 54½ cents, which is really not too good a rate itself. But we can live with it, but we cannot live with the 40-cent rate and serve the outports.

Senator Brewster. For the laymen, describe what you mean by a 40-cent rate or 54½-cent rate?

Mr. Rand. 40 cents per cubic foot is what the military now gets cargo moved for by Sapphire.

Senator Brewster. For what distance?

Mr. Rand. This is the Continent. This is the Bordeaux-Hamburg range, supposedly from the entire coast of the United States. But it has turned into, as I said before, a port-to-port movement in the main, to try to beef this Sapphire service up to justify the 40-cent per cubic foot rate, which in turn the Department of Defense is now trying to impose upon us through competitive bidding.

Senator BREWSTER. Isn't it pretty obvious that if MSTS will guarantee a full load to a single port and hold the return cargo there to accumulate a full load to a single port, that this can obviously be done far cheaper than a ship in normal commerce, calling at several ports to serve the needs of commerce of the United States?

Mr. RAND. Yes, sir. That is the whole point of it. Because by doing this, and affording Sapphire this kind of service, cargowise, confining Sapphire to one port here and one port over there, they think they can show this thing at 40 cents returning a profit.

But as you say, if the liner services, which we are, are serving the outports, and serving two or three ports on the other side, instead of one, we just can't do it. Sapphire couldn't do it; that is why it withdrew from the gulf and all of the other east coast outer ports, outside of New York. He couldn't do it. He couldn't make out.

Sapphire, furthermore, doesn't carry one stick, as far as I know, of commercial cargo. This is strictly a military cargo carrier and they are trying to prove a point which, if proven, could have extreme consequences on all of us, starting with the nonsubsidized lines, possibly going out of business or going foreign in their operations, and also have a profound effect, but possibly more lingering death, with the subsidized lines.

Senator BREWSTER. Mr. Rand, in your judgment would the subsidized lines stagger along for a further distance than the nonsubsidized?

Mr. RAND. I think we could afford to, because of the subsidy. But it would be most unpleasant and I don't think, in fact, I can assure you that our stockholders would be most unhappy.

I think also we should repeat here something that was in Mr. Walsh's statement, that two part-lots of cargo were turned down by two separate foreign-flag lines. One was Black Diamond Line and one was Holland America Line. They were offered this cargo and they turned it down because it was noncompensatory at 40 cents. So there was a foreign-flag carrier turning it down.

So how can anybody convince us—we have been through it, so we are convinced—but how can they convince anybody, in view of what I have told you here, in view of these foreign-flag lines turning this down, how can they convince anybody that Sapphire, an American-flag company with greatly increased wages and operating costs, how can they convince anybody that this is a sensible method of operation?

Senator BREWSTER. Under what legal authority was military cargo offered to those foreign flags?

Mr. RAND. I presume it was—I am not aware of the details surrounding it, but I presume they wanted to get the cargo moved in a hurry and there was no American-flag berth maybe within 3 or 4 days and the foreign flags were right there. That is the only reason I can think of.

Mr. WESTER. Mr. Chairman, they have the right under the so-called Wilson-Weeks agreement, that if there are no available American-flag lines to move their cargo, they can resort to foreign flag, but they must exhaust all of the possibilities of American flag.

Senator BREWSTER. And they cannot do it on the basis of cost.

Mr. WESTER. No, that is not one of the considerations. But to supplement what Mr. Rand has mentioned here, although I am from the

west coast, I did sit in on quite a number of the hearings in docket 65–13, and it was interesting to me to note in their first 11 voyages, by their own admission, they lost close to a half million dollars. This was when they were operating with these low rates on a range of ports.

Subsequently they obviously tried to improve their position by eliminating or limiting their loading and discharging ports and trying to overcome this deficit.

So, obviously it points up the fact that at the cheaper rate, in combination with commercial cargo, they couldn't make a go of it.

This one-half million dollars loss was prior to overhead.

Mr. WALSH. And I dn't think it took into consideration depreciation. A steamship line is not making money unless it can earn depreciation and overhead and sufficient net earnings after taxes with which to replace its property. And therefore, that has to be the criterion for a compensatory rate or for a successful steamship operation.

This again strikes at the very basis of the American merchant marine policy, because Congress has redefined many times the necessity of reserving what is called preference cargo for U.S.-flag ships. And the purpose of that is to perpetuate the American merchant marine.

Obviously unless the freight rates are compensatory, there is no purpose served then in setting aside that cargo for the American-flag ships.

Senator BREWSTER. What is the general international practice in Britain, France, Belgium, Norway? Do they carry all of their own Government cargoes?

Mr. WALSH. As far as I know, they do; yes. I think it is the practice in most of the foreign countries to have the commercial ships carry the Government cargo.

Senator BREWSTER. There is no 50–50? They carry their own Government cargo?

Mr. WALSH. As far as I know; yes.

Mr. RAND. They don't make any concessions at all. Furthermore, while you are talking about that, from a commercial point of view, the foreign flags with which we compete are much more merchant marine conscious than is our Nation. And I don't say that disparagingly at all, but ours is mostly an inland nation and many people don't even know the sea exists. But the foreign countries that we serve, and who have international-flag lines, are very conscious of their own flag merchant marine and what it means to the commerce and future of their country, and they have a lot easier time of it, in providing cargoes, commercial cargoes for their own national-flag lines than we do.

It is a fact of life. It is very difficult. We have made many attempts—and perhaps we have been negligent in a way—but we have made many attempts to get out and hustle and spread the word about the American merchant marine, but it is a very difficult thing in view of the fact that this Nation is composed mostly of States which are inland and not closely connected with the sea.

Senator BREWSTER. We heard yesterday that it had been the general foreign policy of the United States to rebuild certain industrialized countries after World War II, which we have done successfully, but it would appear to the acting chairman of this committee that in the area of the merchant marine we have been a patsy.

Mr. RAND. We have.

Mr. LYKES. Mr. Chairman, appropos of that last point, as far as what foreign flags do, I have been told by one foreign-flag operator that they secure from their own government for its military shipments from this country higher rates than we enjoy under our MSTS space contracts.

Mr. RAND. The president of a German line, one of the two German national-flag lines serving the east coast, told me the same thing, when, about a year ago, I asked him what kind of rates he got on military shipping from United States, manufactured here, which they carry exclusively, compared to commercial cargo, and he said the rates for military are much higher, but don't tell anybody.

Senator BREWSTER. I have one or two more questions. I know I am keeping you here a long time, but I think we both are vitally interested in this discussion.

Mr. WALSH. Very much so. Our time is at your disposal entirely.

Senator BREWSTER. We heard yesterday again that new procedures would not result in a rate war. I would like to have someone comment on that.

Mr. LYKES. We dealt with that somewhat in the text of the prepared statement, Mr. Chairman.

I would hope that our expertise and knowledge of our business is better than someone else's crystal ball or "extensive data."

However, we certainly disagree with the thesis that this will not create a climate which would tend toward a rate war.

Mr. Moot mentioned in his prepared text yesterday that he saw no reason, or rather, objected to the requirement of adjudication of rate differences on the basis of commercial tariff rates.

He also said "military cargo rates should not be priced on the basis of economic demand."

Well, we see no reason in the world why demand shouldn't be considered in the setting of rates. We have been told, as one justification of competitive bidding by the Government, that the Government is the biggest shipper in this country, and therefore they should use this economic strength and economic might to get lower rates.

Now that is certainly one of the conditions which is susceptible or favorable to the origin of rate wars, where you have large shippers using their economic might and strength to drive down rates.

If the biggest shipper can do it, why shouldn't the second biggest shipper or the third biggest shipper? Certainly then you have the climate and atmosphere for the creation of rate wars.

One of the basic percepts of a liner-type operation and all of our regulatory history is one of common carriage and offering the same rates or similar rates to shippers whether they be large or small. And I can't for a minute escape the fear that an abandonment of this concept is going to make it very possible, if not likely, for rate wars to develop.

Senator BREWSTER. There is one last technical point I would like to clear up.

I heard yesterday that some 50 percent of present MSTS cargoes are carried as a result of competitive bidding.

I have heard from certain of your representatives that this is an inaccurate or not fully explained situation.

Mr. Walsh, will you comment on that?

Mr. WALSH. Mr. Chairman, yes. I think that the statement was not quite clear, really, in its implications.

It may be true that MSTS is obtaining a good deal of its contract requirements as stated, but I think that the statement referred to their time chartering activity, under which they might charter ships of various types so that they would have the full use of the ships at their command to do with what they would like to do.

And this of course is an entirely different thing than we are talking about here, in connection with the shipping contracts and the handling of cargo under the shipping contracts.

So the comparison in our opinion is not really a valid one in the manner in which it was put forward.

The military cargo handled under the shipping contracts is really what we would call liner-type, commercial-type cargo essentially. In other words, most of the items they ship under our shipping contracts would be the same types of things that would normally move on the berth liner ships in regular service on a commercial basis.

And that is altogether different from tanker movements, chartering, time chartering of tankers, or even the time chartering of dry cargo ships that are entirely under their control, where they just in effect lease the carrier for a certain length of time.

I don't know whether any one of our other members of the committee would like to amplify that in any way or not. But I think to compare competitive bidding for a full ship, which is not committed, to wherever it is going to go, until a full cargo is obtained under a competitive bid, and the ship can go anyplace, as soon as the decision is reached, is similar to a situation like we are talking about, which would be subjected to competitive bidding, whereby liner ships, which once they go on berth are committed to go from and to particular places, and they have to go on that trip whether or not they succeed in obtaining a certain parcel of military cargo to go with their other cargo. The two situations are entirely dissimilar. And therefore I think they shouldn't be considered as a comparison.

Senator BREWSTER. Gentlemen, you argue there is a very distinct advantage to the entire U.S. economy and our national policy as a whole in berth line service over charter vessels?

Mr. WESTER. I think, if I may address myself to that, I think the distinction here is with the buildup in Vietnam, the liner vessels were being used to near capacity, many times in the early stages of the buildup we would get requests "Can you furnish us 10 full complete ships within a matter of days?" or "Can you give us a ship at a particular port within a matter of days?" They were using the liners to a very large extent and they found it necessary to go outside because the liners' capability was near exhaustion.

So what they did was to go out and charter more and more ships. For one thing, there were quite a number of ships that were strike bound on the east coast. And many of these went under charter to MSTS.

So I think what they are talking about is competitive bidding as between ships. They would go to one operator and say "How much do you want per day for a particular type of ship that you might have?" This is entirely different than talking about competitive bidding on particular parcels of cargo.

Senator BREWSTER. Gentlemen, I thank you very much. We have gone into this in great detail, but it has been very rewarding for this committee and I think we have developed information that will certainly help the Congress in determining national maritime policy.

So at this point I will recess this hearing subject to the call of the chairman, Senator Magnuson.

And believe me, when I say this Commerce Committee intends to proceed further in this area of our national endeavor.

Mr. WALSH. Thank you, Mr. Chairman. There is one more that we would like to submit for the record, "Reasons Why the Common Carrier Berth Lines Believe Competitive Bidding for Rates on Movement of Military Cargo Are Really Unworkable."

Senator BREWSTER. Without objection, that statement will be included in the record at this point.

(The statement follows:)

REASONS WHY THE COMMON CARRIER BERTH LINES BELIEVE COMPETITIVE BIDDING FOR RATES ON MOVEMENT OF MILITARY CARGO OBJECTIONABLE

We feel that the proposed plan to institute a system of competitive bidding for MSTS procurement of space for military cargo will have a detrimental and potentially destructive effect on the future of the American Merchant Marine.

The reasons why the common carrier berth lines believe competitive bidding for rates on movement of military cargo is objectionable follow:

1. True competitive bidding is inconsistent with the concept of frequent regular berth line common carrier service which has been offered by the operators for twenty years to meet the stated requirements of the Department of Defense.

Competitive bidding predicated upon obtaining the lowest possible rates is contrary in concept to the purpose and spirit of the Commerce and Defense Department's agreement which gave priority after the nucleus fleet to established berth line vessels to insure continuance of and development of a strong American Merchant Marine.

2. Competitive bidding will destroy the flexibility available under present uniform rate procedures whereby all American flag vessels on a given trade route are available for the carriage of military cargo from and to the range of ports with competition confined to service offered under negotiated fair and reasonable rates.

Such service permits economies to be effected by DOD through utilization of rate favorable ports and reduction in inventories.

"We believe that implementation of this system will seriously impair the ability of the berth operators to implement replacement programs with the inevitable result that fewer American flag vessels will be available for the long range service for the military requirements."

3. We believe competitive bidding is in complete contradiction to the objectives of Milstrip, a procedure already adopted and functioning in DOD. We believe Admiral Sutherling's letter of October 18 completely supports this view.

4. Movement of military cargo in parcel lots in conjunction with commercial general and commercial bulk cargoes produces an overall savings on a long range and continuing basis simply as a result of basic economies of the steamship business.

5. Competitive bidding does not assure "fair and reasonable" rates. Rates so obtained could be unreasonably high or unreasonably low depending upon conditions prevailing at time of bid. An independent determination of a minimum rate as is done by CAB for MAC in the CRAF program would be required.

6. Since the rates established by berth operators for commercial cargo are determined by worldwide competition against foreign flag as well as American flag competition and the Department of Defense can pay no more than the commercial shipper, it is fallacious to assume that competition does not determine the rates paid by the military under the present negotiated procedures.

7. Adoption of a competitive bidding system can mean that the successful bidder or bidders would receive more and the unsuccessful bidders less military cargo than they have received under the allocation system.

Since many American flag berth line carriers require a share of the military cargo to continue successful operation, adoption of competitive bidding could lead to inability to continue berth common carrier operations by unsuccessful bidders.

The allocation system has been employed by MSTS for about fifteen years and have proven an equitable means of providing transportation of military cargo at low cost to the Government.

8. Competitive bidding and the stated objectives of savings of 25 percent to 30 percent overlooks completely the history of military cargo movement which has shown that the volume and frequency of service is a paramount factor.

The military need the maximum amount of vessels available to offer regular, dependable and special service which cannot be provided by one or more low bidders.

9. Competitive bidding is a short range attempt to obtain lower rates. In the interest of the Department of Defense, the American Merchant Marine and this country any program which does not consider the maintenance of our existing fleet and provide for systematic replacement of over-aged vessels with new modern and more efficient vessels is ultimately going to prove the most expense to the Government.

10. The flow of military cargo consisting of multitudinous commodities does not lend itself to preplanned balanced loads. The service needed by the military is frequent berth line service of the highest quality.

11. Military cargo has historically moved between a large number of ports from Texas to Maine and a foreign range of ports in the major shipping contract areas. No other operator could economically service such a range of ports which is why in the past utilization of all American flag berth operator service at uniform rates has been considered so desirable by MSTS.

If any single operator had the capacity to service such areas, which none have, their rates under competitive bidding would have to be as high or higher than existing rates to cover the added voyage costs involved in such service.

12. Past history on shipment of military cargo indicates the inability of the military shipper services to forecast accurately either the amount or mix of military cargo for thirty days in advance, must less a year, and without such reliable information a prudent knowledgeable carrier would have to add a factor in his bid rate to protect for his loss due to loss of revenue due to poor cargo mix or irregular flow of cargo.

13. No single carrier can on a berth line common carrier operation handle all the military cargo on the major trade routes so competitive bidding would inevitably lead to a multiple level rate structure for the same commodity bebetween the same ports.

14. Competitive bidding procedures based solely on price would only attract the cheapest type of tonnage and would deprive the military of maximum utilization of fast modern vessels built with special features sometimes specified by the Department of Defense.

15. Maximum utilization of low bidding carriers as envisioned under the proposed competitive bidding would undoubtedly result in delays in the pipeline concept of movement of military cargo which delays would result in added inventory and stowage costs to the Department of Defense offsetting prospective savings in ocean rates.

16. Competitive bidding will tend to discourage rate stability which is essential for stable operation and long range planning.

17. If competitive bidding is in fact adopted it should be true competitive bidding and not envision subsequent negotiation or renegotiation as has frequently been the case on time charters.

18. Ultimate attrition of capability available to MSTS. We believe competitive bidding will result in rates which are non-compensatory to the operators from the standpoint of recovery of operating amortization and debt service of capital costs to say nothing of a fair and reasonable return on investment.

At best this will lead to reduction in the size of the fleets of various operators; at worst it will result in the failure or withdrawal from U.S.-flag service of a number of operators.

19. Non-subsidized lines are especially vulnerable to competitive bidding. In some instances they may be unable to bid at all. In others they may have to offer non-compensatory rates in order to obtain cargo.

A procurement procedure which jeopardizes unsubsidized lines will diminish both the service and the competition available to the Defense Department and is therefore uneconomical.

If despite industry objections DOD nevertheless insists on proceeding with such a plan the following are minimum safeguards that industry believes should be considered to minimize its damaging effect while it is being proven that industry's fears are justified.

1. Bidding should be open to any American flag common carrier berth operator providing service on a regularly scheduled, advertised common carrier basis on any trade route for a period of three months prior to the effective date of the award.

2. Request for bid should clearly state ports to be served and for a bid to be responsive should require service between all such ports. It should also state that a minimum of 500 M.T. of cargo should be available for any call at a military berth or port.

3. Request should be based on procurement of parcel lot shipment as against full ship cotract time charter type movements.

4. If bids are to be on an annual basis a suitable escalation clause must be included.

5. The cargo categories for which a rate is requested should be clearly defined.

6. If contract is for an annual period bidding should be for preference, not cargo commitments. "Me Too" should be allowed within 30 days for the 12-month period and cargo distributed equitably among rate-equal carriers.

7. Request should indicate estimated amount and mix of cargo not only for the twelve month period but also for each month to allow an orderly and reasonably balanced flow of cargo.

(*a*) Suggest that initial forecast to operator be given by the 15th of preceding month.

(*b*) Advice to operator for planning purposes fifteen days before on berth date.

(*c*) Firm offer to operator not later than ten days before on berth date.

8. Invitation should request bids on a space or space-occupied basis rather than on measurement of cargo.

9. Bid request should provide specifically the premiums allowed for improved cargo handling gear and heavy lift capability, speed and other such factors.

10. Request should provide a requirement for a guarantee of performance by performance bond or similar arrangement and evidence of owned American flag tonnage capable of performing on the basic bid tonnage.

11. There should be provision for a floor to insure an operator a fair and reasonable floor to insure a minimum return on invested capital of say 9 percent such as is the case in air procurement by MAC.

12. Request should set forth the minimum frequency of service required for each offering on each trade route.

Senator BREWSTER. The committee stands adjourned.

(Thereupon, at 1:10 p.m. the hearing was adjourned, to be reconvened upon the call of the Chair.)

(Subsequently, the following statement, letters, etc., were received to be made a part of the hearing record:)

STATEMENT OF MARSHALL P. SAFIR ON BEHALF OF SAPPHIRE STEAMSHIP LINES, INC.

Mr. Chairman and Members of the Subcommittee, my name is Marshall P. Safir. I am the Chairman of the Board of Directors of Sapphire Steamship Lines, Inc. This is a recently formed American company operating United States-Flag Ships in berth service.

Sapphire Steamship Lines was formed simply because our inland moving companies which transported military household goods were unable to obtain realistic trans-Atlantic ocean freight rates for household goods from the member lines of AGAFBO—the Atlantic and Gulf American Flag Berth Steamship Operators. One of our companies, beginning in September of 1964, proposed to the Department of Defense modifications in its procedures for the carriage of household goods. These proposals contemplated a saving to the Department of Defense of $5 per cwt. on the transportation of household goods.

This reduction would be made possible by the utilization of reusable containers which reduce handling costs and make possible other savings. It anticipated a rate for the ocean carriage of military household goods which took cognizance of the facts that, first, containerized cargo is easy to handle and, second, military household goods move in substantial amounts in both directions across the Atlantic and for this reason should not be subject to a freight rate which was based primarily on eastbound carriage. On December 29, 1964, the Department of Defense approved our proposal, stating that it would become effective April 1, 1965, as it did. Our moving company, however, was not successful in its attempt to secure a downward revision in ocean freight rates from the established American flag lines. Consequently, Sapphire Steamship Lines was organized to provide an American flag berth service which would make available to our companies and others a reasonable ocean freight rate on the carriage of household goods.

While the impetus for the organization of the Sapphire Steamship Lines was the carriage of household goods at reasonable rates, Sapphire Steamship lines does not limit its service to the ocean carriage of such goods. Staffed by experienced steamship men, it is engaged in a regular berth service to carry in either direction across the Atlantic commodities for commercial shippers and for governmental organizations, including the Department of Defense. Sapphire's tariffs represented reduced rates on household goods and on general Defense cargoes. For example, Sapphire's rate for general Defense cargoes is 40¢ per cubic foot. This rate was 14½¢ lower than the rate charged by the lines which belong to the Atlantic and Gulf American Flag Berth Steamship Operators.

Last year I described to another Congressional Subcommittee the efforts members of AGAFBO (most of whom are subsidized U.S. flag operators) to put Sapphire Steamship lines in a position where it could not remain in business. I would like to say simply that such efforts have continued.

However, Sapphire Steamship Lines has won two significant victories.

Last year, as soon as we began operating ships on the North Atlantic, all members of AGAFBO reduced their rates on a selective basis. However, on March 1, 1966, the AGAFBO lines gave up the rate battle and raised their rates back to the levels existing before Sapphire entered the steamship business. Sapphire Steamship Lines has maintained the same low rates.

Last year we indicated that Sapphire's rates would result in savings to the Department of Defense of at least $5 million per annum. The Department of Defense has estimated that its savings approximated $14 million during the one year period in which the lines met Sapphire's low rates.

Sapphire has shown that the rates charged in the past by AGAFBO carriers were unreasonably high. Sapphire Steamship Lines in recent months has been making a profit on each voyage in spite of the difficulties which AGAFBO has put in its way. In the past year, it has been able to purchase three vessels and need no longer rely on chartered vessels. Although we have been successful in the past, we expect an even brighter future. Our competitive spirit was a catalyst to the Department of Defense and perhaps is responsible for the procurement policies recently announced. Our response to competition is to continue to seek new and more efficient methods of ship construction and operation. We believe that our new ideas will result in additional significant changes in the maritime policies of the United States.

The Maritime Administration announced on May 9, 1966, that it would guarantee the mortgage for the construction of three fast container ships for an unsubsidized company providing a liner service. Sapphire Steamship Lines demonstrated to the Maritime Administration that it is feasible to build ships in American shipyards without subsidy and to operate them under our flag without subsidy. I might mention that this is the first time the Maritime Administration has supported an unsubsidized liner company by providing Title II Insurance.

Sapphire Steamship Lines has satisfied the Maritime Administration that an unsubsidized service under the American flag employing unsubsidized American ships and American seamen is feasible. In its past operations, it has established that the Department of Defense has paid unnecessarily high freight rates and that it can achieve substantial savings through requiring competitive bidding for ocean transportation service.

Although we fully support the new procurement policies of the Department of Defense, we do believe that American subsidized lines should be denied subsidy on that portion of their cargoes for which no foreign flag competition exists.

Mr. Chairman and Members of the Subcommittee, we would like to express our support for the efforts which Admiral Harllee and the Federal Maritime Commission have undertaken to fairly regulate both American and foreign flag steamship lines operating in our foreign commerce. As you are aware, the Maritime Commission has been investigating for almost a year the level of rates on government cargoes, and it was in Docket Number 6513 that the Department of Defense announced its new procurement policies.

We believe that Sapphire Steamship Lines has demonstrated that the rates charged the Department of Defense for the carriage of its cargoes have been unreasonably high. We also believe and we have the support of the Maritime Administration that it will be feasible for us to build and operate an unsubsidized, efficient, modern and rapid ocean transportation service. For these reasons, we join with the Administration in opposing S. 3297.

Finally, Mr. Chairman, on May 10, 1966, I sent Senator Daniel Brewster, the Acting Chairman of the Subcommittee, a telegram indicating my concern and surprise regarding certain statements made during the course of your hearings on the morning of May 10th. The telegram stated the following:

"I must express my shock and concern regarding certain statements made during the course of your hearing this morning, May 10. Although apparently not made by the regular witness, I cannot permit this statement to go unanswered. Therefore, in order to complete and clarify the record, please be advised of the following:

"1. The circumstances surrounding the alleged arrest of our ship are still unclear, although our staff is investigating the entire incident.

"2. Our German attorney, on his own initiative, is filing legal actions against those participating in this unwarranted attempt to restrain the vessel.

"3. The ship is set to sail on schedule tomorrow, May 11, and no delay whatsoever has been caused in loading or sailing.

"4. All monies outstanding have been paid and the lien has been removed.

"5. We have reason to believe that this action was retaliatory in nature and was brought by the Port of Bremerhaven and/or its subsidiary and affiliated companies because of the recent diversion by Sapphire of two of its vessels from Bremerhaven to Antwerp for discharge, at which latter port better services were assured."

The tentative findings of our German attorney concerning the legality of the arrest of our ship have been verified. Although the ship was not delayed and sailed on scheduled we intend to pursue this matter further.

Thank you, Mr. Chairman and Members of the Subcommittee.

PACIFIC AMERICAN STEAMSHIP ASSOCIATION,
San Francisco, Calif., May 26, 1966.

S. 3297: MSTS cargoes, FMC rate regulation allocation of cargoes.

Hon. WARREN MAGNUSON,
U.S. Senate, Washington, D.C.

DEAR SENATOR: Pacific American Steamship Association supports the bill S. 3297 as a necessary measure to clarify practices and establish procedural steps in rate-making policies for procurement of ocean transportation by the Defense Department under the 1904 Act (10 USC 2631).

The supporting arguments for this legislation were ably set forth in the testimony delivered by Mr. Walsh of Waterman Corporation of May 10, 1966, on behalf of all U.S.-flag berth carriers having contracts with MSTS. We support that testimony.

In essence, this bill establishes Federal Maritime Commission as the arbiter in case when a group of carriers and MSTS cannot jointly agree on a rate or rates. It confirms the legal status of U.S.-flag carrier agreements established pursuant to Sec. 15 of the 1916 Shipping Act. It confirms the authority of carriers to quote reduced rates to the Government and it requires that commercial rate structures and rate relationships be carefully considered in cases where FMC is called upon to establish a rate for Department of Defense cargoes. It requires the use of an allocation system as a means of accomplishing equitable distribution among available carriers of military cargo.

The bill, as introduced, includes domestic carriers within its purview, however, Mr. Walsh in his testimony for the carriers on May 10 agreed with the Defense Department witnesses that domestic carriers should be removed. Our support for this bill is in fact predicated upon an amendment which confines the terms of the bill to foreign commerce. We are advised that such an amendment is expected to have no important opposition.

We share the views expressed in the testimony on May 10 of Mr. Walsh concerning the dangers inherent in competitive bidding on ocean transportation. All forms of common carrier transportation enjoy some kind of allocation system as the means of procurement. Why ocean transportation should suddenly be singled out for launching into this historically unsound practice is beyond comprehension.

S. 3297 is a means of insuring fair and reasonable rates to the Defense Department and should put to rest the notion that open competitive bidding insures low rates for U.S.-flag ocean transportation. I neffect S. 3297 insures that rates will reflect a factor of capital replacement which open competitive bidding tends to ignore. This feature is essential to the continuance of a strong merchant marine.

Very truly yours,

RALPH B. DEWEY, *President.*

EXCERPT FROM THE HEARINGS BEFORE A HOUSE COMMITTEE ON APPROPRIATIONS, 88TH CONGRESS, 1ST SESSION

PART 4

General KELLY. "The system of procuring contract airlift by formal advertising had many disadvantages which have been overcome by our present system of negotiation with CRAF participants at CAB minimum rates. Prior to fiscal year 1962 contract awards, MATS airlift procurement was accomplished by formal advertising which was open to all carriers, and awards were made on the basis of the lowest possible price. At that time the bidders' list contained some 92 eligible bidders. Among these bidders were many operators who owned no aircraft nor maintenance facilities, and in some cases did not even have a sufficient administrative organization. Under this system of obtaining the most transportation at the lowest cost, we were encouraging the use of equipment which had been, in many cases, fully depreciated. In other words, our system promoted the use of the more obsolete equipment and precluded carriers operating under MATS contracts from obtaining a fair and reasonable profit to enable such carriers to acquire more modern equipment. The more stable and efficient carriers were either precluded from obtaining any MATS business under this competitive system, because of larger depreciation expenses required to support more modern equipment, or were forced to utilize their most obsolete equipment for moving DOD passengers and cargo. In addition, short-term requirements were procured by competitive bids under, or by use of, our call agreements with the resultant rate fluctuating up or down depending upon the capability existing among the carriers bidding for MATS call business. In other words, during the peak traffic season, industry attempted to recoup some of the revenue forfeited by its low bids during the slack season in order to obtain the award.

"Under the present procurement procedure of negotiated bids with CRAF participants at CAB minimum rates, advantages have accrued to both the Department of Defense and the air transportation industry. First, established rates insure reasonable profits to the carriers, enabling the acquisition of more modern equipment for use under MATS contracts as well as in regular operations. Also, airlift contracts are negotiated with CRAF participants who have on hand or have ordered modern turbine powered cargo or convertible aircraft for performance of peacetime contracts with additional capacity available for use of the Department of Defense in periods of airlift emergency. Finally, higher maintenance standards are insured by CRAF participants who are certified or supplemental carriers." (p. 770.)

AFL–CIO MARITIME COMMITTEE,
Washington, D.C., May 17, 1966.

Hon. WARREN G. MAGNUSON,
Chairman, Senate Commerce Committee,
Washington, D.C.

DEAR SENATOR MAGNUSON: The AFL–CIO Maritime Committee and the Labor-Management Maritime Committee wish to go on record in strong support of S. 3297 now before the Senate. The reasons for this needed legislation have been well stated in official testimony before the Merchant Marine Subcommittee of the Senate Committee on Commerce. We repeat the essential benefits which would be gained by passage of the bill. They are as follows:

1. It legalizes below-commercial rates for defense cargoes, and affirmatively requires that defense cargo rates not be higher than commercial;
2. It requires that rates for defense cargoes be fair and reasonable, and provides that the carriers must submit the cost data necessary for determination of such rates;
3. It provides for a Federal Maritime Commission determination of a fair and reasonable rate if the carrier groups and MSTS cannot agree;
4. It provides for continuation of the system of fair and equitable allocation of cargo among the U.S.-flag lines and should prevent the sort of closed negotiation and apparent favoritism now in progress with respect to some areas;
5. It will ensure that the administration of defense traffic by MSTS is designed to preserve the existing American Merchant Marine, and not to drive major parts of our liner fleet out of U.S.-flag service; and
6. It will, so far as defense traffic is concerned, help provide a foundation for the continuation of the spectacular advances in ship technology and cargo handling which is now remaking modern ship design.

We are convinced that the proposed competitive bidding processes now being considered by MSTS will not only complicate the entire rate determination process, but will, in the long run, fail to achieve the objectives sought. It would bring in new lines inexperienced in foreign trade, reduce the quality of service, drive rates toward non-compensatory status, favor companies with no replacement obligations to meet, and greatly impair the liner service, particularly those which must, by contract, maintain a replacement program in the orderly process of providing the nation with a stable and viable merchant fleet.

We urge the passage of S. 3297 as in the best interest of our defense efforts. This legislation will foster stable and reasonable rates, and contribute greatly in sustaining a strong U.S. merchant fleet, particularly in the liner trade.

Respectfully submitted.

HOYT S. HADDOCK, *Executive Secretary,*
AFL–CIO Maritime Committee.
EARL W. CLARK,
HOYT S. HADDOCK, *Codirectors,*
Labor-Management Maritime Committee.

BROOKLYN, N.Y., *June 6, 1966.*

Hon. WARREN MAGNUSON,
Chairman, Commerce Committee,
Senate Office Building, Washington, D.C.:

For many years this union has protested against the procurement policies of the Department of Defense and particularly MSTS with respect to ocean shipping. The systems of negotiated bids employed by the Department has frequently been utilized to force down freight rates received by tramp and tanker operators even below actual cost, the result has been that a number of tramp operators had been forced into bankruptcy. We therefore welcome the recent announcement by the commander of MSTS that in the future shipping would be procured for military cargo on a competitive bid basis. We think that competitive bids are highly appropriate for tramp and tanker operators and for bulk carriers. On the other hand in the past shipping has been procured from both subsidized and unsubsidized minor operators by negotiations. We believe

that some flexibility must be retained in dealings between the Department and the liner operators. This is manifest from the fact that subsidized operators receive operational and construction subsidies which place them in a highly advantageous competitive position with respect to unsubsidized liners. In addition the history of liner operations shows that competitive bidding between liner operators is disastrous. This has been recognized by the Congress throughout the history of our mechant marine legislation. We therefore feel the competitive bidding would not be appropriate for liner operators. We therefore favor the bills, S. 3297 and H.R. 15283 which are designed to continue negotiated procurement with liner companies and we therefore urge their early enactment.

PAUL HALL,
Seafarers International
Union of North America, AFL–CIO.

CIVIL AERONAUTICS BOARD,
Washington, D.C., February 19, 1965.

Hon. LAWRENCE E. HARTWIG,
Chairman, Renegotiation Board, Washington, D.C.

DEAR MR. HARTWIG: Your letter dated January 29, 1965, requests information concerning Board regulations pertaining to MATS contracts before the issuance of Part 288 of the Board's Economic Regulations, the circumstances leading up to the issuance of Part 288, and the Board's experience under Part 288 insofar as the minimum rates therein bear upon the exemption from the Renegotiation Act of 1951 for contracts with a common carrier for transportation at rates regulated by a public regulatory body. Since Part 288 applies only to foreign and overseas rates for military charters and the Board also establishes minimum rates for certain domestic military charters, we have expanded our response to include such domestic services. Also, because of its close interrelation we have included references to Board actions and policy pertaining to minimum rates for military cargo transported on scheduled, as opposed to charter, flights.

Prior to October 1, 1960, the Board's supervision of rates charged the military by civil air carriers was quite limited. To the extent that carriers desired to perform services for the military beyond the scope of their normal operating authority, the Board usually granted the necessary authority without any condition as to the rate charged. In fact, such authority often embraced an exemption for the tariff-filing requirements of the Federal Aviation Act.

During that period, the rates for these services were usually established by competitive bidding among the carriers for specified services during a stated time period. The intensity of such competition resulted in a downward rate spiral which culminated in the assumption of contracts generally at uneconomic levels of compensation. Severe losses were sustained by some carriers with detrimental impact to the national interest in a sound civil air carrier system. In view of these circumstances and after careful consideration with the Department of Defense, the Board decided that it would no longer grant operating authority for military contract operations at rates deemed to be below the minimum economic level for the type of service involved. The Board also rescinded a regulation which until then had afforded carriers authority to perform military charters without reference to the rates charged. Effective October 1, 1960, therefore, minimum rate standards uniformly applicable to all carriers were specified in granting operating authority to perform charter contract services for MATS to foreign and overseas points including Alaska and Hawaii.

The minimum rates for such services are set forth in Part 288 of the Board's Economic Regulations as well as in Board orders authorizing particular operations. From time to time amendments have been incorporated in Part 288 to resolve technical problems or to revise the minimum rates in light of current or anticipated conditions. The Board recently proposed a comprehensive revision of Part 288, to take effect July 1, 1965. A copy of Part 288 as adopted by the Board August 9, 1962, including seven subsequent amendments thereto and the proposed Part 288 applicable to fiscal year 1966, designated EDR–79, are enclosed. There is also enclosed a copy of Board Order E–21000 granting exemptions for fiscal year 1965 to the carriers to operate MATS foreign and overseas charters.

Other types of military contract operations were brought under similar supervision from the rate standpoint in recognition of what appeared to be destructive rate competition. Effective July 1, 1961, authority to perform certain cargo charter services ("Logair" and "Quicktrans") within the 48 contiguous states was made subject to stated minimum rates of compensation. Up to the present time these minimum rates have been set forth only in our orders authorizing particular services.

Board orders granting operating authority for fiscal year 1965 are enclosed for Logair (Order E-21001) and for Quicktrans (Order E-20994). We have also enclosed orders establishing Logair and Quicktrans rates in effect subsequent to July 1, 1961.

In October 1963, the Board found it necessary and appropriate to condition carrier authority to operate scheduled flights to certain military bases on the east coast and in Europe on the maintenance of specified minimum rates for the carriage of military cargo on such flights. Effective July 1, 1964, a similar rate condition was imposed with respect to scheduled flights to/from a military base on the west coast. These rates for military cargo have usually been set forth in air carrier tariffs. Copies of the pertinent orders are enclosed.

You also inquired if in establishing minimum rates, the Board takes in consideration the use by the carriers of certain Government facilities, services and personnel, and that they would be relieved from incurring certain expenses involved in ordinary commercial transportation. The Board did take these facts into consideration. Note, for example, page 17 of the enclosed Notice of Proposed Rule Making (EDR-79) and Appendix A thereto.

Sincerely yours,

ALAN S. BOYD, *Chairman.*

KANSAS STATE UNIVERSITY
SEP 14 1966
MANHATTAN, KANSAS