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# 94-66 AMEND THE MERCHANT MARINE ACT OF 1936

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## HEARING

BEFORE THE

SUBCOMMITTEE ON MERCHANT MARINE

OF THE

COMMITTEE ON COMMERCE

UNITED STATES SENATE

NINETY-FOURTH CONGRESS

SECOND SESSION

ON

S. 3171

TO AMEND SECTION 502(a) OF THE MERCHANT  
MARINE ACT, 1936

APRIL 8, 1976

Serial No. 94-66

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## AMEND THE MERCHANT MARINE ACT OF 1936

APRIL 8, 1976

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

The subcommittee met at 9 a.m. in room 5110, Dirksen Senate Office Building, Hon. J. Glenn Beall, Jr. presiding.

Senator BEALL. The subcommittee will come to order.

This morning the Merchant Marine Subcommittee meets to consider S. 3171, a bill to extend the authority of the Secretary of Commerce until June 30, 1979, to award ship construction subsidy for vessels on which the price has been negotiated between the shipbuilder and prospective ship purchaser.

It also permits the CDS rate for such contracts to rise to the same level as competitively bid contracts.

We have only a short lease on the premises this morning, so we will first ask Mr. Ed Hood, president of the Shipbuilders Council of America to give us a brief outline of this subject. Then we will ask Secretary Blackwell to answer some questions we have.

If any persons wish, they may submit written material for inclusion in the record on this bill.

[The bill and agency comments follow:]

[S. 3171, 94th Cong., 2d sess.]

A BILL To amend section 502 (a) of the Merchant Marine Act, 1936

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That the third sentence of section 502 (a) of the Merchant Marine Act, 1936 (46 U.S.C. 1152 (a)) is amended as follows:

(1) By striking out "June 30, 1976" and inserting in lieu thereof "June 30, 1979."

(2) By striking out the phrase "(i) the negotiated price will result in a construction-differential subsidy that is equal to or less than 45 per centum in fiscal 1971, 43 per centum in fiscal 1972, 41 per centum in fiscal 1973, 39 per centum in fiscal 1974, 37 per centum in fiscal 1975, and 35 per centum in fiscal 1976;"

(3) By striking out the designations "(ii)", "(iii)", and "(iv)" and inserting in lieu thereof "(i)", "(ii)"; and "(iii), respectively.

COMPTROLLER GENERAL OF THE UNITED STATES,  
Washington, D.C., April 7, 1976.

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

DEAR MR. CHAIRMAN: This is in response to an informal request from a member of your staff for our views on S. 3171, which would amend section 502 (a) of the Merchant Marine Act, 1936 (46 U.S.C. 1152 (a)) to extend the authority

Staff member assigned to this hearing: Richard J. Daschbach.

of the Secretary of Commerce to accept a negotiated contract between a shipyard and a ship purchaser. From the information we have developed to date about the construction-differential subsidy program, administered by the Maritime Commission, we have no reason to object to the extension of the negotiation authority.

Sincerely yours,

R. F. KELLER,  
Acting Comptroller General  
of the United States.

Senator BEALL. Mr. Hood, it is always a pleasure to have you before us.

**STATEMENT OF EDWIN M. HOOD, PRESIDENT, SHIPBUILDERS  
COUNCIL OF AMERICA, WASHINGTON, D.C.**

Mr. Hood. Thank you, Mr. Chairman. I will summarize the salient points that were contained in a letter I addressed to the chairman on April 5.

Simply stated, we believe that in considering S. 3171 the subcommittee will want to take recognition of several basic influencing developments.

First of all, the world shipbuilding market has substantially collapsed in the last several years. We have illustrated this by a chart attached to our letter.

Second, there is considerable evidence of price reductions, not only in Europe, but in Japan. Another chart attached to the letter indicates that from a peak in mid-1974, Japanese prices have been reduced by 20 to 25 percent. These prices we are told by our friends in London are about 25 to 35 percent lower than those being quoted in Europe at this time.

Historically, European yards have been able to offer prices lower than American yards. So as a consequence, we are within the ball park, Mr. Chairman, of a CDS range of 40 to 50 percent.

Under today's circumstances, you can find those who will suggest that it might be even higher than 50 percent.

This world shipbuilding situation has naturally impacted on U.S. shipbuilding. On the basis of today's order book and production schedules, come the end of 1978, there will be only seven merchant ships under construction in American shipyards.

This of course will affect operations and manpower, and come mid-1977 employment will begin to drop sharply in affected yards.

So there must be some framework of stimuli for new work, new shipbuilding contracts under the 1970 act, and we believe that S. 3171 should be enacted with one possible change and that is, in view of the new budgetary process, rather than extending the bill for 3 years to June 30, 1979, you might consider extending it to September 30, 1979, to tie into the new budgetary milestones.

And that summarizes our position as best as I can.

Senator BEALL. The House bill, I understand, places a 45-percent ceiling on negotiated contract subsidies.

Mr. Hood. Correct.

Senator BEALL. What figure do you think we should strive for—50 percent as in this bill, or 45 percent?

Mr. HOOD. In my statement Mr. Chairman, we suggested that the ceiling be placed at 50 percent for an indefinite period of time, or alternatively, through some provision for flexibility on the part of the Maritime Administration in the event that the 45-percent limit is demonstrably exceeded.

Senator BEALL. In your statement you note that throughout the shipbuilding world negotiated contracts are a way of life.

How long has negotiated contracting been a way of life or the norm around the world?

Mr. HOOD. The norm around the world goes far back. The norm in this country, with respect to contracts under the 1936 or 1970 acts, was coincident with enactment of the 1970 act and since that time virtually every contract that has been placed was negotiated.

Senator BEALL. In this country does the Maritime Administration act in any way as a party to the contract?

Mr. HOOD. Yes; they are a party to the contract. That is required by the act.

Senator BEALL. And in the negotiations?

Mr. HOOD. Well, the negotiations are essentially on ship characteristics and pricing between the builder and the buyer.

But as we all know, the Maritime Administration keeps a pretty good eye on what is going on in the public interest.

Senator BEALL. They are looking over everybody's shoulder?

Mr. HOOD. Yes.

Senator BEALL. Thank you, Mr. Hood.

[The statement follows:]

STATEMENT OF EDWIN M. HOOD, PRESIDENT, SHIPBUILDERS COUNCIL OF AMERICA

Your Subcommittee will soon give attention to legislation (S-3171) to (1) extend the option of negotiated contracting in connection with merchant ship construction projects coming within the purview of Section 502(a) of the Merchant Marine Act, 1936, as amended by the Merchant Marine Act, 1970, for three years, and (2) raise the 35 percent construction differential subsidy (CDS) ceiling applicable to negotiated contracts as presently mandated by the 1970 Act.

Enactment of this bill, in our view, would be fully compatible with conditions as they prevail today. In light of the present state of shipbuilding economics worldwide, a CDS ceiling guideline of 50 percent, rather than 45 percent as approved by the House of Representatives on March 15, 1976 would seem appropriate, if any opportunity for merchant ship construction in the United States which might develop in the foreseeable future is not to be foreclosed.

Except for one contract for the construction of three product tankers in mid-1975 which was cancelled in late 1975, no other CDS shipbuilding has been placed with American yards since June 30, 1974—20 months ago—though there have been several ship conversion projects in the interim. The outlook for new shipbuilding contracts is meager, and placement of even the limited volume of new work with U.S. builders now projected will be largely contingent upon the availability of CDS support at levels which will assure parity.

Regarding point (1)—extension of negotiated contracting—there appears to be no disagreement in any quarter. Throughout the shipbuilding world, negotiated contracting is a way of life, and all contracts placed with American shipyards as a consequence of the 1970 Act have evolved from this method of procurement. Negotiated contracting has the merit of permitting the owner to obtain an optimum price, of enabling the owner to work closely with a selected shipbuilder on essential details at a formative stage, of facilitating marketing endeavors by individual shipbuilders, and of minimizing the cost and effort involved in the preparation of bids by a multiplicity of bidders, only one of which will usually receive a contract. Results to date argue persuasively for

a continuation of the authority for negotiated contracting beyond the present expiration date of June 30, 1976.

As to point (2) pertaining to cost/price differentials, it needs to be stated that while U.S. shipbuilders have consistently met the declining CDS scale as prescribed by the 1970 Act, ability to maintain a 35 percent level is now doubtful. Because of the sharp decline in merchant ship construction market opportunities everywhere (see Attachment A), there is evidence that some foreign builders are resorting to desperation price cutting in an effort to obtain urgently needed work and to keep their labor force employed—regardless of true cost. This trend toward “starvation pricing” abroad sensitively affects CDS determinations in this country.

Attachment B illustrates the extent to which shipbuilding prices in Japan, for example, have dropped in 1975. This tabulation indicates that, in 1975, Japanese newbuilding prices were reduced 20/25 percent from a mid-1974 peak. With a surplus of shipbuilding capacity rapidly developing in most countries and a depressed market which is expected to persist for at least two to three years, it can be reasonably anticipated that this downward trend in pricing will continue, and no observer, at this time, could authoritatively say for how long.

Mr. A. Ross Belch, President of the British Shipbuilders & Repairers National Association (SRNA), in a speech here on March 3, 1976, described the current situation in this manner:

“... Since 1973 Japanese shipbuilding capacity has increased by one-third and new contracts have fallen to a mere trickle. As we all know, 1975 has seen the demand for tankers—accounting for more than half the world's fleet—disappear almost entirely. And the Japanese are now in the position that they have to scour the world to mop up practically any work which becomes available, simply to keep ticking over the vast production machine which their ambitious expansionist policies have created.

“Whilst one can admire the undoubted efficiency of the Japanese shipbuilding industry and the sense of national dedication which has created ‘Japan Incorporated’ and which has traditionally ensured that all Japanese ships are built in Japan, it is with considerable alarm that we find today that the world's market for ships is being dominated by the Japanese by the simple expedient of cutting prices to the point where competition is virtually killed stone dead. Generally speaking, in the EEC our price levels are about the same and with most ship types Britain is fully competitive with its West European counterparts. But certain prices being quoted by our Japanese competitors today would only just cover the cost of our materials without any allowance for labour costs, overheads or profit...”

In a cable from London only this morning, C. H. Baylis, SRNA Director, advises me: “As regards prices, it is clear that the Japanese can offer firm figures varying from about 25 percent to 35 percent below European prices. The percentage is greater for fairly straight forward vessels like bulk carriers and less for more sophisticated cargo carriers. I must emphasize that any comparison should be with European prices. U.K. and European prices are now broadly in line. I would also emphasize that these prices generally reflect the quotations by larger Japanese yards... Individual small Japanese yards from time to time quote prices as much as 50 percent below ours... Generally one can say with confidence that the Japanese are now competing fiercely for all types of ships and are quoting very low prices.”

It is of course difficult to establish the true differential between a domestic and foreign shipbuilding price at any point in time with exactness because of the unlikelihood of an absolute comparison: two identical ships being constructed simultaneously—one in the United States and one abroad—under identical procurement procedures, production conditions and cost accounting methods. The task is further complicated by price-influencing actions by foreign governments, having no relationship to real costs, to keep people employed and to minimize the social costs of unemployment.

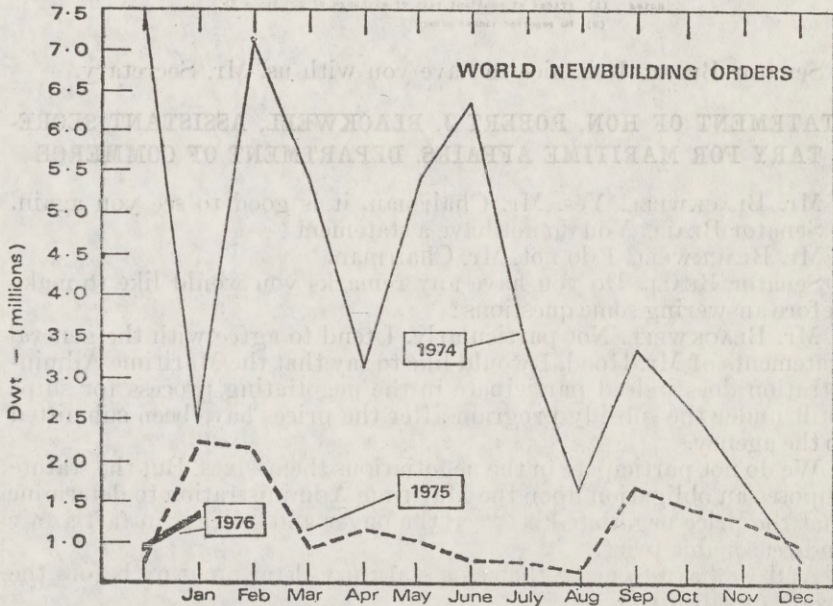
Desperation pricing merely aggravates this difficulty. In another sense, as Mr. Belch and Mr. Baylis state, movement from a seller's to a buyer's market brings with it, not unexpectedly, all of the usual pressures for lower prices in spite of persistent escalation in costs for labor, materials and services. But, this fact is plain: lowered shipbuilding prices abroad, for whatever reason, have the effect of expanding the CDS differential in this country and of discouraging U.S. shipbuilding. One can only surmise, at this moment, but the CDS level for containerships is now probably somewhere between 40-50 percent, and might well exceed 50 percent. The recent Japanese pattern, against the historical fact that U.K. and European shipbuilding prices have generally been lower than those offered in the United States, argues persuasively for a maximum ceiling.

The depth of despair among foreign builders and their reactions thereto plus the duration of the current market slump are unpredictable—to a major extent subject to economic influences wholly beyond control of the domestic builder. These uncertainties, it seems to us, must be recognized in enacting S-3171: if not through placing the CDS ceiling at 50 percent for an indefinite period of time, then through provision for flexibility on the part of the Maritime Administration in the event that a 45 percent limit is demonstrably exceeded.

Finally, on another relevant point: the pending legislation contemplates extension of the negotiated contracting option for three years—until June 30, 1979. In view of the revision in budgetary timing which becomes effective with Fiscal Year 1977, the Subcommittee may want to consider extending this provision until September 30, 1979. Thereby, an important milestone would be fixed in relation to future budgetary factors.

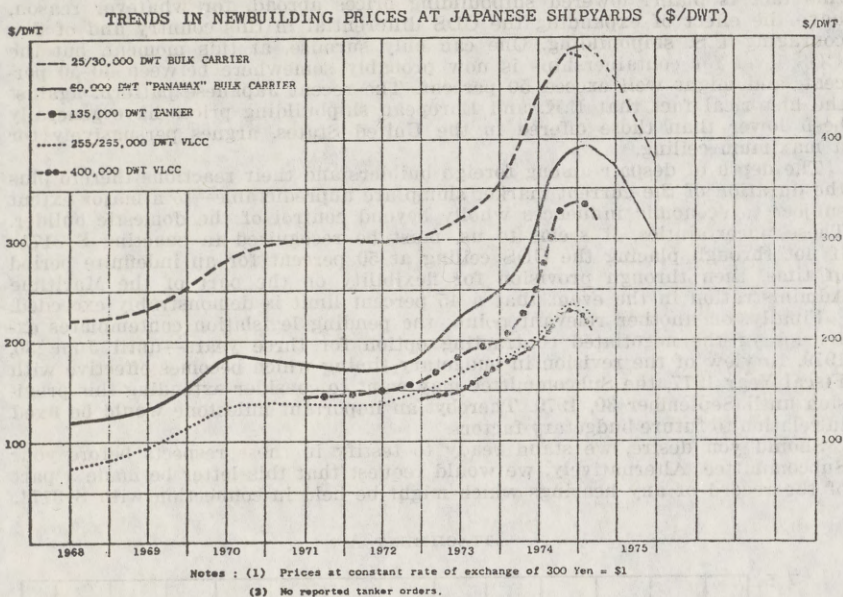
Should you desire, we stand ready to testify in these respects before your Subcommittee. Alternatively, we would request that this letter be made a part of the record of any hearings which might be held in connection with S-3171.

## ATTACHMENT A



## ATTACHMENT B

MARCH 1976



Senator BEALL. It is nice to have you with us, Mr. Secretary.

**STATEMENT OF HON. ROBERT J. BLACKWELL, ASSISTANT SECRETARY FOR MARITIME AFFAIRS, DEPARTMENT OF COMMERCE**

Mr. BLACKWELL. Yes, Mr. Chairman, it is good to see you again.

Senator BEALL. You do not have a statement?

Mr. BLACKWELL. I do not, Mr. Chairman.

Senator BEALL. Do you have any remarks you would like to make before answering some questions?

Mr. BLACKWELL. Not particularly. I tend to agree with the general statements of Mr. Hood. I would like to say that the Maritime Administration does indeed participate in the negotiating process for ships built under the subsidy program after the prices have been submitted to the agency.

We do not participate in the negotiations themselves. But the statute imposes an obligation upon the Maritime Administration to determine that the price negotiated between the buyer and seller is in fact a fair and reasonable price.

And we have to make that as a statutory determination before the award of subsidy.

Not only the staff, but myself as well as members of the Maritime Subsidy Board, have been very active in this type of negotiation.

I would say in almost every case submitted to the agency for the 58 new ships that we have built under the program, that we have been able, working with the shipbuilder, to bring the price down somewhat, and in some cases rather substantially.

Senator BEALL. Your role is that of protecting the public, I assume?

Mr. BLACKWELL. That is right, sir.

Senator BEALL. How many CDS-built ships that have been contracted for since 1970 have been the result of negotiation?

Mr. BLACKWELL. Every vessel that we have built under the subsidy program, that is, 58 new ships, as well as a score of major conversions, have all been under the negotiated contracts. We had, to my recollection, two attempts to go competitive bidding since 1970. One was with the contemplated building of four roll-on roll-off vessels for State Steamship, which were originally put out for bids and which ended up in both an economic and political disaster. They ultimately went negotiated pricing.

And very recently Farrell Lines has gone out for competitive bids on two container ships, after going the negotiated process route. We don't know what those prices will be.

I expect the bids will be open in probably a week. Those are the only two instances where competitive bidding was even tried.

Senator BEALL. Do you think it would be better if we had used the competitive bidding?

Mr. BLACKWELL. No, I don't. I think the statute as written provides sufficient protection to the public in terms of the taxpayers' participation in the building program by the declining CDS rate.

In addition to that, the Maritime Subsidy Board would still have the statutory authority to determine the fairness and reasonableness of the price.

I think in addition to that, as I have testified in our hearing before this committee, in my personal opinion competitive bidding is costly, more costly and time-consuming.

I think it would in fact cost the Government as well as the ship-builder as well as the purchaser more money, and it is the antithesis of the program. The program was designed in 1970 to have the shipyards design ships that could be built in production series, standard vessels, and we would put the marketing of the vessel in the hands of the shipyard rather than having the purchaser go to the yard with his own design.

I know that in this recent case of the Farrell bids, very significant amounts of money have already been expended, not only by the proposed purchaser in getting the plans and specs for the ship, but by the yards who are essentially starting a bidding process which takes a great deal of time when done seriously on the basis of someone else's plans.

It is very, very time consuming. The other thing is that a yard in trouble is very likely to bid extremely low on price simply to get the contract, and not be able to fulfill the contract and ends up with an inferior ship and a great deal of litigation, which I think we all want to avoid.

Senator BEALL. So what you are saying is that the negotiated bidding process under the 1970 act is better than competitive bidding under the 1936 act, because you get a cheaper ship?

Mr. BLACKWELL. I don't think there is any question about it. You not only get a cheaper ship, but it facilitates the development of standardized vessels that can be built in a series, where the shipyard can get the benefit of the learning curve and pass on some of those

benefits not only to the purchaser, but to the taxpayer as well in the form of subsidy.

Senator BEALL. Although the authority for negotiated contracting expires on June 30, 1976, in some cases, for all practical purposes, it expired some time ago, because of the 35-percent limitation?

Mr. BLACKWELL. No question about it. As a matter of fact, in any case where we cannot build a ship at the 35-percent level or below, we are precluded by the statute from using the negotiated contract procurement for vessels.

Senator BEALL. And that in effect puts you out of business?

Mr. BLACKWELL. It doesn't put us out of business. It allows us to then use the option of competitive bidding up to 50 percent, which has the defects that I think all objective people looking at the program, whether they are in maritime or not, I think will agree that it is a cumbersome way to build ships.

As Mr. Hood pointed out, it is contrary to shipbuilding business practices all over the world.

Senator BEALL. Last fall you testified before the House Merchant Marine Committee, I understand, that the differential for container ships was about 43 percent. What is that figure now?

Mr. BLACKWELL. It would be in the 40- to 45-percent range, we believe. We don't know what the prices—we will have a better idea in a few days when the Farrell bids come in, but to some extent that number would be determined by what we consider to be the representative shipbuilding center, whether it is Japan or Western Europe. And if we considered it Japan for container ships, it would be quite high. If we considered it to be Europe, it would be somewhat higher, I would think in the 40-percent to 44-percent range.

Senator BEALL. Do you see the rates increasing or decreasing over the next 3 or 4 years?

Mr. BLACKWELL. My own personal view is that we have gone about as far on the rates, in terms of the differential, as we will go.

This country seems to have been able in recent months to get its inflation under control somewhat better than they have in Western Europe and in Japan.

I think there is also an absolute limit on how long the Japanese can continue to cut prices. At some point they are simply going to have to stop and revert to a pricing practice that returns the yard profit. The one thing that is questionable and does affect the CDS rate is the continuing strengthening of the dollar against the currency in the competitive shipbuilding area.

As the dollar strengthens against the franc or against sterling, it makes it more difficult to meet the CDS standards prescribed in the statute, because those ships in effect become cheaper, and American ships in effect become more expensive.

So as the dollar strengthens, it is much more difficult to meet the statutory guidelines.

The other factors, I think, are encouraging. And I think for other reasons it is encouraging that the dollar become stronger, but not necessarily for the shipbuilding program.

Senator BEALL. Do you think the passage of this legislation, which eliminates the 35-percent figure, will lead to the signing of more contracts in fiscal 1977 and 1978?

Mr. BLACKWELL. I would think so. Based on our current experience, particularly with Farrell Lines, where we have an instance where we can demonstrate that the CDS rate actually frustrated a ship from being built, and we know from our own analyses of several different types of vessels that are being contemplated being built in this country they simply can not be built under the present CDS negotiated contract system. Some of them, LNG's, could be built under negotiated contracts, because the CDS rate there would be below 35 percent.

However, the statute, our authority completely runs out on June 30 on negotiated contracts regardless of the rate.

Senator BEALL. Does the existence of a particular differential figure tend to obligate the Government to pay a specific differential amount?

Mr. BLACKWELL. No, sir. That simply operates as a ceiling, and there are a number of statutory criteria which we follow, and if the proposed applicant for Government assistance is unable to meet that criteria, regardless of what the subsidy rate is, we don't subsidize the ship.

In other words, we have to make an economic viability determination on the use of the vessel, and financial resources is another one. And unless the proposed ship operator can pass muster, even if the rate is satisfactory, we simply will not award the subsidy.

Senator BEALL. Do you think there are adequate safeguards in the act now to protect the public?

Mr. BLACKWELL. I do, sir. I think if you were able to talk to the shipbuilders they would assure you that the Maritime Administration in the 58 contracts that have already been awarded under negotiated contracting authority have in fact perhaps been overzealous in protecting the public interest.

In many cases we cut millions of dollars out of the price of a ship.

Senator BEALL. So there is no experience, no evidence, that this negotiated contracting process has been abused in any way, or that it should not be extended?

Mr. BLACKWELL. Not to my knowledge. GAO has been to the agency, they have looked at some of these awards, and after all, they go back almost 4 years now, and I think we have satisfied them that we are protecting the public interest.

Senator BEALL. A letter addressed to the chairman from GAO<sup>1</sup> in response to a request for their opinion has been placed in the record.

They say:

From the information we have developed to date about the construction differential subsidy program administered by the Maritime Commission, we have no reason to object to the extension of negotiation authority.

As you know, I have introduced S. 3171. Can you support this bill?

Mr. BLACKWELL. I can't at the present time, Mr. Chairman, because I am unauthorized. The Maritime Administration has in fact formulated some language, its own bill, which has been cleared very recently by the Department of Commerce, and it is now before OMB.

But until they act, I am really not authorized to support the bill, or to comment on it in any way.

<sup>1</sup> See p. 1.

I can say if the bill does not go forward, it is going to dramatically affect in a deleterious way the shipbuilding program. I don't think there is any question about that.

Senator BEALL. In your capacity do you feel some obligation to convince the administration we should continue this program?

Mr. BLACKWELL. I have done my best, Mr. Chairman.

Senator BEALL. Do you think there is any rationale for distinguishing between competitive bidding and negotiated bidding, as far as the CDS rates are concerned?

Mr. BLACKWELL. Only to the extent that it is my personal view that competitive bidding is much more cumbersome, it will take longer to build a ship in terms of the paperwork. I think the lawyers are going to get rich. And I don't see any reason why those additional costs associated with competitive bidding should be borne by the shipyards, the proposed purchaser, or the Government, if there is an alternative way to build ships, in which the Government's interest is protected, and I believe there is.

Senator BEALL. You said that Japanese prices have gone about as low as they will go?

Mr. BLACKWELL. Just to give you an indication of how low they are in terms of their being able to attract the tonnage, as far as 1975 the Japanese were able to garner 94 percent of the world's shipbuilding for export. And I think if that figure were looked at within the last several months, that percentage is even higher.

They literally have captured the world shipbuilding business and they have captured it as a matter of price, basically.

Senator BEALL. And the only way we can put our shipyards on parity with this foreign competition is to meet their price?

Mr. BLACKWELL. Well, if we can. There is a point that obviously if the Japanese are essentially dumping ships, I think it becomes a matter of policy whether the United States wants to engage in a counterdumping campaign.

We are concerned by the Japanese pricing, not as much as the Europeans are, because they are literally getting wiped out.

We are concerned because of the impact on the CDS rate determinations that we have to make, because the statute requires us to take a representative shipbuilding center for our foreign cost determination and the parity concept requires us to provide the U.S. purchaser with a ship at the price he would have to pay for a vessel abroad.

It is basically unfair to the American shipbuilder if he can get a vessel in Japan for \$16 million to say no, we are going to use Western Europe, where the rate is \$22 million, and make him pay more than he would have if he bought the vessel in Japan.

Senator BEALL. What effect has the current CDS rate for negotiated contracts had on actual shipbuilding in the United States?

Mr. BLACKWELL. Well, it is essentially impossible to build under negotiated contracting any vessel in the United States other than an LNG ship or a major conversion of an existing vessel.

We can meet the 35 percent CDS rate on major conversions, and the LNG rates are probably in the area between 20 and 25 percent. On everything else, we simply cannot meet the rate and we cannot use that authority in the statute.

Senator BEALL. When was the last CDS contract executed by your agency?

Mr. BLACKWELL. We executed in June 1975 three product carriers for Avondale Shipyards.

In addition to that, during 1975, we executed four major conversion contracts—two for Moore-McCormack, and two for Farrell.

These were fairly significant conversion contracts—\$10 million, \$12 million, \$15 million. But the last new ships were in June.

The financing on those ships was not finalized and the ships, while the contracts have not been canceled, are not going forward to construction. The proposed purchaser is still out seeking not only the long-term charters, but the financing for those carriers.

One of the things we are looking at is the Virgin Island bill, which this committee heard testimony on last week.

Senator BEALL. Those ships may never be built then?

Mr. BLACKWELL. It is quite possible they won't be built.

Senator BEALL. When was the last contract prior to those?

Mr. BLACKWELL. It was about a year earlier, in 1974, and we built three 37,000-ton product carriers for National Steel and we contracted for three huge tankers, almost 400,000-ton tankers, at the Newport News Shipyard.

And two other ships for a company in Philadelphia at National Steel, also 37,000 tons.

Senator BEALL. What happens if the differential is above the permissible CDS ceiling? Can a shipowner or purchaser absorb the cost?

Mr. BLACKWELL. That is a good question. We have had that before us, not only as a matter of policy and legal determination, but actually as an actual proposal by some shipyards and some purchasers.

We have taken the position, Mr. Chairman, that it cannot be done under the old act, and it should not be done, because after all, the act is designed to place the U.S. purchaser on parity with his foreign counterpart. If he is picking up anything over and above the real differential, he is, in fact, paying more than his foreign counterpart.

In addition to that, we have felt that when Congress and the administration worked together in the late 1960's to pass the 1970 act, the basic intention was to get the industry more productive and to reduce the subsidy as far as possible.

We think that allowing the owner to pick up some part of the differential above that prescribed in the statute is not in keeping with the intent of Congress and with the intent of the administration in providing the motivation for productivity that we all were interested in in 1970.

For those two reasons we have taken the position, both on policy and law, that it is not permitted under the 1970 act.

Senator BEALL. Are there situations where the shipbuilder and the prospective purchaser are part of the same corporate entity?

Mr. BLACKWELL. Yes. We built some ships at Seatrain, where Seatrain Shipbuilding and Seatrain Operating Co. were essentially indistinguishable, although the vessels were built for separate companies.

In that case, in determining the reasonable price of those vessels, we used the yard at Sparrows Point which was an existing shipyard, as the competitive gauge for those new ships, so there wouldn't be any intercorporate hanky-panky, if I could call it that.

In fact, both the shipyard as well as the purchaser screamed that the Maritime Administration was not being fair to them. But we wanted to avoid this lack of arms'-length bargaining, so what we did was essentially substituted the productivity standards as well as the prices of similar ships at a comparable shipyard.

Senator BEALL. So although that causes you some concern it also alerts you to be a little more careful?

Mr. BLACKWELL. That is right. We have as well that potential existing at the Sun Yard, but they are not currently engaged in the CDS program, and I take it, if Tenneco were to build LNG ships at the Newport News Shipbuilding facility, that problem could also exist, because that is a parent-affiliate relationship.

And of course Ogden in New Orleans, while it is a shipyard, it also has an operating company. But so far they haven't built any ships.

Senator BEALL. If the U.S. cost differential exceeds 50 percent, that in effect vitiates the negotiated contracting price?

Mr. BLACKWELL. Currently it vitiates everything, as I understand it. We wouldn't proceed competitively or with negotiated pricing.

Senator BEALL. What do we do in a case like that?

Mr. BLACKWELL. We don't build a ship.

Senator BEALL. Should we do anything legislatively to handle the possibility of that occurring?

Mr. BLACKWELL. I don't think it is necessary to do it now.

I think, you know, I have a promotional bent to support the merchant marine, but I also think there is a reasonable price where the Government has to stop in terms of taxpayer support for the industry, and unless the industry can demonstrate that it is becoming more competitive, and reducing its dependence on the Government, I think we should take a second look at it.

I think up until now the shipyards have done a damn fine job and the reason they are having difficulties is not of their own making, but of economic problems that are existing abroad over which they have no control.

But I think when we get to the point of 50 percent, where the Government is putting half the price of the ship in, it is time to take a hard look.

Senator BEALL. How about purchaser absorption above 50 percent?

Mr. BLACKWELL. Here again, as I said, under the present statute we believe it is prohibited, if there is an intention, a continued intention of motivating the industry toward efficiency, and also maintaining the parity concept, where the purchaser does not pay any more than he would if he built the ship abroad.

Because in a sense he is paying a penalty. If he is paying anything more for a ship here than he can pay abroad, regardless of how it is done, in effect we are penalizing him for building in the United States because he can get that ship cheaper in Japan.

Senator BEALL. What if he wants to do this?

Mr. BLACKWELL. If he wants to do it? Of course from the point of view of parity, if he wants to avoid or not be consistent with that, I think that is a personal decision he makes. I think, however, there is the other side of the coin, and that is whether the Government should continue to contribute at a high level if the CDS rates are that high that

we are making the buyer absorb some portion of the differential other than prescribed by the statute, because in that case I would think the rates would be over 50 percent, where the Government and the purchaser are making a contribution to buy a ship that is more than 50 percent higher than the cost of the vessel abroad.

I don't think we have to do it. In any event, we are going to have an opportunity, if the legislation we are discussing now passes, to review the situation in 3 years or possibly a little longer than 3 years as suggested by Mr. Hood, which I also think is a sound suggestion.

Senator BEALL. Thank you, Mr. Blackwell. We appreciate your coming here so early in the morning.

Does anybody have anything else to add to the record?

[No response.]

If not, the hearing is adjourned.

[Thereupon, at 9:40 a.m. the hearing was concluded.]

[The following information was subsequently received for the record:]

STATEMENT OF SEA-LAND SERVICE, INC.

This statement is submitted on behalf of Sea-Land Service, Inc. in support of S. 3171, a bill to amend § 502(a) of the Merchant Marine Act of 1936.

The purpose of the Bill is to extend to June 30, 1979 the authority to award construction-differential subsidy contracts by negotiation between the owner and the yard. Negotiated contracts, rather than competitive bids, have been successfully used in shipbuilding for many years and are generally considered a more efficient and less expensive method for the construction of ships, particularly orders for a series of vessels.

First of all, it should be made clear that a 50% ceiling for negotiated contracts will not increase the CDS money authorized for this program. The amount of the authorization is a separate matter which is not and will not be changed in any way by resetting the CDS rate at 50%.

Also, the 50% ceiling for negotiated procurement has the statutory precedent of many years of the Merchant Marine Act. The fact that a ceiling is set at 50% does not mean that all or any awards would be made at that level.

Under the present law, the authority to enter into a negotiated contract under the Merchant Marine Act will expire on June 30, 1976. The House of Representatives has passed a bill, H.R. 11504 which would extend the authority to enter into negotiated contracts until 1979, however, an amendment was added which would place a ceiling on the CDS rate of 45%.

We support S. 3171 which would not only extend the authority to negotiate contracts to June 30, 1979, but would also permit an increase in the CDS rate to 50%. We believe there is a clear and present need for this authority to negotiate up to 50%. Last November Assistant Secretary of Commerce for Maritime Affairs, Robert J. Blackwell testified that a containership would cost \$40 million in Japan and \$70 million in the United States. This would mean a CDS rate of 43%. However, that was last November. Since then, both the activities of foreign shipyards in quoting prices and the currency differentials have combined to put even greater pressure on the CDS rate.

At present there is a "massive oversupply of shipbuilding capacity" according to Seatrade Publications (January, 1976) and foreign prices are already being quoted substantially below U.S. prices. At the same time, the currency differentials are growing. On the basis of these developments, we would estimate that the November 1975 figures of a \$40 million price in Japan and a \$70 million price in the United States, would be significantly more disparate today. It is apparent that the dropping prices in foreign shipyards have made a 50% rate necessary. Unless the authority to negotiate at such levels is allowed, an owner would be compelled, in today's market, to use competitive bidding or else not build under the CDS program. Negotiated contracting would simply not be available.

Competitive bidding, however, has not been used in 1970 Act's program, nor in most other ship construction projects. Competitive bidding is inefficient and

involves needless expense. This is particularly true in the case of multi-ship procurement where the owner would normally negotiate with one yard and receive a favorable price for awarding a series of vessels. It would also be difficult or impossible to achieve the economies by follow-on construction work. Competitive bidding also involves the preparation of bid responses by several yards at large expense, although one yard will receive the award. This is a totally useless expense to the yards not receiving contracts.

No CDS contracts have been awarded recently. In order to revive CDS contracting in the face of this worldwide depression in shipbuilding we believe it is necessary to authorize negotiated procurement with a 50% ceiling for three additional years. Unless the facts justify awards at that rate, the awards will not be made. However, if the facts do warrant contracts over 45%, the owner should not be arbitrarily compelled to resort to competitive bidding and the likelihood of waste. In other words, the difference of 5% could be eaten up by the needless expenses entailed in competitive bidding itself. For these reasons, we urge the favorable consideration of S. 3171.

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#### STATEMENT OF THE LABOR-MANAGEMENT MARITIME COMMITTEE

The Labor-Management Maritime Committee, composed of major Steamship Lines and Maritime Unions, submits this statement in connection with hearings on S. 3171 held by the Sub-Committee on Commerce, on April 8, 1976. S. 3171 would extend the option of negotiated contracting for ship construction projects under Section 502(a) of the Merchant Marine Act of 1938 as amended by the 1970 Merchant Marine Act for a period of three years. It would also raise from 35 percent to 50 percent the construction differential subsidy ceiling applicable to negotiated contracts, the lower percentage being mandated by the 1970 Merchant Marine Act.

The House of Representatives has approved legislation which would establish a ceiling of 45 percent as compared to the 50 percent ceiling proposed in S. 3171. We would support the higher figure as more applicable to today's economic situation in the shipbuilding industry, based on worldwide conditions.

Raising the applicable CDS ceiling guideline is most essential if commercial shipbuilding in the United States is to continue to progress. It is our understanding that no new CDS shipbuilding has been placed in American shipyards since June 30, 1974, except for a contract for three product tankers and that even this one contract has been cancelled. Thus, unless encouragement of shipbuilding in the United States is forthcoming, our vessel construction program, so well launched by the 1970 Act, will be grinding to a halt. S. 3171 is a step in the right direction for it acknowledges the realities of world ship construction economies in the 50 percent ceiling guideline adjustment and adequately provides for a 3-year extension of the negotiated contracting process. It is our understanding that negotiated contracting reduces the cost in dealing with multiple bidders, leads to securing the best possible contract price, facilitates many administrative and marketing efforts, thus speeding up the whole process of attaining desired shipbuilding goals.

As to the need for raising the construction differential guideline of the 1970 Act to a higher level, it is to be noted that downward trends in pricing in foreign countries, especially Japan, have made the 35 percent ceiling of little effect. The Shipbuilders Council has shown that in 1975, Japanese construction prices on new ships were reduced 20-25 percent. This fact, coupled with a depressed market and a world excess in shipbuilding capacity, makes building in U.S. yards look bleak indeed. The lower the shipbuilding prices in foreign countries, the greater, of course, is the CDS spread and thus, the need for such adjustment in the 1970 Act CDS ceiling as S. 3171 provides.

The Labor-Management Maritime Committee supports the enactment of S. 3171 which encompasses both the negotiated contracting process and the 50 percent CDS differential level as well as the three-year extension of time. As has been previously suggested by others filing with your Sub-Committee on this legislative proposal, the terminal date of the three-year extension might well be September 30, 1979 rather than June 30 of that year due to the new fiscal year time frame now adopted by the Federal Government.

We are pleased with the opportunity of filing this statement and respectfully request that it be made a part of the record of the hearings on S. 3171.

MARITIME TRADES DEPARTMENT,  
AMERICAN FEDERATION OF LABOR AND  
CONGRESS OF INDUSTRIAL ORGANIZATIONS,  
Washington, D.C., April 7, 1976.

Hon. RUSSELL B. LONG,  
*Chairman, Merchant Marine Subcommittee, Committee on Commerce, U.S.  
Senate, Russell Office Building, Washington, D.C.*

DEAR SENATOR LONG: The AFL-CIO Maritime Trades Department, representing 43 international unions whose members are involved in all phases of U.S. shipbuilding and ship operation strongly supports S. 3171, a bill to raise the limit on ship construction differential subsidy under the negotiated procurement program to 50 percent.

The Maritime Trades Department wishes to commend Senator J. Glenn Beall for introducing S. 3171, and for the leadership he has shown in seeking to gain enactment of a bill which will so greatly benefit the nation's shipyard workers and those in allied trades.

At the present time, U.S. shipbuilders must contend with unfair competitive practices by foreign shipyards, which in the words of the Secretary of Commerce for Maritime Affairs, amounts to the "dumping" of new vessels. Led by Japan, nation after nation is offering to build ships at below cost rates in order to attract orders from ship operators. U.S. shipbuilders have been seriously hurt by these foreign price slashing activities.

U.S. shipyards have not had a substantial number of orders for new ship construction for almost two years and their order books have diminished to the point where worker lay-offs may soon occur. In addition, several orders have been cancelled recently.

For these reasons, it is essential to provide the U.S. shipbuilding industry with flexible construction subsidy limitations that will take into consideration the price cutting practices abroad. S. 3171 would provide this needed flexibility by raising the subsidy ceiling for negotiated construction contracts to 50 percent which is in line with the existing subsidy ceiling on contracts obtained through competitive bidding, which is 50 percent.

Under the new bill, U.S. shipowners would continue to be required—as they are at present—to justify their need for construction differential subsidy, whether it be 15 or 50 percent. They would do this by providing data as to the differential between the cost of a U.S. and a foreign built ship. Construction contracts pending before the Maritime Administration for 50 percent construction differential subsidy are evidence that this subsidy level is needed in today's world shipbuilding market.

For these reasons, the AFL-CIO Maritime Trades Department urges the speedy enactment of S. 3171, a bill to aid in the maintenance of U.S. ship construction industry and the jobs of union members who work in these yards and in allied industries. We would appreciate it if this letter could be included in the hearing record as our statement in support of the legislation.

Sincerely,

PAUL HALL,  
*President.*

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UNITED STATES DEPARTMENT OF COMMERCE  
BUREAU OF MARITIME SERVICE  
WASHINGTON, D.C. 20540

Honorable J. Edgar Hoover  
Federal Bureau of Investigation  
Washington, D.C.

Dear Sirs: The AT-CIO Maritime Trades Department has been informed that your office is interested in the activities of the U.S. Maritime Trades Department and its affiliates. The U.S. Maritime Trades Department is a labor organization which represents the interests of the maritime industry in the United States.

The U.S. Maritime Trades Department is a labor organization which represents the interests of the maritime industry in the United States. It is a non-profit organization and its primary purpose is to represent the interests of the maritime industry in the United States.

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