



BEFORE THE
**UNITED STATES SENATE
COMMERCE COMMITTEE**

State of the American Maritime Industry

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Testimony of:

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On behalf of the Shipbuilders Council of America (SCA), I would like to thank Chairman Wicker, Ranking Member Cantwell, and members of the Committee for the opportunity to provide testimony on the state of the American maritime industry, specifically the economic opportunities in the U.S. and shipbuilding industries. I ask that my entire testimony be submitted for the record.

I am Matthew Paxton, President of the Shipbuilders Council of America (SCA), the national trade association of the U.S. shipyard industry. The SCA is comprised of 85 member shipyard facilities and 105 industry partner member companies that represent the vital supply chain that make up the U.S. shipyard industrial base.

From tug boats to aircraft carriers, and everything in between, the domestic shipbuilding industry is diverse and operates in several sectors including government new construction, government repair and modernization, commercial repair and modernization and commercial new construction. SCA Members and the U.S. shipyard industry build some of the most technologically advanced ships in the world for our government customers including the U.S. Navy and the U.S. Coast Guard as well as for a vibrant domestic commercial market.

The Jones Act

That commercial market is sustained by the Jones Act by providing certainty and stability. This law, which is provided at no cost to the U.S. government, helps to ensure the existence of a domestic shipbuilding and ship repair industrial base. The Jones Act also ensures the maintenance of a merchant marine that is sufficient to carry our domestic water-borne commerce and also ensures an adequate number of ships and mariners to meet national security requirements in times of war or national emergency.

From our industry's perspective, the Jones Act also ensures that the U.S. maintains critical shipyard infrastructure and an associated skilled workforce that can build, repair, modernize and maintain the more than 40,000 vessels of the domestic Jones Act fleet. This industrial base also

ensures there is a sufficient workforce to support the construction and repair of our critical national security fleets.

Simply put, the Jones Act sustains a domestic market for which carriers, operators and shipyards vigorously compete. When the Jones Act is not enforced or undermined by shortsighted policy, there can be dramatic influences on that market.

Recently our shipyards completely recapitalized the tanker market due to the oil boom. It is a testament to the Jones Act that the commercial shipbuilding sector was able to rapidly meet the market demand for domestic tankers and deliver these state-of-the-art vessels for that transportation sector. It was a true success for our industry.

In addition, our shipyards recently delivered numerous large ocean going containerships and RO/ROs to recapitalize the noncontiguous fleets. Vessel construction for these important shipping routes is ongoing at several shipyards, but will be completed in the coming years. This fleet includes world's first LNG-powered containership. Again, it is a result of the Jones Act that we have such a capable and robust shipyard industry to build for these markets.

In a contrasting example, a 2017 decision by the Department of Homeland Security to not revoke a series of letter rulings that have allowed foreign-built, foreign-crewed and foreign-owned offshore supply vessels to operate in violation of the Jones Act has created uncertainty and resulted in the cancellation of numerous new U.S. vessel construction contracts. The cancellation of contracts dampens our industry's ability to invest in a world-class workforce and modern, efficient facilities. I raise this issue as an example of how a decision by an agency to not enforce the Jones Act can have an adverse impact on commercial shipbuilding that reverberates throughout the entire shipyard industrial base, further destabilizing its ability to support national defense requirements.

LNG Market Emergence

Most recently, the industry has been concerned regarding the Administration's potential consideration of a long-term waiver of the Jones Act for purposes of transporting domestic LNG. Not only would a long-term waiver be unprecedented, but it would have severe and immediate impacts to a nascent shipbuilding market.

Several U.S. LNG export facilities have begun operations in the last two years. These facilities are already fully subscribed to foreign customers. It is expected over the next 5 years that potentially 11 additional domestic LNG export facilities could come online. As they do, there may be sufficient capacity to be able to service a nascent domestic LNG market. As a result, there are presently several inquiries being made in U.S. shipyards regarding the construction of such vessels which can be constructed well ahead of time to meet that market demand.

A Jones Act waiver is not necessary for the domestic LNG trade. In fact, MARAD has reported that there are 52 LNG carriers in the world that would qualify under existing 1996 legislation to transport LNG from the contiguous United States to Puerto Rico. Opponents of the Jones Act have countered that this is a false because “the law still requires these vessels to be U.S.-registered and U.S.-crewed.” One supposes from this that the Jones Act opposition wants to skirt all US regulations and taxes.

The LNG market in Boston is a spot market (several cargos during the winter) and is likely to remain so. As such, regardless of where the LNG might get loaded in a ship, in Louisiana, Maryland or Qatar, it will be delivered at world price and at a price the market will bear. The best example of that case is happening right now as there has been an LNG carrier sitting off Boston harbor for over a month waiting for a cold snap to cause a regional natural gas price hike before the ship lands the gas.

Thus, unless it is the Congress’s intent to suspend all US regulations and taxes for vessels operating in coastwise trade, then there is no need to waive the Jones Act. Gas customers in the Northeast will not receive any advantage and there are ships in the world today that could serve a coastwise trade to Puerto Rico if there was a market to justify it.

Waiving the Jones Act to allow coastwise trade by foreign vessels will serve no purpose other than to destroy the Jones Act and the American maritime industries it supports and ultimately damaging national security.

Instead of seeking to undermine the Jones Act and undermine the critical shipbuilding manufacturing sector, the United States should be promoting policies that actively support the

expansion of the shipyard industrial base. As the United States has become the world's leader in energy production, so to should we encourage that our domestically produced natural resources, including LNG, be transported on U.S. vessels under such policies as proposed by the Chairman's Energizing American Shipbuilding Act. Not only would that help us regain a foothold on the international shipping market where we've ceded ground to heavily subsidized and government-backed shipyards, but there is a direct relationship from the construction of LNG tanker vessels to the recapitalization of our strategic sealift fleets because of the stabilization it would bring to the shipyard supplier base and shipyards generally.

If you do not think that our adversaries are not making investments maintaining their same industrial base, consider that last month, Russia adopted their own version of the Jones Act for purposes of international trade, which would limit the carriage of the country's national resources, including gas and petroleum to Russian-built, owned and flagged vessels.¹

The Commercial Shipyard Industrial Base & National Security

In a 2016 Force Structure Assessment (FSA) the Navy called for a fleet of 355-ships – substantially larger than the current fleet and also larger than the Navy's previously stated goal of 308 ships. The Congress, under the leadership of Chairman Wicker, made 355 ships the policy of the United States in the FY2017 National Defense Authorization Act.

Simultaneously, the United States Coast Guard is undertaking efforts to recapitalize essential assets such as the Polar Security Cutter (also known as the Polar Icebreaker), Offshore Patrol Cutters (OPC) s, and the waterways river tenders that ensure the safe navigation of inland marine transportation.

To note, the recapitalization of the Coast Guard's fleet is an excellent example of how the Jones Act supports our government fleets. Most shipyards engaged in the construction of Coast Guard assets or are bidding to do so, have engaged in the construction of commercial Jones Act vessels. These yards have benefitted from stable commercial shipbuilding markets to leverage materials and workforce skillsets to develop the capability and capacity to build the most sophisticated Coast Guard vessels in the world.

¹ <https://www.pacmar.com/story/2019/02/01/features/russias-arctic-more-than-promise/675.html>

Additionally, the Maritime Administration is currently recapitalizing its school training ships that support our state Maritime Academies and train the American mariners of the future. In the criteria for awarding the shipbuilding contract for the procurement of those ships, the Maritime Administration specifically requested the shipyards bidding on the contract have commercial experience. The Administration, through this request, recognizes the value in commercial shipbuilding best practices to “leverage existing marketplace expertise targeting companies’ experience in production of innovative U.S.-built ships.”²

Another area of significant concern for government fleets is the recapitalization of the nation’s strategic sealift fleet, which ensures that unitized military cargo can be delivered to the war front. Currently the average age of the ships in this fleet is nearly 40 years³ old, and the number of ships that will reach the end of their programmed service lives over the next 10 years will reduce sealift capacity by over 25 percent. The Navy, in partnership with TRANSCOM and MARAD, is working through a plan to recapitalize that fleet through a combination of service life extensions, acquiring used commercial ships, and investing in new-build construction at U.S. shipyards.⁴ The U.S. shipyard industry is already vigorously competing to build and convert these ships.

In order to build and maintain these ships in as timely and affordable manner, stable and robust funding as well as stable construction rates and long-term procurement vehicles are necessary to sustain those industrial capabilities which support Navy, Coast Guard and other government shipbuilding and ship maintenance and modernization programs. These programmatic attributes provide the horizon and incentives required by industry to make risk-balanced investments in support of our national defense needs.

To meet the demand for increased vessel construction while maintaining the vessels we currently have will require U.S. shipyards to expand their work forces and invest in their physical infrastructure in varying degrees depending on ship type and ship mix. This is a requirement our nation’s shipyards are eager to meet however, meeting the national objectives is made more

² <https://www.maritime.dot.gov/newsroom/press-releases/maritime-administration-issues-request-proposal>

³ <https://www.gao.gov/assets/690/686733.pdf>

⁴ https://www.secnav.navy.mil/fmc/fmb/Documents/19pres/LONGRANGE_SHIP_PLAN.pdf

difficult by unstable procurement and sustainment appropriations and associated procurement strategies.

Unfortunately, any debate within the Administration or in the Congress of repealing or waiving the Jones Act adversely impacts financing for the industry undermining the commercial market substantially. This reverberates across the industry and financial markets, directly impacting our industrial base supply chain and that supply chain's ability to support the demands of our Navy and Coast Guard fleets and incrementally erodes the national defense intent of the Jones Act.

Many of our shipyards and suppliers that compete to build these national security assets are sustained by commercial shipbuilding and repair so they are viable when the time comes to build and repair the national security fleets. Companies that would be bidding on contracts for LNG carriers are the same shipyards and suppliers that the country will look to help recapitalize the nation's strategic sealift fleets. Therefore, undermining the Jones Act through lack of proper enforcement or through broad, unnecessary waivers will directly impact the ability of the nation to meet our own national security objectives.

International Competition in Shipbuilding

The most consistent argument I hear is that we should do away with the Jones Act and outsource the construction of some of our Coast Guard assets, such as the polar icebreaker, as well as commercial vessels, such as tankers and LNG carriers to foreign shipbuilders because of price. Along with the significant national security implications of such sentiments, that argument ignores that the U.S. does not compete on a level international playing field in shipbuilding.

Over the last twenty plus years, with significant government policy and financial assistance, the world shipbuilding capacity grew dramatically, primarily in Asia. At its peak Asian shipbuilders had captured 92% of the world commercial shipbuilding market. In the recent severe and sustained downturn in the world commercial shipbuilding markets, Asian governments have doubled down on the support of their shipbuilding industries.

For example, in 2015 alone South Korea's Daewoo shipbuilding took on more than \$1.9 billion in government-financed debt, as it racked up cheap orders, likely at zero margin. Additionally, South Korea provided financial aid totaling just over \$10.7 billion, from 2015 to 2017 to keep

the company afloat. Despite that enormous capital injection, Hyundai Heavy Industries, another Korean shipbuilder, agreed to acquire a 56% stake in Daewoo this year, with financing coming from the state-run Korean Development Bank⁵, in order to prevent Daewoo from completely going under.

Comparatively, in the same period of 2015 to 2017, the U.S. Maritime Administration provided \$15 million in small shipyard assistance grants and \$49.7 million through the maritime guaranteed loan program, also known as Title XI.⁶

While China's government subsidies are extremely difficult to detect and measure partly because international trade agreements prohibit direct and indirect subsidies, we know that there is a certain amount of market manipulation based on international news reports and recent studies. A September 2017 report from the Center for Economic and Policy Research found evidence that shipyard costs in China decreased implying a subsidy of between 13 and 20 percent between 2006 and 2012, leading to "substantial misallocation of global production with no significant consumer [gains]."⁷

Additionally, between 2013 and 2017⁸, China operated a "cash for clunkers" program that increased subsidies for scrapping obsolete ships by 50 percent to help cut overcapacity in the market. During this period, the Chinese government granted \$247 per gross ton for shipping companies to replace obsolete ships. Chinese shipyards further benefited from this initiative, because the grants were awarded to shipping companies only after replacement orders had been placed in Chinese shipyards.⁹

On top of the scrapping incentive, the Chinese government offers more overt support for its shipyard industry through cash infusions. One such shipyard, Rongsheng, received state subsidies of the equivalent of \$202 million, *per year* from 2010 to 2012. In that same time

⁵ <https://asia.nikkei.com/Business/Business-deals/Hyundai-s-mega-shipbuilder-plan-puts-China-and-Japan-on-edge>

⁶ <https://www.transportation.gov/sites/dot.gov/files/docs/MARAD-FY-2017-CJ.pdf>
<https://www.transportation.gov/sites/dot.gov/files/docs/mission/budget/281151/marad-fy-018-cj-budget.pdf>

⁷ Kalouptsidei, Myrto. Detection and impact of industrial subsidies: The case of Chinese shipbuilding. Washington, D.C. : Cetner for Economic and Policy Research, 2017.

⁸ <https://www.reuters.com/article/china-shipping/update-1-china-extends-ship-scrapping-subsidy-programme-to-end-2017-idUSL3N0Z91FB20150623>

⁹ <https://www.wsj.com/articles/china-ships-reforms-to-sea-1386684631>

period, reports also noted that the shipyard had laid off 8,000 workers, and yet would still need to appeal for more government aid in 2013.¹⁰ Eventually, even state subsidies could not prop up the yard, which went bankrupt and the facility was removed from the government's white list in 2014.

These are examples of direct and indirect government support that distort the international shipbuilding market and render moot any discussion of U.S. shipyards competing internationally. Even with direct government support to shipyards in its various forms and huge government supported shipbuilding credit pools for ship owners, many Asian shipyards are taking contracts at zero-margin simply to keep the economic engine of the country going. It is therefore an extreme misrepresentation to compare the blatant manipulation of foreign shipyards to the market stability provided by the Jones Act.

These countries are investing and financing their shipyard industries because they consider it to be an issue of national sovereignty.

Future Investment in U.S. Shipbuilding

Looking towards the future, we expect there to be the continued investment by the U.S. Navy and U.S. Coast Guard in their recapitalization of critical shipbuilding programs for their fleets. Additionally, the Maritime Administration is in the process of recapitalizing school ships which will support our state maritime academies and we are seeing strong investment in marine transportation around the nation through expansion of ferry and passenger vessel service. Concurrently, the commercial market will continue to respond to industry demands for domestic shipbuilding.

We ask for continued Congressional and Administrative support and enforcement of the Jones Act because it is essential to maintaining the critical U.S. shipyard industrial base that supports our national security fleets.

¹⁰ <https://www.reuters.com/article/us-china-shipping/china-to-aid-ailing-shipbuilders-with-more-subsidies-idUSBRE9B80Q320131209>

Thank you again Chairman Wicker and Ranking Member Cantwell for allowing me to testify alongside such distinguished witnesses today. I look forward to your questions.