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CONTINUING EXAMINATION OF U.S.-FLAGGED VESSELS IN U.S. FOREIGN TRADE

(111–139)

HEARING

BEFORE THE

SUBCOMMITTEE ON
COAST GUARD AND MARITIME TRANSPORTATION

OF THE

COMMITTEE ON
TRANSPORTATION AND
INFRASTRUCTURE
HOUSE OF REPRESENTATIVES

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CONTENTS

Page

Summary of Subject Matter vi

TESTIMONY

Matsuda, Hon. David, Administrator, U.S. Maritime Administration 5

PREPARED STATEMENTS SUBMITTED BY WITNESSES

Matsuda, Hon. David 22

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September 28, 2010

SUMMARY OF SUBJECT MATTER

TO: Members of the Subcommittee on Coast Guard and Maritime Transportation

FROM: Subcommittee on Coast Guard and Maritime Transportation Staff

SUBJECT: Hearing on "Continuing Examination of U.S.-flagged Vessels in U.S. Foreign Trade"

PURPOSE OF THE HEARING

The Subcommittee on Coast Guard and Maritime Transportation will convene on Wednesday, September 29, 2010, at 2:00 p.m., in room 2167 of the Rayburn House Office Building to receive testimony from the Maritime Administration (MARAD) regarding the U.S.-flagged merchant fleet in the foreign trade.

This hearing is a follow-up to a hearing convened by the Subcommittee on the same topic on July 20, 2010. At that hearing, representatives of the U.S.-flagged maritime industry and seafaring labor raised a number of issues with respect to the challenges they face operating under the U.S. flag. The purpose of today's hearing is to continue the Subcommittee's examination of the status of the U.S.-flagged merchant marine and the role of the MARAD in promoting a strong U.S. merchant marine.

BACKGROUND

Ocean commerce has been an essential element of the economic growth of the United States throughout our nation's history. The United States has provided support for its merchant fleet through many different programs including direct and indirect subsidies,[1] cargo preference programs, favorable tax treatment, and other types of programs. However, the maritime policies of the United States have largely failed to create what the Merchant Marine Act of 1936

[1] Franz Eversheim, *Effects of Shipping Subsidization* (1958), at 9. A shipping subsidy is " ... all direct money remittances from the state to its own shipping and also all state measures leading directly to a reduction of expenses or an increase in the receipts of the national shipping."

(46 U.S.C. §§ 1171-1182) envisioned as a merchant marine sufficient to carry a "substantial portion" of the water borne export and import foreign commerce of the United States.

Consistent themes emerge from an examination of U.S. maritime policy. First, U.S maritime policy has evolved as a result of U.S. needs for sealift in times of war or as a response to national economic hardship. Maritime policy in the United States has been a series of responses to emergent national needs rather than an expression of a strategic policy. Second, over the long term, U.S. maritime policy has failed to support a strong merchant marine to carry U.S. trade in peace time.

Historically, there has been strong public and political support for maritime policies intended to strengthen the U.S.-flagged fleet. However, that support has waned and the shipping industry today is characterized by several, sometimes competing, interests that have been ineffective in uniting to confront the challenges posed by international competition and the persistent effects of failed policies.[2]

I. MARITIME POLICY IN THE UNITED STATES

Today, the foundation of maritime policy in the United States is legislation that Congress enacted to ensure sufficient sealift capacity to carry U.S. commercial and military cargo during World War I (1914-1918) and legislation that was largely a response to the economic conditions of the Great Depression.

Important pieces of maritime legislation are the Shipping Act of 1916 (46 App. U.S.C. § 802), the Merchant Marine Act of 1920 (1920 Act) (46 App. U.S.C. § 876), and the Merchant Marine Act of 1936. These pieces of legislation have been supplemented by amendments to cargo preference laws and the Maritime Security Act of 1996 (P.L. 104-239). A brief legislative history is provided below.

Congress reacted to the threats posed to U.S. shipping by World War I by enacting the Shipping Act of 1916, which, among other things, established the U.S. merchant marine as a naval auxiliary and reserved certain government cargoes for U.S.-citizen ship owners. When World War I ended, the U.S. government controlled a large merchant fleet built through a significant ship construction program undertaken by the U.S. during that war. However, while the U.S. fleet was largely committed to the war relief effort, European allies placed their ships back into commercial trades. The result was reduced commercial cargoes for the over-sized U.S.-flagged commercial fleet.

In response to this situation, the Congress passed the 1920 Act, which created government support for the U.S.-flagged merchant marine. The preamble to the 1920 Act established goals that are supposed to drive U.S. maritime policy today, albeit these goals have been modified by subsequent legislation:

> ... 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, ultimately to be owned and

[2] Andrew Gibson and Arthur Donovan, *The Abandoned Ocean: A History of United States Maritime Policy* (2000), at 293.

> operated privately by citizens of the United States; and it is hereby declared to be the policy of the United States to do whatever is necessary to develop and encourage the maintenance of such a merchant marine.

Key elements of the 1920 Act included the establishment of cabotage[3] as a fundamental component of U.S. maritime policy and the creation of a construction loan program to aid U.S. operators in constructing ships in U.S. shipyards.

In the 1930s, the Great Depression, combined with economic policies that had the effect of limiting U.S. foreign trade, nearly caused the collapse of the U.S. merchant marine. Congress responded to this circumstance and sought to prepare for possible military conflict with the enactment of the Merchant Marine Act of 1936. The Merchant Marine Act of 1936 fully acknowledged U.S. operators' dependence on strong government support and included a mix of direct and indirect subsidies and market-oriented programs to promote the U.S. flag.

Direct subsidies included Operating-Differential Subsidies (ODS), which were payments to U.S. operators to offset the higher costs of operating under the U.S flag. ODS payments covered wages and benefits paid to U.S. mariners, insurance costs, and the costs of ship maintenance and repairs. Importantly, for ships to receive ODS payments, they had to be built in the United States. Therefore, the Merchant Marine Act of 1936 provided another direct subsidy: the Construction-Differential Subsidy (CDS). The CDS was paid to U.S. operators to offset what even then were the higher costs of building ships in U.S. shipyards.

The Merchant Marine Act of 1936 also provided an indirect subsidy in the form of the Capital Construction Fund (CCF). The CCF enables U.S. operators of U.S.-flagged merchant ships to set aside tax deferred earnings into a special account for the purpose of building ships in U.S. shipyards.

The Merchant Marine Act of 1936 retreated from the commitment made in the 1920 Act to develop a U.S. merchant fleet capable of carrying the "greater portion" of U.S. foreign commerce in favor of the vague objective of maintaining a U.S. merchant fleet capable of carrying a "substantial portion" of U.S. foreign commerce.

II. CARGO PREFERENCE LAWS

The term "cargo preference" refers to the policy of reserving all or some portion of cargoes generated by government activities for ships flying that government's flag.

The Military Transportation Act of 1904 (10 U.S.C. § 2631) requires 100 percent of military cargoes to be carried aboard U.S.-flagged ships. In 1954, American shipping interests, which were highly dependent upon government-impelled cargoes, strongly supported the passage of the Agricultural Trade Development and Assistance Act of 1954 (referred to as "P.L. 480") (P.L. 83-480) and the Cargo Preference Act of 1954 (Cargo Preference Act)(46 U.S.C. § 1241 (b)). Together,

[3] *Cabotage* refers to the maritime policy of some nations to reserve shipments between domestic ports for domestic operators operating ships flying the national flag. In the United States, cabotage protection for domestic operators is provided by the Jones Act, which reserves domestic commerce for ships that are owned and crewed by U.S. citizens and built in U.S. shipyards.

P.L. 480 and the Cargo Preference Act require 100 percent of cargoes generated by the Export and Import Bank, 75 percent of food aid cargoes, and 50 percent of cargoes generated by civilian agencies of the Federal Government to be carried aboard U.S.-flagged ships.

Cargo preference requirements also apply to cargoes funded through other Federal sources. 46 U.S.C. § 55305(b) requires that:

> When the United States Government procures, contracts for, or otherwise obtains for its own account … any equipment, materials, … or provides financing in any way with Federal funds for the account of any persons unless otherwise exempted, within or without the United States … the appropriate agencies shall take steps necessary and practicable to ensure that at least 50 percent of the gross tonnage of the equipment, materials … which may be transported on ocean vessels is transported on privately-owned commercial vessels of the United States, to the extent those vessels are available at fair and reasonable rates for commercial vessels of the United States, in a manner that will ensure a fair and reasonable participation of commercial vessels of the United States in those cargoes by geographic areas.

Under 46 U.S.C. § 55305(d), each agency with a program affected by this requirement must administer that program under regulations and guidance issued by the Secretary of Transportation who has sole responsibility for determining if a program is subject to the requirements of this section.

III. THE MARITIME SECURITY ACT OF 1996

In response to significant changes in the maritime industry, including the impact of the elimination of funding for the ODS and CDS under the Reagan Administration, Congress enacted the Maritime Security Act of 1996 (which eliminated the ODS program). The Maritime Security Act of 1996 established the Maritime Security Program (MSP), which has as its goal to "establish a fleet of active, militarily useful, privately-owned vessels to meet national defense and other security requirements and maintain a United States presence in international commercial shipping."

The MSP provides a fixed payment, through the Department of Defense (DOD), to each ship enrolled in the program (ships must be under the U.S. flag to enroll). In return, operators of enrolled ships must make their transportation resources and networks available to DOD in time of war, national emergency, or contingency operation. The MSP is administered by MARAD, which approves applications for participation based upon DOD's requirements.

The Maritime Security Act of 2003 (P.L. 108-136) reauthorized MSP for fiscal years (FY) 2006 through 2015 and expanded the program from the original 47 ships to 60 ships. Currently, the Maritime Security Act of 2003 authorizes annual payments that total $174 million or $2.9 million for each of the 60 ships. The annual authorization increases in 2011 to a total of $186 million.

The MSP has shown significant benefits. During FY 2008, MSP operators upgraded the U.S.-flagged fleet by replacing seven ships with newer ones (all ships were built overseas). This increased the availability of military useful capacity by over 362,000 square feet.

The Maritime Security Act of 1996 continues to meet its legislative objective. However, the program itself does not encourage or support expansion of the U.S.-flagged merchant fleet.

IV. THE U.S.-FLAGGED FLEET IN FOREIGN COMMERCE TODAY

In a study developed for MARAD in 2009, IHS Global Insight (IHS) reported that in 1975, the world merchant fleet numbered 22,872 ships.[4] Lloyd's Register of Shipping indicates that as of 2008, the world fleet numbered 52,944 ships.[5] These data indicate that over the period between 1975 and 2008, the number of ships in the world fleet grew by approximately 221 percent.

According to a 1981 report by the Comptroller General of the United States, the number of vessels under the U.S. flag declined from 1,065 ships in 1959 to 576 in 1979. The portion of U.S. foreign trade carried by U.S.-flagged ships declined from 10.2 percent to 4.4 percent over the same period.[6] At the end of December 2007, there were 89 U.S.-flagged ships operating in foreign commerce.[7]

These data from 1975 to the present indicate that the U.S.-flagged merchant fleet declined by approximately 89 percent during this period. As a result, by 2009, only 1.5 percent of the 78 percent of U.S. imports and exports transported by water were carried aboard ships registered in the United States.[8]

MARAD has provided data to the Subcommittee that shows there were 94 U.S.-flagged ships in the foreign commerce as of March 1, 2010: 50 container ships; 23 roll-on/roll-off ships; nine dry bulk carriers; eight multi-purpose ships (including five heavy lift ships); and four tankers. The average age of the U.S.-flagged ships in the foreign commerce is 15 years. All of these vessels were built overseas.

MARAD estimates that the 94 U.S.-flagged ships in foreign commerce provide approximately 1,880 billets for U.S. merchant mariners and approximately 3,760 mariners are employed in these billets. MARAD further estimates that 3,800 indirect jobs (e.g., jobs associated with cargo logistics and handling, marine supplies, and other intermediaries) are associated with the U.S.-flagged fleet.

Ships may enter and exit the U.S. flag with approval from MARAD. According to MARAD, between 2005 and 2009, 39 ships entered the U.S. register, while 27 ships left the U.S. flag. In 2009, 16 ships entered the U.S. flag, while eight left.

The United Nations Conference on Trade and Development (UNCTAD) reported in 2009 that the United States ranked 21st in the world in terms of deadweight tonnage[9] under register, with

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[4] IHS, *An Evaluation of Maritime Policy in Meeting the Commercial and Security Needs of the United States*, (January 7, 2009), at 1.
[5] International Maritime Organization Maritime Knowledge Center, *International Shipping and World Trade Facts and Figures* (October 2009), at 11.
[6] Comptroller General of the United States, *Maritime Subsidy Requirements Hinder U.S.-Flag Operators' Competitive Position*, CED 82-2 (November 30, 1981), at 3.
[7] IHS, *An Evaluation of Maritime Policy in Meeting the Commercial and Security Needs of the United States*, (January 7, 2009), at 1.
[8] *Id.* at 2.
[9] A ship's *deadweight tonnage* is a measure of the weight of cargo a ship is able to carry. A deadweight ton is 2,240 pounds.

about one percent of the world total. The majority of these ships are in the domestic coastwise trade.[10]

V. COSTS OF OPERATING UNDER THE U.S. FLAG

The policies and programs that have been implemented to support the U.S.-flagged fleet have fallen far short of the legislative objective of maintaining sufficient national shipping capacity to carry a "substantial portion" of U.S. foreign commerce. This is due, in large part, to the ineffectiveness of U.S. maritime policy in reducing operating costs.

In general, the costs associated with operating a ship in the foreign trade derive from three areas: 1) the capital costs of acquiring the ship and its related equipment; 2) the costs imposed by governments through taxes and regulation; and 3) the actual costs of operation (including personnel costs and fuel costs).

Today, Congress has equalized the cost of acquiring ships for U.S. flag operators and their foreign competitors. The Maritime Security Act of 1996 made it possible for U.S. flag ship operators to acquire ships in the international market, bring them under U.S. registry, and still qualify for the MSP, military preference cargoes, and limited portions of civilian preference cargoes.[11]

Similarly, U.S. maritime policy now permits the operators of U.S.-flagged ships to calculate their tax liabilities under a "tonnage tax,"[12] which significantly reduces the operators' tax burdens. Several industrialized maritime nations, such as the United Kingdom, Greece, and Norway, have implemented tonnage tax regimes to attract ships to their registries.

However, U.S. maritime policy has been unsuccessful in reducing the operating costs associated with maintaining U.S.-flagged ships trading in foreign commerce.

Ships operating under the U.S. flag must engage U.S.-citizen officers and crew.[13] The difference in crewing costs between employing U.S.-citizen mariners and mariners from other countries can be substantial. For example, as of 2005, the annual cost for crew aboard a 20-year-old bulk carrier crewed under an open register was less than $700,000. Crew costs for the same ship employing U.S. mariners were more than $3 million per year.[14]

In addition, in testimony before this Subcommittee, Mr. Phillip Shapiro, President and CEO of Liberty Maritime Corporation stated, "We [U.S. flag operators] are at an $11,000 a day disadvantage to a foreign-flag ship's, foreign operating costs. The math is very simple … the $2.9 million, I would point out, [provided to U.S. flag operators] under the MSP program … doesn't

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[10] UNCTAD, *Review of Maritime Transport* (2009), at 83.
[11] 46 U.S.C. § 55305(a) requires ships that were built or rebuilt overseas to operate under the U.S. flag for three years before they are eligible to carry preference cargos.
[12] American Jobs Creation Act of 2004 (P.L. 108-357), section 1354.
[13] 46 U.S.C. §§ 8103(a) and (b).
[14] MARAD, figures provided to subcommittee staff, March 16, 2010.

cover the full differential."[15] Importantly, many countries that provide mariners to the world market provide government-funded healthcare and pensions, which relieves ship operators that employ these mariners of costs that operators of U.S.-flagged ships must pay. In addition, some countries do not require their mariners to pay income taxes on their earnings from shipboard employment, which enables ship operators to pay lower wages to their mariners.

VI. THE CRITICAL ROLE OF CARGO PREFERENCE

According to testimony received by the Subcommittee from representatives of U.S. flag operators and seafaring labor, it would be impossible to overstate the critical importance of the cargo preference laws to U.S. flag operators. Mr. Shapiro testified, "Without the Cargo Preference Program cargoes being added to that $2.9 million [provided by the MSP], there is no way that anyone can sail a ship and make any money."[16]

In support of this view, MARAD has informed the Subcommittee that all of the U.S.-flagged ships operating in foreign commerce carry cargoes that are subject to the cargo preference laws. In 2008, preference cargoes accounted for 49.6 percent of all the cargo carried by the U.S.-flagged merchant fleet. In FY 2007, cargo preference provided U.S. operators with revenues of $919.4 million for the carriage of military cargo, $319.8 million for agricultural cargo, and $113.4 million for civilian agency cargo and cargo impelled by the Export and Import Bank.

During the hearing held by the Subcommittee on July 20, 2010, to begin consideration of the state of the U.S.-flagged fleet in the foreign trade, several witnesses who appeared before the Subcommittee raised concern about the Department of Energy's (DOE) apparent presumption that the cargo preference requirements of 46 U.S.C. § 55305 do not apply to loan guarantees that the DOE may issue under the authorization provided under title XVII of the Energy Policy Act of 2005 (Energy Policy Act) (P.L. 109-58). Title XVII of the Energy Policy Act specifically authorized the DOE to make loan guarantees covering up to 80 percent of the cost of the development of renewable energy systems (including offshore wind and ocean energy), advanced fossil energy technologies, hydrogen fuel cell technologies, carbon capture and sequestration facilities, efficient electrical generation and transmission facilities, and a variety of similar projects. The Subcommittee hopes to examine this issue in more detail – particularly the specific role that the Department of Transportation (DOT) is playing in assessing the applicability of the requirements of 46 U.S.C. § 55305 to loan guarantees issued under the Energy Policy Act.

In testimony before the Subcommittee on July 20, Michael Dumas, Vice President and CFO of Intermarine, L.L.C. remarked, "Inconsistency in the application and enforcement of cargo preference laws is neither infrequent nor uncommon. A very real and recent example is a determination by the DOE that the cargo preference laws do not apply to its Loan Guarantee Program authorized under the Energy Policy Act of 2005. The U.S.-flag maritime industry has raised strong objections concerning this matter with MarAd ...."[17] The operators hold the view that

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[15] Testimony of Mr. Phillip Shapiro, Hearing on the "Status or the U.S.-flagged Vessels in U.S. Foreign Trade", House of Representatives, Committee on Transportation and Infrastructure, Subcommittee on Coast Guard and Maritime Transportation (July 20, 2010), at 25.

[16] *Id.*

[17] Testimony of Mr. Michael Dumas, Hearing on the "Status or the U.S.-flagged Vessels in U.S. Foreign Trade", House of Representatives, Committee on Transportation and Infrastructure, Subcommittee on Coast Guard and Maritime Transportation (July 20, 2010), at 3.

the Energy Policy Act's title XVII loan guarantees constitute Federal financing is not different from other Federal Government programs that are covered by chapter 553 of title 46, U.S. Code.

VII. PROPOSALS FOR IMPROVEMENTS IN U.S. MARITIME POLICY

The U.S.'s disjointed approach to maritime policy has never effectively addressed the core problem of the high costs of operating under the U.S. flag. However, several proposals have been developed by various stakeholders within the U.S. maritime community that are intended to reduce the costs of operating ships under the U.S. flag and to help revitalize the U.S.-flagged fleet. Some of these proposals are in alignment with similar policies in other maritime nations; others would continue existing subsidy programs. Some of these proposals are discussed in more detail below.

A. **Mariner Income Tax Exclusion:** Many seafaring nations do not tax the personal income earned by their mariners when employed aboard ship. To help strengthen the U.S.-flagged fleet by helping to lower the cost of labor, some propose extending the foreign-earned income tax exclusion provided in section 911 of the Internal Revenue Code to U.S. mariners working aboard commercial vessels engaged in the foreign trades.

   Section 911 was enacted in 1926 to help place American citizens seeking work abroad on an equal footing with citizens of other countries who were not taxed by their own countries. Section 911 allows U.S. citizens employed outside the United States to exclude up to $80,000 of their foreign-earned income from their gross income for Federal income tax purposes.

   The income tax liabilities of American mariners are an indirect cost borne by U.S. operators, but their foreign competitors have no such burden.

B. **Extend Eligibility for the Tonnage Tax Election:** Many countries do not tax the income of companies that is earned through shipping operations. The United States did tax such income until the passage of the "American Jobs Creation Act of 2004" (P.L. 108-357). Proposed by Chairman James L. Oberstar, the "American Jobs Creation Act of 2004" provided an option for U.S. operators to elect to pay tax calculated on the earning capacity of their ships, as determined by the ships' net tonnage, rather than on the revenues generated by their shipping activities. The advantages to the operators are lower corporate taxes and predictable tax liabilities each year.

   Currently, the option to pay the tax based upon net tonnage is available only to U.S.-flagged vessels operating exclusively in foreign commerce and to U.S.-flagged vessels operating in the domestic trades for less than 30 days in a tax year. The 30-day rule prohibits U.S. operators that operate their ships in domestic trades and in foreign commerce for part of the year from taking advantage of the tonnage tax when their ships are exposed to foreign competition.

   Under a proposal to extend the tonnage tax to ships that operate in domestic trades for more than 30 days in a tax year, operators would be able to take advantage of lower tax liabilities under the tonnage tax for that portion of their operations conducted in international trade, but they would pay tax at the current corporate rate for that portion of their operations in domestic trades.

MARAD reports that the tonnage tax system has been a success. For example, two U.S. liner operators have been able to expand their Asian services. Another operator decreased its income tax expenses by approximately $39.7 million during one quarter. Another liner operator reported that the tonnage tax system reduced the company's effective tax rate 13.5 percent from 37 percent in the previous year. That company's income taxes dropped by more than two thirds compared to a year earlier.

In June 25, 2009, Representative Earl Blumenauer of Oregon introduced H.R. 3049, a bill to amend the Internal Revenue Code to allow U.S. operators that operate ships in domestic and foreign trades to take advantage of the tonnage tax. The bill was referred to the Committee on Ways and Means, but there has been no further action on the bill.

C. **Tariff on Foreign Ship Repairs:** U.S. ship operators are liable for a 50 percent duty on maintenance and repairs performed on their vessels at overseas shipyards (19 U.S.C. § 1466). The tariff was originally enacted in 1866 to support the U.S. ship repair industry. The Tariff Act of 1930 (commonly known as the Smoot-Hawley Act) (P.L. 71-361) set the tariff at its current level.

Some have suggested that this tax should be repealed for U.S.-flagged vessels in foreign trades because it increases the costs of their repairs and it can adversely affect the scheduling of shipyard maintenance periods. Foreign operators competing against operators of U.S.-flagged ships are not subject to such a tax.

D. **Long-term funding for the Maritime Security Program:** The Maritime Security Act of 1996 established the MSP to maintain a U.S.-flagged fleet of 47 militarily useful, privately owned commercial ships. The number was increased to 60 ships by the Maritime Security Act of 2003.

Funding for the MSP must be provided annually. This presents uncertainty for U.S.-flagged operators who must make business decisions far in advance of Congressional appropriations.

Stakeholders within the U.S. maritime community point to a long-term commitment by Congress to funding the MSP as an important signal of support for U.S. flag operators.

VIII. THE MARITIME ADMINISTRATION

The MARAD is the DOT agency that promotes waterborne transportation and the United States merchant marine. MARAD's mission is to, "[i]mprove and strengthen the U.S. Marine Transportation System to meet the economic, environmental and security needs of the Nation." The agency is also the chief advocate for the maritime transportation system and the federal programs that support it.[18] MARAD also maintains a fleet of cargo ships in reserve to provide surge sealift during war and national emergencies.

[18] The Maritime Administration, *Leading the Future – Strategic Plan 2008-2013* (August 2008), at 1.

MARAD, in its present form, was established as an agency of the Department of Commerce in 1950. In 1981, MARAD was transferred to the DOT.

The President requested $352.0 million in FY 2011 for MARAD activities, including $100 million for the operation of the U.S. Merchant Marine Academy at Kings Point, New York.

PREVIOUS OVERSIGHT AND LEGISLATIVE ACTION

The Subcommittee on Coast Guard and Maritime Transportation held a hearing on March 16, 2010 to receive testimony regarding the "Capacity of Vessels to Meet U.S. Import and Export Requirements".

On July 20, 2010, the Subcommittee held a hearing on the "Status of the U.S. Flag Fleet in Foreign Trade".

WITNESSES

The Honorable David T. Matsuda
Administrator
U.S. Maritime Administration

HEARING ON CONTINUING EXAMINATION OF U.S.-FLAGGED VESSELS IN U.S. FOREIGN TRADE

Wednesday, September 29, 2010

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COAST GUARD AND MARITIME TRANSPORTATION,
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE,
Washington, DC.

The Subcommittee met, pursuant to notice, at 4:13 p.m. in room 2167, Rayburn House Office Building, the Honorable Elijah E. Cummings [Chairman of the Subcommittee] presiding.

Mr. CUMMINGS. The Subcommittee will come to order.

We are sorry. Things out of our control. Somebody just said to me on the elevator that these votes get in the way. I reminded him that is why we are here.

In March, the Subcommittee convened to examine the availability of shipping services to carry U.S. exports. In July, the Subcommittee convened to examine specifically the state of U.S.-flag vessels in foreign trade.

I believe that the Subcommittee has gained through these hearings a good overview of the state of the U.S. merchant marine and of the carrier services available to shippers. According to data provided by MARAD and compiled in part by contractors engaged by MARAD to assess the U.S. maritime transportation system, the U.S.-flag fleet, which was comprised of 94 vessels as of March of this year, is carrying less than 2 percent of United States foreign trade.

During our last hearing, witnesses from the shipping lines that operate under the U.S. flag, as well as from U.S. maritime labor, presented specific details regarding the challenges they face operating under our flag, particularly the economic challenges that make such operations more costly than operations under so-called flags of convenience.

We also heard how critical the Maritime Security Program and cargo preference requirements to making operation under the U.S. flag viable. For example, Mr. Phil Shapiro, President of Liberty Maritime Corporation, testified that, "Without the cargo preference programs, cargoes being added to that $2.9 million, there is no way that anyone can sail a ship and make any money" under the United States flag.

Critically, we also examined the fact that the decline in the U.S.-flag fleet in the foreign trade has occurred over the course of dec-

ades. As I mentioned in my opening statement during the July hearing, a study issued in 1981 by the Comptroller General documented the fact that the total percentage of U.S. commercial cargo carried in U.S.-flag vessels had declined from 10 percent in 1959 to just 4 percent 20 years later. From 1979 to the present, the total percentage of U.S. cargoes carried on U.S. vessels has only continued, sadly, to fall.

And as we detailed in our March hearing, it is our Nation's level of imports, rather than our level of exports, that determines the overall level of ocean freight services available to U.S. shippers.

I frankly have no doubt that our inability to carry even a small portion of our U.S. foreign trade commercial cargoes on U.S.-flag vessels represents an economic and even a security risk to our Nation.

And this is where MARAD comes into the picture. The U.S. Maritime Administration, MARAD, is the sole Federal agency charged with improving and strengthening the United States maritime transportation system to meet economic, environmental and security needs of the Nation.

Mr. David Matsuda, the Administrator of the Maritime Administration, appeared before the Subcommittee during our July hearing. However, there were, to be frank, a number of questions that Mr. Matsuda appeared totally unprepared to answer at that time, and we trust that he is prepared today, although I must admit when I read your testimony, I am not convinced of that. So hopefully that gap will be filled between now and the time you answer the questions here today.

At that time, I promised that I and Ranking Member LoBiondo would send a letter to the Administrator outlining the specific issues we wanted to explore further, and that we would reconvene the Subcommittee to hear Administrator Matsuda's answers to these questions. As promised, Ranking Member LoBiondo and I sent out a letter to the Administrator, Mr. Matsuda, in July. We received the Administrator's response only yesterday.

I want to thank Mr. LoBiondo for his cooperation and the bipartisan spirit in which we both joined to make that happen.

Today, we are convening the Subcommittee to hear further from Mr. Matsuda. One of the most important issues that we are looking to address is whether the cargo preference laws apply to cargoes financed with loan guarantees created by the Energy Policy Act and administered by the Department of Energy. It makes zero sense for U.S. loan guarantees to support purchases from foreign countries that would then be carried on foreign-flag ships. That is not a scenario that would stimulate our economy in any way, and it certainly does not provide for U.S. jobs.

For that reason, the DOT must take strong and decisive steps to ensure that the cargo preference requirements set forth in the Title 46 of the U.S. Code are vigorously enforced, and I would hope that Mr. Matsuda would tell us how they are being vigorously enforced now.

In our view, Congress was quite clear when we passed the National Defense Authorization Act of 2009 that the DOT is to be the sole decider, to use President Bush's words, on questions relating

to the application of cargo preference laws. We are concerned that the DOT not relinquish that authority to any other entity.

I am also anxious to hear how MARAD defines the causes and consequences of the challenges facing our U.S.-flag fleet, as well as the policies that MARAD believes should be pursued to maintain and grow that fleet. Again, we did not get decent answers the last time.

For example, proposals have been raised to extend the foreign earned income tax credit to U.S. mariners, repeal the duty on foreign ship repairs, and extend eligibility for the tonnage tax. We are eager to know if MARAD believes that any such measures would be effective mechanisms to support the growth of the United States-flag fleet.

Our U.S.-flag fleet is facing significant challenges and it is MARAD's job as the entity charged with promoting the development of our flag fleet and our maritime transportation network to lead the response to these challenges.

Now, in just a moment, I am going to recognize our Ranking Member, but I ask his patience for just a few minutes as there are two other issues I want to briefly discuss.

Those of you who were watching the Floor last night saw that the Coast Guard Authorization Act passed the House. This bill is a product of four years of diligent work and I commend Chairman Oberstar, Ranking Member Mica, and of course our Subcommittee Ranking Member, Mr. LoBiondo, for all of their work on this legislation. I also commend Chairman Thompson and Ranking Member King on the Homeland Security Committee and our counterparts in the Senate for their commitment to getting this bill done. Development of this legislation has truly been a bipartisan team effort.

The legislation authorizes more than $10 billion for the Coast Guard in fiscal year 2011 and increases the authorized end strength of the service by 1,500 members, to 47,000 personnel.

Further, the legislation strengthens the service's acquisition management processes, something that has been a critical concern to me and to the Subcommittee. It also recognizes the service's senior leadership and strengthens the Marine Safety Program and the service's homeland security missions.

Further, the bill will help save the lives of those working in our most dangerous industry, commercial fishing, by establishing safety, equipment and construction standards for fishing vessels that work in the most dangerous fisheries.

This authorization is long, long overdue, and the safety reforms in the bill are long over due. And I hope that the Senate will pass it before leaving for recess.

Now, ladies and gentlemen, if you were watching the Floor last night, you also heard that our Subcommittee's Staff Director, John Cullather is retiring. And it was with many mixed emotions that I heard this news. On the other hand, I am so excited that John has a chance to do new things and pursue new directions.

On the other hand, John is one of the true professionals on the Hill and he will be sorely missed. His knowledge of maritime issues and of the history and missions of the Coast Guard is truly unparalleled, as is his knowledge of House procedures and his passion of

service to those who work, travel and recreate on our Nation's waterways.

John is also an exceptional man, a profoundly generous and caring individual who has the respect of every single person on the Transportation Committee and of everyone throughout our maritime industry. Everywhere I go, everyone I talk to tells me how much they love working with John and how dedicated he is to the success of this industry.

And John, on behalf of the entire Subcommittee, I express our deepest appreciation for your 30 years of service to the Congress of the United States of America. I also say to you that I know that there have been many times when you worked late at night, weekend; when you, in the words of the great theologian Zwingli, said, "When you are unnoticed, unapplauded, unappreciated and unseen," but yet still you gave your very, very best to make this industry the best that it could be.

And so we take a moment on behalf of a very, very grateful Congress and a very, very grateful people of these great United States of America to thank you for all that you have done. May God bless you and may he bless your journey.

Ladies and gentlemen, now I yield to the distinguished Ranking Member of our Committee, Mr. LoBiondo.

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

I would like to join in with you in thanking John for his years of service and dedication to this Committee and wish you all the best of luck, John. Thank you for all that you have done.

Mr. Chairman, I want to thank you for holding the hearing today. As you had indicated, this is a follow up to a hearing earlier in the month of July on the state of the U.S.-flag merchant fleet. At that hearing, we had several important questions that were unanswered, so we asked the Administrator to come back today. I appreciate the Chairman's dedication on this important issue.

The United States has a long and proud maritime history. However, since World War II, the number of ocean-going vessels operating under American flag has suffered a long, slow and very steady decline. According to the Maritime Administration, there were 94 U.S.-flag vessels operated in the foreign trade at the beginning of this year, less than 1 percent of the world fleet. Nearly all maritime commerce at U.S. ports arrives or departs on board a foreign-flag vessel.

Restoring the U.S.-flag fleet is critical to our economic and national security. We need a robust U.S. fleet to ensure we can move troops and supplies overseas, provide opportunities for U.S. merchant mariners, and preserve our critical shipyard industrial base.

I am very concerned with the continued contraction of this vital national resource, and I hope the Administrator can recommend some concrete steps that we can take to help revitalize the American-flag fleet.

I look forward to working with you, Mr. Chairman and Administrator, on these important issues, and I want to apologize for probably not being able to stay. When we got pushed back, I got another meeting that I can't miss.

Thank you.

Mr. CUMMINGS. Thank you very much.

Mr. Matsuda?

TESTIMONY OF DAVID MATSUDA, ADMINISTRATOR, U.S. MARITIME ADMINISTRATION

Mr. MATSUDA. Good afternoon, Mr. Chairman, Ranking Member LoBiondo. With the permission of the Chairman, I would like to offer my complete statement for the record.

Mr. CUMMINGS. So ordered.

Mr. MATSUDA. And also with the permission of the Chairman, I would like to offer our congratulations to Mr. Cullather as well. I have had the opportunity to work with him over the years and we wish him the best.

Mr. CUMMINGS. Thank you.

Mr. MATSUDA. Thank you for the opportunity to testify before you again on the state of the U.S. merchant fleet in foreign commerce. On July 20, we met to discuss the challenges of U.S.-registry ships operating internationally. Today, I will elaborate on these challenges of operating under the U.S. flag, ways we are helping to level the playing field, and goals we have set for the Maritime Administration.

We know it costs more to operate a U.S.-flag ship versus registering it under a foreign flag, including so-called open registries. This difference can be almost three times as much, depending on the trade, the type of ship, and the company. These higher costs are due to a number of factors, including wage costs, vessel maintenance and repair costs, and insurance costs.

Historical and anecdotal data show wage costs are one of the biggest differences, being much lower in many other countries. In America, companies hiring U.S. mariners pay the costs of medical, pension and other benefits, as well as costs for training and professional certification.

Foreign countries often provide government-subsidized health care and other benefits. Some countries also exempt mariner wages from taxes, while the U.S. does not.

Addressing differences such as these and others named by the Chairman can help level the playing field for U.S.-flag companies.

We at the Maritime Administration realize the importance of having the correct and accurate cost information. In our discussions with the Subcommittee, we felt it critically important to do a comprehensive evaluation of the differential between operating under the U.S. flag versus foreign flag. Using available resources, we are engaging an independent consulting firm to update operating cost data for major cost categories. This first step will serve as the foundation for working to level the playing field going forward.

Turning to ways in which our agency helps close the cost gap between U.S. and foreign-flag operations, we use every tool at our disposal. This includes the Maritime Security Program. As we discussed in the July hearing, our Maritime Security Program provides the military with assured access to 60 commercial U.S.-flag ships and related global intermodal transportation systems, in addition to a pool of trained U.S. mariners.

This is all in exchange for an annual cost of around $3 million per ship. To participate in this program, each ship must operate for

at least 180 days in the international trade of the United States. We support reauthorization of this important program, which is currently set to expire in the year 2015. The Maritime Administration has already made significant progress this year in working with stakeholders and our Federal partners to develop a proposal. Another way that we attract U.S.-flag vessels is through the Government's Cargo Preference Program. Through this program, U.S.-flag carriers are provided with premium opportunities to compete for designated cargo financed by the Federal Government. The Maritime Administration takes it role very seriously in constantly identifying cargo that would otherwise have been lost to foreign carriers.

One example cited in my written statement details how we worked with the Defense Department in issuing a $380,000 penalty. This was issued against a construction company in Guam that improperly used a foreign-flag service for a Federal contract.

In sum, these programs help to retain and, even in tough economic times, attract ships to the U.S. registry. Without these programs, U.S.-flag ships in international trade would potentially scrap, sell or re-flag their ships to foreign registries.

As we near the close of my first 100 days since being sworn in as Administrator, I can tell you that we have already accomplished a lot, and the Obama Administration's goals for this agency and this industry's future are ambitious. We must strengthen the merchant marine. We must expand it through programs such as America's Marine Highway, and we must help prepare the maritime industry for the future with an expanded Panama Canal, stronger global environmental standards, and a new generation of mariners produced by the U.S. Merchant Marine Academy in Kings Point, New York and other institutions.

Our authority and resources provided by Congress drive our efforts to support the U.S.-flag fleet.

At this time, I am pleased to answer any questions the Subcommittee may have.

Mr. CUMMINGS. Thank you very much, Mr. Matsuda.

I want to follow up on an issue we discussed in the hearing back in July. At the time of that hearing, you said that MARAD was examining whether cargo preference laws apply to cargoes financed with loan guarantees created by the Energy Policy Act and administered by the Department of Energy. You indicated back then that DOT's General Counsel was also examining this issue.

What is the status of this examination? And do cargo preference laws apply to cargo financed with loan guarantees created by the Energy Policy Act or not?

Mr. MATSUDA. Well, sir, you did ask that question. I recall answering as you said. We are working with the Secretary's General Counsel at his request, and also with the Department of Energy to formulate the Administration's position on this. This is something that is of high priority. We have progressed to the point where the Department of Energy has since changed their position and has noted on their website even that this issue is unsettled. And we are hoping to achieve a consistent application of the law.

This is a new area, a non-traditional application for the cargo preference laws. And so it is something that is taking a bit of an education and we know that we will get there.

Mr. CUMMINGS. Well, let me make sure I understand this. This is very frustrating to me because I think that a first year law student ought to be able to figure this one out, to be frank with you. And let me tell you why I say that.

It just sort of upsets me that I feel like either we have some people who are incompetent or we need to get somebody else to answer these questions. And let me just tell you why I say that.

According to 46 U.S.C. 55305, and I am sure you are familiar with this: "When the United States Government procures, contracts for, or otherwise obtains for its own account any equipment, materials, or provides financing in any way with Federal funds for the account of any persons, unless otherwise exempted, within or without the United States, the appropriate agency shall take steps necessary and practicable to ensure that at least 50 percent of the gross tonnage of the equipment and materials which may be transported on ocean vessels is transported on privately owned commercial vessels of the United States to the extent those vessels are available at fair and reasonable rates for commercial vessels of the United States, in a manner that will ensure a fair and reasonable participation of commercial vessels of the United States in those cargoes by geographic areas."

Further, 46 U.S.C. 55305(d) states that "each department or agency that has responsibility for a program under this section shall administer that program under regulations and guidance issued by the Secretary of Transportation which shall have the sole, sole, sole responsibility for determining if a program is subject to the requirements of 46 U.S.C. 55305."

Now, given this clear statutory language placing with the Department of Transportation the final authority to make determinations regarding cargo preference, why hasn't DOT determined whether cargoes financed by the loan guarantees administered by the Department of Energy and authorized by the Energy Policy Act are subject to the cargo preference requirements laid out under 46 U.S.C. 55305? Further, when will the Department make its determination?

I have to tell you, this doesn't sound like super, super rocket scientist stuff. Go ahead.

Mr. MATSUDA. Sir, I wish I could tell you a date. This is something that the Administration is working on to develop its position. I can assure you it is getting high levels of attention within the Administration and we hope to have a resolution soon.

I can tell you that last year, there was litigation involving the application of the cargo preference laws. The Administration did come together with a number of agencies and formulated a single position.

Mr. CUMMINGS. Was it a priority back there on July 20th?

Mr. MATSUDA. Absolutely.

Mr. CUMMINGS. And it remains a priority. So where are we now? August and now September, and going into October, and we cannot get an answer.

You know what? We could be here three years from now going through this still ring around the rosy and not have a decision on this. Can you imagine that?

Mr. MATSUDA. No, sir, I cannot. I believe there will be a position. I think there are a number of factors that will lead to that. One I think is specifically your interest, the Congress' interest in having this settled. I know the industry wants this settled. We certainly want this settled. We believe a clear application of these laws needs to be achieved and we are confident we will get there.

Mr. CUMMINGS. Who do we need to go to to get an answer as to when they will resolve these issues? Obviously, you don't have the answer, so who can we go to? Who do we need to go to?

Mr. MATSUDA. At the end of the day, we do not speak for the Administration. If it is coming to a legal position as to how we interpret the law, only the Department of Justice can do that. We hope to not have to involve them, but we are working directly with the Energy Department to try and nail this down.

Mr. CUMMINGS. So you are telling me that the Justice Department has to make that decision? Is that what you just said?

Mr. MATSUDA. At the end of the day they would have the final say on how that would work.

Mr. CUMMINGS. Are you working with the Justice Department on this?

Mr. MATSUDA. No. No. We don't want to. We want to make sure that we arrive at a position that applies the law as intended and as it should work, but there is also the pressure that there are so many stakeholders involved here that the threat of litigation would mean there has to be a Federal position in court.

Mr. CUMMINGS. Is there doubt within the Department of Transportation, which again has sole authority, to determine when the cargo preference requirements of 46 U.S.C. 55305 apply to a cargo, that these requirements apply to cargoes financed with loan guarantees authorized by the Energy Policy Act?

Mr. MATSUDA. I can tell you there is no doubt within the Maritime Administration.

Mr. CUMMINGS. And what is the Maritime Administration's opinion?

Mr. MATSUDA. We believe it does apply.

Mr. CUMMINGS. And have you stated that to the powers that be, to the deciders?

Mr. MATSUDA. Absolutely. And we are working with, like I said, the Energy Department to make sure that they understand our position and that we can use that to develop a singular Administration position on this.

Mr. CUMMINGS. Is there a document that you have presented to them to assist them in their efforts? You have an opinion. Have you had occasion to lay out since July 20th or even before then specifically why you believe in what you just stated?

Mr. MATSUDA. If there is, I can get you any copies of any documents that you would like.

Mr. CUMMINGS. We would appreciate you doing that. OK?

And by the way, is there someone else? We want to be effective and efficient, so is there anybody else that you think I might want to call here so that they might be able to give me a better answer?

I am not trying to be smart. I am just curious. I am trying to get to the bottom line because you have an opinion, but you just told me basically your opinion apparently is not——

Mr. MATSUDA. Well, it is a team effort and we are working with our colleagues to make sure we get this. I can assure you it has very high levels of attention both at our Department and the Department of Energy.

Mr. CUMMINGS. And how soon? Can you give me any idea? Do you think it will be this year, next year?

Mr. MATSUDA. I would hope this year we arrive at a position.

Mr. CUMMINGS. Before the end of the year?

Mr. MATSUDA. That is my hope.

Mr. CUMMINGS. Well, what I am going to do is, I know we are going to have a lame duck session. We will bring you back and maybe you can answer that question then. OK?

If there is anything that you need us to do to get to folks and urge an answer to the question, we would like to do that. And I guess the reason why I am raising this issue, and I am on top of this is because it just goes to the very essence of my opening statement.

You have a lot of people who are just hanging on and they are hanging on by their fingernails. And they are trying to employ people. They are trying to make decisions and it is almost impossible for them to make decisions. And then they look to you and they expect an answer one way or another. I mean, even if you said, look, you know, no way, at least there is an answer. But you have already told me that you have an answer and that answer is that it does apply and that there are efforts to try to resolve the matter.

And so I take you at your word and we will be bringing you back so you can answer that question and probably a few others of these if we can't get answers today.

If there is doubt, for what reasons do you think there is doubt, by the way? In these negotiations that you are working on, what is the doubt?

Mr. MATSUDA. My sense is that it is strictly unfamiliarity with the recent changes to the law and the program.

Mr. CUMMINGS. Mr. Matsuda, you indicated in your testimony that MARAD is undertaking a study to survey a sample group of carriers and strengthen our analytical assessment of the U.S.-flag fleet. I am surprised that MARAD does not diligently maintain such data, but I am glad to hear that a study is being undertaken.

Will this study provide comprehensive data on the cost differential of operating under the U.S. flag compared to operating under a flag of convenience? And will it quantify the impact that different regulatory structures have on the cost differentials? And further, when will the study be done? And please give me a specific date.

You said I think something about six months from the time that the study was commissioned. Has it been commissioned yet?

Mr. MATSUDA. If not today, then tomorrow, yes, it will be.

Mr. CUMMINGS. OK. Let's put a pin in that right there. What does it take to commission it? What do you have to do?

Mr. MATSUDA. Well, sir, as you know, the Maritime Administration has not ever been provided funds to do a study like this. This is something we found within our budget the ability to do. I think

I share your surprise at the fact that there were no studies on record. Maritime Administration has never done one of these before. So we are, working with you and your staff, pleased to undertake this effort.

To get it commissioned, we are simply hiring an outside consultant. It is something that we had heard would be effective in getting this information quickly. The task would be for a six month report back to us, and we hope that they can do that. And we are finalizing the details on that contract right now.

Mr. CUMMINGS. So when you answered me a moment ago and said either today or tomorrow, you meant that literally. Is that right?

Mr. MATSUDA. Literally, I am signing on the dotted line.

Mr. CUMMINGS. Was it your hope initially that you would be able to walk in here and say, Mr. Chairman, we have already got it commissioned, and it just didn't fall? I mean, you still had some negotiations to do? Is that an accurate statement?

Mr. MATSUDA. Oh, yes. I would have loved to have gotten this thing going yesterday, but we want to make sure that this study addresses the needs that this Subcommittee is interested in and that is getting the detailed information that is out there.

Mr. CUMMINGS. So you feel comfortable that when I call you tomorrow at 5:00 o'clock, you will be able to tell me, Congressman, we have commissioned a study. Is that right?

Mr. MATSUDA. Yes.

Mr. CUMMINGS. OK. I am going to call you at 5:00 o'clock.

Mr. MATSUDA. I appreciate that. I will tell my staff.

Mr. CUMMINGS. If you want me to do it earlier, I mean, if you need me to, I will wait until Friday, but no, I am serious. I am going to hold you to your word. What do you think? Five o'clock tomorrow?

Mr. MATSUDA. I think 5:00 o'clock tomorrow it will be done.

Mr. CUMMINGS. I see your staff behind you shaking their head yes. So all right, thank you very much.

Mr. MATSUDA. You bet.

Mr. CUMMINGS. Mr. Matsuda, I just want to clarify something here. MARAD indicated in March that there were 94 flag vessels in the foreign trade, and you have indicated in your testimony that there were 115 such vessels. Has the total number increased since March? And if so, why? Or what accounts for the different figures?

Mr. MATSUDA. I believe the 115 figure includes vessels that are not full-time or even half-time participating in the foreign trade, but they may be largely participating in the domestic trade and then once or twice a year they operate internationally. And these vessels, they come and go. Some years they take an international trip, some years they don't. I believe that is the difference between the two figures.

Mr. CUMMINGS. And would you tell us what trends do you project regarding the size of the U.S.-flag fleet in the foreign trade over the next five years? Have you thought about that?

Mr. MATSUDA. I have. And I have to tell you, I think it is dependent on the trade. If there is ability to participate in, for instance, transportation of wind energy components and projects, that might help bolster those movements. I know that for the carriage of de-

fense cargoes, the draw-down in Iraq certainly will lead to a downturn in the amount of cargo there, and that has been keeping our fleets busy for a while.

The Food Aid transportation, I think that is also something that we are keeping a close watch on. It also depends largely on the resources made available to USAID and the Department of Agriculture for those programs.

But we are taking a look. That is part of the Maritime Administration's job is to understand these trends, how they will impact the fleet, and ultimately our ability to deliver what is needed to the military or for defense or humanitarian relief purposes.

Mr. CUMMINGS. As we discussed at the last hearing, we are eager to know the specific objectives MARAD is working to achieve. Can you please list MARAD's specific performance objectives and indicate the quantitative and qualitative metrics in place to track progress towards the achievement of those objectives?

Mr. MATSUDA. Yes, sir. I believe in the letter you spoke of, we responded and wrote back about both the number of ships currently engaged in the Maritime Security Program, and that is something we track. Also, the amount of cargo space and tonnage available to carry cargo for the military is part of those programs. That is something we track. We are continuing to make improvements to the fleet. The way the program works is that there are age limitations on the vessels. So just by the fact that they are constantly bringing in newer and newer tonnage, it is more efficient. It provides more cargo without actually having to add new ships to the program. So that is one of the primary ways we measure our ability to deliver performance to the military.

The other one is the Cargo Preference Program, and we continue to track how the agencies that ship are meeting the law. That is something that we report on an annual basis.

Mr. CUMMINGS. Now, to put it simply, since World War II, the size of the United States-flag fleet engaged in international trade has been in a constant decline. The Subcommittee is particularly interested in knowing if MARAD has any objectives pertaining to increasing the size of the U.S.-flag fleet or increasing the percentage of U.S. export and import trade carried on U.S.-flag vessels.

Mr. MATSUDA. Sir, I believe it is fair to say that the cost differential between the U.S.-flag and foreign-flag ships means that we have to have an economic incentive to bring ships under the U.S. flag. And without that, ships are going to go elsewhere. They are going to go to these open registries. Any kind of incentive we can offer them, right now, the biggest incentives are these two programs that we feature, and that is, again, Maritime Security and Cargo Preference.

If we can offer them cargo financed by the Federal Government, for example, then that is one way we can make sure that they have the ability to compete and stay under the U.S. flag.

Mr. CUMMINGS. That is why we need to get these questions answered, right?

Mr. MATSUDA. Absolutely.

Mr. CUMMINGS. Based on what you just said, it seems to me that that goes to the essence of what you are doing, I mean, your job.

Mr. MATSUDA. Yes.

Mr. CUMMINGS. And it seems to me that as long as that question is not answered, is not addressed, it is kind of hard for us to—let's put it this way. You have an opinion and until that opinion is adopted by the powers that be, it seems that it would be very difficult for us to even achieve all the things you are talking about. Is that right?

Mr. MATSUDA. I agree. This is one component.

Mr. CUMMINGS. But it is a major part.

Mr. MATSUDA. The Cargo Preference Program is very important in terms of bringing, attracting folks to the U.S. flag.

Mr. CUMMINGS. I know you left the hearing before we had the shippers come up the last time, but they talked about how many of them would be almost out of business if it were not for these preferences. And I know that the President is very anxious to make sure that we get every possible job opportunity and every possible contract opportunity that we can to American-flag folks. And it just seems to me that, to borrow the President's own words, I am really questioning whether we have the urgency of now. And I am a big fan of the President's, but I am just wondering, if you Department moving with the urgency of now?

Mr. MATSUDA. I believe so, and I did review the testimony from the second panel, and watched the video of your questions and answers. And I can tell you, that was a small sampling of folks from the industry, but that represents largely the views that we have heard from the entire maritime industry, that these programs are important and they mean a lot. Without that economic incentive, these folks will take their ships and flag elsewhere and all the jobs that go along with them.

Mr. CUMMINGS. The Maritime Security Act of 2003 authorized an increase in funding for the Maritime Security Program from the present $174 million to $186 million in fiscal year 2012, and until the current program ends in 2015. What amount of funding is the Department of Transportation requesting for fiscal year 2012? Do you know?

Mr. MATSUDA. I can tell you the President will announce that probably in February as part of his budget.

Mr. CUMMINGS. And have you made a recommendation for an increase? Do they ask you your opinion?

Mr. MATSUDA. They do, and it is all part of the consultative process to develop the President's budget.

Mr. CUMMINGS. I know much of this is inside information and all. I got that. But I just want to know, and I am not going to ask you how much, but did you ask for an increase?

Mr. MATSUDA. Sir, we are working to develop that budget recommendation, but we certainly understand the importance of the question of whether it is funded at the fully authorized level or not. We understand that these things can impact the decisions of the shipping companies, the carriers, to know are they going to be able to make the investments in the fleets they need to serve under the U.S. flag in the long haul. These are really long-term questions that they need to know that the United States is committed to the economic incentives that we currently provide.

Mr. CUMMINGS. You indicated in your testimony that there are 12 MSP-eligible vessels that are documented in the U.S., but that

are not receiving payments because the MSP program is fully subscribed. Do you believe that the MSP program should be expanded? If it isn't expanded, what might be done to encourage more operators to come under the U.S. flag?

Mr. MATSUDA. Well, that is a tricky question, and we are currently discussing that as part of the reauthorization proposal. As we mentioned, one requirement of the MSP program is that you have to operate 180 days in the foreign trade. If there is not enough cargo to go around, I don't know if it makes it worthwhile to add ships to the program.

However, at the end of the day, this program helps serve the military and we want to make sure we are meeting their needs to be able to carry the Nation's military cargo.

Mr. CUMMINGS. One of the witnesses who testified in our earlier hearing stated that all but 11 MSP agreements are effectively controlled by foreign citizens. Is that the case? And if so, dose it pose any kind of a security risk to the United States do you think?

Mr. MATSUDA. No. In fact I think it helps in some cases, and that is because part of the MSP program and the VISA program obligates these companies, these parent companies to provide access to their worldwide global infrastructure. To get cargo right now into Afghanistan to fight the war there, we are using routes through countries that there is no way the military could go through if we had to do it ourselves. The bottom line is we rely on these international companies and their infrastructure worldwide to get cargo where we need it to go.

Mr. CUMMINGS. In your testimony, you wrote that "there are ongoing discussions among government agencies and the carrier community about how greater efficiencies might be achieved in the delivery of U.S. Food Aid." You continue and you say, "Among the improvements that should be considered is the modernization of ocean transportation."

Are you familiar?

Mr. MATSUDA. Yes.

Mr. CUMMINGS. What exactly does that mean? And do you believe that U.S. Food Aid should continue to be shipped on U.S.-flag vessels? And what are the modernizations that are under consideration?

Mr. MATSUDA. Obviously, I do believe U.S. Food Aid should be shipped on U.S.-flag vessels, and that to the extent we can, we utilize these U.S.-flag ships. What is being talked about in the testimony was modernizing U.S.-flag ships, the more modern ships we have in the fleet, the more efficient they are to operate, and that could help brings costs down.

The problem is that to get folks to commit and make the investments in new vessels, there needs to be a long-term incentive.

Mr. CUMMINGS. Mr. Taylor, did you have some questions?

Mr. TAYLOR. If you don't mind, Mr. Chairman, and I apologize for some conflicts.

Mr. Matsuda, I gave you some information. Soft pitch, I told you I was going to ask you about Title XI, what your agency is doing to get some ships built in America using the Title XI program. Previous Administrations started a credit council who in my opinion's

sole purpose was to keep any ship from ever being funded under Title XI.

I know you have not been on the job that long, but what steps are you taking to make use of the Title XI Loan Guarantee Program and get some ships built in this Country?

Mr. MATSUDA. Let me start with the Credit Council. I understand that really came about as a result of Inspector General investigations after a number of loan defaults over the years. And they believed that stronger mechanisms were necessary to make sure that these applications were being scrubbed and the outstanding loans were being monitored.

I can tell you that over the last couple of years, the average time to get from application to an answer has been about 289 days per application.

Mr. TAYLOR. I think my letter was over 400 days is what information that we had gathered. And Mr. Matsuda, that is a heck of a long time for anyone to wait, and quite frankly, in this business environment. The Title XI Program, when interest rates are low and credit is flowing easily, people don't need it. Right now is when people need it. And quite frankly, I think that you, given your background, have enough common sense to look through and say that has an opportunity to work; that will never work.

Just by way of refresher, the Title XI Program was working really well until Cruise America, I believe, was going to build the two cruise ships down my way for the Hawaiian trade. My memory is a guy by the name of Zell owned that company and in the immediate aftermath of 9/11, when people were afraid to fly, when people were afraid to get on a cruise ship, if truth be known, I think he pulled the plug on that project way too soon.

But then the Bush Administration followed up by instead of finishing the ships and making them available for things like Hurricane Katrina to put people up in, or things like the refugee crisis down in Guantanamo, again, to put our troops in, sold those ships for pennies on a dollar at a time when scrap prices were ridiculously low, and quite frankly it was the worst of all worlds.

But that was a one-time event based on 9/11 with an Administration that never wanted that program to work. I would hope that you would be very aggressive in trying to find a way to make this program work. The shipyards need the work. People need the jobs and we need those ships as auxiliaries for our fleet should we ever have a major contingency.

The second thing is, and we have spoken about this before, is an amendment to the CLEAR Act. The Chairman was good enough to insert language that said for those rigs operating in our exclusive economic zone, everybody forgets that the first E of EEZ is exclusive, that those oil rigs ought to be built in America. With the Deepwater Horizon, we got the wrong end of the stick every time. The rig was built in Korea. It was licensed in the Marshall Islands and the profits went to Switzerland.

I am for drilling, but I want to see to it that the benefits of that drilling go to the American people. And so we passed language in the CLEAR Act that said those rigs would be built in America. There was some pushback from this Administration saying we don't have the technical expertise to build them. And quite hon-

estly, that is a bunch of bunk. We build nuclear-powered aircraft carriers that have sequentially timed electromagnets to launch and retrieve. We build the world's best submarines. We build the world's best warships. We can build an oil rig.

I would hope that in your capacity in the time that you have in this job, that you would be an advocate for made in America, built in America, and operated by Americans.

So with that, Mr. Chairman, I thank you very much.

If you would like to respond?

Mr. MATSUDA. Yes.

Mr. TAYLOR. Particularly if you like to respond favorably, I would love to hear it.

Mr. MATSUDA. Absolutely. I am concerned about the status of America's shipbuilding industry. It seems that from the Title XI Program that it is one of the only places right now to get long-term debt financing. And that is a real challenge.

The other issue with Title XI is it doesn't necessarily cover every part of the shipbuilding industry. There are a number of medium and small size shipyards that do construction work that still aren't able to invest the time and money into the Title XI process that the large shipyards currently are.

But overall, I agree with you. We are trying to find a way to get this money out the door, and we continue to work with applicants as they come in. The one application you mentioned that was 400 days, we do have a record of one in the last two years that was that long. Each one is different. They are going to have different risks to the government. We have to make sure that we evaluate these. We bring in an external, independent evaluator to look at the application and where the risks are to the taxpayer, and make sure that at the end of the day, it is a good deal for the government.

But it is tough when you build one of these long-term assets, you don't know what the market is going to be like in five, 10, 15 years. Shipping rates just are pretty volatile.

Mr. TAYLOR. Mr. Chairman, if you don't mind?

Mr. Matsuda, some of the smartest people I know in that industry are countercyclical, I that they want to build their ships when the price of steel is down, when the price of aluminum is down, and when labor is readily available and therefore less expensive. That is where we are right now.

What the problem for those folks is is financing, and I really do think it may not create 10,000 jobs. It may not create 5,000 jobs. But if it creates 500 to 1,000 jobs, then it is a worthwhile thing for a company that is investing in their future and investing in our Nation's future.

And again, all I can do is ask you to be as aggressive as you can using your good business sense. And I also want to make myself available, if you see something in, and I forgot what President Clinton ended up calling it, but the bill we passed in 2003 that refinanced, got Title XI going again. If you see something in it that isn't working, I am offering my staff, my help to try to tweak those things because we really need to get this going again.

Thank you very, very much, Mr. Chairman.

Mr. CUMMINGS. OK. Thank you.

Mr. Matsuda, President Obama has announced a goal of doubling U.S. exports over the next five years, and has created an Export Cabinet to guide government efforts to achieve this goal. The Department of Transportation was not designated to be a member of the Export Cabinet. However, a report released by the Export Cabinet on September 16 entitled Export Promotion Cabinet's Plan For Doubling U.S. Exports In Five Years, suggests that this oversight has been erected and the report states that addressing regulatory and infrastructure issues can have a major impact on U.S. exports.

In fact, the Subcommittee held a hearing in March in which we heard from very frustrated American shippers who could not move their goods because they could not get shipping containers in certain areas of the Country. So it is encouraging to us that the Administration has recognized our infrastructure problems.

The report also states that the Departments of Commerce and Transportation have entered into a memorandum of understanding to work together with stakeholders to develop and implement comprehensive competitiveness to focus national freight policy.

What is being done to include U.S.-flag shipping as part of the Administration's export initiative? And how do we make sure U.S.-flag ships are in a position to carry at least a portion of these increased exports?

Mr. MATSUDA. Thank you. Sir, as far as the Export Council goes, Secretary LaHood is a member of the Export Council. He was added fairly recently, but that oversight has been corrected. I can verify that.

The President has made a major announcement in terms of our Nation's infrastructure in proposing a six-year reauthorization of our Federal Surface Transportation Programs, and a front-loaded $50 billion investment in the first year. So I know that our focus has been on infrastructure and how that can help facilitate exports as well.

As far as the shipping services go, maritime services are an export. Anytime you use the U.S. flag, a good chunk of that revenue, profits, and income comes back to the U.S. as opposed to when you use a foreign-flag ship. And so to the extent we can continue to encourage shipping on U.S. flag, given what we are currently doing and things that we can do within our resources, we are absolutely pursuing that.

Mr. CUMMINGS. You just mentioned that the President has called for a six-year authorization of Surface Transportation Programs aimed at infrastructure improvement and developing a world class transportation system in the U.S. However, the Administration failed to mention maritime projects.

What are DOT and the Maritime Administration doing to get the critical needs of our maritime transportation system on the Administration's agenda?

Mr. MATSUDA. Sir, I can tell you that as more details come out, we will find exactly how maritime infrastructure is intended to be linked through this new effort. I can tell you that this Administration has focused on ports and maritime more than many others. Just recently, the Secretary held the first ever National Port Summit where he got together port directors from all over the Country,

the first time this has ever been done, to hear their concerns and talk about what our future needs are.

Mr. CUMMINGS. Do you see the harbor maintenance tax as one of those regulatory issues that the Export Cabinet will talk about? And does DOT and MARAD support ending the double taxation of domestic waterborne cargo under the HMT? And if not, why?

Mr. MATSUDA. Sir, I can tell you that that is an issue under discussion within the Administration. This is something that we hear consistently as being a major impediment to moving on things like our Nation's marine highway. If we can get rid of this double taxation from application of the harbor maintenance tax, we could see more cargo moving on the water.

It is a terrible impediment when you have to pay this tax twice, especially for containerized goods which usually are more expensive or higher value than bulk commodities. So it really works against moving containers on the water in the way that we would like to see in terms of a true marine highway system nationwide.

Mr. CUMMINGS. What is being done to promote MARAD's Marine Highways Program within the Administration as a solution to infrastructure issues?

Mr. MATSUDA. Well, we have launched the program this summer. I know that it remains a priority for the Administration, the first time ever we have provided Federal funds for projects around the Country to help buy equipment, to help get the shoreside and waterside services together, and ready to move these goods.

There are already several operators around the Country who are trying to do this, and making a very tough go at it, given the factors working against them. The problem is that there is competition from trucks, but it comes at an environmental cost and it comes at a cost for congestion on our roads when we really could be moving these goods on the water.

So we are getting the money out the door. Secretary LaHood in August named a number of corridors around the Country where this could work. I will note that one of the projects that we received actually designates as number of East Coast stops, including the City of Baltimore.

I think there is great excitement around the Country when I go out to the ports and meet with the Directors and other port interests seeing a true marine highway system come about.

Mr. CUMMINGS. Many seafaring nations do not tax the personal income earned by their mariners when employed aboard ship. In order to help strengthen the U.S.-flag fleet by helping to lower the cost of labor, some propose extending the income exclusion provided in Section 911 of the Internal Revenue Code to U.S. mariners working aboard commercial vessels engaged in foreign trades.

Under Section 911, American citizens working abroad can exclude up to $80,000 of their foreign-earned income from their gross income for Federal income tax purpose.

Should Section 911 be expanded to include seafarers?

Mr. MATSUDA. I can tell you the Administration doesn't have a position on that question exactly, but anything we can do to reduce that difference and create more of an economic incentive for folks to remain under the U.S. flag will be helpful, and will help retain and grow the U.S.-flag fleet.

Mr. CUMMINGS. Are the U.S. shipyard and ship repair industries adequate to meet an emergency mobilization requiring extensive shipping capacity?

Mr. MATSUDA. Well, that is something that we work with the Department of Defense on to have a good understanding of what our industrial capacity needs are. I can tell you that one of the big concerns I would have right now in the shipbuilding industry is the loss of one of the two sole Jones Act vessel builders. And I think that would have an impact on the market for Jones Act ships.

Mr. CUMMINGS. Data provided by MARAD to the Subcommittee compares the cost of crewing a 20 year old bulk ship under U.S. flag and under an open registry in the year 2005. MARAD indicated that the costs of the U.S. crew under this scenario was about $3 million per year, whereas the cost of a crew under an open registry was less than $700,000.

How do crew costs compare for other types of vessels such as a container ship? And how would they compare for a ship that carried a high value cargo such as LNG?

Mr. MATSUDA. Sir, as you know, there are no U.S.-flag LNG carriers, and that is something that is of concern to us. We are leveraging our ability to ensure that U.S. crews can get on to foreign-flag LNG ships so they can get the training and still be able to work in that industry.

As far as the costs go, I think that is consistent with what we have been seeing. But sir, I really want to make sure that we get this study to you so at least we can give you some better, more detailed information about the costs of the various types of trades.

Mr. Taylor did you have any other questions?

Mr. TAYLOR. No, sir.

Mr. CUMMINGS. Rear Admiral Philip Greene was recently appointed Superintendent of the U.S. Merchant Marine Academy. Can you tell us why Admiral Greene is the right person for the job? And what plans he will implement to strengthen the Merchant Marine Academy?

Mr. MATSUDA. Absolutely, sir. First, let me offer you a meeting with Admiral Greene. I understand we are working with your staff to try and make that happen soon.

We spent a long time in a very deliberate effort to go out and find the very best candidates for the job of Superintendent of the U.S. Merchant Marine Academy. We had more than 50 well-qualified applicants. We used an executive search firm to really go out and get the best candidates. We did a lot of outreach to folks within the Academy community to make sure we got the right person for the job.

And we invited folks from the Academy itself, the midshipmen, the faculty and staff and others in the greater Academy community, and Admiral Greene came out as our selectee. We think he is the right person for the job and we have high expectations for him.

Mr. CUMMINGS. How many staff vacancies are there at the Merchant Marine Academy?

Mr. MATSUDA. I believe there are, actually I can tell you exactly here.

Mr. CUMMINGS. And tell me out of how many people.

Mr. MATSUDA. Merchant Marine Academy I believe has approximately 230 staff, and I would say give or take 20 positions that we are currently hiring. We are also dealing with a number of faculty positions that we are trying to make sure they are on board before the start of the new trimester.

Mr. CUMMINGS. And that is 20 out of 240, you said?

Mr. MATSUDA. Roughly, yes.

Mr. CUMMINGS. And what measures have been implemented to ensure that the proper management of the Academy finances?

Mr. MATSUDA. The GAO had done a report last year detailing 47 recommendations to improve the financial fiscal controls at the Academy. I can tell you that as of today, we have completed 42 of those, and my goal was to have all 47 completed by the end of the fiscal year. So staff will be working hard over the next 24 hours to get the remainder of them on my desk.

I can tell you that we take very seriously making sure that we have these controls in place and that we promote a culture of responsible fiscal management at the Academy. We know that working with Admiral Greene as the new Superintendent, we will have that support and he will have the ability to make sure that these practices remain in place.

Mr. CUMMINGS. The GAO released a report in August, 2009 that identified numerous instances of improper and questionable sources and uses of funds by the Academy and its affiliated organizations. A MARAD audit authorized by then-Deputy Secretary Barrett in 2007 found that barriers between appropriated and non-appropriated fund instrumentalities at the Academy had broken down. This resulted in transactions at the Academy that were "most probably illegal."

We note that the other service academies have some authority in the case of mixed-funded athletic and recreational extracurricular activities to treat appropriated funds as non-appropriated funds. In addition, the Coast Guard Academy has a NAFI manual that states "policy governing the use of appropriated funds and non-appropriated funds to support the Coast Guard's non-appropriated fund programs is based upon several sources, including Federal statutes, Comptroller General discussions, the financial resource management manual, and the policies and procedures followed by the other military services for the use of the APF in NAFI operations."

With that, would you please explain why the Merchant Marine Academy seemingly does not have the authority the other service academies have?

Mr. MATSUDA. Sir, there is a major difference between the U.S. Merchant Marine Academy and the other Federal services academies. And it is that the midshipmen who attend there are not employees of the Federal Government. They are students. They don't have the same types of morale, welfare and recreation funds and accounts that these other branches do.

Having said that, the NAFIs that were at the Academy, as you noted, the fiscal controls broke down over the years and it didn't seem that there was a very good situation up there. Earlier this year, I issued an order to make clear what our goal with these NAFIs is, and that is that we are going to take action to close down

some of them. Many were just simply bank accounts being controlled by Federal employees that were off the books.

We are keeping some of them open and others we are going to reform and make sure that if they continue to exist, that their dealings with the Federal Government are transparent and that their actions—what they are doing—are accountable to the people that they are supposed to benefit.

Mr. CUMMINGS. Has the Department of Transportation or MARAD done any sort of analysis to determine what legislative solutions there might be to the Academy's apparent inability to manage this?

Mr. TAYLOR. Mr. Chairman?

Mr. CUMMINGS. Yes?

Mr. TAYLOR. At some point could I weigh in on this?

Mr. CUMMINGS. Please.

Mr. TAYLOR. Mr. Chairman, in my capacity as the Chairman of the Seapower Subcommittee, we did look into this. And you raise good questions and I think they deserve good answers. The Academy being one of the smaller service academies was looking for ways, and quite honestly, for fear that if they asked for too much money from Congress, that one possible reaction would be Congress shutting the Academy down.

Towards that end, the Academy had several initiatives to use the facilities to provide additional training to mariners on a fee basis. And they used those funds to subsidize the Academy.

All the academies are legally allowed to have, for example, someone give them a yacht. They use the yacht for a while. They sell the yacht. They plow that money back into their athletic program. That is the norm certainly at Annapolis, and similar type programs in the other schools replace the word yacht for airplane or something else.

In the case of the Merchant Marine Academy, they were not specifically given the authority to do that in law. So while there was never any question, never any question that those funds somehow ended up in somebody's pocket, that was never an allegation. The real allegation was that somebody in the GAO said they are doing this. They are doing this for the right reason, but the law doesn't allow them to do this.

In the Seapower Subcommittee, we did come up with language that does allow them to do this, just like the other academies. Again, it was done for the purpose of subsidizing the Academy through nontraditional means without coming to the taxpayer to pay for it.

And quite honestly, it is my personal opinion that the Commandant at the time, Admiral Joe Stewart, was given a very raw deal because, quite frankly, I think Mr. Matsuda's predecessor did a very poor job of explaining to Admiral Stewart what the parameters were that he could operate in. He was never really told by his predecessor that you need to be staying in these boundaries.

And so it has been looked into. There has never been any allegation of a dime of that money going into anybody's pocket. What they did I think they did for all the right reasons, but unfortunately they were not given the legal authority to do those things, and therefore under the law, it was not allowed.

But those things have been addressed and, again, he's fairly new on the job. Quite honestly, because of my kid going there, I follow the Academy matters closer than most. And I can tell you that we would be more than happy, and my employee from the Seapower Subcommittee, Captain Will Ebbs, anytime that you want to speak to them, and Captain Ebbs has done extensive research into this. I think he will tell you almost verbatim what I just told you.

Mr. CUMMINGS. Thank you very much.

Mr. TAYLOR. Thank you, sir.

Mr. CUMMINGS. I really appreciate that. That was extremely helpful.

Let me go to something else and then we are just going to finish.

Tell me something, you know, the National Defense Authorization Act of 2009, which became law in October of 2008, required the Secretary of Transportation to direct the Superintendent of the Merchant Marine Academy to prescribe a policy on sexual harassment and sexual violence for the Academy.

I understand that the previous Superintendent resigned and it took some time before the new Superintendent was appointed. However, has a policy on sexual harassment been implemented at the Academy? And if so, who is responsible for ensuring that the policy is effective?

Mr. MATSUDA. Yes, sir. The policy at the Academy is, in short, is that they do not tolerate sexual harassment, sexual assault. And I can tell you that my conversation with the Superintendent verifies that and we are doing everything we can to make sure that that policy is being implemented effectively.

The law you mentioned required a report back to Congress and we are hoping to get that to you shortly. We want to make sure that if there are lessons within that survey and that report, that we can get those to you, and also make sure that they are being implemented; that if there is anything to learn, we are using that to improve.

Mr. CUMMINGS. All right. If there are no further questions, we will call this hearing to an end and I will provide you with a date as soon as we are clear as to the lame duck session, and you and I will talk at 5:00 o'clock tomorrow.

Mr. MATSUDA. I look forward to it, sir.

Mr. CUMMINGS. Thank you very much.

[Whereupon, at 5:23 p.m., the Subcommittee was adjourned.]

Department of Transportation
Statement of the Maritime Administrator
David T. Matsuda
Before the
Sub-Committee on Coast Guard and Maritime Transportation
United States House of Representatives

On the
State of the United States' Merchant Fleet in Foreign Commerce

September 29, 2010

Good afternoon, Mr. Chairman and Members of the Committee. Thank you for the opportunity to testify before you today on the state of the United States' Merchant Fleet in foreign commerce.

Three weeks ago, the President laid out a bold vision for renewing and expanding our Nation's transportation infrastructure – in a plan that combines a long-term vision for the future with new investments today. The President has called for a 6-year authorization of surface transportation programs and, with the current state of the economy in mind, the Administration proposes that $50 billion – a significant share of the new investments – be frontloaded in the first year. The new transportation program envisioned by the President needs to be part of a long-term framework that reforms the infrastructure investment process and expands our levels of investment so that we can have a truly world-class transportation system.

On July 20th, we met to begin to discuss the major challenges facing our ships operating in foreign trade and the requirements of U.S. registry. As I testified then, the state of the U.S. flag fleet in foreign trade has decreased over time – from 980 ships in 1947 to just 115 today. It is clear these challenges have existed for many years.

At the request of the Subcommittee, I have focused my testimony today on a continuing examination of U.S.-flagged vessels in U.S. foreign trade. I will particularly discuss the challenges of operating under the U.S.-flag, and the Maritime Administration's implementation of Congressional mandates to support U.S.-flag ships operating in foreign trade.

Our foreign trade fleet is subject to the full range of applicable U.S. laws covering business, financial, environmental, and employment regulations.

The Maritime Administration (MARAD) administers the laws enacted by Congress to support the continued existence of a U.S.-flag fleet in international trade. The major programs affecting the foreign trade fleet are the Maritime Security Program (MSP),–Voluntary Intermodal Sealift Agreement (VISA), and Cargo Preference programs. These programs support the U.S.-flag fleet, providing the Department of Defense (DOD) with assured access to the sealift capacity essential to support ongoing mobility requirements.

The MSP program sustains militarily useful vessels, while cargo preference covers a broader range of vessels. The MSP and Cargo Preference fleets combined carry about two percent of U.S. foreign trade. These ships employ approximately 5,000 mariners. In 2008, in addition to the commercial cargoes that support our economy, under cargo preference requirements, these vessels carried over 1 million metric tons of petroleum for the military; delivered over 8 million tons of general and containerized cargo for DOD; approximately 84,000 military household moves; over 60,000 military privately-owned vehicles; and about 2 million metric tons of humanitarian food aid worldwide.

For various reasons that we are exploring, U.S.-flag operations is more expensive than foreign operations. Investors who are considering the costs and benefits among the various vessel registry alternatives can find better opportunities using international and open registries. Today, over 80 percent of the ships in international commerce fly open-registry flags. Although open registries differ in their requirements, common elements are that there are generally no taxes on profits or no fiscal controls and the shipping company is free to recruit its crews internationally, although these elements are not the only ones that affect the differences in the cost structures compared to the U.S.-flag fleet.

Challenges of Operating Under the U.S.-Flag

Many of the challenges facing the operators of U.S.-flag ships are due to the higher costs of operating ships under the U.S.-flag. First, there are higher costs for ship operations. Based on rough estimates, we believe that overall, U.S. costs are approximately three times higher than the global maritime fleet average. The range of cost differences vary primarily by ship type, age, and other factors.

The greatest difference in operating costs is accounted for by mariner labor costs. U.S.-flag ships must use U.S. crews, including riding gangs. For several reasons, wage costs for mariners are significantly higher in the United States than many other countries that provide mariners to the world fleet. For example, under U.S. law, companies hiring U.S. mariners pay the cost of payroll taxes, medical, pension, and other benefits. In addition, the salary and benefits packages must be competitive with shore-side positions, and also provide for training and certification requirements and compensation for the sometimes dangerous conditions and arduous work schedules that we expect of our mariners. Open-registry ship operators generally pay lower wages, and often are not required to provide for continuing training and education of mariners.

Further, wages paid to U.S. mariners are subject to U.S. income tax. In other countries, such wages are often exempt from taxation. Several proposals have been made to address this difference. Legislation to exempt a portion of mariner wages from income tax was introduced by Chairman Oberstar in 2001, but was not enacted by Congress. Similar legislation was considered by the Senate in 2004, but did not become law. H.R. 1798, the Working American Competitiveness Act, introduced by Congressman Gregory Meeks, would amend the IRS code to exempt from taxes foreign earned income by a broad group of qualified individuals.

Beyond vessel operating costs, there are other U.S. requirements that result in increased costs for U.S.-flag carriers. For example, carriers that repair their vessels in foreign shipyards are required by federal law to pay a 50 percent *ad valorem* duty on those repairs before entering a U.S. port. The amount that is added varies, based on the cost of the repair. Another major area of cost differential is potential exposure to legal liability, which U.S.-flag carriers have identified as one of the most significant differences in separating U.S.-flag from non-U.S.-flag costs. Potential exposure to personal injury and environmental claims is generally higher in the United States, as the rights of injured victims and level of expected environmental responsibility are generally more rigorously enforced in the U.S. than in many other countries. This may also impact insurance rates for U.S.-flag vessels.

We have limited information submitted by carriers on their operating costs. We do not have comprehensive, consistent information on the broader range of impediments to the use of the U.S.-flag registry. In order to further expand our basis for analyzing the factors that limit the attractiveness of the U.S.-flag registry, the Maritime Administration is undertaking a study to survey a sample group of carriers and strengthen our analytical assessment of the U.S. flag fleet.

MARAD Administration of Congressional Mandates

The Maritime Administration manages the programs enacted and funded by Congress to support the U.S. foreign trade fleet. As previously mentioned, the three major program areas we administer, the MSP, VISA, and Cargo Preference, are interlocking mechanisms to sustain a fleet aligned with military sealift requirements, Government-financed export cargoes, and commercial cargo. U.S.-flag operators have consistently emphasized the importance of these programs, and their reliance on these programs to alleviate some of the differential between U.S. and foreign flag operating costs.

Maritime Security Program

One of my primary goals as Maritime Administrator is to strengthen the Merchant Marine to better align our sealift programs with the needs of our country. The MSP program goes a long way toward that goal with enrollment of over half of the U.S.- flag ships in foreign commerce.

Each MSP Operating Agreement specifies that the vessel covered by that agreement must operate in U.S. foreign commerce for not less than 180 days in any Fiscal Year. Carriers must have sufficient cargo to operate competitively in U.S. foreign commerce.

The MSP provides the United States with a core privately-owned and -operated U.S.-flag fleet in international trade that is also available to support U.S. national security requirements. The MSP was established as a ten-year program in 1996 and reauthorized for another ten years from 2006 through 2015. To assure retention of these ships under U.S-flag and their immediate availability for defense purposes, carriers in the program receive an annual retainer fee, not a differential subsidy. The amount of the payment, currently $2.9 million per ship per year, is set by Congress. This subsidy does not cover the per ship crew costs for an average containership in the program, which are on average $4.5 million higher than similar open registry containership.

With the MSP, the U.S. gains assured access to a vast global network of support and infrastructure, including logistics and operational expertise. The benefits of this enhanced readiness have been most notably demonstrated in the Northern Distribution Network that three MSP carriers established to support the transportation of goods and supplies to Afghanistan in support of military operations. The MSP carriers established a custom door-to-door intermodal transportation service to streamline the delivery of military goods and supplies across multiple borders and difficult terrain. One DOD study estimated that the complete replacement of the MSP fleet with Government-owned assets would cost in excess of $7 billion for initial construction and would require an annual expenditure of $1 billion for operation and maintenance of the fleet. However, this estimate does not address whether the current set of programs is the most cost-effective way to achieve national security objectives related to the merchant fleet.

There are currently 60 ships in the MSP. The program is fully subscribed. Since the program was reauthorized for the ten-year period of fiscal years 2006 through 2015, companies participating in the program have replaced some of their MSP ships with newer, more modern, and more capable ships that are available to meet national requirements. For example, in the last five years (2006 – 2010), 36 vessels have utilized the "expedited" MSP flag-in process, which also gives them immediate access to Government sponsored cargoes. Twenty-four of these vessels are currently receiving MSP payments. Twelve vessels are MSP-eligible and are currently registered as U.S. documented vessels, but are not receiving payments since the program is already fully subscribed.

This fast track to gain access to Government-impelled cargoes provides an alternative to the three-year wait under the Cargo Preference statutes. It is an example of how the MSP, as leveraged by the Maritime Administration, DOD, and the industry, can provide a dynamic and forward-looking environment to en-

courage additions to the U.S.-flag fleet, and avoid the negative impact of policy disparities that may result from the provisions of other statutes.

During the same time period, 18 MSP or MSP-eligible vessels have flagged out without needing to request further MARAD approval. Fourteen of these vessels were previously in the MSP, but were allowed to transfer to foreign flag after being replaced in the MSP with newer and more efficient vessels. Four MSP-eligible vessels were returned to foreign registries.

The MSP is making available crews, containerships and Roll-on/Roll-off vessels.[1] The Maritime Administration ensures that the intermodal infrastructure DOD needs is also available, as required by law. A 2009 evaluation of the MSP stated that the commercial shipping and inland commercial transportation in the Middle East has been crucial for execution of Operations Enduring Freedom and Iraqi Freedom.[2]

President Obama's FY11 budget proposed that the MSP should be extended through 2025. In May 2010, Representative Ike Skelton, recognizing the importance and effectiveness of the MSP, introduced HR 5136, the FY 2011 DOD Authorization Bill, which included extension of the MSP under Title XXXV from FY 2016 through FY 2025. The Maritime Administration has already made significant progress this year in working with stakeholders and our Federal partners to gather information on the future needs and potential of the program.

In anticipation of the end of the current program authorization, MARAD, the United States Transportation Command (USTRANCOM), and the maritime industry have had several discussions on a follow-on program. There are indications from USTRANSCOM that the size of the MSP fleet may need to be increased by four to six ships to meet new requirements identified by DOD this past year.

Voluntary Intermodal Sealift Agreement Program

The U.S. commercial emergency preparedness sealift program, VISA, is sponsored by the Maritime Administration and DOD and was implemented in 1997. This program provides DOD with assured access to U.S.-flag vessel capacity in the event of war or other national emergency. MSP companies are required to commit all of their MSP dry cargo vessel capacity to VISA. Non-MSP ship operators also commit capacity to the VISA program in order to receive priority consideration for DOD peacetime and wartime cargoes.

During Operations Iraqi and Enduring Freedom, 124 VISA vessels including 78 current and former MSP vessels supported U.S. military operations and Iraqi rebuilding efforts. The VISA fleet has delivered over 500,000 twenty-foot equivalent units of containerized cargoes to support U.S. troops since September 2001. As of September 1, 2010, 49 U.S.-flag operators were enrolled in the VISA program. The VISA fleet currently includes 135 ships and 213 barges, tugs, and other miscellaneous vessels. Over 165,000 twenty-foot equivalent units and 3.9 million square feet of capacity are committed to the VISA program. The MSP fleet commits approximately 75 percent of the total capacity to VISA.

[1] As of the end of FY 2009. FY 2010 data will be available in October. At the end of FY 2009 the number of ships measure was not met, at 59; an additional ship was added in December, 2009 bringing the MSP to full participation.

[2] Final Report, Maritime Security Program Impact Evaluation, Econometrica, Inc, July 2009.

Cargo Preference

The Government's cargo preference programs ensure a certain amount of cargo can be competed for by U.S. vessels, helping them to remain under U.S. flag. The Maritime Administration implements the Cargo Preference programs for civilian agencies. In addition, MARAD has provided information to DOD to assist them in enforcing the Military Cargo Preference Act of 1904. For example, MARAD assisted DOD in taking enforcement action in Guam that resulted in a construction company receiving the equivalent of a $380,000 penalty for shipping crushed rock from South Korea to Guam on a foreign-flag ship when a U.S.-flag ship was required for the DOD project.

Since 2000, GAO has prepared several reports on U.S. Food Aid Programs including ones that examine the impact of Cargo Preference laws. These reports have generally noted that while there is continued support for cargo preference, however, it makes sense as part of the ongoing policy review to look at ways to make the program more cost-effective and to reduce its impact on Federal deficits. There are ongoing discussions among Government agencies and the carrier community about how greater efficiencies might be achieved. Among the improvements that should be considered is the modernization of ocean transportation. The Government agencies continue to work on achieving consensus on these complex matters.

Cumulative Effect of MSP, VISA and Cargo Preference on the U.S.-Flag Fleet

The interlocking MSP, VISA and Cargo Preference programs help to retain, and even attract, ships to the U.S. Each of the programs provides an element of the base cargo that carriers rely upon in their aggressive pursuit of commercial cargoes for their ships. Without this base, carriers simply cannot survive in an international marketplace dominated by open registries. Although MSP is essential, by itself it is not sufficient to support an active, privately-owned U.S. flag commercial fleet. The VISA program, with its guaranteed access to Government cargoes, is an incentive for ships, which are principally those in the MSP program, to remain under U.S.-flag. The Government Cargo Preference programs provide an important source of income. With the expected decline in DOD shipments after the withdrawal of combat forces in Iraq and Afghanistan, carriers have expressed to you, and to us, that they need more cargo to try to remain competitive in international trade.

Additional Initiatives to Leverage Program Results

Although the foreign trade fleet is the focus of this hearing, I want to mention how a primarily "domestic" program is being maximized to also support DOD sealift requirements. Recently, MARAD awarded a contract to further develop the design of ships particularly suited for use in the American Marine Highway system. The study will include identifying owner's requirements through discussion with perspective marine highway owner/operators, surveying the current status of marine highway design development, and the development of a matrix of concept designs covering a range of marine highway ship design solutions. Particular emphasis will be placed on developing ship characteristics and design features that will enable a vessel to be attractive for DOD sealift needs. The study is being conducted in coordination and with cooperation of the U.S. Navy as part of the interagency Dual Use Vessel Development plan.

Developing a robust U.S.-flag fleet in domestic trade is a fundamental underpinning of a strong U.S.-flagged fleet in the U.S.-foreign trade. A solid domestic fleet of U.S.-flagged vessels can provide the home-grown mariners we need for international trade. It can also help revitalize our U.S. shipyards, whose specialized industrial base is essential for the construction and maintenance of our military fleet of ships and U.S. commercial vessels vital to our military sealift capacity. This U.S. fleet can also provide

jobs that by law cannot be outsourced, through direct employment in marine transportation and shipbuilding, as well as other industries that support our marine transportation system. Additionally, ensuring that we have a robust domestic fleet that utilizes America's Marine Highway system will also assist our efforts to stop the decline in vessels engaged in foreign commerce. These domestic vessels perform the valuable function of moving inland export cargoes to our seaboard ports, and making them available for vessels engaged in foreign commerce.

Two weeks ago, Secretary LaHood announced Marine Highway Grant awards for specific projects and studies. These funds are being maximized to ultimately place more vessels into service and increase the capacity of several Marine Highway operations. This will trigger limited shipyard activity, create jobs afloat and ashore, and long-term employment potential for our maritime workforce.

MARAD also plays a key role in the application of uniform laws and policies to protect the environment, and has been actively involved in the areas of invasive aquatic species and air emissions reductions. MARAD partners with other Federal agencies through policy efforts, research, and practical technology applications, as well as with international organizations to help achieve sound environmental stewardship.

Testing of ballast water treatment technologies takes place aboard MARAD vessels, and has grown to a multi-state and multi-agency cooperative effort that includes the development of protocols for technology testing and verification, and the development of independent testing facilities to provide data for certification of technologies to International Maritime Organization and U.S. Coast Guard standards. We have also provided ship platforms for testing, as well as scientific, technical, engineering, and marine architectural support and year-end funding in this area, and worked to coordinate development of facilities for testing and verification of technologies.

MARAD has also played a role in decreasing port and vessel air emissions. Our cooperative efforts have included testing of fuel switching technologies for low sulfur fuel, air emissions treatment technology testing on vessels, port and vessel air emissions technology evaluation and transfer with Pacific Rim ports such as Shanghai; development of standards for natural gas fuel on ships; developing models for analyzing and comparing air emissions of vessels, trucks, and trains to allow for various multi-modal freight analysis and planning; and cold ironing and shoreside power.

Piracy

I would now like to turn to an area of great concern to the U.S. merchant fleet in foreign commerce: Pirate attacks in the Horn of Africa (HOA) waters off the coast of Somalia. These attacks threaten commercial shipping transiting vital trade routes. Over the past year, Somali pirates have unsuccessfully attacked the HARRIETTE, the LIBERTY SUN, and the MAERSK ALABAMA (twice). At any given time, approximately six to eight U.S.-flag ships are in the region, of the approximately 200 that are in the area, on average. These ships are carrying DOD cargo bound for Operations New Dawn and Enduring Freedom or humanitarian cargoes destined for East Africa.

Together with the USCG, MARAD leads Working Group 3 of the Contact Group on Piracy off the Coast of Somalia.[3] The Working Group focuses on shipping self awareness and interaction with industry. MARAD is uniquely qualified for this role because of the agency's specialized knowledge of sealift vessels; our established relationships with the shipping community, maritime unions, the marine insurance community, and global maritime industry associations; and our oversight of Government impelled cargoes transiting the Horn of Africa. We have been a leader in promoting international action to combat the piracy crisis. Since 2008, we have conducted outreach and interaction with industry and other Federal

[3] Working Group 3.

agencies, and focused on best management practices to counter piracy and on industry concerns. Although the number of U.S.-flag vessels transiting the HOA region is relatively small, the potential for risk to our ships and seafarers demands that we take effective action to ensure our fleet is well protected.
The Working Group has been involved in the development and dissemination of Best Management Practices (BMPs) on self-protection measures that ship owners can incorporate into their operations. In addition to continual refinement of BMPs, the Working Group plans to focus on anti-piracy training and other issues related to human factors.

This MARAD initiative, and the dedication of the global maritime industry and their governments, has successfully diminished successful attacks on ships and the implications for freedom of navigation in the HOA. We will continue our commitment to help assure the safety of our vessels and mariners transiting the area.

I am dedicated to achieving the strongest and most viable U.S. flag fleet possible. Our statutory authority and resources drive our efforts to achieve an effective maritime policy and a fleet that meets our national security needs and supports our economic interests. I pledge to you that I will do my utmost to ensure that our policies and programs are effective.

At this time, I will be pleased to answer any questions you may have. Thank you.