

OPINION **IN DEFENSE OF THE JONES ACT**



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THE JONES ACT: A NATIONAL ECONOMIC AND STRATEGIC IMPERATIVE

The Jones Act has and continues to be a lightning rod for opinion. Bill Gray's opinion piece, Jones Act "Build American" provision strikes again, in our November 2010 issue drew a strong response from our readers.

The following are two of those opinions. One response came from shipbuilder Fred Harris, president of General Dynamics NASSCO, whose San Diego shipyard builds both commercial and government vessels.

The other is written by H. Clayton Cook Jr., counsel from the maritime law firm Seward & Kissel LLP. Cook served as General Counsel at the U.S. Maritime Administration from 1970 to 1973.

Mr. Gray's opinion piece, titled Jones Act "Build American" Provision Strikes Again, asserts the claim that short sea shipping will not become reality until the U.S.-build requirement of the Jones Act is abolished. With this statement, Mr. Gray misrepresents the facts and neglects economic and national security implications by failing to mention that the Jones Act, the long established U.S. maritime law, is no more preferential to domestic manufacturing capacity than the foreign government shipbuilding subsidies in Asia and Europe to which Mr. Gray would like to see American jobs outsourced.

Since the end of World War II, America has allowed its shipbuilding capacity to decline into insignificance. In the 65 years since 1945, the U.S. has delivered less than a third of the vessels produced between 1941 and 1945. More recently, since 1980 and the end of federal government subsidies, the U.S. has delivered 137 oceangoing commercial vessels—an average of 4.5 per year. In 2009, the U.S. contributed only 2.8% of the world's new construction deliveries.

Asian and European countries heavily subsidize their shipbuilding operations, up to 30% of construction costs in some cases. Foreign shipbuilders have leveraged state-sponsored subsidies for facility expansion, modernization, R&D, and customer financing, enabling them to offer substantially lower prices while gobbling up huge portions of the world's shipbuilding order book. That volume, in turn, has allowed these yards to improve

processes and efficiencies consistent with the U.S. shipbuilding boom of the 1940s. Without government support, foreign shipbuilders have had difficulty competing in a free market economy.

Prior to August 2007, Indian shipbuilders were given 30% subsidy on all ship sales to foreign firms and on ocean-going merchant vessels more than 80 meters to domestic clients. The abolition of the subsidy scheme, according to Shipyard Association of India [sic], has adversely affected new orders, as Indian vessels are now pitched unfavorably against those from Korea, Japan and China, where subsidies are as high as 40% (JHA, Ambrish. Shipbuilding-India Aspires to Emerge as a Leading Player. 01 April 2009).

How can American shipbuilders expect to offer competitive pricing when foreign states are footing a third of the bill and sustaining volumes based on those subsidies that dwarf the entire U.S. shipbuilding enterprise? Unfortunately, Mr. Gray offers little insight into this conundrum other than the simple suggestion of yielding the U.S. market and outsourcing hundreds of thousands of jobs to these foreign interests. Once ceded, what then of the high cost of U.S. labor and ownership? Perhaps lower cost foreign sailors could further reduce the price of U.S.

ocean transport, thereby unilaterally disarming to the detriment of economic and strategic common sense.

U.S. shipbuilders have survived without subsidies for more than a generation. As such, this debate cannot focus on government subsidies as the answer to affordable ships, but rather on the role of a relevant transportation policy, including sustaining the Jones Act, as a national economic and strategic imperative.

The Jones Act ensures a skilled workforce to design, build, repair, maintain and sail America's domestic fleet while providing the nation a strategic sealift capability during time of conflict or national emergency. Because of the Jones Act, more than 500,000 people are employed each day in the United States, 100,000 of which are shipyard workers. For every shipyard job, it is estimated that 2.8 more jobs are created down the supply chain. Overall, that's \$29.1 billion in annual labor compensation, equating to \$100.3 billion in economic output and \$11.4 billion in taxes.

Mr. Gray asserts via proxy quoting Ernst Frankel that the productivity of U.S. shipbuilders lags due to ineffective workplace organization and management. While this inefficiency is evidenced in short-run shipbuilding programs that have struggled, volume remains imperative to successful shipbuilding. Since 2006, General Dynamics NASSCO has consistently delivered high quality ships for Jones Act and government service with unsurpassed ship-to-ship learning rates. This success is attributed to a committed team of shipbuilders improving their craft on a steady, 14-ship production run that has provided NASSCO the ability to reduce cost, improve processes, and increase the skill sets of its workers. Volume represents the key to affordable shipbuilding—something the world's leading shipbuilding nations have enjoyed for



**Fred Harris,
President
GD NASSCO**

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THE JONES ACT CREATES AN ATTRACTIVE MARKET FOR INVESTORS

There are two of Bill Gray's November piece conclusions on which I can agree. Congressional inaction on the Harbor Maintenance Tax lacks any rational explanation. And, the case favoring Roll On-Roll Off (Ro-Ro) services for the East Coast I-95 corridor is overwhelming. But I differ with his assertions that it is because of Jones Act U.S. build requirements that "America has no suitable short sea Roll On/Roll Off (Ro-Ro) ships", and that these Jones Act provisions "only benefit a very small number of unionized shipyard workers." I'll return to these in a bit, but first I'd like to provide a somewhat different "Jones Act" perspective.

RESERVATIONS OF NATIONAL COMMERCIAL OPPORTUNITIES

The reservation of the economic benefits of the Nation's domestic waterborne commerce to U.S. citizens owning and operating vessels built in the United States was introduced in our Navigation Acts of 1817 (1817 Acts). Our "Jones Act", section 27 of the Merchant Marine Act of 1920, now codified as section 55102 of Title 46 of the United States Code, is simply the most recent form of the reservation of this commercial opportunity to U.S. citizens. In the post-World War II world, we have seen similar reservations of commercial opportunities for U.S. citizens, with broad support in both Republican and Democratic circles, in the Outer Continental Shelf Lands Act of 1953, the Fishery Conservation and Management Act of 1976, the Law of the Sea, Exclusive Economic Zone Proclamation of 1983 (EEZ) and the American Fisheries Act of 1998.

The last of these, the 1998 Fisheries Act, reserved the exploitation (harvesting, processing and transporting) of U.S. fisheries resources within the 200 nautical mile EEZ to U.S. citizen owned and built vessels (with citizenship standards more stringent than those of the Jones Act). And, in the just concluded Congress, legislation was enacted by the House that would have "Americanized" an entire range of economic activity from seabed and sea to the wind above. In economic terms the Jones Act is neither a U.S. nor an international anomaly.

World-wide EEZ national build requirements are wide-spread. Consider the current situation for Brazil.

"DUAL USE" VESSELS FOR COMMERCE & NATIONAL DEFENSE

The importance of commercial vessel "privateers" was manifest in our War of Independence and our War of 1812. The 1817 Acts recognized the importance of this U.S. owned and U.S. built "dual use" tonnage. In the run up to and during World War I, the U.S. found itself lacking vessels for its commercial trades and its North Atlantic wartime requirements. The Shipping Act of 1916, and the Merchant Marine Acts of 1920 and 1936, were intended to prevent a recurrence of these problems and to ensure the availability—of a U.S. owned commercial fleet, and a U.S. based shipbuilding infrastructure, that would support our domestic and international trades in peacetime, and serve as a military auxiliary in time of war or national emergency.

The 1916 Act had addressed U.S. citizenship. The 1920 Act dealt with the role of our domestic trades in meeting these objectives with its section 27 U.S. build requirement. The 1936 Act required U.S. ownership of U.S. built vessels for participation in Maritime Administration (MARAD) "differential subsidy" programs allowed the U.S. flag owners to approximate the operating and capital costs of its lower cost foreign fleet competitors, with reserve funds to provide a tax "neutrality." The Merchant Marine Act of 1970 extended the differential subsidies to the international bulk trades and provided a revised "CCF" tax deferral program for the liner and bulk trades and Great Lakes and non-contiguous domestic services. The 1970 Act ushered in a decade of U.S. shipyard expansions and series productivity improvements.

The 1960s and 1970s witnessed new vessel concept designs by U.S. naval architects and marine engineers for Container, LASH and Ro-Ro vessels, that were built by U.S. shipyards, financed by U.S. banks and leasing companies, and proven by first-in-service U.S. domestic and international operators. The designs for these 1970 Act vessels were reviewed for, and these "dual-use" vessels incorpo-

rated, "national defense features" funded by the U.S. government.

In the 1980's, "subsidies" became politically "unfashionable." Following the Reagan Administration's termination of the "differential subsidy" programs, and unable to compete in operating or capital costs, the U.S. fleet international operators whose fleets had provided the Department of Defense (DOD) with access of majority of its "dual-use" tonnage, sold their fleets to foreign shipping lines, or simply ceased international operations.

TODAY & TOMORROW

So, today it is only the Jones Act, that remains to support the construction of domestic trade commercial vessels in U.S. shipyards and the operation of these vessels in our domestic trades, to which DOD can look to supply its mobilization capacity shipbuilding and ship operating needs in time of war or national emergency.

The merits of maritime alternatives to highway-based truck transportation are well recognized. The urbanized Northeast Corridor of Jean Gottmann's "Megalopolis" is well suited to Atlantic Coast Roll-On/Roll-Off services that would provide a water alternative to Interstate 95 and Interstate 81. The Energy Independence and Security Act of 2007 directed the Department of Transportation (DOT) to establish a coastwise shipping program, but failed to provide funding. Congress and the current Administration have provided modest amounts for a DOT America's Marine Highway (AMH) Program. But the DOT has had only limited success in moving its AMH program forward.

DOD's Office of the Chief of Naval Operations is required to ensure that there is sufficient commercial tonnage sealift capacity available to support military mobilizations. The DOD remains committed to the dual use vessel concept, even as it is now limited to vessels in Jones Act commercial services. Reductions in Jones Act vessel shipyard costs were the subject of DOD National Shipbuilding Research Program workshops in 2007 and 2008. Associated financing cost studies showed that using the MARAD

Title XI and CCF programs it was possible to achieve “zero percent” financing in some situations.

Today the DOD and the DOT are engaged in a project to develop and design, and see to the construction and operation, of a series of dual-use vessels that will be both commercially viable and capable of meeting a portion of DOD’s military sealift needs. The project envisions a Ro-Ro vessel that can be constructed in series, benefiting from shipyard learning curves and quantity purchasing to reduce the per-ship costs for prospective owners. The I-95 corridor is at the heart of this. And, one of subjects involved is the use of LNG dual-fuel engines, with DOD paying for the increased costs as “national defense” features.

If successful, this DOT/DOD project will meet the program objectives of both DOT’s AMH Program and DOD’s Strategic Sealift Program. And it will help to sustain and perhaps revitalize the struggling domestic shipbuilding industrial base that is essential to the construction and repair of the DOD fleet. This important effort would not be possible without Jones Act protection.

BILL GRAY’S JONES ACT

I wonder if Bill Gray is correct in saying that “America has no suitable short sea Roll On/Roll Off (Ro-Ro) ships.” Saltchuck’s TOTE has a successful Portland to Anchorage Ro-Ro service with NASSCO built \$150 million Ro-Ros. And TOTE is on record saying that an I-95 corridor Ro-Ro service with U.S. built Ro-Ros would be feasible if more favorable shore-side labor agreements could be achieved. And, isn’t the test for a proposal whether the vessel’s fully financed U.S. cost will fit into a business plan that will allow the project to proceed and provide acceptable returns to its investors—not what the vessel may or may not cost at some foreign location? The U.S. prices that Bill quotes do appear so high that they may have blocked the Coastal Connect project. But, I wonder about the relevance of this comparison.

Bill Gray has said that the Jones Act “only benefits a very small number of unionized shipyard workers.” But, the U.S. build requirement benefits workers in both union and non-union shipyards and component manufacturing jobs across the U.S. It benefits employees at naval architect and ship classification, ship broker and ship insurer firms, and at banks and ship financing and law

firms. And, it protects the substantial associated federal, state and local tax revenues that are involved. A 2010 Price-WaterhouseCoopers study concluded that Jones Act was responsible for 40,334 vessels, 499,676 related jobs, \$100.3 billion in economic output and \$11.4 billion in federal, state and local taxes.

So, I cannot agree with Bill Gray on these points, and am a bit of the view that while “Mr. Gray is entitled to his own opinions about the merits of the Jones Act, Mr. Gray is not entitled to his own sets of ‘facts’”.

CONCLUSIONS

Commentators often say that the Jones Act stifles domestic trade vessel investment. But, it has long seemed to me that the very opposite is true, that the Jones Act in fact provides an attractive market in which barriers to entry are high and investor returns are reasonably assured. I look to the more than \$5 billion in Jones Act trade renewals and expansions of the past decade as evidence for this proposition, and to the \$1.2 billion Aker/OSG product tanker project as evidence of this trade’s attraction to non-citizen investors. Bill Gray’s Jones Act understandings are different from mine.

I am generally skeptical when someone states that a particular Jones Act service can’t be undertaken because the vessel’s U.S. shipyard price is some multiple of the vessel’s price at some foreign location. I wonder about the statement’s relevance. Isn’t the test whether the vessel’s “fully financed cost” will fit into a business plan that will allow the project to proceed and provide acceptable returns to its investors. Wouldn’t it have been more precise for Bill Gray to have said that the Coastal Connect project could not proceed because “the fully financed cost of the vessels was so high that it would not allow the business plan to succeed and provide an acceptable return.”

ABOUT THE AUTHOR

H. Clayton Cook, Jr. is a Counsel in Seward & Kissel LLP’s Corporate Finance Group. He has been engaged in private law practice or U.S. government service since 1960. He served as General Counsel of MarAd from 1970 through 1973. There he was responsible for the legal aspects of the implementation of the Merchant Marine Act of 1970, and for the drafting of the Federal Ship Financing Act of 1972 which governs MarAd’s current Title XI program.



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decades. Short sea shipping could provide that needed volume.

What must be done to encourage short sea shipping enterprises in

the U.S.? Mr. Gray argues that the high capital cost of ships is preventing an American Marine Highway (AMH) from taking root. On the contrary, a study

commissioned by the Center for Commercial Deployment of Transportation Technologies (CCDoTT), states that the cost of a U.S.-built vessel represents approximately 14% of the total operational costs for short sea service, on a per-container basis. The remaining 26% of the total 40% water-side costs to operate a ship within the AMH consists of known variables, such as fuel, crewing, food, insurance, maintenance, and pilots/tugs for docking. The remaining 60% of AMH costs lie in landside variables such as marine terminal operations, inland transportation, insurance, vessel loading and discharge, and other administrative costs. The economies of scale gained by using a ship instead of a truck for cargo movement make the water-side costs of AMH minimal in comparison to the costs of landside drayage.

The solution to bolstering U.S. shipbuilding and providing the means to getting cargo off of our roads and onto the marine highway lies in a comprehensive transportation policy that addresses infrastructure requirements and balances modal funding fairly across the road, rail, and ocean sectors. This policy must enable the development of highly producible ship designs that can be built in sufficient numbers to reduce recurring costs, and include affordable access to capital money for owners and operators through programs like Title XI. The objective of such a policy should be to incentivize owners and operators, along with state and local authorities, to invest in ocean transport. The Jones Act is fundamental to achieving this objective.

The American Shipbuilder stands ready to build affordable, high quality vessels in support of the American Marine Highway. Shipbuilding is vital to our national security and economy, and it is the Jones Act that maintains critical U.S. shipbuilding capability and capacity. As an industry, we must demand a more focused, comprehensive transportation policy that balances economic and strategic imperatives to improve and expand intermodal transportation in the U.S. to the benefit of all.

ABOUT THE AUTHOR

Fred Harris is the President of General Dynamics NASSCO and a board member of the Shipbuilders Council of America. A 1967 graduate of Maine Maritime Academy, Mr. Harris has more than 43 years of experience in the operations, design and construction of submarines, Navy surface ships and commercial, Jones Act ships.



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