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STATEMENT OF

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BEFORE THE

HOUSE COMMITTEE ON THE

MERCHANT MARINE AND FISHERIES

ON

U.S. FLAG SHARE OF THE U.S./CANADA

TRADE ON THE GREAT LAKES

Mr. Chairman and Members of the Committee:

We appreciate the opportunity to be here today to discuss our report on U.S.-Flag Share of the U.S./Canada Trade on the Great Lakes (GAO/RCED-86-115, dated May 8, 1986). These are our main points.

--Canadian-flag ships have historically carried most of the waterborne trade that moves between the United States and Canada on the Great Lakes/St. Lawrence Seaway system. In the last three decades, the Canadians have increased their share of the trade on the Great Lakes while capturing most of the new trade that resulted from the St. Lawrence Seaway opening. The Seaway trade now accounts for between a quarter and a third of the U.S./Canada trade.

--The portion of the trade American ships carry has been falling, mainly because (1) American ships are more expensive to build and operate; (2) the Canadian Great Lakes shipping fleet is better adapted to the St. Lawrence Seaway; (3) Canadian assistance programs were more effective than U.S. assistance programs in encouraging fleet development; (4) factors such as geography, long-term contracts, and domestic trade policies favored Canadian operators; and (5) American fleet operators concentrated on domestic traffic.

HISTORICAL TRADE DATA

In 1984, the latest year for which complete data were available, about 185 million tons of cargo was shipped between ports on the Great Lakes/St.Lawrence Seaway system. About 40 million tons moved between U.S. and Canadian ports. Most of the remainder was domestic cargo moving between ports in the United States or between ports in Canada. Almost all the U.S./Canada trade is made up of dry bulk commodities such as coal, iron ore, and grain carried in dry bulk ships.

Between 1953 and 1979, the U.S./Canada trade on the Great Lakes and through the St. Lawrence Seaway doubled from 25.1 million tons to 51.1 million tons. But in the early 1980's, traffic declined and by 1983 traffic had fallen to 35.4 million tons. It rebounded somewhat in 1984 to 40.1 million tons.

U.S.-flag participation in the total U.S./Canada trade has declined from 29.2 percent in 1953 to 6.4 percent in 1984. On the Great Lakes, the U.S.-flag share fell from 30.3 percent to 8.7 percent during the same period. American ships have never carried much of the Seaway trade and in most years, U.S.-flag participation was 5 percent or less--sometimes less than 1 percent.

REASONS FOR LOW LEVEL U.S.-FLAG PARTICIPATION

Our research and discussions with American and Canadian maritime officials disclosed that a variety of factors contribute to the low level of U.S.-flag participation in the U.S./Canada trade.

Vessel operating and construction costs

We found a number of studies and analyses indicating that Canadian operating and construction costs have almost always been lower than those in the United States, making it difficult for American operators to compete. For example, a 1982 study showed that annual labor costs for 25,000 ton ships in Canada were only about 54 percent of U.S. labor costs on similar ships.

Modernization of the Canadian Great Lakes fleet

The opening of the St. Lawrence Seaway resulted in increased vessel construction as Canadian operators upgraded their fleets to take advantage of new trading opportunities. They built ships to seaway maximum size and thus were able to carry the maximum tonnage possible. On the other hand, U.S. operators did not build ships for the Seaway trade, and most U.S. Great Lakes ships are either too large to use Seaway locks or too small to carry enough cargo to compete with Canada's ships. It is important to remember that the St. Lawrence river is a major route for domestic shipping in Canada, much like the Mississippi in the U.S., so that ships adapted to the Seaway were much more important to the Canadians than they were to us.

<u>National Assistance Programs</u>

The participation of American and Canadian fleets in the U.S./Canada trade has been affected by the maritime assistance programs offered by the United States and Canadian governments. Canadian government assistance began before the St. Lawrence Seaway opened in 1959, while U.S. support of its Great Lakes fleet was not available until 1970. By that time, the Canadian fleet was firmly established in the Seaway trade.

<u>Canadian assistance</u> - The Canadian Great Lakes fleet was assisted by Canadian government tax incentives and subsidy programs.

The Canadian Vessel Construction Assistance Act of 1949 provided two basic incentives to help shipowners: accelerated depreciation and tax exemptions. Under the act, Canadian owners of ships built in Canada were allowed to depreciate their ships over 3 years at a 33-1/3 percent rate. The act also exempted proceeds from the sale of a ship from income tax if the money was used to replace the ship with another one built in a Canadian shipyard.

Amendments to the 1949 act in 1957 broadened its scope and made possible what became known informally within the industry as the "angel plan." Nonshipping corporations were able to use tax incentives available under the angel plan by becoming shipowners and offsetting the accelerated depreciation allowance against income from nonshipping activities. This provided an additional source of capital for Canadian shipbuilding--Canadian officials told us 12 ships were built through this method between 1961 and 1966.

Ship construction subsidies were added by the Canadian government between 1961 and 1985. The initial subsidy rate for commercial ships was 40 percent, but when the subsidy ended in June 1985, it was down to 9 percent. The subsidy was at first limited to new construction, but in 1976 was extended to conversions of existing ships. Subsidized ships were permitted to engage in either foreign or domestic trade.

Canadian government officials told us a major reason the subsidies were begun was to bridge the gap between the cost of a Canadian-flag ship built elsewhere in the British Commonwealth and that of a comparable vessel built in Canada. Without the subsidy, according to officials of one Canadian fleet, more vessels would have been purchased abroad.

American assistance - Although the United States has aided its merchant marine through subsidies and other forms of assistance at least since the Merchant Marine Act of 1936 was passed, the programs authorized by the act were generally unavailable to Great Lakes bulk fleet operators until the act was amended in 1970. By this time, the Canadian fleet had gained an edge in the Seaway trade and American operators had little incentive to build seaway maximum vessels. Consequently, maritime subsidy programs designed to offset the competitive advantage enjoyed by foreign competition had little impact on U.S.-flag participation in the U.S./Canada trade.

Subsidies available to the U.S. merchant marine have included operating and construction subsidies to help U.S. ships compete with lower cost foreign competitors, but Great Lakes operators could not use the subsidies until the Merchant Marine Act of 1970 extended operating and construction subsidy programs to Great Lakes bulk vessel operators. Even then, however, only one vessel operator took advantage of the operating subsidy program, and no Great Lakes vessels have been built with a subsidy. The Maritime Administration also provides three programs to reduce the cost of capital for ship operators, and while a number of U.S. Great Lakes ships have been built with funds made available through federal assistance, all are primarily engaged in domestic shipping.

Cabotage laws

Most nations have requirements, known as cabotage laws, to protect their domestic trade from foreign competition. In the United States, Section 27 of the Merchant Marine Act of 1920--commonly referred to as the Jones Act--requires that all cargo moving among U.S. ports be carried on vessels that are domestically registered, built, owned, and crewed by Americans.

Canada's Shipping Act has similar restrictions for domestic trade but permits foreign-built vessels that meet Canadian construction standards to engage in Canadian domestic trade after paying a duty of 25 percent of the vessel's fair market value. As a result, Canadian Great Lakes operators have been able to purchase lower-cost foreign vessels and use them for both domestic and U.S./Canada trade. The U.S. fleet cannot do this because foreign-built vessels are not permitted to operate in the U.S. domestic trade.

Other Canadian advantages

Canadian vessel operators have certain other advantages: the U.S./Canada Seaway trade parallels Canadian domestic traffic through the Seaway. As a result, Canadian ships can carry U.S. cargo on the backhaul of a domestic shipment, giving them a significant advantage over U.S. carriers who usually have to come back from Canada empty because most of the U.S./Canada trade moves from the U.S. to Canada, and U.S. ships are precluded from carrying the Canadian domestic cargo that comes back along the St. Lawrence. In addition, a significant share of the U.S./Canada trade is tied up in long-term contracts between Canadian vessel operators and Canadian buyers of raw materials that typically move from the U.S. to Canada. Canadian buyers of U.S. raw materials usually prefer to use Canadian ships. For example, a province-owned electrical generating plant that uses U.S. coal is likely to have a long-term contract to ship the coal on a Canadian ship.

Summary

To sum up, both the U.S. and Canadian fleets are structured to take advantage of the domestic shipping opportunities which they are largely guaranteed. While Canadian subsidies were timely and encouraged construction of ships that are well adapted to the St. Lawrence Seaway, the Canadians have dominated U.S./Canada shipping in large part because serving the Canadian domestic needs gives the Canadian fleet advantages for U.S./Canada shipping.

This completes my statement. We would be glad to respond to your questions.