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His Master's Voice - Patrick Brown

David Hahn, president of BC Ferries Services Inc (BCFS) is clearly terrified of ghosts. Following a course charted by Premier Campbell, who first of all sunk the fast ferries with political torpedoes, and then gave them away for maximum political effect, Mr Hahn has decided to avoid the BC shipbuilding scene altogether by ordering two or three new main route ferries, dubbed 'Super-Cs', from Europe.

In fact, he's so determined to order them from German or Finnish shipyards that he hasn't even bothered to obtain a quotation from the most eligible local builder, Washington Marine (which among other things, now owns most of BC's shipyards). Not much gratitude to Mr Washington, who was thoughtful enough to take the three fast ferries off the government's hands, and park them in plain view on the North Vancouver waterfront.

Ferries VP Mark Stefansson says: 'Our estimates indicate that there is just 20% of the large shipbuilding capacity left in BC as there was a decade ago.' That was when all the shipyards co-operated to construct the two 470-car 'Spirit Class' superferries. The proposed 'Super-Cs', presumably, would not be quite as big—the current double-ended C-class ferries have about one-third the displacement of a 'Spirit Class' ship (see box, below).

According to Transportation Minister Kevin Falcon, 'inefficient' BC shipyards would push the price of the three vessels up by \$60 million from the budgeted \$510 million. His figures, one supposes, come from Fred Wright, BC Ferries' consultant on such things. It's Mr Wright who has recommended building a billion dollars' worth of ferries (22 of them) over the next fifteen years, and building the larger ones offshore.

Many BC residents have been appalled at the proposal to shatter a long-standing tradition of building our own ferries. But Mr Hahn, like Ronald Reagan, sees himself on film. 'There was a very bad movie made in BC about seven years ago, and I feel like we're being asked to do the sequel.' He must have been given a video; he wasn't in the country at the time.

BC Ferries Tendering

BC Ferries state that they have followed the normal process in considering tenders for the construction of the three 'Super-C' ferries. The first phase, labeled 'prequalification', is to determine whether prospective bidders have the organization

The public interest

Although changes have been made by the provincial government (through the *Coastal Ferries Act* and the formation of BC Ferries Services as a government-owned private corporation), BC Ferries remains the major provider of a significant element of the province's transportation infrastructure.

There is, inevitably, an overwhelming public interest in the safety, performance, and cost of the ferry service. It's the largest ferry service in the world.

For British Columbians it affects not only day-to-day transportation decisions, but also long-term personal decisions on where to live and what to do. Private company or not, the people of BC expect BC Ferries to exhibit a high degree of social and corporate responsibility. Nearly a quarter of the province's population depends on BC Ferries to reach Vancouver and the rest of the world. This makes it very difficult for BCFS to pursue narrow corporate objectives, no matter what its mission statement may say.

The new legislation has put BC Ferries Services beyond the reach of Freedom of Information legislation, and private corporations don't have to release any information on their activities if they choose not to. So despite a high degree of public interest in the decision to build new ferries offshore, BC ferries has provided little factual information to justify its use of international shipbuilders.

and facilities to do the work. According to BC Ferries, the three largest Canadian yards, and 11 international yards, were invited to participate. Two Canadian yards declined. The third, probably Washington Marine (which owns the largest BC shipyards) did not qualify.

'The evaluations concluded that the Canadian bid did not have the shipbuilding infrastructure, technology or experience required to build large, complex vessels like the Super-C Class vessels,' said Mr Hahn. He has declined on several occasions to make public the criteria used for evaluation.

The result of this evaluation is that two yards, in Germany and Finland, have been selected to submit final design-build bids on the construction of the three new ferries. The BC yard has not been invited to bid. There will be no opportunity to

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confirm whether local builders still have the 'infrastructure, technology or experience' or whether Mr Wright's estimate that it would cost \$60 million more to build the vessels here than in Europe is correct.

The Record of the BC Industry

Mr Hahn has criticized the recent record of the BC shipbuilding industry, particularly on the construction of the Spirit Class vessels and the catamaran fast ferries. Both projects, he said, were intended to help the industry. Neither, he said, were completed on time; both went over budget. 'Unfortunately, neither was successful when it came to sustaining long-term job creation or developing shipbuilding infrastructure,' he said.

Speculation & Comment

It is difficult to understand why BC Ferries has denied BC shipyards the opportunity to make a proposal on these three ships, and, despite clear public interest, the company has declined to make any further information available. It is

possible that the financing available on European built ships is much more generous than could be arranged on locally built ones—as anyone with a home mortgage knows, the interest rate is crucial, the total cost of the house and the interest over 25 years can be double the cost of the house.

Of course financing of the \$125 million in duty would have to be separately arranged by BCFS.

It's interesting that the federal Minister of Industry, who they have to ask for the duty exemption, is David Emerson, whose last job was chair of BC Ferries.

It's also interesting that the duty would not apply if the new ferries were built in the US. NAFTA also exempts the US from this duty as well. But if a US yard were to win the contract, all such contracts would then be open to US bidders. This would make the Canadian ship market open to the US, while the US market is barred to Canadian bidders (because of the *Jones Act*). A level playing field?

Shipbuilding: the numbers

(All the figures in this section are necessarily approximate, since they represent estimates by BC Ferries itself, or various experts. I have tried to be conservative.)

The few numbers BC Ferries has released indicate that they expect their new ferries to cost \$170 million each if built in Europe, a total of \$510 million. Transportation Minister Kevin Falcon has indicated that, due to the 'inefficient' BC shipyards, the same ferries would cost an additional \$60 million if built in BC, or \$570 million. On the other hand, if the 25% duty is applied to the European price, it would amount to additional \$127 million, totalling \$637 million.

(Mr. Hahn: 'The import duty will not affect our decision ... whether it is waived or not, we will be buying these [imported] ships.')

Direct Contribution to the Local Economy

Approximately two-thirds of the cost of a ship is in materials, and one third is the value added to the materials, mainly labour, either in the yards or by local subcontractors (think interior finishing, catering equipment, etc). Assuming that the materials would cost the same wherever the ships were built, the additional direct contribution to the European economy if the ships were built in Germany or Finland would be about \$170 million. If the ships were built in BC, allowing for \$20 million per ship in 'inefficiencies', the

C-Class Ferries

The BC Ferries fleet currently includes five double-ended 'C-Class' vessels, all built in Vancouver and Victoria between 1976 and 1981. They are the *Queens of Surrey, Oak Bay, Alberni, Coquitlam, and Cowichan*, all about 6,000 tons displacement and 139 metres in length. The most recent large ferries built in BC were the *Spirits of Vancouver Island* and *British Columbia*, 19,000 tons displacement, 168 metres in length, and built under BC Ferries' supervision through a co-operative effort of several companies in 1993–94.

The newly proposed ferries are described as 'Super-C Class' ferries. The proposed contract is 'design/build', which would seem to indicate that there will be some changes from the existing C-Class vessels, but that they would be similar in size and concept.

direct contribution to BC's economy would be \$190 million.

'Spin off' Benefits to the Economy

Economists often apply an 'economic multiplier' to such direct contributions, on the assumption that each additional employed worker indirectly supports two other workers when he and his family spend his pay. This calculation would yield a total benefit to the BC economy of \$570 million if the ships were built in BC, and to the European economy of \$510 million if they were built in Europe.

Taxes

If the ships were built in Europe, the taxes paid by shipyard workers, at least \$34 million, go to the governments of either Germany or Finland. The total taxes on direct and indirect economic activity would likely be three times that.

If the ships were built in BC, the taxes paid by the shipyard workers alone are estimated conservatively at some \$38

million. The total taxes on both direct and indirect employment could be as much as \$114 million. Much of this would go to the provincial government, through their share of income and sales taxes, etc.

So if BC Ferries decides to buy ferries in Europe, there

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would be a significant cost to all BC taxpayers. This despite the fact that BC Ferries is now a private corporation. (And, of course, ferry riders would have to cover an additional \$127 million in duties payable to the federal government.)

Financing the New Ferries

On the formation of BC Ferries Services, the provincial government claimed some \$427 million in assets in payment for their shares, as well as the real estate holdings of the former BC Ferry Corporation. In the spring of 2004, BCFS floated a \$250 million bond issue at the somewhat generous interest rate of 5.74%. This, together with \$200 million 'bridge financing' with a consortium of Canadian banks, was used to pay off the debenture which was floated last year to pay the BC government for its shares in the former BC Ferry Corporation. (See 'Government strips BCFS assets', *Island Tides*, January 29, 2004, this is a featured article on www.islandtides.com).

So BC Ferry Services Inc is still substantially debt financed, even before undertaking the construction of these three new vessels. Thus the financing secured is probably very important to BC Ferries; maybe even more important than the actual price of the new ships.

European Financing

When the European nations, in 2000, all agreed to stop

subsidizing the construction of ships, they switched their efforts to assisting in the financing of ship purchases, possibly by guaranteeing credit and subsidizing interest rates.

Currently, there is a lively debate in the EU as to whether construction subsidies should be reinstated in order to compete with the Japanese and the Koreans. Germany, whose labour costs may be the highest in Europe, is currently spearheading the drive for subsidies.

There is little data available on the financing subsidies now on offer by the Europeans, but, in order to remain competitive, the Canadian shipbuilders have asked for government guarantees of 25-year, low, fixed interest rate financing of up to 87.5% of ship costs, along with a tax credit of some 20% of ship costs. They have also requested changes in the tax treatment of ship leases and depreciation (ships are depreciated over 40 years).

User Pay

Under the *Coastal Ferries Act*, the construction of new vessels is one of the reasons listed which would justify a larger-than-normal fare increase. Users of the Mainland to Vancouver Island service, which carries no provincial subsidy, therefore have a significant interest in both the cost and financing of these three new vessels.

Building ships in BC—feast or famine ~ Patrick Brown

The shipbuilding industry worldwide suffers from immense overcapacity, made worse by South Korea building market share through quoting on tankers and container ships at what the Europeans say is 15-20% under cost. European yards have fought this with construction subsidies (officially abandoned at the end of 2000), government R&D grants, and innovative financing schemes, which are also government supported. Germany and Finland have specialized in passenger ships.

Labour costs in European yards are not much different from the US and Canada; in fact, in many cases, the costs are significantly higher. Figures from the US Bureau of Labour Statistics indicate that German shipbuilders' hourly wages may be almost double Canadian levels, and Finnish and Japanese wages may be 40% more than Canada's.

How to Kill an Industry

Canada is not alone in its need for a strategy to ensure the survival of a shipbuilding industry adequate to meet its own requirements. Neither is BC, with the largest ferry fleet in the world.

Here are some ways not to do it:

1. Don't bother with a build-at-home policy. Canada is a trading nation, and if we are competitive, world markets will ensure the survival of our industry.
2. Governments and large fleets should build ships in bunches, at short notice. Don't plan too far ahead. Delay announced projects for political reasons.
3. Withdraw subsidies before other nations do; it sets a good example and saves tax money.
4. When awarding government contracts, don't consider anything but price.
5. Don't provide any tax breaks, even if they are provided to other industries.
6. Have senior government officials repeat often that the industry is inefficient and has insufficient capacity.

The US supports its shipyards through the *Jones Act*, a very old piece of legislation that requires vessels trading between US ports be built and registered in the United States. (This protectionist legislation is specifically exempted from any NAFTA challenge.)

The US also supports its shipyards through careful allocation of contracts for the navy, coast guard, and other government departments. The yards, in fact, are treated as a strategic asset by the government.

Australia supports a subsidy of 5% of the total value of each new vessel.

South Korean yards, with the greatest over-capacity of all, are reportedly taking a 20% loss on contracts in order to maintain their 40% share of the international shipbuilding market. (They specialize in bulk carriers and container ships, not passenger ferries.)

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Canadian Import Duty

Canada has not subsidized shipbuilding since the '80s. Instead, in order to encourage domestic shipbuilding, Canada charges a 25% duty on each new vessel imported into Canada.

This duty would apply to any new ferries built in Europe; so BC Ferries has applied to the federal government for an exemption.

Normally, there would be two valid reasons for such an exemption: that the vessel was being built by government, or that it was of a type that could not be built in Canada.

BC Ferries claims to be government no longer, but a private corporation, so they've thrown that excuse away. So Minister Falcon, Mr. Hahn, and Mr. Stefansson are being very insistent that the BC industry isn't capable of building the new ships.

What Have You Done for Me Lately?

In fact, BC Ferries has done little lately to support local shipyards, despite relying on their continued existence to carry out many of the annual refits required on each vessel in the fleet. (Some of the refits are carried out by BC Ferries' subsidiary, Deas Pacific Marine, which, in its new privatized form, has even gone into competition with the other yards for non-BC ferries business).

It's been a matter of feast or famine as far as major ferries are concerned. In the '60s, BC yards built the *Queens of Tsawwassen, Sidney, Nanaimo, New Westminster, Burnaby, Victoria, Esquimalt, Saanich, and Vancouver*. (The latter three are scheduled to be replaced by the three new ferries).

In the '70s, most of these ferries were lengthened and enlarged. Towards the end of the decade and into the '80s, the

five 'C-Class' ferries were built. Then no major vessels were built until, at the start of the '90s, the two *Spirits* were innovatively built in pieces and welded together at a yard on the Fraser River. Finally, in the mid '90s, the three fast cats were built: completely different with brand-new technology.

This erratic building program (under several different governments) has not exactly provided a steady flow of work to keep shipyard workers employed and facilities and technology updated.

To be fair, Canada's federal government has also not been helpful to BC's shipyards: reducing, delaying, and cancelling at short notice vessels for the navy and the coast guard. How is this capital-intensive industry, with a 1,300 person labour force, supposed to do any long-term planning, or justify investment in new technology?

And Elsewhere . . .

The US and Australian governments regard their shipyards as part of the nation's strategic infrastructure, and manage their ship construction to ensure the continuing health of an industry that they may need at short notice in the future.

BC Ferries has failed to do this in the past, and appears to give this aspect even less importance in the future.

(The Australians call this a 'rolling build' strategy, replacing their navy vessels at 20 years rather than refitting them.)

Our near neighbours, Washington State Ferries, require that all their shipbuilding work be carried out in the state. In the ten years 2001-2011, they will spend \$400 million refurbishing their aging fleet of 29 vessels. And some of their ferries are much older than BC's!

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