DEPARTMENT OF TRANSPORTATION

STATEMENT OF THE ACTING MARITIME ADMINISTRATOR

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BEFORE THE SUBCOMMITTEE ON AGRICULTURE AND THE SUBCOMMITTEE ON COMMERCE, JUSTICE, STATE AND JUDICIARY OF THE COMMITTEE ON APPROPRIATIONS

U.S. HOUSE OF REPRESENTATIVES

ON U.S.-FLAG FREIGHT RATES FOR GRAIN SHIPMENTS TO THE FORMER SOVIET UNION

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Mr. Chairman, members of the Committee, my name is Richard Bowman and I am the Acting Maritime Administrator of the Department of Transportation. I am here today at your request to comment on cargo preference issues pertaining to Russian aid and to respond to your questions. There has been a great deal of confusion and misinformation on Russian aid shipments. Thank you for giving me the opportunity to address these issues which are so vital to both the agricultural and maritime industries.

Before I address specifically Russian cargo preference issues, I would like to discuss cargo preference in general. It appears that the original intent of the cargo preference laws has been forgotten. U.S. cargo preference programs are part of the overall statutory program to support the privately owned and operated U.S.-flag merchant marine. They require that a certain percentage of government-impelled cargo be carried on U.S. vessels. Cargo preference applies to shipments of either government-owned or government-financed commodities that are being transferred to recipient nations on either a donated basis or a very concessional loan basis. Our merchant marine is vital to U.S. national security, providing essential sealift capability in wartime. In addition, the ships that carry these cargoes provide important jobs for American seafarers who in turn are available in time of national emergency to crew the sizeable fleet of laid up Government vessels. Cargo preference guarantees the availability of cargo to U.S.-flag ships and is important to the financial viability of U.S.-flag operators thereby ensuring that the vessels, trained crew, and vessel service industries continue to exist.

Prior to 1985, the courts affirmed that U.S. law required U.S.-flag vessels to carry blended credit cargoes under cargo preference. The Food Security Act of 1985 eliminated this requirement while increasing the preference requirements for the remaining agricultural programs from 50 to 75 percent. This agreement is commonly called the cargo preference compromise. Under the terms of the compromise, USDA's commercial export promotion programs are statutorily exempt from cargo preference requirements. These include the Commodity Credit Corporation (CCC) export credit guarantee programs and export bonus programs, such as the Export Enhancement Program (EEP). At the same time, cargo preference requirements for U.S. foreign food assistance programs were increased from 50 to 75 percent. These include the P.L. 480 programs, the Food for Progress program, and donations under the authority of section 416(b) of the Agricultural Act of 1949.

The EEP has grown in importance since the mid 1980s and now subsidizes an estimated 20 to 40 million tons a year of agricultural exports. EEP pays a bonus award to exporters of agricultural commodities. The size of the bonus reflects the difference between (a) the domestic U.S. price of the commodity plus transportation costs to the recipient country, and (b) the price of alternative (non-U.S.) export supplies of the commodity in the recipient country. Because of the cargo preference compromise, U.S.-flag vessels carry none of this cargo. As a result, the size of EEP bonuses is much smaller than it would be if EEP shipments were required to be carried on the more expensive U.S.-flag vessels. In other words, the cargo preference compromise removed a government requirement that was of value to U.S.-flag carriers so that the EEP program could operate at a lower cost and could export more of value to the agricultural community.

I want to point out that the volume of cargoes moving under programs exempt from preference has gone up substantially since 1985, while movements under preference programs have remained relatively static until this year's additional CIS shipments.

Originally, most of the food assistance to the Commonwealth of Independent States (CIS) countries was under the CCC export credit guarantee (GSM-102 and GSM-103) programs, which are among those exempt from preference on the basis that transactions under the program are at commercial terms. Cargo preference applies when the programs have concessional (as opposed to commercial) terms. As soon as Russia started to default, USDA stopped shipments. The Russian defaults now exceed $800 million. President Clinton's new aid program consists of low cost concessional agricultural credits under the Food for Progress program. Since it is a U.S. food assistance program, it is clearly subject to preference and U.S. carriers seek their 75 percent legal share of this traffic which would clearly not move without significant U.S. government support.

There clearly are problems in the Russian trade, which have caused freight rates to rise. The increasing rates are caused by a combination of port congestion, costly contracting terms and vessel discrimination.

Both foreign and U.S. freight rates have escalated over the last month because too much cargo is being delivered in too short a time frame. This causes congestion at the discharge port. The vessel owners are now expecting to spend at least 30 days at the discharge port. 4.1 million MT of U.S. and EC aid cargo is expected to arrive at three Russian source ports within the next two to three months. The Russians maintain that these ports can receive 4.2 million MT, but this estimate allows for neither weather delays nor oversize vessels which must lighter down to meet port draft restrictions. We understand that USDA is pressing the Russians to expedite movements through ports. ~~Therefore,~~ However, we expect significant delays to continue, which will put upward pressure on rates.

Costly government contracting terms also function to increase rates for both U.S. and foreign-flag carriers. Use of more commercial shipping terms would help decrease the risk to the vessel owner and therefore lower rates.

Here are some examples of costly non-commercial contracting terms:

1. Discharge terms

   Normally, free out terms function as an incentive to the receiver to quickly discharge the vessel, because free out terms mean free of cost to the vessel. A fast discharge earns the receiver additional monies; a slow discharge incurs additional costs to the receiver/charterer. The time used to calculate the benefit/cost starts when the vessel arrives at the discharge port. In the Russian charters, time does not start until the vessel actually berths in the port, which could be 25 days after arrival. There is no incentive for a prompt discharge; therefore, the "free out" discharge terms are actually berth terms in disguise.

2. Payment Terms

   Commercial voyages are paid upon leaving the load port whereas preference voyages are not paid until after arrival at the discharge port. There are frequent payment delays. The opportunity cost of delayed revenues is significant and adds several dollars to the rate.

3. Fumigation

These costs and delays are normally the charterer's responsibility. By placing fumigation burdens on the vessel owner, costs are increased.

4. Unrealistic port limitations

Arbitrary port restrictions force larger efficient vessels to lighter cargo or to pay "fees" to get into larger berths. These restrictions are published in port manuals but do not reflect reality.

One final cause for upward rate movement is vessel discrimination. Exclusion of vessel types, such as tankers or barges, lessens the competition and can drive rates up.

High rates represent risks inherent in the current market. They do not represent "rate gouging". For years, MARAD has had a system in place which prevents rate gouging, called the fair and reasonable guideline rate. Each potential contract award is scrutinized relative to vessel costs which are filed annually with MARAD. No bid is accepted if it exceeds the "guideline rate" calculated on that vessel's cost plus a modest profit. Many fixtures are significantly below the rate due to market competition forces.

Please bear in mind that in the normal commercial setting, freight rates fluctuate widely as the forces of supply and demand drive the market. Normally, vessel owners have an opportunity in good times to make up for when the market for vessels was down. However, in the cargo preference area, vessel owners are limited in their ability to charge what the market will bear. In carrying preference cargoes, vessels receive up to, but not more than, "fair and reasonable" rates. These rates are based on a vessel's capital, operating and voyage costs with a modest percentage applied for overhead and profits. Most of the time, because of intense competition, vessel owners are forced to bid well below the fair and reasonable rate. When as now, demand for vessels is increased and rates are up, vessel owners receive no more than fair and reasonable rates and cannot make up for the times when they carried preference cargoes at a loss.

MARAD has tried to cut the cost of preference cargo carriage numerous times. For example, in 1986 MARAD published an analysis which proposed six cost saving measures. Two were adopted in some trades and have been successful - open bidding for P.L. 480 cargoes and chartering for consecutive voyages. The latter is used in the Israeli trade, and U.S.-flag rates are very competitive.

A working group composed of MARAD, USDA and AID has recently been established to look at and address the problems which are pressuring rates in the Russian trade. Secretary Peña has talked to Secretary Espy directly and both are committed to working together on this. They have made it very clear to their staffs that the Administration is going to move in lock step to ensure that Russia receives the maximum amount of aid while assuring that U.S.-flag vessels receive their rightful share of these cargoes at rates which are fair and reasonable.

Mr Chairman, this completes my statement and I will be glad to answer any questions that you and members of the Subcommittee may have.