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THE RELATIONSHIP OF MARITIME POLICY TO U.S. AGRICULTURE EXPORTS

Y 4. G 74/7: M 33/3

The Relationship of Maritime Policy...

HEARING

BEFORE THE

INFORMATION, JUSTICE, TRANSPORTATION, AND AGRICULTURE SUBCOMMITTEE

OF THE

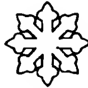
COMMITTEE ON GOVERNMENT OPERATIONS HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

SEPTEMBER 30, 1993

Printed for the use of the Committee on Government Operations



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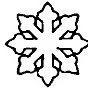

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THE RELATIONSHIP OF MARITIME POLICY TO U.S. AGRICULTURE EXPORTS

THURSDAY, SEPTEMBER 30, 1993

HOUSE OF REPRESENTATIVES,
INFORMATION, JUSTICE, TRANSPORTATION,
AND AGRICULTURE SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2203, Rayburn House Office Building, Hon. Gary A. Condit (chairman of the subcommittee), presiding.

Present: Representatives Gary A. Condit, Karen L. Thurman, Lynn C. Woolsey, Ileana Ros-Lehtinen, and Stephen Horn.

Also present: Edward L. Armstrong, professional staff member; Aurora Ogg, clerk; and Diane M. Major, minority professional staff, Committee on Government Operations.

OPENING STATEMENT OF CHAIRMAN CONDIT

Mr. CONDIT. Good morning. We are calling this meeting to order.

Today's hearing is a part of a continuation of this subcommittee's examination of U.S. agricultural exports. There is some good news on the export front. In 1992 agricultural exports were up over 12 percent, to a total value of more than $42 billion. Agricultural exports are estimated to create more than 1 million jobs in the United States.

The USDA estimates that every $1 received from agricultural exports generates another $1.50 in business activities for the rest of the economy.

Despite this good news, we think this is a time for great caution. We are in the midst of a great debate over NAFTA, and agriculture has been brought back to the table in the GATT negotiations.

Because of my concerns, I intend to keep this subcommittee focused on what we can do to keep the United States the world leader in agricultural exports.

Today's hearing will break some new ground because this is the first time we will be looking outside the USDA's program to help exporters. This subcommittee has oversight jurisdiction over both agriculture and transportation. Today we will look at the relationship of the maritime policy to agricultural exports.

This is a broad topic. However, I have asked the Members of the subcommittee and witnesses to try to stay focused on the topics we are addressing today.

We are very interested in the Vice President's task force recommendation that a commission be established to study this issue.

In preparing for this hearing, I have been told that this issue has already been studied a great deal, that it hasn't been studied enough, and that the studies have been too narrow.

Hopefully, we will have a thoughtful discussion of the National Performance Review's proposal to create a commission today.

I am also interested in the "conference system" currently in place in the U.S. maritime industry. We have with us today the author of the report that claims the system creates a 18-percent increase in transportation costs.

We also have a panel of maritime experts who have prepared testimony stating that the conference system is vital to a safe, orderly, and reliable shipping system for exporters.

This hearing is not about NAFTA, but I would be remiss if I failed to ask these excellent witnesses their thoughts on NAFTA as it relates to maritime transportation.

Normally, I would turn to the ranking member, Mr. Thomas for any statements.

We will ask that his statement, when he arrives, be included in the record, and give him an opportunity to make a statement if he would like as well.

[The prepared statement of Mr. Thomas follows:]

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Congress of the United States
House of Representatives
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OPENING STATEMENT
THE RELATIONSHIP OF MARITIME POLICY
TO U.S. AGRICULTURE EXPORTS

September 30, 1993

2203 Rayburn House Office Building

Mr. Chairman, thank you for calling this important hearing. I look forward to hearing from today's witnesses as we examine the United States Maritime industry and how it affects the cost of transporting our agricultural products overseas.

This is not a new issue. The Bush Administration established the Advisory Commission on Conferences in Ocean Shipping, which was mandated by section 18 of the Shipping Act of 1984. It was the first time such a comprehensive study had been conducted on the conference system. It was hoped to be the final step in collecting data on ocean liners regulated by the Federal Maritime Commission, the need for antitrust immunity and the continuation of filing tariffs publically. After hearing from over 100 witnesses, holding five field hearings and conducting a series of in-depth interviews, the Commission could still not reach a consensus. Consequently, the report did not make conclusions or recommendations. I am afraid the National Performance Review's recommendation to establish a similar independent commission will face comparable results.

That should not hold us back, however, from adjusting our international shipping policies when necessary. With so many global changes it is worthwhile to reassess, not only the economic, but also the national security implications associated with foreign trade routes.

Since the 1970's, Congress has enacted legislation deregulating almost every mode of transportation. First, there was airline deregulation and then came truck, rail, bus and maritime -- all with the inherent feeling that the marketplace provides the most efficient and economical transportation system.

Today we will hear the United States Department of Agriculture echo the same concerns. Dr. Allen Ferguson will present us with a report entitled, Maritime Policy and Agricultural Interests: Impacts of the Conference System. It was a research project

conducted for the USDA to examine the rate-setting structure of liner vessels and its influence on the costs for transporting agricultural exports.

I look forward to hearing more on this report and from our witnesses. Today's hearing will certainly help us better understand the specific implications surrounding foreign trades routes and how they affect both agricultural and maritime industries.

Mr. CONDIT. I will turn for any other members for comments.

There are none so we will begin with the first panel.

Our first panel today will feature Federal witnesses.

We are pleased to have the Commissioner of the Federal Maritime Commission, the former U.S. Senator William D. Hathaway with us. Mr. Hathaway will be joined by Dr. Kenneth C. Clayton, Acting Administrator of the Agricultural Marketing Service for the Department of Agriculture.

Commissioner Hathaway is accompanied by Mr. Schmitt, and Mr. Clayton by Mr. Neenan.

We have a practice of swearing all witnesses in.

Could you please rise?

[Witnesses sworn.]

Mr. CONDIT. Commissioner Hathaway, would you like to begin?

STATEMENT OF WILLIAM D. HATHAWAY, COMMISSIONER, FEDERAL MARITIME COMMISSION, ACCOMPANIED BY AUSTIN SCHMITT, CHIEF ECONOMIST AND DIRECTOR, BUREAU OF TRADE MONITORING

Mr. HATHAWAY. Yes. Thank you very much,.

Mr. Chairman. I would like at this time to make one slight correction in our statement on page 12. At the end of the runover paragraph, we need a little transition statement there, to the effect that "if the Commission gets into the 1984 Act," and then on the rest of it, the antitrust exemption, and so forth, makes a little more sense than the way it is stated at the present time.

Mr. CONDIT. Your corrections are noted and will be changed for the record.

Mr. HATHAWAY. And, Mr. Chairman, I would like our entire statement to be made a part of the record.

Mr. CONDIT. Without objection.

Mr. HATHAWAY. And I will just give a brief overview, particularly covering the first three points that you asked us to cover in your letter; that is, the FMC's role, USDA's work under contract to analyze the effect of the shipping conferences, and the National Performance Review proposal to create a commission.

I think that our printed testimony covers points four and five adequately and doesn't need that much elaboration. Of course, I will be happy to answer any questions on any part of our statement.

Now, let me preface my remarks by saying at the outset that I am the chairman of a regulatory commission that is composed of five members. We have only three appointed, but two vacancies at the present time. We are basically a regulatory commission.

We are not a policymaking commission. It is not up to us to say what the law is or ought to be. Whatever the Congress decides the law will be, then we will regulate accordingly.

But in this particular instance, we were called upon by Secretary Peña, some month or so ago, to comment on an early draft that we had seen of the Gore report, which we did, and then this committee has just asked us to come forward to testify in regard to the allegations that have been made by the USDA and others that the current system isn't serving them well.

My point being, that we are not taking sides in this matter. We are giving you the benefit, we hope, of our observations over many years; mine, only 3½ years since I have been there, but others on the staff have been there for over 25 years. And then, of course, there is the history of the act that goes really back to 1916.

With that in mind, let me proceed.

The FMC's primary role is to regulate ocean shipping and related entities. We are primarily concerned with the Shipping Act of 1984, although we do administer other acts, such as the Merchant Marine Act of 1920, and others. The 1984 act, as you well know, has the antitrust exemption for conferences, which has been on the books since the 1916 act, which followed upon the Alexander report, which was an indepth survey of the maritime industry and recommended that the shipping conferences be maintained, but that they be regulated, and be entitled to an antitrust exemption.

The reason that Congress has continued this exemption ever since 1916, and incorporated it again into the 1984 act, and with the ACCOS Commission that met just a couple of years ago, reendorsed the conference system with antitrust immunity, is that it does provide a great deal of stability, particularly with respect to rates and the availability of ships. And also antitrust immunity is in harmony with the conference systems in the rest of the nations throughout the world, all of which have conference systems that allow antitrust immunity to the members of those conferences.

However, unlike the other nations of the world, we have injected into the conference system some element, and we think a strong element of competition.

First of all, we have as section 6(g) of the 1984 act under which, if an agreement is too anticompetitive, then the Commission may go to a district court and seek an injunction against that particular agreement. There is a long list of prohibited acts which basically enjoin carriers from discriminating in any way, shape or manner.

There are volume discounts that are permitted by law, such as time/volume rates and service contracts, but I suppose the greatest benefit to competition is the fact that independent action is mandated in conferences. No conference can prevent any of its members from taking independent action, that is, offering a lower rate to a shipper, if that particular carrier desires to do so, and no conference can inhibit its members from doing that.

Of course, in addition to that, there is the practical matter, that there are other carriers besides the conference carriers. There are the independent carriers in just about every trade and they also offer more competition to conferences.

Now, my friends on my right have, in their statement, attacked the conference system, stating that it does not benefit, particularly, agricultural shippers and that they are paying higher rates than they would have to pay if we took away the antitrust exemption and got rid of the conference system.

Well, first of all, Mr. Chairman and members of the committee, let me just comment on the statement of the agricultural people in general. First of all, it appears to me that the data may be biased because AGOTC which worked with the Department of Agriculture to solicit responses to surveys, said in their letter, "The sooner you

do this, the sooner we will have good ammo to convince Congress of the need to change the current ocean transportation scheme."

There are also many confusing questions that went out in the survey, one of which was, "What is the difference between the conference tariff rate and any other rate used in 1992 for comparable service?" Well, at best, that question is ambiguous.

In many instances, the responses to the survey were grossly inadequate. For example, for cotton shippers, only 5 out of 313 cotton shippers answered the survey.

Then, without going into detail throughout the entire statement, there are some areas where we feel that there are some erroneous conclusions drawn. On page 4 of the statement, they are talking about the rates on nuts. Down at the bottom of the page they state, "dried fruit and nuts to Europe increased by 30 percent last year."

Well, over the span of years from 1983 to date, in 1983, the total rate per container was $2,960. Today it is $2,663. So it is actually lower.

Now, there was a time in 1992 when the rate dropped to $1,900, but the carrier who was offering that rate went out of business that year, he was charging so much less. He dropped out. So for most of the years involved, rates are in the $2,500 range and that is about what the rate is today.

Also, at the bottom of page 5, they say that, "These findings are consistent with a 1986 study by the Federal Maritime Commission. Based on a survey of 86 exporters, FMC found that a minority of shippers were satisfied with their treatment by conferences."

Well, it really depends on how you read that survey. One-third of them said that they were very satisfied. One-third said that they were pretty well satisfied and one-third said that they were dissatisfied. USDA has bunched the two that said that they were pretty well satisfied or dissatisfied and said that they weren't too happy.

I would think that the more objective way to look at it would be to say, well, two-thirds of them were at least partly satisfied with the system.

And then one other error, and this isn't all that we have found in the testimony is on page 6 of the testimony, which says, quoting from "Worldwide Shipper" of June 1993:

> Based on the survey results, the study concluded that "The liner industry has a relatively poor image, particularly among its major customers. Most of this image problem is directly attributable to the conference system which limits carrier responsiveness and flexibility, constrains carriers from focusing on their customers and in the customer's eyes tends to overshadow their efforts to improve quality."

Well, that is only the first statement in the conclusion. The conclusion in that document from which that was taken then goes on to say:

> In reality, the actual performance of the industry has improved substantially. Rates have been reduced significantly, sailings have increased, transit times have improved, in many cases, and qualitative evidence suggests that overall reliability has improved as well. The carriers have not been rewarded for these improvements, however, neither through recognition of the improvements by their major customers, nor in their financial performance.

Then it goes on to say how they should improve their image. And the real conclusion is at the last sentence of this report, in the concluding paragraph:

Clearly the story is not getting out to the world and, in particular, to major customers regarding the very real improvements that the liner carriers have made over the last several years.

It seems to me that most of the so-called surveys are more anecdotal than they are actual surveys that would be statistically qualified to buttress the conclusions that the USDA is trying to draw.

But second, and this is much more important, in this endeavor, the one thing that we need is the availability of ships. You can't just get across the ocean—you can get across the ocean by airplane, but 90 percent of the tonnage is carried by ships. The airplanes can't carry that amount and there is no other way. There is no bridge across the ocean, there is no tunnel. You have got to have the ships available.

It is like a public utility, only worse. If you are going to have a bus company taking the people from Washington, DC, for example, or any other big city, from place to place, at least if the buses aren't running, you can say, take the subway, hire a cab or you can take your own automobile. There are various other modes of transportation. But if you take your goods to the pier, and there is no ship—there is no other way you are going to get it there.

So we have to have ships. That is a need that Congress has recognized throughout its history, that we have to have ships available, and 85 percent of agricultural products go by ship, so we have just got to have those ships available. And these conferences do encourage stability to allow owners of ships, carriers, to stay in and they won't be the victims of any rate wars. And as a result of staying in, there is a greater availability of ships than if the situation were what the proponents of taking away the antitrust immunity would advocate.

I mean, even with this security of a conference, in the last 10 years, 15 carriers have gone out of business. I think only one new carrier has come in in the last few years. In fact, a couple of them came in just recently and didn't last much more than a year.

So the point I want to emphasize is that the conferences do provide the necessary space and availability and service that we need to carry our exports and to take in our imports. I mean, our exports have doubled as a percentage of gross national product just in the last 20 years, and we expect that they are going to be on the increase.

Now, what if we didn't have this conference system at all? What if we yanked the antitrust immunity? Then undoubtedly there would be a rate war and undoubtedly rates would come down for a short period of time. But then a lot of the carriers would go out of business, they would be driven out of business. They couldn't keep up with it.

Once they are out of business, there is going to be necessarily a consolidation. There are going to be fewer carriers who will end up monopolizing the trades. Then the lower-cost items, like the agricultural products, aren't going to be carried. Carriers are going to be going after the high-price cargo; that is, the cargo that is going to profit them the most.

They won't be able to afford to have extra space. They won't be able to afford to go over to Asia with a full ship and come back with only a half ship. They will have to economize considerably

more than they would be if they have the protection of a conference. And, in that way you are not going to be able to get regular sailings that you are getting now, and the prices are necessarily going to go up, because you are going to have fewer people in there competing who are going to be dominating the trade.

Then you add to the scenario that, once you get rid of antitrust immunity, the next step would be to get rid of tariff filing. Then once you get rid of that, there is going to be rank discrimination as well as high prices.

You know, it is somewhat like an electric utility, rather than the bus company, or the train, or any other mode of transportation. I mean, you couldn't very well afford to have different electric companies competing to service the electrical demands of the people in any particular area. Their lights would be out half of the time. What the people want is something that they can rely upon and that they will have day in and day out when they turn on the switch, the lights are going to go on.

It is the same situation here with respect to shipping. The shipper wants to be sure that when he goes down to the pier with his goods, there is going to be a ship there, and that the rates, which have been going down actually since the 1984 act, will be reasonable.

Now, in commenting upon the independent commission that is probably going to be recommended by the Gore Commission, let me say in the first place, that having served in the Congress for 14 years, I have some doubts about any independent commission telling Congress what to do.

I mean, Congress has a multiplicity of committees that they can investigate these matters just as easily as an independent commission can do. But assuming we are going to have an independent commission, my only hope is that it is a truly independent one and not the kind of commission that I saw in the earlier draft of the Gore recommendation, where it was weighted in favor of getting rid of some of the subsidy programs.

If the independent commission should get into the 1984 act, I think that it would be both unwise and unnecessary, as I mention in my testimony. We have already had the review mandated by the 1984 act, 5 years after the act had been in existence. The review commission, in 1992, after having met for a year, recommended no changes whatsoever in the 1984 act. It seems to me that it is too early, this being only a year later, to have another review of the 1984 act.

Without further ado, Mr. Chairman, I thank you for listening. And I am willing to answer whatever questions.

Mr. CONDIT. Thank you, Mr. Commissioner, we will get back to you in just a few minutes with some questions.

[The prepared statement of Mr. Hathaway follows:]

STATEMENT OF
THE HONORABLE WILLIAM D. HATHAWAY
CHAIRMAN, FEDERAL MARITIME COMMISSION
BEFORE THE
COMMITTEE ON GOVERNMENT OPERATIONS
SUBCOMMITTEE ON INFORMATION, JUSTICE,
TRANSPORTATION, AND AGRICULTURE
UNITED STATES HOUSE OF REPRESENTATIVES

SEPTEMBER 30, 1993

Mr. Chairman and Members of the Subcommittee, it is a pleasure to appear before you to discuss the issue of maritime transportation as it relates to agricultural exports. Appearing with me today is Dr. Austin L. Schmitt, the Commission's chief economist and Director of its Bureau of Trade Monitoring.

I would like to begin by briefly explaining the Commission's role in regulating the maritime industry.

The Federal Maritime Commission is an independent regulatory agency, with five commissioners nominated by the President and confirmed by the Senate. The Commission is responsible for overseeing the business practices of ocean shipping lines and related entities operating in the maritime commerce of the United States. The Commission has no "promotional" responsibilities; since 1961, the promotion of an adequate and efficient U.S. merchant marine has been vested exclusively with the Maritime Administration of the Department of Transportation. The Commission, by contrast, is charged with protecting the well-being of U.S. oceanborne commerce through fair and evenhanded economic regulation of all carriers, regardless of nationality.

The principal statutes enforced by the Commission are the Shipping Act of 1984 ("1984 Act"), the Shipping Act, 1916, the

Intercoastal Shipping Act, 1933, the Foreign Shipping Practices Act of 1988, and section 19 of the Merchant Marine Act, 1920. Under these laws, the Commission's responsibilities include:

- Investigating discriminatory rates, charges, classifications, and practices of ocean common carriers, terminal operators and freight forwarders operating in the foreign and domestic offshore commerce of the United States.
- Protecting shippers, carriers and others engaged in the foreign commerce of the United States from restrictive rules and regulations of foreign governments and practices of foreign-flag carriers that have an adverse effect on the foreign commerce of the United States.
- Protecting the rights of U.S.-flag shipping companies to transport cargoes in U.S. foreign commerce and foreign-to-foreign trades.
- Reviewing and monitoring agreements of common carriers and other persons engaged in U.S. foreign commerce. These agreements include conference, pooling, joint service and space charter agreements.
- Receiving and reviewing tariff filings (but not regulating rate levels) by common carriers engaged in U.S. foreign commerce.
- Regulating rates, charges, classifications, rules, regulations and tariffs of carriers that are owned or controlled by foreign governments.
- Regulating rates, charges, classifications, practices and tariffs of ocean common carriers operating between the mainland United States and "domestic offshore" locales such as Hawaii and Puerto Rico.
- Licensing international ocean freight forwarders.
- Bonding non-vessel-operating common carriers.
- Ensuring that passenger vessel operators have financial resources sufficient to pay judgments for personal injury or death or to repay fares for the nonperformance of a voyage.

Starting with the original Shipping Act enacted in 1916, Congress has followed a policy that permits ocean shipping lines to enter into agreements on rates, levels of service, revenue pooling and similar matters. Such agreements can take many forms; a typical carrier agreement covering rates and service is known as a "conference" agreement.

Ordinarily, agreements among competing enterprises on prices or services would be subject to the antitrust laws. The policy decision, as represented in the Shipping Act, that international ocean shipping warrants an exemption from the antitrust laws has two historical foundations. First, Congress has consistently concluded, after extensive study and debate, that ordinary price and service competition is incompatible with the ocean shipping industry, whose members -- like a public utility -- have very high fixed costs that remain constant regardless of current cargo levels. In order to ensure reliable and high-quality ocean transportation for U.S. exports and imports, Congress has found that it is necessary to allow ocean shipping lines to enter into cooperative arrangements under which they can cover their costs and maintain frequent sailings between the United States and the rest of the world, even during times of economic distress when cargo levels may drop drastically.

The second foundation for the Shipping Act's exemption from the antitrust laws is a recognition by Congress that all of the United States's major trading partners follow similar policies of exempting ocean shipping from competition laws. Rather than place

the United States in direct conflict with other sovereign nations that provide markets for U.S. products, Congress instead has sought to harmonize U.S. policy with the rest of the international maritime community.

The policy of allowing an exemption from the antitrust laws for ocean shipping laws was most recently reaffirmed -- and, in fact, strengthened -- by Congress in 1984 after extensive study and debate. However, the Shipping Act stipulates a number of conditions which an agreement must meet in order to qualify for an antitrust exemption:

- The agreement must be filed as a public document with the Commission; it is a violation of both the Shipping Act and the antitrust laws to operate under an agreement that has not been filed.

- The filed agreement must be accurate and complete; secret provisions and side agreements are likewise unlawful.

- Conference agreements must include a number of mandatory provisions. These include a provision that any member line can quit the conference upon reasonable notice and without penalty, and a provision that any member line can establish an independent rate on a particular commodity whenever it chooses, and the conference is required to publish the member line's independent rate in the conference tariff on no more than 10 days' notice.

- Conference agreements also must provide "open" membership to any carrier in a trade.

- Certain kinds of agreements are expressly forbidden by the Shipping Act. These include group boycotts, predatory practices aimed at an independent carrier, and understandings that cargo from certain shippers may be carried only by particular carriers.

In general, agreements that meet the filing and content requirements of the Shipping Act will go into effect 45 days after they are filed. The Commission retains authority, under section

6(g) of the Act, to seek an injunction in U.S. district court against any agreement that threatens to cause, or is causing, an unreasonable increase in transportation costs or an unreasonable decrease in service. Such relief can be obtained against either an agreement that has been filed, but is not yet in effect, or an agreement that is in effect. It appears, however, that "unreasonable" as it is used in section 6(g) was intended to have a limited, rather than expansive, meaning. The legislative history of section 6(g) makes it clear that Congress believed that ocean shipping agreements are generally beneficial to the foreign commerce of the United States, and that the Commission should seek to enjoin an agreement only when the agreement's benefits are clearly outweighed by substantial harm to shippers, ports or other protected persons.

In order to discharge its responsibility of guarding against harmful agreements, the Commission requires that all agreements be accompanied by specified economic information when they are first filed. If that initial submission is insufficient, the Commission can delay an agreement's effectiveness by an additional 45 days while adequate information is obtained. Furthermore, the Commission can at any time require carriers to file reports on their business operations, under oath and in the form prescribed by the Commission.

Given economic conditions in major U.S. trades since 1984, including generally depressed rate levels brought about by chronic vessel overcapacity, no agreement has arisen so far that, in our

judgment, meets the section 6(g) enforcement guidelines devised by Congress. Nevertheless, the Commission has used its information-gathering powers to effect changes to certain agreements before they were implemented and to place other particularly significant agreements under continuous monitoring programs, which require the member carriers to submit at regular intervals detailed information on their rates, market shares, financial results, and relationships with shippers.

In addressing the impact of the 1984 Act on agricultural exports, I would like to first address a draft report prepared by Dr. Allen Ferguson for USDA, which was the subject of a Journal of Commerce article last July. The report is without foundation. In particular, the so-called 18 percent "monopoly premium," highlighted in the report is invalid, inaccurate and meaningless.

The data sample on which the report was based was not merely non-random, but systematically biased. For example, an Agricultural Ocean Transportation ("AgOTC") memo that was used as a cover letter soliciting survey responses (Appendix A) stated that "The sooner you do this, the sooner we will have 'good ammo' to convince Congress of the need to change the current ocean transportation scheme." Indeed, the selection of parties to be polled (AgOTC and its member associations), the survey distribution process, and the covering letters accompanying the questionnaires virtually guaranteed that the data would be unrepresentative and unreliable.

The two or three key questions driving the report's findings were confusing. For example, respondents were asked to identify or estimate the "Difference Between Conference Tariff Rate and Any Other Rate you used in 1992 for comparable service." The question is presented in such a way that respondents could reply (a) by comparing 1993 rates (it was distributed in March of 1993) to 1992 rates; (b) by comparing conference tariff rates, which may have moved little or no cargo, to independent rates established by conference members, which may have been the rates under which cargo actually moved; (c) by comparing conference tariff rates with conference service contract rates; (d) by comparing conference tariff rates to non-conference carrier rates, etc. The term "comparable service" is also subject to varied interpretations. In addition, "estimates" were requested, instead of actual rates, which are publicly available. Nevertheless, these responses were the basis for Dr. Ferguson's calculation of the so-called conference "monopoly" premium. The high rate of unusable responses (about 27 percent) also suggests conceptual problems in key questions.

The problems resulting from the survey's poor response rate were more extensive and serious than the report seems to have recognized. For example, Dr. Ferguson received only five responses from cotton shippers for the three trades he analyzed. By conservative estimate, there are 313 cotton exporters in the U.S.-Japan trade alone. Dr. Ferguson received only eight responses from forest product shippers, although an official of the National

Forest Products Association informed us that the Association sent the Ferguson questionnaire (labelled "AGOTC CONFIDENTIAL QUESTIONNAIRE") to 250 to 300 members.

The report also appears to overly emphasize the recent Trans-Atlantic Agreement ("TAA") rate increases by failing to weigh responses properly according to commodity and trade. A preferable approach would have been to examine and compare our two major outbound trades and the conferences that operate in them, the U.S.-Far East trades served by the Transpacific Westbound Rate Agreement ("TWRA") and the U.S.-European trades served by TAA.

According to the USDA:

> The Pacific Rim's agricultural imports from the United States are currently larger than those of the rest of the world put together. In 1991, developed countries of the Pacific Rim imported 33% of total United States agricultural exports. Japan is the largest market for American agricultural liner exports; Korean and Taiwanese markets are each larger than that of any single non-Asiatic country. Further, while already very large, the Pacific Rim markets are the fastest growing segment of America's agricultural export market (Ferguson draft report, p. 8)

TWRA serves the major Asian markets for U.S. agricultural commodities. Given the size of that market and the fact that it is the source of the fastest growing demand for additional agricultural products, it is clear that TWRA is, at least in terms of American agricultural exports, our most important conference.

It has been our experience at the Commission that the U.S./Far East trades, and especially those to our major Asian trading partners, have been -- and are currently -- highly competitive. Indeed, in the two trades that Dr. Ferguson's report discusses --

Japan and Taiwan -- the average difference between TWRA's rates and those of nonconference independent carriers for a select group of major moving agricultural commodities appears to be on the order of five percent. Rate differences vary somewhat by commodity and trade, ranging from virtually no difference on some low valued commodities to just under ten percent, with most differences falling in the two to five percent range. Those minor differences could probably be accounted for by the generally superior service that conferences provide. In short, there appears to be no significant pricing problem in the Far East trades, and certainly no 18 percent "monopoly premium."

In the U.S.-European trades, a substantially smaller quantity of agricultural commodities move by liner shipping. In those trades, TAA, a new conference, put into operation on January 1, 1993, a business plan which involved rate increases for all shippers. However, the conference members justified the higher rates by reference to the $400 million dollars per year that they were collectively losing due to chronic overcapacity and falling rates in preceding years.

Even before the TAA rate increase went into effect on January 1, 1993, the Commission heard from U.S. exporters. Because of the relatively significant increase in prices, the Commission investigated those complaints to evaluate whether or not a potential violation of the 1984 Act was involved. Of the approximately 50 informal comments the Commission received about the TAA rate increase -- most of them between November 1992 and

February 1993 -- ten were from shippers of forest products, four were from beer, wine and spirits exporters, two were from processed food shippers, and five came from nuts, rice, or offal exporters.

Ultimately, the Commission concluded that TAA's January rate increase did not constitute "an unreasonable increase in transportation costs" and that seeking a federal court injunction against TAA would be unwarranted and unsustainable. Among the considerations underlying that decision were the immediate history of rate declines and carrier losses -- which one shipper characterized as "an El Dorado of riches for shippers because rates have fallen to their lowest level ever" -- the lack of detailed financial data evidencing substantial harm to shippers, and the continued availability of competitive transportation options for most shippers.

Nevertheless, the Commission continues to closely monitor TAA's pricing and service behavior. We note, however, that shipper responses to TAA's latest round of proposed rate increases appear to be relatively moderate.

One lesson that the Commission drew from working with the shippers who came to us about TAA's January rate increase was the importance of educating the shipping public about the Commission's authority to seek federal court injunctions and the procedures likely to be involved. We discovered that the nature and extent of that authority were often misunderstood. In particular, the importance of active shipper assistance, including detailed

financial information, for any successful Commission case was not clear to many shippers.

Before ending this portion of my testimony, I believe it is important to respond to those critics of the 1984 Act who would go so far as to eliminate antitrust immunity and abolish conferences. Shippers of lower valued commodities -- including agricultural shippers -- would indubitably suffer under such a regime. If antitrust immunity for carriers were simply eliminated, the resulting rate war causing short-term rate reductions would drive many carriers from U.S. trades. As a result, the longer-term effects would include increased market concentration and an increase in rates.

Shippers of low-valued commodities are generally the first to suffer when carriers leave a trade. This was recently illustrated when Compagnie Generale Maritime was forced by losses to leave the Atlantic trades, to the detriment of those agricultural shippers who had been benefiting from its low rates. Perhaps that is why the majority of agricultural shippers, responding to the Commission's most recent survey on the 1984 Act, voted against prohibiting conferences. In fact, the pro-conference majority among agricultural shippers slightly exceeded the overall pro-conference responses of the 326 shippers that responded. (See Appendix B, 1988 Shipper Survey Results.)

I have also been asked to comment on the report of the Vice President's National Performance Review. This report recommends the establishment of a commission to review the future of the

maritime industry in the U.S. and "the benefits derived by the taxpayers from maritime industry subsidies and related issues." Senator Hollings and Congressman Lipinski have each introduced legislation to create a separate maritime commission with the express purpose of preserving and revitalizing the U.S.-flag fleet. The Lipinski bill, H.R. 3103, was recently reported out of the Merchant Marine Subcommittee.

The antitrust exemption provisions in the Shipping Act reflect difficult and complex issues that do not lend themselves to quick and easy analysis. The 1984 Act was the product of five years' work, and represents a series of carefully crafted legislative compromises. The Act also provided for the establishment of the Advisory Commission on Conferences in Ocean Shipping ("ACCOS"), composed of members of Congress and representatives of the private sector, for the purpose of conducting a comprehensive study of the conference system. The ACCOS process involved five years of information collection and analysis by the FMC staff, full participation by interested persons (including carriers, shippers, ports and U.S. Government agencies), and field hearings in New York, Charleston, New Orleans, San Francisco and Portland. In its report to Congress, issued in April 1992, the Advisory Commission made no recommendations on any further changes to the Shipping Act. Thus, the regulatory aspect of U.S. maritime policy -- as distinguished again from the promotional aspect -- has already been carefully examined and revised in those areas where a consensus

could be reached on the appropriate changes. It is reasonable to question whether Congress needs to revisit the 1984 Act so soon.

With regard to the North Atlantic Free Trade Agreement ("NAFTA") and its possible effect on agricultural exports, it is our understanding, based on discussions with the U.S. Department of State and the Maritime Administration, that the only transportation-related issue addressed by NAFTA is the removal of limitations faced by truckers carrying cargo across the borders. We also understand that NAFTA will have no impact on U.S. cabotage laws; U.S. coastwise domestic water trades will not be opened to foreign water carriers. Given the anticipated sizable trade growth brought about by NAFTA, opportunities should be provided for water carriers to participate more in the crossborder trades, especially with Mexico.

Finally, in response to your request, I have attached a brief summary table of the types of shipping subsidies provided by other nations (Appendix C), many of which compete with the U.S. for agricultural markets. The table was prepared by the Maritime Administration's Office of International Activities and is contained in their September 1993 publication entitled Maritime Subsidies.

Mr. Chairman, this concludes my formal statement. I would be pleased to respond to any questions you or the members may have.

APPENDIX A

MEMO FROM AgOTC TO MEMBERS THAT WAS SENT OUT BY THE AMERICAN COTTON SHIPPERS ASSOCIATION AS A COVER LETTER TO THE FERGUSON/AgOTC QUESTIONNAIRES THEY DISTRIBUTED

AGOTC
Agriculture Ocean Transportation Coalition

225 Nineteenth Street, N.W., Suite 200, Washington, D.C. 20036 (202) 347-2060 Fax: (202) 785-8676

MAR 1993

DATE: March 9, 1993

TO: AgOTC Members

FROM: Peter Friedmann

SUBJECT: Charging Ahead

In order to convince Congress that our Shipping Act agenda (less conference power, deregulation of contracts) is worth pursuing, we need to tell them the economic benefit to the U.S. economy of the changes we seek.

In order to quantify the injury resulting from the current conference system (including refusal to sign contracts, or allow individual lines to sign contracts) the U.S. Department of Agriculture has commissioned Dr. Allan Ferguson to conduct a credible study. Dr. Ferguson has drafted the attached questionnaire.

It is very important that each AgOTC member, and as many companies that are members of AgOTC trade associations, complete as much of this questionnaire as possible. It may look long, but it will not take long to complete. An estimate, as opposed to the precise figure, for each of the questions asked, is acceptable.

Please take the time to complete the study and to mail it directly to Dr. Ferguson at: 15119 Vantage Hill Road, Silver Spring, MD 20906.

The sooner you do this, the sooner we will have "good ammo" to convince Congress of the need to change the current ocean transportation scheme.

Attachment

APPENDIX B

1988 SHIPPER SURVEY RESULTS

TABLE SIXTY-FOUR

ANTITRUST IMMUNITY

CROSS-TABULATIONS

SHOULD CONFERENCES BE PROHIBITED IN U.S. TRADES
TABULATED BY PRIMARY COMMODITY CLASSIFICATION OF EXPORTS

	Conferences should be prohibited	Conferences should not be prohibited	No View	Totals
Agriculture	24 (31.2%)	42 (54.5%)	11 (14.3%)	77 (100.0%)
Forest Products	23 (52.3%)	17 (38.6%)	4 (9.1%)	44 (100.0%)
Transportation	6 (25.0%)	15 (62.5%)	3 (12.5%)	24 (100.0%)
Mechanical	6 (37.5%)	8 (50.0%)	2 (12.5%)	16 (100.0%)
Apparel	8 (40.0%)	8 (40.0%)	4 (20.0%)	20 (100.0%)
Electrical	7 (38.8%)	10 (55.6%)	1 (5.6%)	18 (100.0%)
Metalliferous	8 (44.4%)	6 (33.3%)	4 (22.2%)	18 (100.0%)
Nonmetalliferous	7 (33.3%)	11 (52.4%)	3 (14.3%)	21 (100.0%)
Consumer Goods	8 (28.6%)	15 (53.6%)	5 (17.8%)	28 (100.0%)
Medical	2 (28.6%)	4 (57.1%)	1 (14.3%)	7 (100.0%)
Chemical	16 (30.2%)	30 (56.6%)	7 (13.2%)	53 (100.0%)
Overall	115 (35.3%)	166 (50.9%)	45 (13.8%)	326 (100.0%)

SUMMARY TABLE OF MARITIME SUBSIDY MEASURES

APPENDIX C

Country	Other Aids	Maritime Insurance Aids	Research and Development Aids	Cabotage	Government Ownership	Customs Duty, Levies, and Requirements	Tax and Depreciation Benefits	Export Aids	Scrap and Build Aids	Bilateral or Trade Agreements	Cargo Preference Requirements	Financing Programs	Restructuring Aids	Construction Subsidies	Operating Subsidies
Algeria		•		•	•					•					
Argentina	•	•		•			•			•	•				
Australia				•	•	•	•	•			•	•		•	
Bahamas				•		•									
Bangladesh		•		•	•					•	•				
Belgium	•		•	•	•	•	•	•		•		•		•	
Brazil		•		•	•	•	•	•		•	•	•			
Burma					•						•				
Canada			•	•			•	•	•						
Chile				•	•	•	•			•					
Colombia		•		•											
Cote d'Ivoire	•	•		•	•					•					
Cyprus	•						•								
Denmark	•		•	•	•	•	•	•	•	•		•		•	
Ecuador				•	•						•				
Egypt	•	•		•			•			•					
Finland			•	•		•	•	•		•		•		•	
France	•		•	•			•	•		•	•		•	•	•
Germany	•		•	•	•	•	•	•		•		•	•	•	
Greece	•			•		•	•	•	•			•	•		
Honduras				•						•					
Hungary				•	•										
India	•	•		•	•		•		•	•	•	•		•	
Indonesia	•			•	•	•				•	•				
Israel	•	•			•		•			•					
Italy	•	•	•	•	•	•	•	•		•	•	•	•	•	•
Japan	•		•	•	•	•	•	•	•	•		•	•	•	
Kenya	•	•			•						•				
Korea	•		•	•		•	•	•		•	•	•	•		•
Kuwait					•					•	•				
Malta		•			•		•							•	
Mexico	•	•		•	•	•	•			•					•
Morocco	•	•			•		•			•	•			•	•
Netherlands	•		•			•	•	•		•		•	•	•	
New Zealand				•			•								
Nigeria	•	•		•		•				•					
Norway	•		•				•			•		•		•	
Pakistan				•	•		•		•	•					
Panama	•				•		•								
Peru	•	•		•			•			•		•		•	
Philippines				•		•	•			•	•				
Poland	•			•	•										
Portugal				•	•		•			•	•			•	•
Rumania	•			•	•					•			•		•
Singapore					•										
South Africa								•		•		•			
Spain	•	•		•	•	•	•	•		•	•	•	•	•	
Sri Lanka	•			•	•	•				•		•			
Sweden				•		•	•			•		•			•
Switzerland	•						•					•			
Taiwan				•	•	•	•			•	•	•		•	
Thailand				•		•	•			•	•			•	
Turkey				•			•				•			•	
United Kingdom	•			•	•		•			•			•	•	
United States	•			•		•	•			•	•	•			•
Uruguay				•	•	•	•			•	•	•			
Venezuela				•	•					•	•				

Source: Maritime Subsidies, September 1993, Maritime Administration, Office of International Activities, Department of Transportation.

Mr. CONDIT. Mr. Clayton.

STATEMENT OF KENNETH C. CLAYTON, ACTING ADMINISTRATOR, AGRICULTURAL MARKETING SERVICE, DEPARTMENT OF AGRICULTURE, ACCOMPANIED BY ROBERT NEENAN, ECONOMIST, TRANSPORTATION AND MARKETING DIVISION

Mr. CLAYTON. Thank you, Mr. Chairman and members of the committee.

We appreciate the opportunity to appear before you today to discuss the impact of the Shipping Act of 1984 on agricultural exports and several other issues.

Accompanying me today is Robert Neenan of the Transportation and Marketing Division of our Agricultural Marketing Service at USDA.

I, too, would like to submit my written testimony for the record.

Mr. CONDIT. Without objection.

Mr. CLAYTON. Thank you. And we will make brief summary remarks regarding the Shipping Act of 1984.

Mr. Chairman, export trade, as you noted, is important to America's farmers, and to the U.S. economy. Total U.S. exports, agricultural exports, exceeded $42 billion in 1992, generating over 1 million jobs in farming, food processing services, and transportation.

Agricultural exporters collectively are one of the largest customers for ocean liner services. Farm and forest product exports combined account for about 25 percent of total tonnage and 12 percent of the total value of U.S. outbound liner cargo. As one of the largest customers, agriculture has a considerable stake in maritime regulatory issues.

About $16 billion worth of agricultural commodities were shipped to foreign markets via liner vessels in 1991, incurring roughly $2 billion in total freight charges. The key markets for these products are the Pacific rim and the European Community.

Mr. Chairman, ocean transportation is an integral component in agricultural export marketing. Shippers rely on carriers for efficient and dependable service to meet the needs of overseas customers. In addition to quality service, exporters require competitive freight rates to meet the challenges of the international marketplace.

Over the last several years, USDA has heard from a wide range of agricultural shippers regarding the impact of conference practices. Two major concerns have been expressed: First, conferences are not responsive to agricultural shippers' concerns. Second, some conferences have chosen to limit or prohibit the use of service contracts.

Shipper discontent with conference practices is illustrated by the results of several survey studies. A 1991 study by Fresno State University indicated that conferences are viewed by some cotton exporters as an impediment to trade and that conferences are less responsive to shipper needs than independent carriers. These findings are consistent with a 1986 study by the Federal Maritime Commission, and a more recent study conducted by an independent consulting firm.

Mr. Chairman, shippers desire ocean freight contracts to hedge against future rate increases, to facilitate forward sales contracting and to customize the logistics for product delivery. Contracting provides stability, planning and flexibility that cannot always be achieved within the confines of the conference tariff system.

Surveys by several agricultural trade associations indicate that shippers believe that rate levels in the long term would be lower if conferences were eliminated. However, there has been a general lack of quantitative information on this matter.

To examine these concerns, including the economic impact of conference rate settings activities on U.S. agricultural exports, USDA contracted with a private economic consultant, Dr. Allen Ferguson to undertake a study of the impact of the Shipping Act of 1984. That study has been completed and will be released in the near future.

Since Dr. Ferguson is testifying today, I will only summarize a few of his key findings.

Based on his analysis of six agricultural commodities in three major exports markets, these findings include, first, the cartel premium attributable to conference market power, that is, the ability to set rates above the competitive level, amounts to some 18 percent of the cost of ocean transportation.

Second, elimination of the market power of conferences would result in a minimum increase in total agricultural export revenues of $239 million per year.

And third, adding the annual gain in agricultural revenues that would result from increased exports as a consequence of lower shipping costs would raise the expected gain to $400 million.

This analysis only covered about one-third of total U.S. agricultural liner exports. Including more commodities and trade routes would certainly magnify the total effect.

In essence, Dr. Ferguson's report indicates that the conference system imposes a hidden tax on agricultural exporters, costing millions of dollars. These general estimates of the economic cost of the conference system must, of course, be weighed against any economic benefits. However, there is little, if any, analytical evidence to suggest that ocean shipping cartels expand domestic employment or increase U.S. export trade.

Mr. Chairman, as I have already noted, ocean shipping and maritime regulation are important to U.S. agricultural exporters. I believe our research indicates that ocean shipping—the ocean shipping conference system can have a detrimental impact on agricultural exporters and does impose economic costs on the economy in general.

Mr. Chairman, if I might, I would also like to address just a couple of points that Mr. Hathaway raised in his testimony. In particular, the point was made that conference arrangements do provide for stability when it comes to availability of ocean carriage. From an economists point of view, I would have to observe that stability is oftentimes something of a code word for protecting the status quo. Also, I think I would have to observe that at least in some cases, stability also can amount to a lack of incentive to innovate, to become more efficient, and I do think it is important, as you review this issue, that we be careful that we peel away from the code

words and we look at the actual issues that underlie some of those concepts.

Mr. Chairman, with this, I will conclude my testimony. My associate and I will be glad to respond to any questions that you or the committee might have.

[The prepared statement of Mr. Clayton follows:]

Statement of Kenneth C. Clayton, Acting Administrator
Agricultural Marketing Service
United States Department of Agriculture
before the
Information, Justice, Transportation and Agriculture Subcommittee
House Committee on Government Operations
September 30, 1993

Mr. Chairman and Members of the Committee:

We appreciate the opportunity to appear before you today to discuss the impact of the Shipping Act of 1984 on agricultural exports, and several other issues. Accompanying me today are Martin F. Fitzpatrick, Jr., Director of the Transportation and Marketing Division of the Agricultural Marketing Service, and Robert Neenan, also of the Transportation and Marketing Division.

My remarks will focus on the five subjects of interest to the Committee:

1. The role of the USDA/AMS Transportation and Marketing Division.
2. The Shipping Act of 1984, and work under contract to analyze the effect of shipping conferences on agricultural exports.
3. The National Performance Review proposal to create a commission to study maritime issues and exports.
4. How the North American Free Trade Agreement might affect shipping and agricultural exports.
5. A summary of the types of shipping subsidies provided by other nations which compete with the U.S. for agricultural markets.

1. THE ROLE OF THE USDA/AMS TRANSPORTATION AND MARKETING DIVISION

The role of the Transportation and Marketing Division is to develop programs, research, and technical assistance activities to promote an efficient and cost-competitive transportation and marketing network for U.S. agriculture. Program areas include international transportation, domestic transportation, wholesale market development, transport technology, and rural transport systems.

2. WORK UNDER CONTRACT TO ANALYZE THE SHIPPING ACT OF 1984 AND THE EFFECT OF SHIPPING CONFERENCES ON AGRICULTURAL EXPORTS

To put this complex subject into context, the following sections include background on export trade, the importance of ocean shipping to U.S. agriculture, and current issues related to ocean liner conferences. This information provides the framework for USDA-sponsored research regarding the impact of the conference system on farm and forest product exports.

Background on Agricultural Trade

Export trade is important to farmers, and to the U.S. economy. Total U.S. agricultural exports exceeded $42 billion in 1992[1], generating over 1 million jobs in farming, food processing, services, and transportation. In many years, the output from about 30 percent of total U.S. harvested acreage is shipped to export markets, generating about 20 percent of farmers' cash

receipts.[3]

In recent years, agricultural exports have accounted for 10 percent to 12 percent of total U.S. foreign trade.[4] Agriculture was the second largest contributor to the U.S. trade balance in 1992.[5] Last year, agriculture had a net trade surplus of over $18 billion, while total U.S. merchandise trade was in deficit by $96 billion.[6]

Agricultural exporters, collectively, are one of the largest customers for ocean liner services. Farm and forest product exports combined account for about 25 percent of the total tonnage and 12 percent of the total value of U.S. outbound liner cargo.[7] Agricultural commodities constitute 73 percent of total ocean world shipments of refrigerated cargo.[8] As one of the largest consumers, agriculture has a considerable stake in maritime regulatory issues.

About $16 billion worth of agricultural commodities were shipped to foreign markets via liner vessels in 1991, incurring roughly $2 billion in total freight charges.[9] The major commodity groups transported by liner include fruit and vegetables, cotton, meat, forest products, and tobacco. The key markets for these products are the Pacific Rim and the European Community. Agriculture accounts for over 20 percent of the total volume of liner exports to the Pacific Rim.[10]

4

The Importance of Ocean Shipping

Ocean transportation is an integral component in agricultural export marketing. Shippers rely on carriers for efficient and dependable service to meet the needs of overseas customers. In addition to quality service, exporters require competitive freight rates to meet the challenges of the international marketplace.

Shipping cost constitutes a significant portion of the total export cost for many commodities. Ocean freight rates account for about 5 to 6 percent of the landed cost in Japan for cotton, 11 percent to 15 percent for forest products, and 31 percent to 35 percent for many fresh fruits and vegetables[11]. As a result, the ability to compete in the international marketplace can be affected by transportation cost. For example, U.S. cotton exporters must compete with rival suppliers in China, Pakistan, Australia, Paraguay, India and the former Soviet Union.[12] This intense international competition is frequently contested on the basis of cents per pound, or even a fraction of a cent per pound.

Although freight rate levels declined for several years after the passage of the 1984 Act, rates for many agricultural commodities have increased in recent years. In some cases, the increases have been quite significant. For example, freight rates for shipments of dried fruits and nuts to Europe increased by around 30 percent last year, with additional increases this year of up to 12 percent.[13] An important question is whether these rate increases were primarily caused by

world market forces, or by agreements established among carriers to set freight rates or to limit vessel capacity.

Shipper Concerns

Over the last six years, USDA has heard from a wide range of agricultural shippers regarding the impact of conference practices. There are two major concerns: that conferences are not responsive to their concerns, and conference limitations on the use of service contracts.

Shipper discontent with conference practices is illustrated by the results of several survey studies. Fresno State University conducted a study in 1991 of the cotton industry in California, surveying 11 firms that ship about 90 percent of the State's $650 million worth of cotton exports.[14] Cotton exports account for roughly 8 percent of total liner traffic to the Pacific Rim.[15] The survey results indicate that conferences are viewed by some cotton exporters as an "impediment to trade", and that conferences are less responsive to shipper needs than independent carriers.[16]

These findings are consistent with a 1986 study by the Federal Maritime Commission (FMC). Based on a survey of 86 exporters, FMC found that a minority of shippers were satisfied with their treatment by conferences.[17] A total of 62 percent of respondents said that their requests or complaints to conferences regarding rate problems were met with "unsatisfactory" or only "partially satisfactory" responses.[18] Regarding service-related requests or complaints, over 71

percent perceived that the conference response was entirely or partially unsatisfactory.[19] A USDA study presented similar findings, indicating that only a small portion of shippers perceive that conference carrier service improved after passage of the 1984 Act.[20]

A private consulting firm recently surveyed 25 large corporations to solicit their opinions regarding ocean liner shipping.[21] Despite some evidence of improved transit times, increased sailings, and reduced rate levels, the shippers only gave liner carriers an overall rating of 3.0 on a scale of 1 to 5 (1=poor, 5=excellent)[22]. In comparison, rail, truck and air carriers all received higher average overall ratings, ranging from 3.3 for rail to 4.0 for trucking. Over 70 percent of the survey respondents expressed concern with the conference system.[23] Based on the survey results, the study concluded that "The liner industry has a relatively poor image, particularly among its major customers. Most of this image problem is directly attributable to the conference system, which limits carrier responsiveness and flexibility, constrains carriers from focusing on their customers, and in their customers' eyes tends to overshadow their efforts to improve quality."[24]

The other major concern regarding conferences that has been voiced by agricultural shippers is that some conferences have chosen to limit or prohibit service contracts.[25] Although the Shipping Act of 1984 created the concept of service contracts, the Act also gave conferences the authority to regulate or prohibit the use of contracts by conference members.

In the U.S. to the Pacific Rim trade lane, which accounts for about one-third of total U.S.

agricultural trade,[26] very few agricultural exporters have been able to obtain service contracts with conference member lines. In 1988 and 1990, only 1 percent of total conference cargo to the Pacific Rim was shipped using service contracts, down from a mere 10 percent in 1987[27] Industry surveys indicate that, in general, a relatively small amount of agricultural exporters are using service contracts.[28]

Shippers desire ocean freight contracts to hedge against future rate increases, to facilitate forward sales contracting, and to customize the logistics of product delivery. Contracts allow exporters to quote complete landed-cost prices to buyers in advance of the commodity harvest. For peanut, cotton, and many other shippers the ability to quote future prices and contract sales weeks or months in advance of product movement is an important aspect of their marketing efforts.[29] In addition, contracts can be tailored to meet the specific timing and logistical requirements of the individual foreign customer, adding value to the product exported. These sentiments were clearly endorsed by a number of shippers that testified before the Advisory Commission on Ocean Shipping Conferences of 1991.

Carriers can use contracts to secure cargo for future voyages and provide customized service to steady clients. In general, contracts allow shippers and carriers to form mutually beneficial long-term business partnerships to establish and maintain markets. Contracting provides elements of stability, planning, and flexibility that cannot always be achieved within the confines of the conference tariff system.

Service contracts also promote rate and service competition among carriers. Analysis of freight rates by the staff of the Advisory Commission on Conferences in Ocean Shipping indicated that "port-to-port rates were significantly lower when conferences allowed their members to take independent action on service contracts."[30] The analysis indicated that conference rates were 13 percent to 17 percent lower during periods of independent contracting by conference members.

Impact of Conferences

Surveys by several agricultural trade associations indicated that shippers believe that rate levels, in the long term, would be lower if conferences were eliminated.[31] However, there was a considerable lack of quantitative information in this regard.

To evaluate these concerns and quantify the impact of conference rate-setting activities, USDA has made efforts to evaluate the economic impact of conferences on U.S. agricultural exports.

The Agricultural Marketing Service (AMS) contracted with a private economic consultant, Dr. Allen Ferguson, to undertake a study of the impact of the Shipping Act of 1984 on U.S. agricultural exports. That study has been completed, and will be released in the near future. Dr. Ferguson is testifying today, but I would like to summarize his findings:[32]

Based on analysis of six commodities and three major markets, the key findings are:

1. The cartel premium attributable to conference market power--the ability to set rates above the competitive level--amounts to some 18 percent of the cost of ocean transportation.

2. Elimination of the market power of conferences would result in a minimum increase in total revenues of $239 million per year, or 4.6 percent of revenues, from the present levels of agricultural exports.

3. Adding the annual gain in agricultural revenues that would result from increased exports as a consequence of lower shipping costs, would raise the expected gain to $400 million, or 7.7 percent of total revenues.

The analysis only covered about one-third of total U.S. agricultural liner exports. Including more commodities and trade routes would magnify the total effect.

Although there is not an abundance of empirical research on this subject, the findings of this study can be compared with a few previous estimates. The U.S. Department of Justice has also examined this issue, and made estimates based on an independent study conducted by staff of the Advisory Commission on Conferences in Ocean Shipping and earlier work by J.W. Devanney.[33] Based on this analysis, the Justice Department estimates the conference premium at about 15 percent, with a total impact of $2 billion to $3 billion per year for all U.S. trade.[34] A 1984 study by Cassell estimated the total welfare loss due to the conference system at $470 million to $2.46 billion per year.[35]

Dr. Ferguson's findings indicate that, at a minimum, eliminating conference antitrust immunity would increase farm and forest product exports by $161 million ($400 million less $239 million). Previous USDA studies show that each dollar received from agricultural exports stimulates another $1.40 worth of business activity for the U.S. economy.[36] Also, USDA estimates indicate that every $1 billion in exports generates up to 22,000 jobs.[37]

Using the USDA multipliers, a $161 million increase would generate an additional $225 million ($1.40 x $161 million) in economic activity. The total effect on the U.S. economy would be $386 million ($161 million + $225 million) and nearly 3,500 new jobs. In essence, the conference system imposes a hidden "tax" on agricultural exporters, costing millions of dollars.

These general estimates of the economic cost of the conference system should be weighed against economic benefits. However, there is little if any analytical evidence to suggest that ocean shipping cartels expand domestic employment or increase U.S. export trade.

Proponents of the current system contend that conferences provide benefits to shippers by creating stability in the liner shipping market and preventing "ruinous competition" among carriers.

A 1984 study by the U.S. Department of Transportation addressed this issue by reviewing a wide range of economic studies. The report concluded that "The argument that liner shipping

is subject to ruinous competition has a long history and has been offered by many industry observers as a rationale for exempting the industry from antitrust prohibitions against cooperative price making. From shipping company's perspective there is no doubt that the cost structure of the business makes adjustment to reduced demand difficult and painful. However, the issue hinges on whether liner shipping differs substantially from other industries with similar cost structures. This same argument has been applied to many other industries and typically economists have been unconvinced that the public interest would be served by permitting collusion."[38]

The Federal Trade Commission examined this issue in 1989 and concluded that the arguments that conferences prevent destructive competition were "not persuasive."[39]

In testimony before the Advisory Commission on Conferences in Ocean Shipping, former Assistant Attorney General James Rill stated that "Arguments that collective rate making benefits the industry should be rejected...once collective rate making is eliminated or substantially limited, prices adjust to levels that would be established under a competitive regime."[40] Clearly, Dr. Ferguson is not alone in his views regarding the impact of the conference system on freight rates and carrier competition.

Conclusion

In conclusion, ocean shipping and maritime regulation are important to U.S. agricultural exporters. Our research indicates that the ocean shipping conference system can have a detrimental impact on agricultural exporters, and imposes economic costs on the economy in general.

3. **THE NATIONAL PERFORMANCE REVIEW PROPOSAL TO CREATE A COMMISSION TO STUDY MARITIME ISSUES AND EXPORTS**

As you know, the Administration has not issued a position on the Shipping Act of 1984. However, Vice President Gore's National Performance Review Team recently proposed the formation of a commission to study several maritime issues, including the potential consequences of shipping deregulation.

The details of the proposed maritime review commission have not been released, making it difficult to comment on the potential composition and role of the commission. If a commission is formed, USDA hopes to take an active role in assessing the impact of any proposed changes in maritime regulation on agricultural exporters.

4. **HOW THE NORTH AMERICAN FREE TRADE AGREEMENT MIGHT AFFECT SHIPPING/AGRICULTURAL EXPORTS**

The Transportation and Marketing Division has conducted research and participated in working groups regarding land transport issues related to the North American Free Trade Agreement (NAFTA). However, USDA efforts have not focused on how NAFTA will impact maritime transportation, the subject of today's hearing. At the present time, USDA defers to the Department of Transportation regarding the impact of NAFTA on ocean shipping and liner exports.

5. **A SUMMARY OF THE TYPES OF SHIPPING SUBSIDIES PROVIDED BY OTHER NATIONS WHICH COMPETE IN AGRICULTURAL MARKETS**

Many nations directly or indirectly subsidize their merchant shipping fleets. However, USDA has not collected a large amount of current data regarding ocean liner shipping subsidies by other nations, and has not conducted any detailed analysis regarding the impact of these subsidies on the competitiveness of U.S. agricultural exports. Further research would be required to provide the Committee with a detailed evaluation of this issue.

It should be noted that a comprehensive study of the impact of maritime subsidies should encompasss a number of exporting countries, markets, and commodities. Competition in the world grain market tends to be concentrated among a few countries such as the U.S., Canada,

Argentina, Australia, and France. However, market share for many high-value liner agricultural products such as fruit and vegetables tends to be spread among a number of nations. For example, 1990 U.S. world corn export market share was 77.4 percent, and nearly 31 percent for wheat, and 47 percent for oilseeds.[41] In comparison, U.S. world orange export market share has ranged from 10 percent to 15 percent in recent years.[42]

In addition, a distinction should be made between direct and indirect subsidies. The costs of direct operating subsidies are paid by taxpayers, the burden of indirect subsidies to national shipping interests such as shipping conferences is shouldered by exporters, importers, and consumers.

CONCLUSION

Mr. Chairman, this concludes my statement. My associates and I will be pleased to respond to any questions the Committee may have.

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Mr. CONDIT. Thank you, doctor. We appreciate it very much. I have some questions.

The first question is for both Commissioner Hathaway and Dr. Clayton. In reviewing your testimony, I noted that the USDA used a 1986 FMC survey to criticize conference arrangements, however, FMC has used its 1988 survey to generally praise them. What is the deal with the survey? Can they be read either way?

Mr. HATHAWAY. Well, Mr. Chairman, the "1986 survey," that is the one I mentioned in the course of my testimony.

Mr. CONDIT. Sure.

Mr. HATHAWAY. That, you know, two-thirds really were satisfied. It depends on how you read them. One-third were fully satisfied, one-third was—this is rough figures, were partially satisfied and one-third was not satisfied. So I think the USDA has taken the unsatisfieds and the one-third that were partially satisfied, and said only one-third were satisfied.

Well, only one-third were fully satisfied, but it is hard to get any customer or any enterprise to be fully satisfied. And I think it is to our credit that one-third were fully satisfied and at least the other third were partially satisfied.

Mr. CONDIT. So it is kind of like——

Mr. HATHAWAY. Everybody has a gripe. Some people are against Mother's Day.

Ms. WOOLSEY. I hope not.

Mr. HATHAWAY. I think the way that the survey should have been read is that two-thirds are satisfied.

Mr. CONDIT. You think it just depends on how you ask the question then?

Mr. HATHAWAY. Well, or read the result, right, either way.

Mr. CONDIT. Dr. Clayton, can you read the surveys either way you want?

Mr. CLAYTON. I think Mr. Hathaway, in his testimony, pointed out that one can always pick away at any kind of a study or a survey. Clearly one has to be careful in trying to read survey results.

From our perspective, at the Department, one way we would respond to that general issue is by the contact that is made with us by agricultural shippers, who do express a very general sense of discontent with the current arrangements; sort of "ground truthing," just from calls and visits to the office from people who are involved in trying to ship.

Mr. CONDIT. Well, would this proposal, this independent agency, help us in resolving this? I mean, one side reads it one way, one side reads it another way, or maybe it depends on how you structure the independent agency, if you have too many——

Mr. HATHAWAY. Well, I think, Mr. Chairman, if I may answer.

Mr. CONDIT. Sure.

Mr. HATHAWAY. That it would be more important to know the basis of the dissatisfaction. I mean, if we just ask anybody in the room: Are you satisfied with your corner store? They might say yes, they might say no. And if you don't get any more than that, there really isn't any true value to the survey.

But, you know, the dissatisfaction may be just on minor matters that would not be very difficult to correct. They may be major matters, but I would think it would be extremely important to find out

just what the basis for the dissatisfaction was, rather than just how many are and how many aren't.

Mr. CONDIT. Any other comments, Dr. Clayton?

Mr. CLAYTON. I would just observe, Mr. Chairman, one of the reasons that we have expended resources and efforts in looking at this whole general area is what we certainly perceive there to be a very genuine concern by shippers who are trying desperately to compete in foreign markets, and we certainly felt the concerns expressed to us were significant. And as we, at the Department, and you up here in the Congress, try to sort out what we do to ensure that agriculture is competitive in the global marketplace. Certainly one has to look at the marketing chain between producer and ultimate consumer, and clearly transportation is a key element. And clearly from the people we have talked to, there are concerns about that element of the marketing chain.

Mr. CONDIT. We will hear from some of those shippers and maybe they can be more specific.

Let me go on to Dr. Clayton.

Mr. Hathaway has laid down some pretty heavy criticisms of your report. Could you describe your internal review process for reports at AMS and how do you react to these criticisms?

Mr. CLAYTON. Well, let me say, Mr. Chairman, maybe at the outset, that certainly Dr. Ferguson is slated to appear before you this morning, and as regards the technical details of his study, he is probably in the best position to respond to some of those criticisms.

For our part, we do have a staff of professional economists who have worked many years on these issues as well. We find it useful from time to time, though, to go out and involve the private sector in helping us to study some of these issues, this, of course, being a case in point. The study certainly did receive wide review within our agency, very careful review, I might add.

But I might also add, again, I don't want to really get into the technical detail because I think Dr. Ferguson can handle that better than I. But I would observe that, generally speaking, the results which he came up with were consistent with other studies which have been done in the past.

Certainly, key data elements that were used in this study are consistent with data otherwise available. It seems to me that, as I said a moment ago, what is important here is that shippers do perceive that they face problems. And as we look at reinventing government, as we look at reinventing business, the common theme in all of that is identify your customer and serve your customer. And I think our agricultural industries are making tremendous strides, in fact, in trying to do that.

The General Accounting Office and others have criticized the Department, and criticized U.S. agriculture for not paying enough attention to their customer. And I think that criticism is being taken to heart. I think there is a legitimate interest and attempt to try to identify customers better, to more specifically address their needs. And clearly part of a customer's need is a set of shipping arrangements which will make a product available to them. And to the extent that our shippers are constrained and are unable to meet the specific requirements of their customers, I think U.S. ag-

riculture is disadvantaged, ultimately the U.S. economy is disadvantaged.

Mr. CONDIT. How much money did the USDA spend on this report?

Mr. CLAYTON. $25,000.

Mr. CONDIT. Commissioner Hathaway, our next panel will offer testimony about specific problems they have with the shipping conferences. Could you give me some idea of how the FMC investigates discrimination charges in a proactive way, process, or do you simply react to complaints?

Mr. HATHAWAY. No, no, we don't. We do react to complaints, and we think we get about in the neighborhood of 100 a year. Some of them are handled by our ombudsman who can resolve them very rapidly. Of course, others have to have more thorough investigations. We also do an awful lot—I can't tell you statistically exactly what number—of investigations on our own to make sure that the law is complied with.

In fact, we are in the midst of a big investigation in the Atlantic, which finally resulted in a compliance agreement. We got about $25 million from penalties we inflicted there. And we have just completed one in the Pacific and we are trying to get a compliance agreement there. We had a large amount of money collected there as well, and we are trying to be as active as we can within the budgetary limits that we have to investigate malpractices throughout the world.

And in regard to shippers' complaints, we have just completed a study that was conducted by one of our Commissioners, Mrs. Hsu, who is, at the present time, over visiting the EC. Hearings were held in four or five different cities about shippers' complaints with carriers. And she didn't make any recommendations with respect to changing either the law or the regulations but did recommend that we look into some of the carriers' practices in requiring bonds, which the Commission is going to do. But we are staying up with it just as well as we can.

Mr. CONDIT. Was that an in-house study?

Mr. HATHAWAY. In-house, yes, that was an in-house study, but it was open to anybody to testify and many people—many shippers—did testify, particularly nonvessel-operating common carriers and shippers associations throughout the country.

Mr. CONDIT. I am going to stop right there. I have some additional questions but I do want the other members to get around before we are called upon to go vote or they have to leave to their other duties.

Mr. Horn, do you have questions you would like?

Mr. HORN. Let's see which microphone is working.

Can you pick me up there?

Dr. Clayton, there seems to be some difference of opinion on the instructions and the data selection. Now, as I understand it, Dr. Ferguson's report was submitted in May of this year; is that correct?

Mr. CLAYTON. Roughly, in that timeframe, May, June, yes, sir.

Mr. HORN. When is it expected to be published and available to the public?

Mr. CLAYTON. We have made it available today in a draft form. It has now entered into the publication process, so it is a question of how long that takes, 2, 3, 4 weeks perhaps.

Mr. HORN. What took so long to make it available? Was there a dialog going on back and forth between the Department and Dr. Ferguson?

Mr. CLAYTON. I think, Mr. Horn, it was just a question of normal review process. We do try to take some pains to carefully look at these things and it was just a matter of spending the time going through the report.

Mr. HORN. After the review, did you find any loose ends that didn't satisfy you?

Mr. CLAYTON. No. I think it was limited to just editorial kinds of things, presentation kinds of things, but in terms of the substance of the report, we found nothing that we asked Dr. Ferguson to change.

Mr. HORN. Let me go back to the initial instructions Dr. Ferguson had. I take it, the basic thrust of your particular division is that you like to eliminate conferences, like to eliminate the antitrust exemption, with the belief that this will get lower rates for shippers of agricultural commodities; is that correct?

Mr. CLAYTON. I am not sure I want to let you put me into a policy position here in terms of our stance on the conferences. Let me try to approach it just a little bit differently.

I think our fundamental concern is that everything that can possibly be done to make our agricultural exports competitive in global markets be done. To the extent that conferences in some way impact on that competitiveness, we believe it is incumbent upon us to examine those kinds of things, to raise questions about them, and to participate in policy debate on those issues.

Certainly, we can accept the notion that one ought to be careful and look at both benefits and costs. Our review is that, in this case, that the costs likely outweigh the benefits, but we think it is important that they be carefully reviewed and that there be some real information brought to the table. And that really was the purpose of Dr. Ferguson's report, to try to begin to add some greater specificity in terms of these likely impacts, so that as policy decisions are made on the conferences, that they be done with full information available.

Mr. HORN. You have heard of Miles' law, haven't you, being in government, Rufus Miles, great Assistant Secretary of HEW, says, where you stand is based on where you sit. You are sitting in agriculture.

I would assume, I would expect that you are fighting for the rights of farmers, best interests of farmers, from your perspective.

Now, the question is, did you give any instructions as to the type of sample you wanted taken or did you want a total universe in terms of gathering the data so you could make some policy recommendations?

Mr. CLAYTON. I believe the instruction that we gave Dr. Ferguson was to gather as much data as he could possibly gather, and we left it to him then to proceed as best he could to obtain as much data as he could. There were no particular——

Mr. HORN. You didn't review his basic methodology?

Mr. CLAYTON. Yes, sir.
Mr. HORN. You did review it?
Mr. CLAYTON. Yes.
Mr. HORN. Were you happy with the sampling approach?
Mr. CLAYTON. Yes.
Mr. HORN. OK. In your review process, and Mr. Neenan seems to be thoroughly familiar with it, what did your experts in research think about it or did you have experts in research methodology?
Mr. NEENAN. We did take a look at the sample size and, indeed, as pointed out by Mr. Hathaway, the sample size is small, which clearly limits the scope of the findings, but beyond that, we didn't have too many problems with the methodology.
Mr. HORN. Was it a random sample or a selective sample?
Mr. NEENAN. No, it was not random. It was similar to FMC surveys. It was whoever chose to respond.
Mr. HORN. Usually, I found as a social scientist that if it isn't random and it is sort of selective and you have got advocacy groups beating the drum to respond, it really isn't worth the paper it is written on, unless you have systematically gone out and chosen a random sample to see what a cross section really believes in a particular area.
It is interesting anecdotal data, isn't much of a survey.
When I was Acting Chairman of the U.S. Commission on Civil Rights, we spent a lot of time going over the methodology to make sure that we had something we could report to the President and Congress about that was solid, not just ephemeral or a passing newspaper headline but something you could base public policy formation on. That is what I am curious about as I listen to the dialog.
I know absolutely zilch about this problem, but when I look at witnesses before us, I have to say, is the evidence in the report credible? And I don't know at this point. I haven't seen the study. But as a government administrator, I want to make darn sure it is credible, because otherwise people start doubting any recommendation you make if you have a lot of numbers and columns, and they don't mean anything.
Mr. CLAYTON. I certainly couldn't agree with you more in terms of the general point I think that you are making.
I would observe that in Dr. Ferguson's report, toward the end of it, I think he does very carefully lay out the potential for upward or downward bias and the estimates that he has made. I think he has taken pains to be as cautionary as he can to the readers of the report.
Again, I think it is probably best that he responds specifically to your questions. But I would observe that, you know, it was a basic—a mail-survey-type approach, which is certainly widely used and is potentially fraught with many of the difficulties that you have outlined.
I think nonetheless, the results, however much statistical credence you want to put to them, are enlightening, they are interesting. They are interesting in part because they are very consistent with other studies that have been done in the past.

Although previous studies did not focus specifically on agricultural commodities, this one did and its results are roughly in the ball park of what those other studies showed.

So I think as information to the debate, not necessarily the sole deciding study on the issue, but as information to the debate, I think it does have some validity.

Mr. HORN. What did this study add to our knowledge that the Fresno State study had not already added to our knowledge?

Mr. CLAYTON. This study, I think, was the first or one of the first, at least, attempts to actually quantify what the impact of the conferences might be on agricultural shippers. Most of the earlier studies were basically surveys of one sort or another and gathering of views and impressions, and so forth.

This was an attempt to actually quantify, which I think for public policy purposes is something we need, because I think we need something that is reasonably solid upon which to make, obviously, a very critical policy decision.

Mr. HORN. Since I haven't seen the study, I can't tell what was qualified and quantified and what wasn't. But are you saying it is simply a matter of the opinions being quantified or is there a basic freight rate data that was quantified? What was it?

Mr. CLAYTON. The latter. There is an attempt to actually estimate what premium shippers may, in fact, be paying as a consequence of the conferences.

Mr. HORN. When you fill out that questionnaire, the shipper involved had to do some actual digging of data, compilation of data, or was this just a seat-of-the-pants guess by someone on the receiving end of the questionnaire?

Mr. CLAYTON. Not having been there when they filled out the questionnaires, obviously, I can't specifically answer that. Perhaps, Dr. Ferguson, when he comes to the table, would be able to help you more specifically.

Mr. HORN. Let me ask one last question at this point.

I am told Japan grants the broadest type of antitrust exemption to both liner, nonliner ocean transporters for both its domestic and foreign trades. If the United States repealed its antitrust immunity for common carriers, which is what your group desires, would this impair or improve our trade balance with Japan?

Mr. CLAYTON. That is a difficult analytical question which is going to be tough for me to respond to just sitting at the table this morning. Perhaps the observation I could make is that we ought not to focus exclusively on Japan, although I certainly appreciate the importance of that particular country to us in a trade context.

In a more general context, I think one also has to look back toward us, and I believe we are one of the biggest, if not biggest import-export countries in the world. It would be interesting to know how shipping lines and countries would react if, in fact, we did not have the conference system here, because one would have to believe there would be interest nonetheless in servicing U.S. markets, both from an import and an export standpoint.

Beyond that, I think the question you raise is a difficult one that would require some analysis, and I don't think I can respond to that specifically.

Mr. HORN. Let me just say, we would be glad to leave the record open, if you would like to add some written comments, feel free to do so.

Chairman Hathaway, I wonder if you have any reaction to that particular question?

Mr. HATHAWAY. Well, if that were the case, then, of course, it would allow the Japanese to collude to raise the prices on our exports, and that would be detrimental to us.

Mr. HORN. The scenario you sketched is quite a common one, in terms of freeing up the market. Some carriers drive others right down in terms of prices. Many go into bankruptcy, and so forth, and you have a few remaining oligopolies, maybe even a monopoly, at which point, the prices go up and there is no real competition.

It is always a difficult line between short-run satisfaction and long-run satisfaction, and I don't know if you agree or disagree with that theory of economics, Dr. Clayton. I would appreciate having your views.

Mr. CLAYTON. I would just wonder if you have extended your long term out far enough. If, in fact, there is $16 billion worth of agricultural freight moving out of the United States, $2 billion, or $3 billion worth of freight revenue to be gained, one would have to believe that there is some incentive to find some way to develop carrier capacity and, in fact, compete for that business.

So I think one probably has to make sure you extend it out far enough. It may go through some of the cycles you described, but I am not sure about the endpoint. It may well be that there would be an incentive with enough revenue at stake, that you may well see some interested parties wanting to help move that freight.

Mr. HORN. I hope you are right, Dr. Clayton. I sit on the Aviation Subcommittee and have watched the American Airlines with deregulation. I certainly don't want to reregulate them, but we are getting down to the point where, as you know, they have lost as much in profits in the last year, or rather lost as much in the last 3 years as they made in profits since the end of the Second World War, and there is only one airline that made money last year. And it isn't the big ones.

Mr. CLAYTON. Difficult policy issue.

Mr. HORN. Right.

Mr. CONDIT. Thank you, Mr. Horn.

Mrs. Thurman.

Mrs. THURMAN. Thank you, Mr. Chairman.

As you know, the performance review by the Vice President has suggested that—and making a recommendation that we should do another study on this whole area, and from the information I hear, it sounds like there is a lot of conflict within a lot of these reports that we are hearing about.

To both of you, do you think that the studies that were done, I guess when they did the 1984 Shipping Act, there was a commission that was put together to do a study; do you think that study was adequate? Does it need to be expanded?

And I would like both of your views on that.

Mr. HATHAWAY. Well, the study that was required by the 1984 Shipping Act was one that was to take place 5 years afterwards, and it did take place. And during that 5 years, this agency, as well

as other governmental agencies and the private sector furnished a lot of information so that the Advisory Commission, when it was appointed, could study that information.

The Advisory Commission then held extensive hearings here in Washington and throughout the country, and then in 1992, did not recommend that any changes in the 1984 act take place.

Prior to that, as you know, prior to the 1984 act coming into being, it started in 1979, discussions of it, and there was a lot of studying done in the 5-year period and a lot of battles raised between the carriers and the shippers to come to some compromise agreement, which the 1984 act is.

So I think it has been studied pretty thoroughly, both before it was enacted and since it has been enacted and just recently, and there is no need for a further study, at least at this time. I think every act ought to be studied periodically, but certainly not the very next year after one study has been completed.

I presume that the Gore recommendation is to study other parts of the law, the subsidy programs, the Jones Act and the cargo preference, operation and differential subsidy, and so forth, and not the 1984 act, and maybe those need to be studied. I don't know. We don't have jurisdiction over those and so we don't get into it.

Thank you.

Mr. CLAYTON. One point that might be worth drawing attention to with respect to the Commission, which did review the 1984 Shipping Act, I think if you review the work of that Commission, one of the things which strikes you is that it is somewhat deficient in terms of quantitative assessment of what the actual effects were on various shipping concerns, be it agriculture or other industries in this country, as well as impacts on the general economy.

I think those kind of quantitative assessments were largely absent from the earlier Commission study. So I probably would disagree a bit with Mr. Hathaway, in the sense that certainly he is right, there have been lots and lots of studies, but in terms of quantitative analysis, which means what economic effect it is having, I think the results there are many fewer.

I would agree with Mr. Hathaway that the Commission proposed in the—in the Vice President's report, will be a more broadly based review of our maritime industry, kind of a top-to-bottom review.

Mrs. THURMAN. One other question that is a hot issue in Congress right now is on NAFTA. Is there anything in the agreement that you know of that would have any effect upon the issues we are talking about today?

Mr. CLAYTON. Mrs. Thurman, let me go first on that one, perhaps. The Department of Transportation had the lead within the administration as regards transportation issues that were negotiated as a part of the NAFTA. We at USDA did participate in those. The most part of NAFTA, when it comes to transportation issues, focuses on, particularly, land transportation, to some extent rail. I think there really is not much in there that specifically speaks to the maritime issue.

Another way, though, to come at your question, perhaps, is what effect NAFTA might have in terms of trade between the United States and Mexico. There I think there is a position certainly held

on the part of the administration that trade will be enhanced, in particular, agricultural trade.

I believe Secretary Espy was up yesterday testifying before the Agriculture Committee, and I think he noted that we expect that agricultural exports should be boosted by some $2 billion, $2.5 billion. One would have to believe that at least some of that might move over water.

In that sense, perhaps there is a connection with respect to transportation over water, but provisions of the NAFTA, per se, I think do not specifically address these issues.

Mr. HATHAWAY. Yes, Mrs. Thurman, I agree with what was said.

Mr. CONDIT. I thought maybe you might take this opportunity to make your statement that you weren't able to make yesterday in the agricultural committee.

Mrs. THURMAN. Mr. Chairman, I was being very good, polite.

Mr. CONDIT. As you always are.

Dr. Clayton, your testimony quoted the former Assistant Attorney General for Antitrust as being preopposed to collective ratemaking, yet it appears that not one injunctive action was taken against the conference since the 1984 act was implemented. In your opinion is there a breakdown, does the industry need more oversight?

Mr. CLAYTON. Well, I suppose your question really would have to be directed to the Department of Justice. I certainly can't speak for them in terms of what they did or didn't do and why they did or did not do it, and I think from a purely legal point of view in terms of whether there are any violations of the statute that I am probably not the best person to answer that.

I think my role, at least as I perceive it, is more one of laying out to you what I think the impacts of the act have been on the agricultural community.

Mr. CONDIT. Well, the only reason I bring it up, you used the Assistant Attorney General as a quote, saying that they were pretty much opposed to it, to the collective ratemaking. Evidence has been pretty much opposed to it. Seems to me there would be some kind of action instead of just words.

Do you see an absence of action or do you think what they have done has been pretty fair?

Mr. CLAYTON. To be honest, I am not quite sure of the division of labor between Department of Justice and the Federal Maritime Commission and so perhaps Mr. Hathaway can respond particularly to the question better than I can.

Mr. CONDIT. I will let you take a pass on it.

Mr. HATHAWAY. I think, Mr. Chairman, the situation that you depict is covered by section 6(g) of our act which states, I will just read it very briefly:

> If at any time after the filing or effective date of an agreement, the Commission determines that the agreement is likely, by a reduction in competition, to produce an unreasonable reduction in transportation service or an unreasonable increase in transportation cost, it may, after notice to the person filing the agreement, seek appropriate injunctive relief under subsection (h).

Since 1984, as you mentioned, we have not sought injunctive relief. It isn't up to the Department of Justice to do it. I don't think the Department of Justice could step in. It is up to us to do it. We

have examined every agreement to that end. We are guided somewhat by the conference report to the 1984 act that says that even if an agreement is likely to cause the requisite reduction in competition, the Commission can obtain injunctive relief only if the likely net result will be an unreasonable increase in cost to shippers or an unreasonable reduction in the frequency or quality of service available to shippers.

With that in mind, we look at every agreement that comes in. As you know, they all became effective automatically in 45 days, yet in that time we do get in touch with the parties and question them about different aspects of the agreement, may be too anticompetitive. We are presently engaged in looking over the TAA agreement which the EC is looking over.

We have, and Austin Schmitt here on my left has, on almost a daily basis been querying shippers as to what basis they would have, not just allegations, but evidence that they have to show that the transatlantic agreement is actually anticompetitive, and if we get sufficient evidence we will go to court. So far in the years since the 1984 act we have not taken any case to court, but this one has probably received more notoriety, but very little evidence to support our taking action against it.

Mr. CONDIT. So you see no need since 1984?

Mr. HATHAWAY. So far we don't, but we continue to monitor all the agreements.

Mr. CONDIT. Dr. Clayton, you testified about the intense international competition often based on a fraction of a cent per pound. Does the AMS or any other government entity track this in terms of the transportation portion of landed cost?

Mr. NEENAN. We are in the process of developing a project at this time along those lines. It is still in the early stages, but we hope to start tracking that.

Mr. CONDIT. How long before you have this completed?

Mr. NEENAN. I think quite a while, simply because there is a lot of data to collect to cover a sufficient number of commodities and trade routes and a lengthy time period, so not in the near future.

Mr. CONDIT. Commissioner Hathaway, how does the FMC protect shippers, carriers engaged in foreign commerce of the United States from restrictive rules and regulation of foreign governments?

For example, it has been said that the Canadians have a way of reimbursing transportation costs for their shippers.

Mr. HATHAWAY. We may proceed under section 19 of the 1920 act or we can proceed under the 1988 act, the Foreign Shipping Practices Act. We have had many actions, we have some of them still pending against various nations around the world. And, it has been shown over the years that when we have exercised our jurisdiction under particularly section 19, it has been extremely effective. Of course, the ultimate threat to the foreign countries or to the foreign carriers is that they will have their tariffs suspended and will not be able to land at our ports. That is quite a club to hold over their heads, and as a result of that we have, I think, levied one penalty, but never collected any penalties because they have usually come around and eradicated the unfair practices before we had to take that action.

We continue to have some of them report on a periodic basis to make sure that salutary situation stays in place.

Mr. CONDIT. Is it, in fact, correct that the Canadians subsidize their transportation costs?

Mr. HATHAWAY. I don't know that case. I have not heard of that case, and it has not been brought to my attention. It may be in the works somewhere through our secretary's office.

Mr. CONDIT. OK. So there has not been any action or questions to the Canadian Government? We would like very much for you to get back to us. It is our understanding that that occurs, and it is called a crow's nest agreement, some way that they subsidize the shippers which puts us at a—Dr. Clayton?

Mr. CLAYTON. I think, Mr. Chairman, the crow's nest issue is actually a railroad issue. The crow's nest issue is a rail subsidy issue. It certainly can affect the competitive position of Canadian grain farmers as it relates to them moving grain to the ports, but I think the crow's nest specifically is related to railroads. Certainly we could confirm that back to you.

Mr. CONDIT. I would like for you to do that if you can.

That really concludes, unless Mr. Horn or Mrs. Thurman has any additional questions, concludes the panel, but Dr. Clayton, since I have you here, I would like to ask you, do you have any thoughts on the Gore proposal to give the Trade Promotion Coordinating Council greater control over the U.S. export programs?

Mr. CLAYTON. I am not in a position to respond on that this morning, I am sorry.

Mr. CONDIT. No? We tried. Mr. Horn has one last question.

Mr. HORN. Chairman Hathaway, I am told that the rates for bulk cargo and forest products, recycled and metal scrap wastepaper, paper waste are exempted from the tariff filing requirements, and I am just curious——

Mr. HATHAWAY. Tariff rates.

Mr. HORN. Tariff requirements. Does this make the rates more binding or less binding? What is the relationship there?

Mr. HATHAWAY. I don't think it has any effect on it whether they are binding or not.

Mr. HORN. I just wondered why they were exempted per se?

Mr. HATHAWAY. Well, partially politically because of certain Members of Congress that didn't want them in there.

Mr. HORN. I thought maybe someone from Maine would know something about forest products. I thought I would get a lucid answer.

Mr. HATHAWAY. Most of our forest products goes into paper, and those usually go on liners that do come under our jurisdiction, so they are not exempt.

Mr. HORN. Good. Thank you.

Mr. CONDIT. Mr. Hathaway, can I ask you one quick question? Have we taken any action against foreign competitors in the last year or so?

Mr. HATHAWAY. Yes, we have taken action against Japan, China, Taiwan, and Korea as well as some South American nations.

Mr. CONDIT. What type of action?

Mr. HATHAWAY. Just to—well, one of the more recent ones that we have had with Korea was because they would not allow our

nonvessel-operating common carriers and freight forwarders to operate in their country, whereas we allowed them to operate here. They have since changed their law to allow ours to operate there. That was taken care of in less than a year's time.

Mr. CONDIT. Were those disputes were resolved to the satisfaction of this country?

Mr. HATHAWAY. Yes, they all are at the present time, correct.

Mr. CONDIT. OK. We might want some documentation just for the record.

Mr. HATHAWAY. We would be glad to give you thorough documentation on all the foreign actions we have taken in the recent past.

Mr. CONDIT. We thank you gentlemen very much. You have been very kind with your time. We appreciate it so much. Thank you, commissioner.

We will take panel two, Dr. Ferguson, Mr. Granatelli, and Ms. Morley. If you would remain standing and raise your right hand, we have a policy of swearing in our witnesses.

[Witnesses sworn.]

Mr. CONDIT. We will begin with Dr. Ferguson. You pretty much know where we are headed. Your name has been used a lot in the first panel.

STATEMENT OF ALLEN R. FERGUSON, ALLEN FERGUSON ECONOMICS, INC., SILVER SPRING, MD

Mr. FERGUSON. Thank you very much, Mr. Chairman. I appreciate having been invited to testify this morning, after having been involved in this field for many years. I am delighted that this subcommittee is taking up maritime policy when, for the first time in decades, there seems to be some prospect that the whole package of maritime policy will come under review.

I want to emphasize that I am appearing this morning as an independent economist. I represent neither the shippers nor the carriers. My report was performed under contract with the U.S. Department of Agriculture which, Congressman Horn in particular, imposed no restraints whatsoever upon my methods, my data, or my conclusions. It was a completely open contract, and I had very good relations with the staff. No inappropriate interference at all.

With regard to the other papers that I am speaking about this morning, my note on the reform of maritime policy and, of course, my comments about the proposed commission were done entirely on my own, no sponsor, no funding, and I will finally say that I have not been paid at all by any party for my appearance this morning. This is pro bono action on my part.

I have submitted written testimony which I hope will be incorporated into the record and I shall try to summarize it very briefly.

I will begin with my study of the impact of the conference system, and then touch on my proposals for general policy reform, and if time permits make some brief comments about the contemplated Commission on Maritime Issues. Let me say in a prefatory way that in the controversy over these issues there is altogether too much hostility among the parties given the reality of the situation.

Let me begin with the conference—I am sorry, I lost track of my notes.

Mrs. THURMAN [presiding]. That is OK.

Mr. FERGUSON. It is my belief that the crisis in the maritime industry and the excessive economic costs of maritime service are largely the consequence of existing maritime policy. Let me address that first by talking about the conference system and my report. That report summarizes the research I did for the Department of Agriculture.

Its purpose was very modest. It was to develop initial quantitative estimates of the general magnitude of the economic effects of ocean liner conferences on agricultural exporters, and it was an experiment with a new research approach which, if it works, and I think it did, may be of value for future work by the Department of Agriculture and anyone else interested in quantifying these costs.

I did not reach policy conclusions, and I want to emphasize this is not a definitive study—I would say parenthetically for $25,000 you don't get a definitive study of anything that I know of—there have been previous major studies of the conference system, many done by prominent economists. Almost all of them conclude that the conference system imposes economic inefficiencies and costs on the American and indeed on foreign economies. There are severe data problems with any effort to quantify these costs. My study is, I believe, the first in which specific costs to the agricultural sector are measured at all. It is also the first in its approach, basically a ground-up approach leading toward summary results.

The study survey, which has already been referred to, developed key data that as far as I know have never been developed anywhere. For example, the Federal Maritime Commission has never developed them. The key information deals with two ratios—the cost of ocean transportation as a fraction of delivered prices on exports, and any, what we might call "monopoly mark-up," that conference market power imposes, any monopoly markup as a fraction of total ocean transportation costs.

The sample is small. It is not random. The results, I believe, are indicative of general magnitudes and the data are better than anybody else's as far as I know. This is a very slim data base. The study examined in detail about $5 billion worth of agricultural exports, some 20 percent of total agricultural liner exports. Six major groups of commodities exported to three major markets—Japan, the European Community and Taiwan—were subject to detailed analysis.

Dr. Clayton has already touched on the highlights of my findings, and I will simply restate them very briefly. The study indicates that about 18 percent of ocean transportation costs are attributable to conference market power. This equals an estimated cost of $168 million per year to this limited sample of agricultural exporters, and, taking account of the effects on export volume, to an estimated cost of $406 million imposed on the total trade, export and import, covered in the sample.

These results are consistent with those of the few other studies that have looked at this area, and, as has already been mentioned, the inputs that I obtained from the survey are consistent with similar inputs obtained by the Department of Agriculture for other purposes.

The key estimate of $406 million one would like to multiply to compute a firm estimate of the total impact of the conference system. That cannot be done with precision. However, by looking at some facts one can make a guess. The data that I used excluded two important kinds of agricultural exports—meat and meat products and tobacco. In fact, only about 35 percent of the agricultural exports to the six markets that were studied were included in the quantitative analysis. Those markets account for 59 percent of the exports of liner-type agricultural products.

Agricultural exports amount to only about 10 percent of total U.S. exports, and imports, which equal about 120 percent of exports, were not covered at all. Thus, very large gains would accrue to the trade, perhaps in the order of $10 billion to as much as $40 billion a year to exporters, importers, workers and consumers if one could estimate the total effect of the conference system. The cost to agricultural exporters alone appears to be on the order of $600 million to $1 billion.

Now, I will turn to the second part of my written testimony, a brief paper suggesting reforms of maritime policy. Here again let me repeat that I believe the debate has become too acrimonious and it has done so in part because of the failure to look at all of the pieces of the puzzle.

There are really two sets of American maritime policies. The first one makes the U.S.-flagged commercial fleet inefficient and gives rise to legitimate complaints by the carriers. The second set of policies undertakes to offset the impact of the first set, giving rise to legitimate complaints by the shippers. The public as a whole has legitimate complaints about the whole business because they are the ones who pick up the tab. They also seldom get represented in the dialog. The policies have failed, yet they cost something on the order of $10 to $40 billion, and I emphasize "something on the order of." At least half of the costs are borne by Americans, and they share amounts to something like $50 to $110 per year per employed American worker. That is my rough, very rough, estimate of the costs to American workers of the present maritime program.

Attempts have already been made to patch up the system. They, too, have failed. It is necessary to avoid fixating on one piece of the problem such as the financial plight of the carriers. This practice of focusing on one issue at a time, I think, is one of the reasons why controversy is excessively acrimonious. Further, there is a set of integrated policies that promise to solve most of the maritime policies. I am sure that the members of the subcommittee are familiar with the main components of maritime policy, so I shall jump immediately to costs of the policy and then talk about what to do about it.

The costs to the taxpayers, the direct cost to the taxpayers, are of two sorts. First, the operating differential subsidy was budgeted in the 1993 budget for $220 million. Cargo preference was budgeted for $501 million, a total of $700 million plus change, excluding administrative costs.

The shipper and consumer costs are far greater. The Jones Act costs something in the order of $1.5 to $2 billion annually. Tolerance of conference rate-setting, after subtracting costs borne by foreigners and by American importers, imposes an additional annual

burden on American shippers as a group of an estimated $2 to $8 billion.

Taking $5 billion as mid-point estimate of the sum of all these costs borne by the American public, produces a cost per American seafarer of $185,000. If my calculations were off fivefold, which they are not, the public is still paying $37,000 to support each American seafarer.

Now, the justification made to the public for these costs is jobs and defense. With regard to jobs, the tail that wags the dog is a minute labor force; 27,000 people were employed in U.S.-flag ocean-borne shipping in 1991. Their rates of pay are relatively high. The annual rates run from about $30,000 for an unlicensed steward, that is basically a housekeeper, to some $230,000 for a captain, a master.

The seafarer's jobs and salaries do depend on the protection and subsidies that are developed into what I have called the second set of maritime policies. However, overall the job benefit is probably negative. In other words, these policies probably reduce jobs in the economy as a whole. Through raising the cost of transportation, the policies give some protection to industries that are import-competitive, but more directly the reduction in the volume of ocean transportation depresses the demand for longshoremen, depresses the demand for export industries, and raises the cost of manufacturing in industries that rely on foreign materials. The defense argument is the final fall back position for the defenders of the status quo, and that was traditionally a very strong argument. More recently the Department of Defense has changed from its previous solid and consistent support of these maritime programs to at least a position of ambiguity, and as you know, some representatives of the Department of Defense have testified that they see no need for a U.S. commercial fleet to provide logistic support in any expected emergency.

Perhaps more important in terms of the economics is that 80 percent of whatever defense benefit derives from the vastly expensive tolerance of the conference system redounds to foreign countries, because 80 percent of our liner traffic is carried in foreign bottoms.

Now, briefly, recommendations: The recommendations I shall sketch should be budget-neutral or better, and they should generate large economic benefits for the country as a whole. For the carriers: First, the recommendations include great reductions in operating costs by removing the requirement that 100 percent of the crews be U.S. citizens.

Second, the Coast Guard should be mandated to update and change manning requirements so as to approach full exploitation of the available technology and the practices of other advanced industrial countries.

Capital costs should be reduced, first, by eliminating the requirement to buy and repair ships in the United States; second, by permitting greatly expanded foreign investment; third, by permitting U.S. carriers to liquidate assets profitably, namely, to sell ships—when the market calls for doing so—on the world market.

These changes, implemented in toto, would largely eliminate any need for subsidy and protection. They would also result in some benefits to labor, both port workers and throughout much of the

economy. Nevertheless, as a matter of fairness there should, in my judgment, be some subsidization of early retirement for the small, aging sea-going labor force. Taxpayers would get direct benefit by the elimination of cargo preference, by allowing the operating differential subsidy to lapse and by not reestablishing the construction differential subsidy. Shippers and consumers would gain by the elimination of the antitrust exemption and the elimination of the Jones Act.

Military support is another matter. It should be the responsibility and should come out of the budget of the Department of Transportation. Other studies of mine have indicated that a modern reserve fleet and a merchant marine manpower reserve make good sense economically, provided they meet the needs of defense and come out of the defense budget.

In conclusion, the present policies are so contradictory and inefficient that they may, perhaps paradoxically, present an opportunity to revise them so extensively that most, if not all, of the interested parties as well as the American public, would gain from reform.

Thank you very much. This completes my statement.

Mr. CONDIT [presiding]. Dr. Ferguson, thank you very much for that interesting testimony.

[The prepared statement of Mr. Ferguson follows:]

IMPACT of MARITIME POLICIES
on AGRICULTURAL EXPORTS
Testimony by Allen R. Ferguson
before the Committee on Government Operations;
Information, Justice, Transportation, and Agriculture
Subcommittee

September, 1993

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IMPACT of MARITIME POLICIES

on AGRICULTURAL EXPORTS

Testimony by Allen R. Ferguson

before the Committee on Government Operations

Information, Justice, Transportation, and Agriculture

Subcommittee

September 30, 1993

Mr. Chairman, I greatly appreciate your kind invitation to testify before this Sub-Committee on the topic of maritime policy and, particularly, on how that policy affects agricultural exports.

My oral testimony in response to the Chairman's question as to my work for USDA on the effect of conferences on agricultural exports will consist of summary and commentary of my report Maritime Policy and Agricultural Interests: Impacts of the Conference System. I understand that copies of the draft report have been transmitted to the Subcommittee staff by the Department of Agriculture.

My oral testimony in response to the Chairman's more general question as to the effects of regulations and policies of the maritime industry on agricultural exports will be based on "Reform of Maritime Policy: Building Blocks for an Integrated Program" which appears below. It pertains to the total economic affects of maritime policy, not only agricultural impacts, but the latter are subsumed under the broader scope.

My comments on the proposed study commission on maritime issues and exports will be based on the brief note below, "The Proposed Commission on Maritime Issues and Exports".

I have not studied the impacts of NAFTA.

It is to be emphasized that although my Report on the Conference System was prepared under contract with the Department of Agriculture, neither that Department nor any other entity shares responsibility for my comments on either maritime policy in general or on the proposed new commission on maritime policy. Further, I make no policy recommendations in my Report for USDA.

REFORM OF MARITIME POLICY:

BUILDING BLOCKS FOR AN INTEGRATED PROGRAM

by

Allen R. Ferguson

September, 1993

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PREFATORY NOTE

This brief paper has been prepared without client or sponsor, solely on my own initiative.

It is based on my experience in analyzing maritime policy and on my prior study and discussion. Little new specific research underlies it.

Its purpose is to throw into the current policy debate my personal ideas on how to increase the efficiency and viability of the United States merchant marine and to eliminate both the costs of current inefficiencies and the costs of efforts to compensate for them.

In briefest compass: There is a set of integrated policies that promises to solve most of the maritime problems. Properly adjusted and timed these proposals at worst should be budget-neutral. They would create economic benefits in the tens of billions of dollars per year. Yet they would provide efficiently whatever commercial fleet and reserve fleet are worth their cost. Since, there is room for all the interested parties to make some gains, there should be a significant prospect of success if the gains to each can be made clear, while separate gains to single interests are withheld.

This note is to constitute the basis for testimony before the Committee on Government Operations; Information, Justice, Transportation, and Agriculture Subcommittee

Allen R. Ferguson
September 27, 1993

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REFORM OF MARITIME POLICY: BUILDING BLOCKS FOR AN INTEGRATED PROGRAM

by
Allen R. Ferguson

I. THE PRESENT CRISIS

The immediate crisis in maritime policy arises from the fact that APL and SeaLand, the two largest American-flag liner companies are taking steps apparently to implement their threat to "flag-out", that is, to withdraw from registry under the United States flag. That action would be likely to affect no more than 4,000 to 5,000 jobs. The press reports a statement by SeaLand that its move would cost only 525 jobs (by which they probably mean berths, but because of the rotation of crews, about 2.5 employees fill a berth during a year).

Much more important, in terms of economic performance and competitiveness of the economy, is the fact that American consumers, producers, exporters and importers, as well as taxpayers are substantially hurt by the current maritime system. International trade is inhibited rather than facilitated.

Present maritime policy is largely to blame. At present there are two sets of American policies: one makes the U.S. commercial fleet inefficient; the other partially offsets those inefficiencies. Present policy is a hodgepodge of subsidization, protectionism, regulation and taxation that makes a mockery of sensible Industrial Policy; it supports a loser, not a winner.

II. RECOMMENDATIONS

The larger building blocks of major reform are presented here. Although financial aspects have not been developed, it should be possible to adjust and time these proposals to be, at worst, budget-neutral in the short run and to save Federal money in the relatively near future. Economically more important, reform would increase the efficiency and competitiveness of the American Economy as a whole, contributing to increased employment and exerting downward pressure on prices and on tax burdens. The suggested changes would also mitigate inequitable distribution of the burdens of transition. Further, the vitality and competitive strength of the U.S.-flag fleet would be enhanced.

The fundamental fact underlying these reforms is that everything which raises the cost of US-flag carriers provides justification for the wasteful programs designed to save the American-flag fleet from its own inefficiencies.

The reforms would provide gains to labor, to ship owners and

operators, to taxpayers, to shippers and consumers. They would increase military support capability. In economic terms, the industry is not operating on an efficient production surface; hence, gains for all participants are available.

Gains to Labor:

♦ To protect American seafarers --a labor force that is on the average relatively old, 46 years of age-- provide for some Federal support for early retirement of older workers and re-employment support for younger ones.

♦ The policy changes proposed below would increase the demand for longshoremen by expanding American water-borne commerce.

♦ Indirectly and marginally they would increase demand for agricultural, manufacturing and service workers, as well as for goods and services.

♦ Little, if any, shipyard labor would be made redundant by implementing these recommendations, since the order books of American commercial shipyards are virtually empty.

Gains to Ship Owners and Operators:

Operating Costs:

Given the protection of seafarers prescribed above, manning and crewing laws (among others) should be changed.

♦ The requirement to use only citizen crews should be repealed.

♦ New legislation should require new Coast Guard regulations designed to increase productivity greatly. Specifically, manning requirements and flexibility in use of crews should approach the practice of other industrialized nations, taking advantage of modern technology.

♦ Safety and other operating standards should be reviewed and revised to remove restraints that are not worth their cost.

Capital Costs:

♦ To lower capital costs toward an internationally competitive level, the requirement that U. S.-flag operators use only ships that are built and repaired in American shipyards should be repealed.

♦ Capital funds already reserved for purchase of American-built ships should be made available for purchase on the world market.

♦ The effective cost of capital to American ship owners, especially American owners of foreign-flag ships, could be reduced to be more competitive with foreign owners by removal of the effect of Sub-Part F of the Tax Code. That is a complex issue requiring more analysis than it has proven possible to provide here. Since the problem is international differentiation in taxation, it might be appropriately addressed through GATT, after suitable analysis by disinterested experts in taxation.

♦ Restrictions on foreign investment in U. S.-flag shipping companies should be reduced or eliminated. Similarly, obstacles to selling U.S.-flag ships to foreigners should be abandoned.

Those reforms would go far toward eliminating the inefficiencies that are believed to make the U.S. fleet non-competitive and, hence, would largely obviate the "need" for protection and subsidization. Therefore, those props could be dramatically reduced with minimal damage to the financial position of the American fleet and with substantial increases in efficiency and competitiveness.

Budgetary/Taxpayer Gains:

♦ Cargo preference should be eliminated.

♦ Operating Differential Subsidy contracts should be allowed to lapse, as scheduled.

♦ The Construction Differential Subsidy should not be reestablished.

Shipper/Consumer Gains

International trade:

♦ The antitrust exemption for ocean-liner price fixing should be removed. That would be expected to end conference rate-setting powers. Note, in passing, that the European Community's Commission on Competition has challenged the TAA, and it and Canadian authorities are considering further challenges to the conferences.

Domestic Trade:

♦ The cabotage laws (the Jones Act) should be repealed.

♦ Some way would have to be found to mitigate the impact on operators in the domestic trades and on their creditors for the decline in capital value of their U. S.-built ships. Combinations of phased retirement of vessels and financial assistance should be explored.

Military Support

♦ A modern reserve fleet should be established in accordance with Department of Defense specifications and funded through the Defense budget.

♦ A Merchant Marine Manpower Reserve, probably as a naval unit, should be established to assure qualified and trained crews for the reserve ships.

♦ The construction differential subsidy should be replaced by authorizing purchase of ships for the commercial fleet and for the reserve fleet on the world market.

♦ Any commercial operating fleet deemed vital --after critical inter-agency review-- to military or economic security should be subsidized directly, out of the Defense budget.

♦ No attempt should be made to subsidize shipbuilding for commercial purposes.

The justification for these recommendations is sketched briefly in the following pages.

III. HIGHLIGHTS OF PRESENT POLICY

<u>Policies Depressing Productivity</u>:

To fly the American flag a ship must be operated under archaic crewing statutes and regulations, dating from 1915. They require, according to a report of the National Research Council, that crews be 50% to 90% larger than those of other industrialized countries. They also directly depress the productivity of individual crew members by precluding "cross-over" between departments, despite the fact that modern technology and foreign practice permit such operation.

The crews must be American citizens, whose compensation is typically far more than that of their foreign competitors. In calendar year 1991, a fully employed Captain received close to $120,000 per year plus fringes and food and quarters when at sea; the lower ranks of licensed personnel average $67,000 cash and low-rank unlicensed personnel $21,224. Crew costs are the largest single ship-operating cost.

To obtain full governmental support, U. S.-flag operators must use ships that have been built and are repaired in American yards. American-built ships cost at least double and sometimes several times as much as operationally comparable ships available on the world market. Sealand, the only significant U.S.-flag ocean liner operator whose international operations are not subsidized, uses foreign-built ships.

A third policy that may reduce American competitiveness is embodied in Sub-Part F of the Internal Revenue Code. Prior to the Tax Reform Act of 1986, operators of U. S.-owned foreign-flag vessels were allowed to defer taxes on foreign earnings, provided the earnings were reinvested in ships. Foreign maritime nations reportedly permit their national-flag carriers to accumulate such profits tax-free. This tax difference is blamed by the Federation of American Controlled Shipping for contributing to the recent sharp decline in the American-owned, foreign-flag fleet.

There are a number of possibly less potent restrictions on American efficiency, including ship-design standards, restrictions on routing ocean liners, on disposing of subsidized vessels, on competition among subsidized carriers.

Offsetting Policies:

Two major subsidies have been intended to compensate for the high-cost of American operators and shipbuilders. The Operating Differential Subsidy (ODS) and the Construction Differential Subsidy (CDS) were designed to pay American ship operators the difference between American and foreign costs.

The ODS is scheduled to lapse shortly, at the end of 1997 for liner operators and in 2001 for bulk carriers. No CDS payments have been made since the mid 1980s. American operators who receive ODS are, with exceptions, still required to buy only high-cost, American-built vessels.

Although direct subsidization has disappeared, or will do so under present plans, there is continuing pressure to reintroduce those subsidies under various guises.

Two major protectionist policies immunize American-flag ship operators from some consequences of their inefficiencies. First, the "Jones Act", bars foreign vessels from all American domestic transportation. Second, Cargo Preference mandates that 75% of nearly all civilian government-compelled cargoes and 100% of military cargoes be carried in American bottoms.

Finally, all ocean liner companies serving American international trade are effectively exempted from the antitrust laws, under the Shipping Act of 1984. With this immunity, they operate cartels, called "conferences" (or "agreements"). About 80% of liner traffic in U. S. trades is carried by foreign companies. The conferences regulate their members' capacity, sailing frequency, ports served, and, most important, conferences set prices. Through the Federal Maritime Commission (FMC) the United States Government acts as cartel manager, publishing and enforcing prices set by these, predominantly foreign, associations.

A single conference covers all major routes between the United

States and Europe. The Trans Atlantic Agreement not only sets rates but "manages", that is limits, capacity that may be offered by its members and affiliates. Similarly, in the Pacific, the Transpacific West-bound Rate Agreement regulates all west-bound trades. The Trans-Pacific Freight Conference of Japan covers some 95 percent of in-bound trades from Japan; another conference encompasses all non-Japanese routes from Asia. All these Pacific conferences are bound together under the Transpacific Stabilization Agreement, which, like TAA, "manages" capacity. The Federal Maritime Commission has approved all these agreements.

IV. FAILURE OF POLICY

These policies have failed. United States-flag ocean carriers are not competitive; they are among the world's least efficient fleets, being less efficient than those of other high-wage, industrial countries as well as those of many developing countries. The U. S.-flag fleet's share of carriage of American trade has declined from 27.3% in 1980 to 18.6% in 1990. Both the liner fleet and, especially, the cargo preference fleets are rapidly aging. The U.S.-flag international liner fleet may well cease to operate under the American flag in the near future, if regulations are not drastically modified, and, being old and inefficient the cargo preference fleet's value as a military reserve appears to be small.

One current tool for maintaining a viable commercial fleet tied to the American trades and available for use in emergencies is the "Effectively U.S.-Controlled (EUSC) Fleet", ships registered under foreign flags but owned by American firms. The EUSC fleet consists largely of tankers and other bulk carriers, plus a few liner-type ships. In 1990 it numbered some 230 vessels, and has declined some 40% in recent years.

The number of American seafarers has declined. In 1960 there were some 100,000 active seamen. In 1990, 27,000 seafarers were employed on ocean-going vessels.

There is controversy as to the performance of the U. S.-flag operators in the Gulf Crisis. Several facts are clear: A vast amount of trans-ocean traffic was carried in American-flag vessels. The U.S. fleet did not provide the level of support expected: many foreign vessels were used even in the trans-ocean movement, and virtually all of the cargoes carried on American commercial freighters were transshipped west of Suez or east of the Persian Gulf to foreign-flag ships, with foreign officers and crews. Those foreign vessels made delivery in the war zone itself. Difficulties in manning and operating the Ready Reserve Force Fleet (sic) were encountered. The Navy declined to divert some of the presumably available American ships to avoid adverse impact on American commerce.

American shipyards orders for major commercial general cargo vessels have essentially disappeared.

V. THE COSTS

These failing policies cost American taxpayers, traders and consumers billions of dollars every year. It is, however, very difficult to obtain reasonably reliable estimates of some of the costs.

Taxpayers' direct cost in recent years have derived from the Operating Differential Subsidy (ODS) and Cargo Preference. The 1993 budget provided for $220 million for ODS outlays. Of this, some 90% is paid to offset crew cost differentials.

Cargo preference increases the cost of assistance programs and of military shipments (a large component of which is household goods). The 1993 budget provided for $501 million for Cargo Preference programs.

Shipper costs derive directly from two main sources, cabotage (the Jones Act) and tolerance of the conference system.

The International Trade Commission published the first and only (so far as I am aware) serious estimates of the economic costs of the Jones Act. Three estimates (based on different elasticities of demand for ocean service) of the welfare costs in 1988 were presented: the minimum estimate (based on an elasticity of -3.5) was $3.6 billion in 1988 dollars. Even this estimate seems high to me, therefore I have modified it to reflect an elasticity, based roughly on some of my previous work, of -1; that produces an estimated cost of $1.6 billion. In contrast, the cost of direct subsidies to sustain the existing Jones Act fleet was estimated by ITC at only $619 million. Thus, protectionism costs some two and one-half times as much as would a rational program to provide whatever the Jones Act benefits might be --even without regulatory change. If the regulatory changes suggested above were implemented, the required subsidy would be vastly less, probably between 0% and 10% of the cost of the Jones Act.

The conference system (exempt from antitrust laws) produces monopoly rents for the ocean liner companies that cost American exporters and consumers an estimated $2 to $8 billion per year. Although there is not an adequate research base for refining such aggregate estimates, I recently completed one stage in a study of the cost borne on exports of only six major agricultural commodities to three of their largest markets and reached the following preliminary conclusions:

1. The conferences' "cartel premium" amounts to some 18% of the total cost of ocean transportation; the annual burden on the small portion of agricultural exports equals $406 million, or 7.7 percent of the value of that trade.

2. Although there is no way of expanding those results to obtain a reliable estimate of total cost to American trade, the inclusion of more commodities or more markets would magnify the estimated dollar impact. The commodities covered in the study amounted to less than one-third of total value of agricultural liner-type exports. Agriculture's share of total exports, (liner and non-liner) is about 10%.

3. Manufacturers who use foreign inputs and American consumers also pay a cartel premium to the conference members, and the value of imports plus exports is some 220% of that of exports alone.

Consequently, the study indicates that the power of the conferences over rates imposes very great costs indeed on the American economy. Finally, because 80% of liner traffic in all the American trades is carried by foreign shipping companies, all but 20% of the billions of dollars in conference premiums go to foreign corporations, including some state-owned carriers.

These estimates indicate that the present policies in toto generate annual costs to the trade of between $5 billion and $15 billion. Additional costs of comparable magnitude are imposed on American consumers and manufacturers who use imported inputs.

In addition there are other, more indirect, costs of present policies. By increasing the costs of ocean shipping, the maritime programs that President Clinton has inherited depress the volume of exports and of imports. They reduce the incentives for productivity in ocean transportation: the direct subsidies simply pay American-flag operators for their inefficiency; the conference system and the Jones Act protect them from competitive pressures.

The Jones Act, combined with the policies that raise the cost of American operators, probably is largely responsible for the fact that there is no trans-canal domestic liner traffic and little American-flag participation in the fast-growing international cruise business.

VI. RATIONALE

As one would expect, such an inefficient policy has major defenders. (The first Law of Policy Economics is: "Every inefficiency is somebody's income.") The basic public justifications for both protectionism and subsidization are jobs and defense.

Jobs

The tail that wags the dog is a minute labor force. Twenty-seven thousand American workers were employed in ocean shipping in 1990. Their present jobs and incomes do depend on present policies. However, present policies also reduce jobs. Most directly, stevedoring and longshoremen's jobs suffer; the policies reduce demand for providing such services to international liner operators, to domestic operators at both ends of the routes and, for any given expenditure on preference cargoes, to Cargo Preference carriers. Indirectly the policies, of course, reduce employment in export industries and in industries that use imported materials and equipment. They also provide some protection for import-competitive jobs. I know of no general study of the employment impacts.

Assuming a cost of $20 billion per year the total cost to the American economy is in the order of $600,000 per seagoing worker per year. Most published estimates of cost per worker cover only some of the programs, typically the direct subsidies. Thus, present policies effectively levy a tax (net of any defense benefits) of about $170 per employed American worker per year to support 27,000 highly paid workers. The average seafarers' wage is many times the minimum wage and also far more than many workers in manufacturing. The annual rate of pay (excluding benefits other than vacation) ranges from $30,000 for unlicensed stewards, who are essentially housekeepers, to more than $230,000 for masters.

Defense

The final fall-back position of defenders of the current maritime programs is that national security requires a US-flag commercial fleet and a ship-building mobilization base. To introduce major policy changes requires diminishing or demolishing much of that claim.

The basic "logic": There are three main stated military purposes, (1) having a commercial fleet that can support the military in times of emergency, (2) having a reserve fleet in being for the same purpose, (3) having a ship-building capability to supply new ships in time of war. All these arguments have been expanded, coincident with the end of the Cold War, to cover real or imagined non-military emergencies involving some sort of isolation of the American economy, severe oil or other supply shocks.

First, support from the commercial fleet: There is no free lunch. If the US-flag fleet is employed in peacetime serving commercially important trades it is not an entirely reliable military reserve. Historically, extended war has meant increased industrial activity and inflationary pressures. Pulling vessels and crews off commercial routes would tend to exacerbate those tendencies. This general proposition was verified in the Gulf

Crisis.

In the case of the conference system about 80% of whatever military gain is achieved by permitting its continuation in American trades accrues not to the United States but to foreigners.

Most important in this context, the Department of Defense has recently declared that it can fight foreseeable wars without support from the U. S.-flag commercial fleet. Additionally, it has said that any needs it might have are too unimportant to justify any expenditure of Defense funds to assure the fleet's existence.

Second, there appears to be near consensus on the utility of a reserve fleet in being, with adequate reserve manpower. It avoids the delusion that commercial vessels can be readily available at little cost. Properly organized such a fleet could be ready for rapid deployment. Since the purpose of such a fleet is to bolster national security, its, size, composition, crewing, as well as its deployment and financing should be DOD responsibilities.

Present policies do not provide such a fleet either effectively or efficiently. The reserve fleet is largely made up of old vessels acquired from US-flag operators, they are not well adapted to military needs. The trade press reported that many (10 out of 70) reserve ships called up in the Gulf Crisis broke down en route and 30% missed their activation date due to required repairs. Manning from under-employed seafarers posed problems that will become progressively more difficult as the already-old seafaring population ages further in the next decades.

Third, justification for a shipyard mobilization base is basically implausible. It is essentially a plan to re-fight World War I or II. The justification requires one to believe that United States shipyards are incorrigibly inefficient. Historically that has been the case for large commercial ships, however recently one new company has contended that it can build ships efficiently, without subsidy.

In addition one must believe all of the following:

a. a future war will be so long, so large in its logistics demands and with such great attrition of the commercial fleet that large injections of additional ships will be needed, and

b. the then-existing reserve fleet will be inadequate to provide those additions (whether that will prove to be true at some future date depends <u>inter alia</u> on whether reserve fleet policy is rationalized), and

c. there will be no possibility of buying or chartering enough existing vessels on the world market and no possibility of having enough new ships built in foreign yards in time to meet logistical needs.

It would appear to be difficult to make a convincing, reasonably objective case that massive attrition is likely to be a critical problem. On the other requirements, since most of the world's fleets and shipbuilding facilities are in friendly hands and all those countries have shown a great willingness to export to the United States, this set of assumptions implies some sort of masochistic refusal to profit by supporting the Nation that has carried the main burden of the defense of the free world for nearly half a century and, presumably, would be playing such a role again.

All six conditions (there are three under "a" and two under "c"), must be fulfilled. The absence of only any one of them obviates the need for an American commercial shipbuilding capability as a mobilization base. Thus, the argument that commercial shipyards should be subsidized is, at best, fragile.

VII. SUMMARY AND CONCLUSIONS

The United State's maritime policy is internally inconsistent, both generating inefficiency and seeking to offset it. The policy has failed to maintain a competitive commercial fleet, a viable shipbuilding industry or an effective military reserve. The policy costs something in the order of $11 to $35 billion per year. Those costs are borne by taxpayers, workers, exporters, importers and consumers.

Attempts have been made to patch up the system. They have failed. It is necessary to avoid fixing one piece of the problem, such as reducing burdens on carriers, as the Bush Administration proposed, without touching other pieces. Such measures would remove any motive for supporting broad policy reform that the one special interest that was helped might have had. Such a move would reduce the potential support for what really needs to be done.

There is a set of integrated policies --described in "Recommendations"-- that promises to solve most of the maritime problems: to reduce budgetary and economic costs, to provide efficiently whatever commercial fleet and reserve fleet are worth their cost, to expand trade and employment, to distribute gains and costs fairly. Since, there is room for all the interested parties to make some gains, there appears to be a significant prospect of success if the gains to each can be made clear, while separate gains to single interests are withheld.

THE PROPOSED COMMISSION ON
MARITIME ISSUES AND EXPORTS

Allen R. Ferguson

In response to the Chairman's question on the proposed commission, I have only a few comments.

1. In the absence of an Executive or Legislative decision to take steps to eliminate the problems that raise the costs of and degrade the efficiency and effectiveness of the United States Merchant Marine, a thorough review of the issues is appropriate.

2. There have been many commissions on maritime policy, going back to early in the Century. More recently, there have been high-level reviews of a broad array of maritime policies and regulations. Late in the Bush Administration, the great majority of participants reportedly favored major reform, eliminating the antitrust exemption for the conference system and reducing protectionism, but the Secretary of Transportation, as Chairman, recommended no action --on the ground that there had been no "consensus" for change. Again, earlier this year, in the Maritime Revitalization Working Group all the agencies except the Department of Transportation and the Federal Maritime Commission reportedly recommended major change but no proposal for action was forthcoming.

3. To avoid continuing inaction in the face of the failure of past policy and present budgetary and economic constraints, any new commission should be markedly different from those of the past.

a. Its mandate should not be merely to devise ways of reviving the United States-flag fleet, or simply examining the conference system or any other single aspect of maritime policy.

b. The mandate should be, rather, to determine whether the existing regulation and subsidization of maritime activities best serve the economic and security interests of the United States. Transportation should be acknowledged as a service to the Economy not as end in itself. The ultimate objective should be to assure maximum contribution by ocean transportation to the growth, competitiveness and fairness of the United States Economy as a whole.

c. The Commission should be constrained to recommend policies that would be no worse than budget-neutral *in toto* and that should produce net economic gains to the public. Individual policies should be evaluated in terms of objective cost-benefit analysis.

d. With the help of the Department of Defense, the commission would ascertain whether there are security benefits from

maintaining a commercial fleet and whether any such benefits are worth their cost.

e. A full range of maritime policy options, such as those presented above in "Reform of Maritime Policy: Building Blocks for an Integrated Program", should be explored.

f. The composition of any commission is critical. It should be appointed by the President. Ideally, it would consist of independent experts in the fields of transportation, macroeconomics, industrial organization and international commerce, supported by inputs from the affected parties and governmental agencies.

If it is necessary to keep the Commission predominantly within the government, several departures from past practice are essential. The Commission should be led by a "neutral" chair, for example, a White House agency, such as the National Economic Council or the Office of Management and Budget. It should include representation from all the agencies substantially affected by maritime policy such as Defense, Treasury, Justice, Agriculture, the Trade Representative, AID and State, as well as those more closely associated with producer interests, such as Transportation and the FMC. Outside experts with no financial ties to the industry or other affected commercial interests should be full members of the commission. Commercial interests should have an opportunity to present their views on each issue and on the whole package, but it is inappropriate that they have more than a small minority representation as members, for example one shipper, one carrier and one labor representative.

3. Finally, the proceedings should be open to the public, and the positions of all members should be included in any final report or pronouncements on commission results.

Mr. CONDIT. Mr. Granatelli.

STATEMENT OF ROBERT GRANATELLI, CHAIRMAN, ALLIANCE FOR COMPETITIVE TRANSPORTATION, WILMINGTON, DE

Mr. GRANATELLI. Mr. Chairman, my name is Bob Granatelli. I am here on behalf of Himont, which is a resin manufacturer and an exporter employing over 1,700 citizens in the United States. I am also speaking as the chairman of the Alliance for Competitive Transportation [ACT].

I have given a list of ACT members to the clerk for submission. In addition, I have given comments on the National Industrial Transportation League for the record. The Alliance for Competitive Transportation represents, for all practical purposes, the economy of the United States. This coalition encompasses all economic sectors, manufacturing, agriculture, chemicals, forest products, automobile, retail, so on and so on, household names such as J. C. Penney, Ford, Corning Glass, Goodyear, Black & Decker, Kodak, so on and so on. In fact, there are over 90,000 U.S. companies that are represented by ACT.

Why? Because these companies, these employers have come together because we can't live with the current ocean regulatory scheme. We need to remain competitive. Mr. Chairman, international trade has been the means by which the economy has kept its head above water in the past few years, but the current ocean transportation system threatens our trade competitiveness by subjecting companies such as mine and the other 90,000 members to ocean shipping restrictions to which none, none of our foreign competitors are subject to.

Our concern is not with the unregulated oil tankers and bulk shipping which handles grain exports, nor are we talking about cargo preference or any government subsidized shipments. We are talking simply about commercial shipments on regularly scheduled containerized vessels. Such containerized shipments constitute the vast majority of our exports and certainly all of our value-added exports which were produced by U.S. labor in U.S. factories and processing plants. If we cannot get our products to market in a competitive fashion, we cannot continue to be competitive.

Today U.S. regulatory intervention and steamship cartels combine to deny the United States an equal chance in the international marketplace. The result is that companies such as mine, which would prefer to manufacture in the United States, are forced by our own Shipping Act of 1984 to ship production and jobs offshore.

The benefits we have heard in the last panel are very familiar. These were the same arguments that were used in a debate of motor carrier and rail deregulation. These are nothing more than a tortured explanation of benefits. We have the most efficient logistics network in the United States today. The carriers, the motor as well as rail industry, are far stronger today than they were under a scheme of strong regulatory intervention.

The situation has become absolutely untenable. The cartel which controls the flow of cargo across the Atlantic is unfortunately only the latest and most grave result of the Shipping Act. It injures both the United States economy and Europe's. Fortunately, the FMC has concluded that as bad as the situation is, there is no violation

of U.S. laws, specifically in regard to the Shipping Act of 1984. Fortunately, the European Community is not so willing to sit back and allow the steamship cartel to cripple its export community, and they are taking action.

I am here to ask you to take action to protect our economy. This issue is about trade. The Shipping Act of 1984 provides complete immunity from our competition laws, the antitrust laws. As a result, the steamship line in international trade have formed cartels, although they like to be called conferences. What we have to think about is do we want the United States to be subject to a handful of people who make decisions in a cartel environment if we should compete or not? That is what we have today. We have in this room a chairman of a very large cartel. Do we want to put the economic destiny of many industries in the hands of a few people? Let alone most of those people are foreign interests.

On top of this, the Shipping Act of 1984 imposes on exporters a scheme of regulation and government intervention that exists nowhere else in the world.

Specifically, if you can believe it, U.S. companies have to disclose to the foreign competitors all our costs of doing business, our costs of transportation. If I were to sign a contract with the steamship line or with the cartel, my rates are published to everyone, including all of our competitors. They know my transportation costs, but I do not know theirs.

I find it also interesting in the previous dialog competition is equated with price wars. Competition is also equated with discrimination, but it was mysteriously silent what is unreasonable. I guess it depends on if the glass is half full or half empty.

If an Italian manufacturer of the same product is shipping his resin to the same customer in, say, Japan, nobody publishes that information, nobody publishes the transportation costs. I have no access to that information, but the Shipping Act of 1984 again makes it for everyone to see.

Another thing I can do, I can ship an order from our Houston plant to a Mexican plant. Our production costs are relatively the same. Though being an American citizen I personally prefer, if I can, to steer that order to our Houston plant. But when I export from Mexico my relationship with the carrier becomes confidential, and there is no FMC that publishes and thus discloses my transportation costs to all my competitors.

The interesting concept is a carrier who serves both Mexico and the United States is unwilling to make us competitive from Houston, but will do so from Mexico because as a member of the cartel he cannot make us competitive. The ocean carriers who form these cartels, benefiting from antitrust immunity and Federal disclosure of transportation costs, are overwhelmingly foreign-flagged and foreign-owned steamship lines.

Across the Atlantic where the transatlantic agreement has created such injury for U.S. exporters and forced the European Community to take action, there is only 1 U.S. steamship line and 12 foreign lines. Meanwhile, here in the United States we are faced with higher ocean rates and carrier indifference.

As was said earlier, there has never been a 6–G action brought to a district court by the FMC. What does an American company have to do to prove cartel practices are unreasonable?

I hope that I have made it clear that this is just not some obscure transportation issue, but a matter which truly impacts the competitiveness of the U.S. economy. This is an international trade issue, nothing else. It has even attracted the attention of Newsweek, whose full page article I ask be included in the record of this hearing.

This issue warrants the involvement of every Member of Congress who has in his district an employer in manufacturing, retailing, farming, forest products, and so on who have to compete with foreign producers and who depend on ocean transportation to get to the international market. The Alliance for Competitive Transportation has drafted legislation which would, one, limit the amount of ocean cargo capacity allowed to be aggregated into cartels, prohibit a conference from interfering with confidential contract negotiations between an individual carrier and the importer/exporter and end the FMC requirement for contract requirements so they truly remain confidential.

I ask members of the committee to consider sponsoring legislation similar to that that was introduced last year by then Congressman Carper which would accomplish these objectives. Thank you for the time.

[The prepared statement of Mr. Granatelli follows:]

TESTIMONY OF ROBERT GRANATELLI, HIMONT

AND

THE ALLIANCE FOR COMPETITIVE TRANSPORTATION

BEFORE

THE COMMITTEE ON GOVERNMENT OPERATIONS

SUBCOMMITTEE ON INFORMATION, JUSTICE & AGRICULTURE

SEPTEMBER 30, 1993

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Submitted by:

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TESTIMONY OF

ROBERT GRANATELLI, HIMONT

AND THE

ALLIANCE FOR COMPETITIVE TRANSPORTATION

before the Committee on Government Operations,

Subcommittee on Government Information, Justice and Agriculture

September 30, 1993

Mr. Chairman, my name is Bob Granatelli. I am here on behalf of Himont, a resins manufacturer and exporter employing over 1,700 American citizens in the United States. I am also speaking as Chairman of the Alliance for Competitive Transportation.

The Alliance for Competitive Transportation represents, for all practical purposes, the economy of the United States of America. This coalition represents virtually all economic sectors: manufacturing, agriculture, chemicals, forest products, automobile manufacturers, retailers, etc. Household names such as JC Penney, Ford, Corning Glass, Goodyear, Black & Decker, Kodak, and on and on. In fact, over 90,000 US companies are represented by ACT. These companies, these employers, have come together because we desperately need substantial changes in our ocean regulatory scheme if we as individual companies and as a nation are to remain competitive in the global marketplace.

Mr. Chairman, international trade has been the means by which the economy has kept its head above water these past few years. But our ocean transportation system threatens our trade competitiveness by subjecting companies, such as mine and the other 90,000 members of ACT, to ocean shipping restrictions, to which **none of our foreign competitors are subject.**

Our concern is not with the unregulated oil tankers and bulk shipping which handles grain exports. Nor are we talking about cargo preference or any government subsidized shipments. We are talking about commercial shipments on regularly scheduled, containerized vessels. Such containerized shipments constitute the vast majority of our exports and certainly all of our value-added exports, which are produced by US labor in US factories and processing plants.

If we cannot get our products to market in a competitive fashion, we cannot continue to be competitive. Today, US regulatory intervention and steamship cartels combine to deny the US an equal chance in the international marketplace.

The result is that companies such as mine, which would prefer to manufacture in the US, are forced by our own Shipping Act of '84 to shift production and jobs off-shore.

The situation has become untenable. The cartel which controls the flow of cargo across the Atlantic is, unfortunately, only the latest and most grave result of the Shipping Act. It injures both the US' economy and Europe's. Fortunately, the Federal Maritime Commission has concluded that as bad as the situation is, there has been no violation of US laws, specifically with regard to the Shipping Act of 1984. Fortunately, the European Community is not willing to sit back and allow the steamship cartel to cripple its export community, and they are taking action. I am here to ask you to take action to protect our economy.

The Shipping Act of 1984 provides complete immunity from our competition laws, the antitrust laws. As a result, steamship lines in our international trade have formed cartels (although they would prefer to be known as "conferences").

On top of this, the Shipping Act of '84 imposes upon US exporters a scheme of regulation and government intervention that exists nowhere else in the world. Specifically, if you can believe it, US companies must disclose to all their foreign competitors our costs of doing business, our costs of transportation. If I were to sign a contract with a steamship line or with a cartel, my rate is published by the US government, and disclosed to all my competitors abroad. They know my transportation costs, but I do not know theirs.

For example, if an Italian manufacturer of the same product is shipping his resin to the same customer in, say, Japan, no government agency publishes his costs of doing business, his costs of transportation. I have no access to that information, but thanks to the Shipping Act of 1984, he has access to my costs. How can I compete in such an environment?

One way I can compete is by shifting the order from our Houston plant to a Mexican plant. Our production costs are the same, though I personally prefer to produce in the Houston plant. But when I export from Mexico, my relationship with the carrier becomes confidential. There is no Federal Maritime Commission that publishes and thus discloses my transportation costs to all my competitors.

The ocean carriers who form these cartels, benefitting from antitrust immunity and Federal disclosure of our transportation costs, are overwhelmingly foreign-flagged and foreign-owned steamship lines. Across the Atlantic where the TransAtlantic Agreement has created such injury for US exporters, and forced the European Community to take action, there is only one US steamship line, and 12 foreign lines. Meanwhile, we here in the US face higher ocean rates and carrier indifference.

I hope that I have made it clear that this is not just some obscure transportation issue, but a matter which impacts the competitiveness of the US economy. This is an international trade issue, nothing less. It has even attracted the attention of Newsweek, whose full-page article I ask be included in the record of this hearing.

This issue warrants the involvement of every member of Congress who has in his District an employer in manufacturing, retailing, farming, forest products, etc., who must compete with foreign producers, and who depends upon ocean transportation to have access to the international marketplace.

The Alliance for Competitive Transportation has drafted legislation which would address the issues I have raised. It would (1) limit the amount of ocean cargo capacity allowed to be aggregated into conferences (cartels), (2) prohibit conferences from interfering with contract negotiations between an individual ocean carrier and the US exporter/importer (3) end Federal Maritime Commission contract filing requirements so that terms of contracts remain confidential, just as they are for ocean contracts everywhere else in the world.

I ask the members of the Committee to consider sponsoring legislation similar to that which was introduced last year by then Congressman Carper, which would accomplish all of these objectives.

Alliance for Competitive Transportation

An Alliance of Over 90 Thousand Exporters and Importers
Supporting Enhancements to U.S. Competitiveness through Substantive Reforms

CHEMICAL MANUFACTURERS ASSOCIATION
AMERICAN FOREST & PAPER ASSOCIATION
NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE
AGRICULTURE OCEAN TRANSPORTATION COALITION
AMERICAN ASSOCIATION OF EXPORTERS AND IMPORTERS
AMERICAN AUTOMOBILE MANUFACTURERS ASSOCIATION
RUBBER MANUFACTURERS ASSOCIATION
OHIO FOREIGN COMMERCE ASSOCIATION
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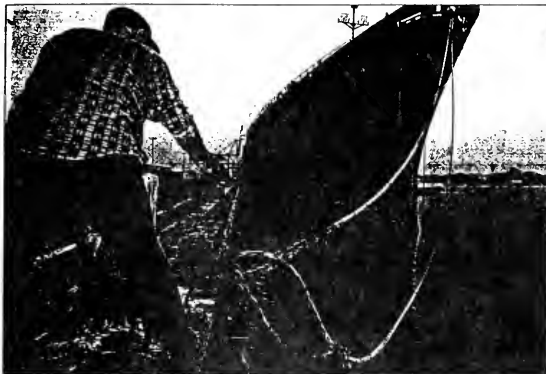

FREDERICK CHARLES

Bolstering the bureaucracies: *Sea-Land's Shining Star docks in New Jersey*

Al Gore's Battle of the Bizarre

Shipping: Reinventing government misses the boat

THE BEST THING ABOUT BEING VICE president, Al Gore told late-night talk-meister David Letterman, is the Secret Service code name "Buttafuoco." Loyal soldier that he is, Gore didn't reveal the worst thing about his position. But the fate of his first attempt to help Bill Clinton reinvent government offers a clue to the toughest part of Gore's job: turning report into reality.

Take his voyage into the treacherous crosswinds of the maritime industry. If there's any part of the federal government that needs to be reinvented, the sprawling apparatus that oversees the shipping industry is it. "The structure of maritime policy was developed in the mid-1930s in preparation for war," notes Washington lawyer Gerald Seifert. There's a Maritime Administration, which hands out subsidies and manages a reserve fleet for wartime; a Federal Maritime Commission to regulate international service; the coast guard, responsible for safety and navigation, and bureaucrats tucked away in places like the Agriculture Department and the Agency for International Development, who make sure that most government cargo sails on U.S.-flag ships. Bolstering these bureaucracies are congressional subcommittees that fix such details as how much food aid should sail from the Great Lakes rather than from the Gulf Coast ports—a matter of considerable interest to folks in Duluth, Minn. And behind the committees is big money. Although fewer than 10,000 Americans work aboard the 348 active U.S.-flag oceangoing vessels, their unions contributed at least $2.3 million to last year's federal election campaigns, cementing the status quo.

Flying the flag is expensive. Giving U.S.-flag vessels the first shot at government cargo costs Uncle Sam roughly $600 million a year. U.S. ships will get up to $87.95 a ton to carry food aid to Russia, while foreign ships haul identical loads for as little as $21.95. Operating subsidies cost U.S. taxpayers $215 million last year—more than $100,000 for every shipboard slot preserved. Those privileges don't come free. To hoist the Stars and Stripes, a shipping line must hire American seamen and build its vessels in high-cost U.S. shipyards. In theory, that preserves maritime jobs. But not in reality. Just check out the cruise lines that sail to Alaska from Vancouver, British Columbia. By making their voyages international, they can use ships and crews of any nationality. That creates no billets for U.S. sailors, and it means less dock work in Seattle. Says Edward Emmett of the National Industrial Transportation League, a shipper group: "Nobody can look at the existing system and say that it's working."

Gore's assault on government waste was expected to tackle this maritime mishmash. Gore named a task force whose members had no ties to the shipping industry, and its draft report in July urged a revolution: no more subsidies; no reserved government cargo; no more antitrust exemption letting cartels set international rates. For good measure, it called for an end to the Jones Act, which allows only U.S.-flag ships to run between U.S. ports. "What is left of the U.S. maritime industry stands as a stark reminder of how protectionist economic regulatory policies by our government literally razed the economic underpinnings of our once mighty and proud merchant marine fleet," the task force warned.

Well-timed leak: But none of those scrub-the-barnacles recommendations made it into the plan for "reinventing government" that Gore and Clinton released on Sept. 7. After a well-timed leak set off protests from unions, shipping lines and Congress, shipping deregulation sank out of sight. In its place, Gore recommended Washington's standard solution to touchy problems: appoint a commission and study the problem. Even that may not float, since the forces that deep-sixed the Gore panel's early draft oppose a new commission—unless it's lodged in the industry-friendly Maritime Administration. Unions object to discussing anything that could eliminate shipboard jobs for their members. Carriers fear that banning cartels would drive down international rates, and they don't want foreigners horning in on domestic routes. "I don't think you need a commission," says Mark Aron of CSX Corp., which owns Sea-Land Service, a major shipping line. "The main issue is, do you want a U.S. flag? If you do, you have to have some subsidies."

ALAN SINGER–CBS

Loyal soldier: *Gore hamming it up with Letterman*

Without subsidies, Sea-Land and its main competitors will soon place some of their ships under foreign flags. In effect, they would run three separate fleets: one with foreign crews—and foreign-built ships—for international trade; a U.S.-flag international fleet to carry government cargo, and a domestic fleet to serve places like Alaska and Puerto Rico. It's an arrangement that borders on the bizarre. Then again, if government policy weren't bizarre, it wouldn't need to be reinvented.

MARC LEVINSON

Mrs. THURMAN [presiding]. Ms. Morley.

STATEMENT OF JIL MORLEY, DIRECTOR OF TRANSPORTATION, BLUE DIAMOND GROWERS, SACRAMENTO, CA

Ms. MORLEY. Good morning, members of the committee. My name is Jil Morley. I am speaking as transportation manager for Blue Diamond Growers. Blue Diamond is a nonprofit, agricultural, marketing and processing cooperative operating in the State of California. We handle approximately one-half of the almonds produced in California, and this product comes from our member owners who are some 4,700 small farmers.

Our member farms average approximately 40 acres each. Blue Diamond has extensive experience in the almond business, having begun operations in 1910. Our cooperative is the primary force in developing almond markets around the world. Blue Diamond has opened virtually every export market for almonds that now exists, and we sell currently to more than 96 countries overseas.

Almonds are currently the largest food export from California and the sixth largest food export from the Nation. During this past fiscal year we shipped more than 220 million pounds of almonds, valued between $400 and $500 million. The majority of this tonnage was exported and is an important component of our farmers' income. It would not be an exaggeration to say that Blue Diamond depends on export sales. Without these sales our farmers would not be able to survive and thousands of almond trees would need to be pulled out of the ground. It is essential that we have available to us efficient and least-cost ocean carriage for these exports.

Blue Diamond is active in all modes of transportation and is a member of the Agriculture Ocean Transportation Coalition, AG/OTC, for which I currently serve as president and also speak this morning. AG/OTC is the national multicommodity agricultural ocean transportation organization. Members include growers, processors, suppliers, vendors to the farm, forest, fiber agricultural industry.

As Bob Granatelli mentioned before, a lot of what we are talking about this morning is really more of a trade issue than a regulatory issue, although the two become intertwined. Agricultural products tend to compete in a world marketplace where many countries can source the same product. This means that margins are thin already, and substitution of foreign agricultural products is a constant threat. The same is true for virtually every other agricultural product the U.S. exports—seed, cotton, forest products, dried fruits and nuts, rice, fresh fruit, et cetera.

The transportation portion of the total cost therefore can be the critical factor in making or breaking an export sale, and that transportation factor needs to reflect a fair market value. Currently ocean carriers are allowed to jointly discuss and fix rates. They can even artificially manipulate vessel space which has the same effect of manipulating rates.

Under this situation, fair market rates cannot be forthcoming. These supposedly competing carriers, their allegiance is actually to each other rather than to their customers, the exporters. It has been hard enough trying to get business transacted with just conferences, but the trend toward so-called super conferences, such as

the transatlantic agreement, TAA, is cause for much further alarm. This super conference reputedly commands 83 percent of all ship capacity off the east coast and off the west coast, which is where I export from. It is closer to 100 percent.

In its first year of operations the TAA arbitrarily decided not to offer service contracts to two or three agricultural commodities, including almonds. At the same time it did offer them to other types of cargo. This was designed to hurt Blue Diamond, and it certainly succeeded.

There was no consultation with exporters, no middle ground. There was virtually no warning. It was announced about 2 weeks prior to the heavy fall-Christmas shipping period so as to have the greatest adverse impact, and there was nothing we could do about it. The transatlantic monopoly raised our rates 30 to 40 percent overnight.

I noticed, Mr. Hathaway, in his earlier presentation talked specifically about rates for dried fruits and nuts, and I have to say those figures were totally unfamiliar to me. I am not sure where that information came from, but I can categorically state, and it is a matter of public record at the FMC that our rates went up 30 to 40 percent in the first year of TAA's operation.

The TAA was able to do this because of their monopoly lock on ship space to Europe. In the second year the transatlantic monopoly raised our rates another 20 to 25 percent; 4,700 Blue Diamond farmers now have to pay 50 to 60 percent higher prices for transportation than only 18 months ago.

The monopoly magnanimously offered a service contract proposal this year which culminated in an 8 percent discount in exchange for commitment of 1000 containers on my part. Net result, our ocean transportation rates are still up 40 to 50 percent over 18 months ago, and still the FMC cannot define unreasonable. But quite apart from the issue of rate increases, the manner in which this arrangement was reached was in the realm of the unreal.

Each stage of the so-called negotiation was arbitrarily dictated by the monopoly. The message of "take it or leave it" was unmistakable. Without bogging down in detail, one incident made this negotiation distinctly memorable. We approached the monopoly and offered to commit more than the 1,000 containers so that we could get a larger discount in return.

These 15 lines in the transatlantic agreement that are already in a closed door meeting to which I, the exporter cannot attend, then held a secret ballot so that each other didn't know how they treated this subject. I had never heard of anything like that before, and it still blows my mind that it can happen in real life today.

For the record, the result of the secret ballot was a refusal to take our extra cargo. They knew they had us as a prisoner and didn't need to offer us anything in the way of an extra discount. If one sorts through all the horror stories of dealing with conferences and goes to the root cause, it is that there is too much vessel capacity available. If this capacity was unregulated and left to float in the free market like any other commodity, the appropriate rates would not, according to the carriers, be compensatory. Thus, we have this government-enforced system where customers of the carriers subsidize this excess capacity.

Why should Blue Diamond farmers be responsible for poor management decisions like buying ever bigger ships? Why should we subsidize inefficient operators while we are fighting for our own individual survival and having to lay off our own employees? This past year Blue Diamond laid off over 100 employees due in part to these ocean rate increases.

Over the years the maritime industry has manufactured very successfully a special status for itself which was always questionable and nowadays is not supportable, as noted in Vice President Gore's national performance review. For example, I am told that there are 700 Department of Transportation employees for each American ocean carrier. Facilitating American exports to secure the economic advantages which accrue and the hundreds of thousands of jobs they create seems unquestionably the right place to focus government support.

This is especially true in light of the current balance of trade. At the very least the Shipping Act of 1984, which allows these foreign-dominated cartels to choke American exports must be amended. We have proposed legislation to accomplish this and ask you to support it.

In conclusion, I thank you each for taking your valuable time to hold this important hearing. There are one or two issues I would like to comment on from previous speakers, particularly as Bob Granatelli mentioned, the frequent reference by Mr. Hathaway to the section 6(g) of the 1984 Shipping Act which says that they have injunctive relief available to them if there was an unreasonable rate increase or unreasonable reduction in service.

They have never defined what is reasonable or unreasonable. Blue Diamond lodged a complaint with the FMC over an ocean charge called terminal handling. Terminal handling is what it costs to get the container from the pier on to the ship. Those costs rose 400 percent in 3 years in one trade lane. FMC still didn't see it as a cause for unreasonableness or any action at all.

The constant reference, as the steamship lines will later on be talking about rates in say 1983 or 1985, whatever the year is, that they are lower than 1993 rates is, as Bob again mentioned, it is erroneous. The deregulation of domestic transportation has made that industry much more efficient, much more productive. The rates are lower today than they were 10, 12 years ago when regulation was done away with.

The 1984 Shipping Act review that got held during 1991 and 1992, the reason the studies came out the way they did, was because there were two shipper members on the panel versus about 11 or 12 Federal maritime and steamship lines, and all the other vested interests. There was no way the shipper opinion could prevail. That is it. Thank you.

[The prepared statement of Ms. Morley follows:]

Before the
Subcommittee on
Information, Justice, Transportation
and Agriculture

Committee on
Government Operations

Hearing on the
Maritime Industry and
its Relation to
Agricultural Exports

Testimony of
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Manager of Transportation
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Date Submitted: September 30, 1993

Before the
Subcommittee on
Information, Justice, Transportation
and Agriculture

Committee on
Government Operations

Hearing on the
Maritime Industry and
its Relation to
Agricultural Exports

Good morning Mr. Chairman and Members of the Committee. It is a pleasure to be with you this morning to discuss the importance of agricultural exports. Mr. Chairman, I especially want to thank you for holding this hearing. It is very much appreciated as is the opportunity to be here with you this morning.

Blue Diamond Growers is a non-profit agricultural marketing and processing cooperative operating in the State of California. We handle approximately one-half of the almonds produced in California. This product comes from our member-owners, some 4,700 small farmers. Our member farms average approximately 40 acres each.

Blue Diamond cooperative has extensive experience in the almond business, having begun operations in 1910. Our cooperative is the primary force in developing almond markets around the world. Blue Diamond Growers has opened virtually every export market for almonds that now exists. We sell to more than 96 countries overseas. Almonds are currently the largest food export from California and the sixth largest food export from the United States.

During this past fiscal year, Blue Diamond has shipped more than 220 million pounds of almonds valued at over $400 million. The majority of this tonnage was exported and is an important component of our farmers' income. It would not be an exaggeration to say that Blue Diamond is dependent on export sales. Without these sales our farmers would not be able to survive and thousands of almond trees would need to be pulled out of the ground. It is essential that we have available to us efficient and least-cost ocean carriage for these exports.

Blue Diamond is active in all modes of transportation and is a member of the Agriculture Ocean Transportation Coalition (AG/OTC) for which I currently serve as president. AG/OTC is the national multi-commodity agriculture ocean transportation organization. Members include growers, processors, suppliers and vendors to the farm, forest, fiber agriculture industry.

Agriculture comprises the largest volume of exports in U.S. foreign commerce. As we know, exports have been largely responsible for keeping the U.S. domestic economy "above water" during these past few years. As both President Bush and President Clinton have publicly stated, export markets for U.S. products provide the greatest opportunity for future U.S. economic growth.

Agricultural products tend to compete in a world marketplace where many countries can source the same product. This means that margins are thin already, while substitution of foreign agricultural products is a constant threat. The same is true for virtually every other agricultural product the U.S. exports: seed, cotton, forest products, dried fruits and nuts, rice, fresh fruit, etc.

The transportation portion of the total cost therefore can be the critical factor in making or breaking an export sale and needs to reflect a fair market value. Ocean carriers are allowed to jointly discuss and fix rates. They even artificially manipulate vessel space. Fair market rates cannot be forthcoming under these conditions. These supposedly competing carriers' allegiance is actually to each other rather than to their customers, the exporters.

It has been hard enough trying to get business transacted with just conferences, but the trend toward so-called super-conferences, such as the Trans-Atlantic Agreement (TAA), is cause for further alarm. This super-conference reputedly commands 83 percent of all ship capacity off the east coast to Europe and closer to 100 percent off the west coast. In their first year of operation, the Trans-Atlantic super-conference arbitrarily decided not to offer service contracts to two or three agricultural commodities including almonds. At the same time, it offered them to other types of cargo. This was designed to hurt Blue Diamond and it did.

There was no consultation with exporters. There was no middle ground. There was virtually no warning. It was announced about two weeks prior to the heavy fall/Christmas shipping period so as to have the greatest adverse impact and there was nothing we could do about it. The Trans-Atlantic monopoly raised our rate 30-40 percent overnight. They were able to do this because of their monopoly lock on ship space to Europe.

In the second year, the Trans-Atlantic monopoly raised our rates another 20-25 percent. 4,700 Blue Diamond farmers must now pay 50-60 percent higher prices for transportation than 18 months ago. The monopoly magnanimously offered a service contract proposal this year which culminated in an eight percent discount in exchange for a commitment of 1,000 containers on Blue Diamond's part. Net result: our ocean transportation rates are still up 40-50 percent over 18 months ago. But, quite apart from the issue of rate increases, the manner in which this arrangement was reached was in the realm of the "unreal". Each stage of the so-called negotiation was arbitrarily dictated by the monopoly. the message of "take it or leave it" was unmistakable. Without bogging down in detail, one incident made this negotiation distinctly memorable. When we approached the monopoly and offered to commit more than 1,000 containers in return for a larger discount, the 15 lines acting in concert decided their response in a secret ballot. I think this says a lot for how artificial the conference system is and how it interferes and meddles in Blue Diamond's export business. For the record, the result of the secret ballot was a refusal to deal fairly since we were their prisoner in any event.

If one sorts through all the horror stories of dealings with conferences and goes to the root cause, it is that there is too much vessel capacity available. If this capacity was unregulated and left to "float" in the free market like any other commodity, the appropriate rates would not, according to the carriers, be compensatory.. Thus, we have this government enforced system where customers of the carriers subsidize this excess capacity. Why should Blue Diamond farmers be responsible for poor management decisions like buying ever larger ships? Why should we subsidize inefficient operators while we are fighting for our own survival and having to lay off our own employees? This past year Blue Diamond has laid off over 100 employees due in part to these ocean rate increases.

Over the years, the maritime industry has manufactured a "special" status for itself which was always questionable and nowadays is not supportable as noted in Vice President Gore's National Performance Review. I am told that there are 700 Department of Transportation employees for each U.S. ocean carrier.

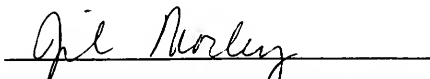
Facilitating American exports to secure the advantages which accrue and the hundreds of thousands of jobs they create seems unquestionably the right place to focus government support. This is especially true in light of the current balance of trade. At the very least, the Shipping Act of 1984, which allows these foreign-dominated cartels to choke American exports, must be amended. We have proposed legislation to accomplish this, and ask you to introduce it.

If it is appropriate Mr. Chairman, I would like to encourage this Committee to be particularly attentive to the Marketing Promotion Program. As you know, this program has helped numerous agricultural exporters, including Blue Diamond, export their products to foreign markets. Enough good things cannot be said about this program. The ocean transportation industry should be a major supporter of this program. It is this program that has led to increased agricultural exports. This increases the requirement for ocean transportation.

Mr. Chairman, at present, there is an effort to take this program out of the Department of Agriculture, as well as its funding, and transfer it to an interagency group under the Department of Commerce. Secretary Brown has indicated on several occasions that he could better use the funds allocated to agricultural exports for his Department. If this were to happen and agricultural exports fell, then the demand for ocean transportation would also fall. It is programs like this that serve both the farmer and the ocean transportation community that should be expanded and supported. This action together with competitive ocean transportation rates would greatly enhance U.S. agricultural competitiveness and increase jobs in the United States.

Mr. Chairman and Members of the Committee, your attention to my testimony is very much appreciated. I would be particularly pleased to respond to any questions that you might have. Again, I thank each of you for taking your valuable time to hold this important hearing.

Respectfully submitted,



Jil Morley, Manager, Transportation
Blue Diamond Growers

September 30, 1993

Mr. CONDIT [presiding]. I apologize for the interruptions. We had a vote going on and we were trying to be considerate of your time and move things along, so we thank you and the audience for bearing with us. Since I just arrived, I will defer to Mr. Horn and let him start a round of questions.

Mr. HORN. Well, I, too am sorry I had to leave for the vote, but I heard some of Ms. Morley's testimony. Your testimony is obviously devastating, and since you and I are from California, it reminds me of how farmers were treated at the turn of the century with the Southern Pacific Railroad monopoly, and my hero, Governor Hiram Johnson waged his campaign on one issue, to kick the Southern Pacific out of California politics, and he succeeded, but apparently nationally we haven't done the same thing. And as was true in those days, the Interstate Commerce Commission wasn't doing anything. They were sort of captives of the railroad interest, and from what your testimony is saying, the Maritime Commission seems to be captive of the maritime shipping interests, and nobody is looking out for either the consumer or the shipper.

Now, given the excess capacity of vessels all over the world, is there any way Blue Diamond and other groups like you can ally to hire some of that capacity that is outside of that conference?

Ms. MORLEY. Outside of conference?

Mr. HORN. Outside of the transatlantic conference? Is there any way you can just charter a vessel to do what you want it to do or are you stuck with the choice of only the conference?

Ms. MORLEY. I guess there are several aspects to answer that, but the overriding one is that we are in the business of processing and marketing almonds. That is what we are good at.

To get into entering into the realm of chartering ships is—we would have to hire more people to be able to do that, to understand intricacies of doing that.

Mr. HORN. I would think given the excess capacity that a creative ship operator would be looking for shippers such as you and say we will solve your problem, we will beat them at their own game.

Ms. MORLEY. They don't have to. This excess capacity is under the control of the conferences and conferences can increase the rates for the cargo that is moving to cover those empty slots.

Mr. HORN. Is it required that every ship that crosses the Atlantic be in that conference?

Ms. MORLEY. It is almost 100 percent off of the west coast where I ship, yes.

Mr. HORN. I know it can be 100 percent, but you would think there would be some enterprising entrepreneur that would want to make a buck.

Ms. MORLEY. There is one that I made a service contract with this year that goes from the west coast to north Europe. However, they are what is called a con bulk carrier. Half the ship is devoted to lumber products, then they put some regular products on top. They can't handle all of the agriculture that comes out of northern California. They sail every 2 weeks. There are two ships a month. There is only so much they can carry.

Mr. HORN. Do you see any alternative other than saying the Maritime Commission ought to enforce what the law says, or you don't feel they are enforcing the law?

Ms. MORLEY. I have kind of given up on the FMC. Why groups like the Alliance for Competitive Transportation and AG/OTC have come together is for the kind of legislation we would like to see. We believe the law has to be changed, and the kind of legislation we would like to see would be to reduce, not eliminate, but reduce the amount of antitrust immunity conferences have. To be able to do things like contract one on one with the carrier of our choice instead of having to deal with 15 lines that all have totally different costs and different interests and politics, and it is almost impossible to weave your way through them to a deal, and those self same contracts, once they are negotiated become confidential and not a matter of public record.

My primary competitor, for example, is Spain, the country of Spain. They have almond producers. If both Spain and California are competing for a piece of the business to Germany, the Spanish guy's transportation costs is not a matter of public record, but mine is. We want those kinds of issues in a level playing field.

Mr. CONDIT. May I just interject? Our understanding that the act allows anyone in the conference to make an independent arrangement. From your testimony, obviously that is not being done. It is not illegal. It allows them to do that. Why isn't that happening?

Ms. MORLEY. You would have to ask the ocean carriers themselves for the real answer to that. The member carriers that I do business with in, for example, the Atlantic conference have said off the record, every single one of them, that there is a silent agreement amongst them not to take independent action, and I would imagine that since rate deals are a matter of public record that an examination of the FMC's own files would show a tremendous drop, in fact, in the case of my commodity, to zero of any independent actions this last 12 months versus prior years. I mean, it can be scientifically shown that this has been——

Mr. CONDIT. That there is a decline?

Ms. MORLEY. Yes.

Mr. FERGUSON. Mr. Chairman, I might be able to make a comment that would be helpful on that. In 1982 or 1983, I testified on the proposal for requiring independent action, and pointed out then that the way the law was written, independent action wasn't really independent action, and indeed I think in retrospect there is a substantial amount of truth in that.

Any carrier that proposes independent action in practice puts the proposal before the rest of the conference. Since conferences typically operate on a unanimity rule, that exposes each innovator to potential future retaliation by all the members of the conference. One would think that independent action meant that ship line ABC could file a tariff with the FMC without hindrance. That appears not to be the case. It does typically, I understand, go through a conference procedure.

Mr. CONDIT. Mr. Horn, were you——

Mr. HORN. That is quite all right.

Mr. CONDIT. Do you want to finish?

Mr. HORN. Go ahead.

Mr. CONDIT. Well, OK. Dr. Ferguson, the ocean carriers maintain that the rates on agricultural commodities have risen little over the past 10 years. Do you agree with that assessment?

Mr. FERGUSON. Well, first of all, let me say that I have not studied it. I am familiar with general arguments about what has happened on rates. Rates are usually measured in nominal terms. The rates that would be interesting are what economists call real rates. The rate increases or decreases should be measured against the cost of the carriers. I was involved in litigation some years ago where the defendant carriers made the argument that their rates had, in fact, declined when they were adjusted for the consumer price index.

The consumer price index has nothing whatsoever to do with the cost of operating steamship companies. When I developed an index of the cost of those companies, it turned out that their rates had gone up very substantially over the period. I have not done that kind of study in this case, in this area, but I don't believe anyone has.

Mr. CONDIT. Mr. Granatelli and Ms. Morley, do you concur with Dr. Ferguson's recommendations that he read earlier in his testimony? Have you had an opportunity to look at them?

Mr. GRANATELLI. Yes, very much so, yes.

Ms. MORLEY. Yes.

Mr. CONDIT. I don't know, but just from what we have looked at your testimony and your comments, if you do those kinds of things, it almost makes the Federal Maritime Commission irrelevant. Is that your view and if so, what do you do then? Can you roll the functions of them into another department, the Department of Transportation, something like that?

Mr. FERGUSON. Well, that is what happened with the CAB, as you are well aware, and the residual functions of the CAB. Basically I am suggesting that most of the things that the FMC and MARAD do be discontinued. The residual functions of FMC, I think obviously would tend to be rolled into the Department of Transportation, but some should be rolled into the Department of Justice. If you are talking about reasonable rates, that ought to be in the hands of the experts on price reasonableness.

Mr. CONDIT. In doing that, and I am sure we will get some response later, but in doing that, what is the cost savings? Have you calculated that?

Mr. FERGUSON. I have not looked at the cost, the reduction in salaries or anything of that sort. Whereas those tend to get a lot of attention—they have got attention in the Hoover Commission report, the Grace Commission report and so on—the real savings are in correcting the policy errors, not in administering inefficient policies in an efficient fashion. The savings from sound policies are these enormous numbers, up to tens of billions of dollars annually.

Mr. CONDIT. Mr. Granatelli, testimony that we have received from the ocean carriers suggests that a reduction in transportation costs would not reduce the price your organization members charge. In other words, they say landed costs would remain the same. Only the profit margin would get larger. Do you agree with this? Do you have any come back to that?

Mr. GRANATELLI. I am glad they are concerned about our profit. No, I don't agree with that.

Mr. CONDIT. Why?

Mr. GRANATELLI. What we want to do is purchase transportation that the price is set by a market and not by a cartel. In plastic resin the United States is competing against worldwide producers. Our buyer is purchasing based on a landed price.

Today in many trades the ocean freight is more than 20 percent of the landed price of the commodity, so ocean transportation can put us into a country or take us out of a country. I am also familiar as my past employment was with a forest products company. On lumber where rail rates, depending on the producing region, can get you into a territory or not. If the ocean carriers simply think that if we are able to buy transportation or market-based rate and that we can put it in our pocket, that is simply dreaming. What we need to do is get a market-based rate to get our product into the market on a competitive basis against the worldwide competitors.

The other interesting thing is if you want a good example of cartel and its inefficient process, we have a large movement from Houston to Venezuela, and there is a very strong cartel in the South American trades, and we pay $100 a metric ton to move resin from Houston to Venezuela. Yet the same ship that leaves Houston and stops in Mexico and goes on to Venezuela where there is no cartel environment between Mexico and Venezuela, the same commodity on the same ship on the same line is now $60 a metric ton. In this case we paid a $40 metric ton for the benefits of these cartels who are concerned about our profits.

Mr. CONDIT. OK. Ms. Morley, you stated that the transatlantic super conference arbitrarily decided not to offer service contracts to two or three commodities, including almonds. Could you elaborate on this and speculate what the motives might have been.

Ms. MORLEY. Here again, we would have to ask the carriers or the cartel themselves for what their reasons were. They never clearly answered to me why they decided to do this. The timing on this was that the harvest comes in in August, September. Traditionally that is about the time that ocean freight rates for the new crop get negotiated.

The TAA at that time was trying to form itself, trying to get approval from the FMC. In fact, since they had to negotiate agricultural commodities at the same time, they behaved like they already had approval from the FMC. Carriers that should not even have been talking to each other yet until they had FMC approval were speaking back and forth, former independents to former conference members, and I can only—I have no idea why they singled out agricultural commodities.

Mr. CONDIT. Have you ever filed a protest with the FMC regarding discrimination or any other type of complaint?

Ms. MORLEY. Yes. On that particular issue, we were in contact with the former Chairman, Chris Koch, at that time.

Mr. CONDIT. What was the process and did it resolve itself satisfactorily?

Ms. MORLEY. It was informal because it was something that needed to be dealt with right away. The formal process takes years.

Another complaint, which I alluded to before, was that we filed a complaint with the FMC regarding surcharges. This is a rather esoteric part of how freight rates get constructed, but they are highly questionable and we petitioned the FMC for a rulemaking. It took about a year and it resulted in no new rulemaking. It was most disappointing.

Mr. CONDIT. Should it have taken a year to resolve this?

Ms. MORLEY. No. In that same year, we spent, I would say, well over a million bucks.

Mr. CONDIT. Just on the process itself or——

Ms. MORLEY. No, not on the process, on the surcharges. You know, that is why we needed urgency on this matter.

Mr. CONDIT. OK.

Mrs. Thurman, would you like to pick up there?

Mrs. THURMAN. Did you want to answer for——

Mr. CONDIT. I am sorry. You want to respond to that, too?

Mr. GRANATELLI. I am not sure of the etiquette, but I would like to make a comment.

We are a small shipper and I had a situation with an ocean carrier that I thought was just unreasonably—just unreasonable, from a commercial basis, but they hid behind a very obscure tariff item. Out of frustration, I wrote a letter to one of the commissioners of FMC, who seemed to be shipper-oriented, who called me up and just couldn't believe this was happening.

And by the way, as a penalty for this carrier to extract my obedience with the tariff item, they do a little clever thing. They hold onto your bills of lading. When they hold onto your billings of lading, you can't take them to the bank and collect on your commercial transaction. So I can't imagine doing business with a person who holds up a commercial transaction because you don't obey.

So I had one of the legal types from FMC to call me and said, gees, we will get into this. Frankly, I don't want them to get into it because a commercial relationship should be the way to solve it.

Of course, to this day, it never has been resolved and I am not going to take the paths nor the time to hire outside experts who are experts in this Byzantine world. Needless to say, we simply can't do business with this carrier because they still hide behind a very obscure tariff item in our commercial relationship.

So I guess what we would like, is to get the third party out of the way between us and our transportation suppliers. They don't provide any add.

Mr. CONDIT. Mrs. Thurman.

Mrs. THURMAN. Mr. Granatelli, during your testimony, you talked about the rates and the problem that—because we have to publicize them. Can those be addressed through the GATT agreements? Can we do anything——

Mr. GRANATELLI. I am just a mere transportation person. I, frankly, have not kept up with GATT. I don't even know how to answer the question.

Ms. MORLEY. From what I have read in the press, U.S. maritime interests are being led to the GATT table kicking and screaming. They don't want maritime issues under GATT, although I think eventually it will be, but it is going to be many, many years.

Mr. HORN. Mr. Chairman, may I——

Mr. CONDIT. Sure.

Mrs. THURMAN. Let me just ask, since I asked the last panel about the Vice President's reinventing government, assuming that takes place and Congress does something with that, how would— and I am going to ask it to all three of you, how would you structure it and who do you think should participate?

Mr. FERGUSON. Everyone else seems to be reticent. I seldom am. I think that the Commission, in the first place, is a good idea. It is perfectly true that there have been lots of commissions. It is also true that nothing has happened.

The Bush Commission, the ACCOS, did not make any recommendation on the grounds that there was, "no consensus." In fact, the trade press indicates that there was near consensus, because two agencies opposed change and all the rest of the departments and agencies favored change. The minority was the Department of Transportation and the Federal Maritime Commission.

Similarly, earlier in this year, there was no agreement reached, but most, again, all but the same two of the participants favored substantial change. So to avoid continuing inaction, any commission that might be set up should be very different from the ones that have been set up so far.

Its mandate should not be anything like revitalizing the maritime industry. Its mandate should be to look at maritime policy to see whether the full array of maritime programs can be improved so as to increase the competitiveness and the efficiency and the equity of the American economy. Transportation should be recognized as a service, not as an end in itself, and that should be spelled out in the mandate for the Commission.

I see no reason why the Commission could not be urged, if not required, to come up with a budget-neutral or better set of recommendations, and with the help of the Department of Defense, it should look at any security benefits, make some calculation as to whether they would be worth what they cost, and in particular, how much maritime capability the Defense Department would be willing to fund.

The full range of policy options should be examined. Perhaps a set such as those in my "Reform of Maritime Policy." Obviously, there are other such sets, but what is important is that the focus on one particular issue or handful of issues.

The commission, in my judgment, should be appointed by the President. It should be broadly representational, should not be in the hands of or dominated by the special interests of either side or by the government agencies who, Mr. Chairman, face the possibility of losing their jobs if some of the recommendations are put into effect.

The commission should have representation from the major Departments, Agriculture, Justice, Defense and so on. It should, in my judgment, have powerful participants who are experts in macroeconomics and industrial organization and trade. One can imagine one of the noble laureates in economics participating in that, for example.

And finally, its proceedings should be open to the public and any final report or announcements should include comments on the position of all of the parties and should not be anything like a simple

statement that "no changes are recommended because we could not achieve consensus." That is a long-winded answer to your question, and I apologize for that.

Mr. CONDIT. That is fine.

Karen.

Mr. GRANATELLI. Well, there is no sense in repeating what the gentleman has already said.

Mrs. THURMAN. So you agree with him?

Mr. GRANATELLI. I agree with him. But the most amazing thing is we have studied this to death, but I guess my question as a taxpayer and also as a transportation person is, how many times do we have to study an issue that the rest of the world already knows the answer? We are the only country in the world that has this scheme.

Now, do we know something special that the rest of the world hasn't learned? So if we have to do it one more time, let's do it one more time. Let's do it right, like he suggests. But, let's also keep in mind that we have a situation here that the rest of our trading partners don't simply have.

Ms. MORLEY. I endorse Mr. Granatelli and Dr. Ferguson's comments. I guess I am also disappointed that the National Performance Review report has come out in conclusion of yet another commission of something that has been studied to death. I would have preferred to have seen the original recommendations that were in Vice President Gore's National Performance Review as it pertains to maritime, not—not addressing cargo preference or the Jones Act, or any of the U.S. flag carrier subsidies, but as it relates to cartel conferences.

I would have just liked to have seen action right away rather than yet another commission which may result in nothing, and nothing happening.

Mr. FERGUSON. May I amend what I said, to say that my comment was based on the premise that the Gore Commission report, as reported in the trade press, was a dead issue. I would certainly agree that it would be much better just to go directly to the recommendations that were reported in the press as the draft of the NPR report.

Mrs. THURMAN. Mr. Granatelli, you made a very profound statement and I just need to ask this question. What is everybody else doing that we are not doing? I don't know the answer.

Mr. GRANATELLI. When you really cut through the smoke; when you get down to the fine point, because you are going to hear—you are going to hear, I am sure later on, that there are cartels in the world and other countries have tariffs or similar requirements. And in fact, Canada, who I am responsible for, the international transportation out of Canada also has a tariff filing scheme, but what is missing is they don't have a filed rate doctrine, so at the end of the day, they can, even when they publish a rate, they can adjust that rate to meet your market competition.

So we truly are unique worldwide. There is absolutely—at the end of the day, there is a scheme here that is completely different, and the scheme requires absolute rigidity and tariff filing requirements, public knowledge. If a carrier wants to make a commercial adjustment, it has to be done with either two vehicles: Within the

tariff independent action, or through a service contract. In all these cases, at the end of the day, it is public knowledge. That is not the case with our trading partners.

Mrs. THURMAN. Just that one single issue?

Mr. GRANATELLI. That essentially would drive us to a market-based system of transportation procurement. We are not asking for lower rates. We are not asking for special deals. God forbid that competition is called "price wars."

I mean, I find that amazing; and it is discriminatory, all these evil things that is everyday business for all of us.

So don't get caught up in the smoke. If we are going to study it again, let's study it again. But you know what is happening? Our export volumes are declining while going through these exercises one more time.

Mrs. THURMAN. OK.

Mr. CONDIT. Mr. Horn.

Mr. HORN. Yes, let me ask a question of all of you, somewhat like Mr. Granatelli's last comment.

Although there could be exceptions based on the value or type of good, generally U.S. trade deficit means that more merchandise goods are entering the United States than are leaving it. Since much of our trade imbalance results from our trade overseas, as opposed to Mexico where we have a $5 billion trade surplus, there are obviously a number of ships leaving the United States that are not full. Has this affected rates?

How much of the decrease in rates is a result of trade imbalances? Is there anything where that pressure has caused a change in rates that any of you can see? Because they are obviously leaving with less goods than they brought.

Mr. GRANATELLI. Actually, on the Pacific trades, which is one of the strongest trades, the ships are fuller westbound than they are eastbound. In fact, it is kind of a game they play, when you look at the major export commodities being plastic resin, waste paper, forest products, they are all very heavy.

Mr. HORN. Are they bulk?

Mr. GRANATELLI. No. They go in a container. Obviously an inbound container of stereo receivers doesn't weigh 45,000 pounds. So what happens is westbound, the ship is, frankly, overcapacity from a tonnage standpoint. So the spaces are filled up.

Mr. HORN. How about eastbound, when you are on the east coast?

Mr. GRANATELLI. On the east coast?

Mr. HORN. On the east coast, what is the situation there? Anybody know the situation on the east coast?

Ms. MORLEY. At the moment, westbound from Europe the ships are more full than going out eastbound.

Mr. HORN. So it is the reverse on our east coast despite the nature of the product and value?

Ms. MORLEY. It has been the relationship of the dollar to European currency really at the moment.

Mr. GRANATELLI. Yes, that drives a good part of the equation.

Mr. HORN. Well, let me just say to Dr. Ferguson, since I picked on the methodology with the Department of Agriculture first, I want to say, I have read your testimony. It is among the most lit-

erate and helpful I have seen as a Member of Congress, so I thank you for the testimony, whether we can argue about the random sample or not.

Mr. FERGUSON. Thank you very much. No, we will not argue. It was not a random sample. I think it was a useful sample.

Mr. CONDIT. It would be interesting to listen to you two go at it for awhile. We have some additional questions, but we know you have been up here over an hour and we would like your permission to submit those to you in writing and have you respond to those.

Without objection, we are going to leave the record open for 10 days, if you have additional—or any witness has additional information they would like to submit, we will leave the record open for 10 days. So we appreciate your testimony. It was good testimony and we will be back to you with questions.

Thank you.

[The information may be found in the appendix.]

Mr. CONDIT. We will take panel 3; Francis O'Donnell, Elliot Schrier, Ronald Gottshall, and Joel Greenberg.

Would you please remain standing or stand so that we can swear you in.

[Witnesses sworn.]

Mr. CONDIT. Thank you very much. Have we got everyone up here?

Mr. Schrier, over to the right; Mr. O'Donnell.

We are going to start with Mr. Gottshall; is that correct?

Mr. GOTTSHALL. That is correct, thank you.

Mr. CONDIT. And you can introduce who you represent and as we go along, each one of you tell about yourself.

STATEMENT OF RONALD GOTTSHALL, MANAGING DIRECTOR, TRANSPACIFIC WESTBOUND RATE AGREEMENT, SAN FRANCISCO, CA

Mr. GOTTSHALL. Good morning, Mr. Chairman, members of the subcommittee. My name is Ron Gottshall. I am the managing director of the Transpacific Westbound Rate Agreement, which is an organization of nine common carriers in the Pacific trade, and that is where my expertise is, is in the Pacific.

I know something of the Atlantic in general terms, but I am not an Atlantic witness.

The TWRA covers the trade from the United States to Asia. It has been in existence since 1985 when it replaced seven other conferences that were previously in the trade. It reflected the new way that shipping is done and that point—to move in our trade nowadays, you can start out in Syracuse, NY, and be in Bangkok, without regard to what the ship deployment is.

But I would like to concentrate on some slides that are up here, and they are facing the committee so that you can get a better idea.

[Slides shown.]

Mr. GOTTSHALL. This is a representation of the agricultural exports to the Pacific rim.

Now, I say agricultural exports because when we do the census, for some reason they don't put lumber in with USDA, so these are exclusive of lumber.

The big purple area there is the portion which is handled by liners or tramps—I mean by tramps or nonliner vessels; the grain, the soybean, whatever it happens to be that is in the agricultural sector that is not covered.

The small portion there, the green portion is the liner segment of the trade. And I might say on either side there are some very minor things, a little bit of air and so on, and that is what I am going to concentrate on.

Now, in the Pacific trade, you will notice that it is divided into two areas there. The orange area represents the nonconference participation in that liner segment of the market and the yellow portion represents the conference. It is, roughly, a 47–53 split.

The next slide.

Now, the next slide is a much broader base. It is the total liner market. This is all commodities, plus the agricultural commodities, and this particular slide shows two things: No. 1, it shows the market starting in 1979 and what it is today up in the orange section up there; it shows an increase from 1985 forward of approximately 7.2 percent a year annualized.

The second story it tells is the TWRA participation in that market, which started out relatively high but has continued to decline as more nonconference carriers have come into the trade. Today it is approximately a 50/50 split, and it may be a little less than 50 actually. So certainly we haven't had the kind of market domination.

The next slide is what has happened to agricultural products in that marketplace. And the top line up there shows the direction of agricultural exports through—from 1985 through 1992, which out performed the general market. It was 8.7 percent.

Also the value down there shows that the value has gone up. Generally speaking, it had a little loop. I can't explain that, but it appears to have recovered.

All of these trade statistics, whether it is the general or the agricultural market, are directly attributable to the decision in 1985 to change the exchange rate ratio of the dollar and the yen. The bright side is it stimulated exports. The dark side is it increased our costs in some of the major markets.

The next chart here is a chart in which we have used census and current freight rates to show what the relationship is with the various commodities in the market. The first one there is almonds, which we have heard a lot about. Freight represents 3 percent of the landed cost.

Now, landed cost is cost of freight at the port of export plus freight. It is hard to believe that 3 percent which—of the commodity which well exceeds the norm, since on most agricultural commodities it can be expected to be 10 to 20 percent, has somehow put a large number of people out of business. I really find that difficult.

Mr. HORN. I don't understand the criterion. You say 3 percent of the cost?

Mr. GOTTSHALL. Three percent of the landed cost, which is the cost at the port of export, plus the freight, divided by the freight, is the cost of freight.

Now, that is all right down there at the bottom, I think, as a per ton on the chart.

Mr. HORN. I am not familiar with the terminology. What do you mean the cost at the "port of export"? What cost?

Mr. GOTTSHALL. The value of the product.

Mr. HORN. The value of the product coming from the plant. Is this the wholesale cost or the retail cost?

Mr. GOTTSHALL. No. This is what is declared to Customs and ultimately put in the census, divided by the number of tons. I think it is down there reflected at the bottom.

Mr. HORN. Well, on what basis is that cost figure given customs?

Mr. GOTTSHALL. U.S. dollars at the port of export.

Mr. HORN. Does it have any reality to cost production, cost of sale? I mean, where does that cost line up?

Mr. GOTTSHALL. I would have to believe that it does, because you are supposed to report to Customs what the value of the product is you are exporting. That is our whole balance of trade statistics are based on these numbers.

Mr. HORN. It is one value, if you sell to a wholesaler? It is another value, if you sell directly to a retailer?

Mr. GOTTSHALL. This is what is declared, and that is all I can say.

Mr. HORN. All I can say is it is a nonfigure, as far as I am concerned, unless there is some specific criteria that the government has, in which case, Mr. Chairman, I would like questions to be asked of Customs as to what cost figure they use and expect and enforce.

Mr. CONDIT. We can insert the question—in the record to Customs, having them define why they do it this way, and I am sure there is a reasonable explanation for that.

Mr. GOTTSHALL. This is straight off the customs manifest, so I can't—presumably, since there is only two major exporters of almonds, I would have to believe it was one of them.

The other one there is—there is one there on beef, which moves in refrigerated containers. Once again, freight as a percentage of the landed value is relatively low.

Down at the bottom I believe it is about 5 percent, and then there are oranges.

Now, let me say one thing as we talk about this. In both cases, the oranges and the beef move in reefers. A reefer is bought specifically and acquired by the carriers only for export of agricultural commodities. That is the whole reason why they buy them.

So—and it is a very expensive piece of equipment, so the freight reflects that. And, unfortunately, the beef is very expensive. And on the other hand, the oranges are relatively cheap, but the value of transportation that is added to it creates a very salable item.

Oranges are actually the largest fruit export off the west coast.

Finally, there is one other over there, hay. We must be doing something right, in 1972, 14 percent of the all the liner exports to Japan, which is over half—35 percent of the total market, over half of those, 14 percent of those were hay shipments.

So I think, in summary, there is a pretty good indication that freight is not a major factor on many commodities, and certainly the marketplace proves it.

We have had a couple of cases where we have had capacity problems, and that question has been brought up.

Capacity is a two-way street, literally. What vessels acquire for an eastbound trade may, in fact, be light on capacity, or may, in fact, have excess capacity in the westbound trade.

On the other hand, 2 years ago, you couldn't find space on our ships in the export trade. So it is all—it is something that has to be a little flexible in the marketplace.

I had a couple of other points I wanted to bring up in response to some questions. I think the chairman asked about the crow's nest pass rates. Those are rates established by the Canadian railroad for fostering Canadian exports on vessels exiting Canadian ports, and it is basically comes from the prairie provinces, they get a reduced rate. We have had some hay shippers who claim they have been injured, but I find that they are gradually phasing out the hay crow's nest pass rates.

The other point was brought up by several people in IA. In the TWRA, we have had years where we have taken the equivalent of 180,000 independent actions, and contrary to what Professor Ferguson said, or Dr. Ferguson, there is no formal requirement to bring those before the conference, anyone can file them on 10 days notice and anybody can join in. And I certainly—we publish 100,000 tariff pages every year. We at any given time have 20,000 pages on file with the Federal Maritime Commission and there is certainly no impediment.

Furthermore, most commodities, if it is presented to the conference, it requires only a majority vote to pass. Some commodities, it is three-quarters, but the line is still free to take independent action, and in many cases, and not reflected in the statistics, is the fact that knowledge that a carrier will take independent action causes the freight rate to be reduced, in any event.

So that is the conclusion of mine. If there is any questions later on, please do so.

Mr. CONDIT. We will get back to you.

[The prepared statement of Mr. Gottshall follows:]

BEFORE THE SUBCOMMITTEE ON INFORMATION, JUSTICE AND AGRICULTURE
COMMITTEE ON GOVERNMENT OPERATIONS
UNITED STATES HOUSE OF REPRESENTATIVES

Statement of Ronald B. Gottshall
Managing Director, Transpacific Westbound Rate Agreement
September 30, 1993

My name is Ronald B. Gottshall. I am Managing Director of Transpacific Westbound Rate Agreement ("TWRA"). Before joining TWRA I directed Sea-Land Service's transpacific pricing for 11 years, during times when Sea-Land was a conference and at times when it was a non-conference carrier in Pacific trades. I have 39 years of experience in the international and domestic surface transport industry.

1. SUMMARY OF TESTIMONY AND DATA.

The United States trade to Asia constitutes over 60 percent of U.S. exports moving on liner vessels. TWRA is an ocean rate conference in that trade. TWRA has 9 liner carrier members, all operators of containerized vessels.[1/]

Rate conferences like TWRA exist in all world trades. Their members adopt ocean tariff rates to be published and charged by member carriers for many thousands of commodities moving between innumerable points in the trade covered by the conference.

Conferences are limited to liner carriers. Most ocean trade is carried by charter and specialized carriers, which are not part of conferences but which to a substantial degree compete

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1/American President Line, Hapag-Lloyd Line, Kawasaki Kisen Kaisha, Mitsui-OSK Lines, A.P. Moeller-Maersk Line, Neptune Orient Line, Nippon Yusen Kaisha, Orient Overseas Container Line, and Sea Land Service.

with liner operators. As Exhibit 1 shows, over 85 percent of U.S. agricultural exports move on these non-liner carriers. Conference liner carriers divide the remaining 11 percent segment of the agricultural product market with competing non-conference carriers.

As Exhibit 2 shows, in the trans-pacific the export trade liner carriers move under 16 percent of total agricultural export tonnage to Asia. Conference carriers have only a little over 50% of the liner portion. Exhibits 3-6 show the liner/non-liner breakdown and the conference/non-conference liner market shares in the export trade to Asia for several representative agricultural exports.

In the case of forest products, paper, citrus and certain other refrigerated products, non-liner charter carriers actively compete with liner containership operators for these major moving cargoes.

As Exhibit 7 shows, U.S. agricultural exports in the TWRA trade to Asia have experienced large and rapid growth, more than doubling between 1985 and 1992. Ocean rates are not inhibiting this dramatic growth from occurring. Similarly, this great trade growth is not caused by ocean rates. It is caused by favorable exchange rates, growing demand in prospering Asian countries, a lessening of governmental restrictions abroad and high quality U.S. product that is delivered to Asia quickly and in prime condition by ocean carriers.

As Exhibit 8 shows, ocean rates are a relatively small portion of the value of most cargoes exported. The main exceptions involve lower value refrigerated commodities. As to such commodities, ocean rates constitute a somewhat higher portion of landed cargo value because ocean carriers must provide highly costly special equipment dedicated to agricultural exports that is not readily usable for return hauls in the import trade. Those commodities, however, (largely refrigerated fruits and vegetables) have shown large growth in the Asia market and applicable conference rates are substantially lower on these commodities than they were a decade ago. Clearly, ocean rates have not discouraged even those exports in which ocean freight is more than a nominal portion of landed cargo value.

As a result of rapid build-up of modern fleets by non-conference carriers, TWRA carriers have a diminishing segment of the growing transpacific ocean market, as Exhibit 9 shows.

TWRA carriers <u>cannot</u> (and do not) charge rates that are set artificially above levels dictated by market economics. Most TWRA rates on major moving commodities, including agricultural commodities, are only slightly in excess of rates charged by the main non-conference liner carriers -- usually between 1 and 5 percent more. Non-conference carriers have substantial excess capacity in the Pacific export trade. If the TWRA rates were to exceed the actual value of the conference service -- as that value is determined by the market -- cargo shippers could readily switch to non-conference carriers or to charter service. The

continued existence of excess capacity on non-conference vessels tells me that the small differences between TWRA rates and independent rates are consistent with the value of the TWRA service provided and that slightly higher conference rates do not reflect any kind of artificial conference "premium" as Mr. Ferguson wrongly claims.

TWRA rates on agricultural commodities are low. They are among the lowest rates that we charge. As Exhibit 10, prepared by an economic expert, shows, our rates on agricultural exports are lower now than they were a decade ago.

Conferences perform an important function in creating a market in which rate levels are known, well publicized and can be counted on. They add to stability and predictability of rates required to assure investment in this industry.

In my considered judgment if conferences were eliminated from U.S. trades, several long-term trends would be greatly accelerated with deleterious effects on agricultural exporters.

-- industry concentration would be greatly increased, leading to a few megacarriers and ultimately oligopoly

-- capital investment would be decreased, especially by carriers unable to provide additional capital to compete as mega-carriers

-- rates would, until concentration runs its course, be more volatile in the short run with more drastic short term increases and decreases and with favoritism to cargo interests having particular clout vis-a-vis competitors.

-- the likely elimination or reduction of both American-owned carriers and carriers from other more developed industrial countries, such as Japan and Europe, an in favor of countries like China which subsidize and protect their national fleets from competition in a variety of ways.

-- in the long term, higher rates and reduced vessel capacity available to handle low-value agricultural products traditionally paying the lowest rates, especially during times of peak demand for space.

2. **THE MARKET**.

The transpacific market is the largest of all U. S. liner trades for both imports and exports. 49.9 percent of all U.S. liner exports by volume and 60 percent of all liner exports by weight were in the TWRA trade to Asia. The import market from Asia is about 62.1 percent of all liner imports by volume.

The U.S. export trade to Asia has had an average rate of growth of 7.2 percent per annum for the past eight years, despite recession in Japan, Korea and Taiwan. The import trade has had minimal growth during the same period.

The reason for this reversal of fortunes is simple, and it has nothing to do with ocean rates. In September 1985, the G-7 at a meeting in New York agreed to allow the dollar to weaken against major world currencies. When this occurred, U. S. exports became extremely competitive in the world market and especially in Asia. This started a surge in exports which is anticipated to continue for the next several years although there

will be some market correction from time to time. At the same time the sharp change in exchange rates, while favorable to exports has substantially increased the cost of U.S. imports and dramatically slowed their growth.

The growth of U.S. agricultural exports in the TWRA trade to Asia since 1985 has paralleled the market as a whole and has been extraordinary in some subsectors. All indications are that there will be continued growth in exports of both refrigerated and dry agricultural commodities, such as fruits, vegetables, meat, frozen food, nuts, hay, animal feed, cotton, hides, and others.

A significant portion of these commodities will be transported by non-TWRA specialized charter vessels and/or on non-conference liner operators directly competing with TWRA carriers. TWRA carriers, by remaining price and service competitive, expect to continue to participate in the carriage of agricultural commodities. TWRA carriers have in particular made enormous investments in specialized refrigerated equipment to handle agricultural commodities. This equipment is dedicated to these commodities and has little use in the inbound trade from Asia.

3. SERVICE AND INVESTMENT

Ocean carriers of all kinds have vastly improved service quality in the last two decades. Nowhere has capital investment been greater or service quality been improved more than in the case of liner containership operators like TWRA's members.

- Capacity has been increased through aggressive building programs in the 1980's.
- Massive investment in modern terminal facilities in both the U. S. and Asia.
- Conversion to fuel efficient diesel powered ships.
- Transit times have been reduced through redeployments and faster vessels.
- Service has been expanded to cover inland intermodal service.
- Extensive feeder vessel networks have been formed to bring container service to more countries and ports.
- Building of specialized and costly refrigerated equipment to transport U.S. agricultural exports.
- Design and building of special double stack rail cars for intermodal movement in the U. S.

Since 1970 the cost of a containership and a fleet of containers has increased dramatically along with other all costs. Today, for example, an operator who wishes to serve a portion of the trade from California to Japan, Korea, Taiwan, and Hong Kong with a weekly service would have to invest about $425 million for 5 vessels; $90 to $110 million for equipment (containers, chassis, railcars, etc); a major financial commitment for terminal facilities at origin and destination; and initial operating capital. All told the carrier would have to commit somewhere between $600 and $700 million to operate a weekly

service with a maximum of 2000 Forty Foot Equivalent Units ("FEU").

4. DECLINING OCEAN RATES.

Despite the cost and capital requirements for container service, ocean carriers have been able through operating efficiencies to keep ocean rates down even without adjusting for inflation.

For example, in the case of California almonds (shipped by agricultural cooperatives like Blue Diamond) conference rates declined by 20 percent from 1982 - 1993 (i.e., from $2124 per forty foot container in 1982 to $1701 per container now). Adjusted for inflation that is a 45 percent decrease during a period in which carrier costs rose but were offset by productivity improvements passed along to cargo shippers. It is the equivalent of a rate of only $1161 in 1982 dollars.

The rate on California oranges -- which is higher because refrigerated service is provided -- similarly went down significantly. Between 1982 and 1993, it went down 14 percent without adjustment for inflation, and it went down 41 percent when adjusted for inflation. The West Coast rate on oranges in 1982 was $5056 per forty foot container. Stated in 1982 dollars, today's rate on oranges is $2966 per forty foot container.

These examples are not atypical. The container carrier industry is extremely cost efficient and increasingly so. It is so efficient that it has lowered rates in the face of costs that increase for most things necessary to run the business.

Professional industry critics who claim that rate conferences protect the inefficient and discourage progress are simply ignorant about how our industry works or do not want to know the facts.

Rates for agricultural commodities are among the lowest of all commodity rates. Except for refrigerated commodities which receive a high cost specialized service rates on agricultural commodities are well below rates on import commodities and are below most other rates in export trades. Rates on export refrigerated commodities are also higher than in dry cargo because -- (a) there is little refrigerated cargo moving eastbound from Asia and (b) refrigerated containers have a smaller interior size than comparably sized dry containers and therefore are not practical for use in the import trade where high volume cargo permits.

5. FACTORS AFFECTING THE MOVEMENT OF AGRICULTURAL. EXPORTS.

Agricultural exports -- like other exports -- move because there is demand for the product in foreign countries, because governmental restrictions inhibiting their movement have eased, because currency relationships favor U.S. sources of supply, because the U.S. product is good and properly priced, because there is adequate supply to meet demand, because of effective sales efforts, and because there is the transportation capability to move the product quickly, efficiently and reliably from buyer to seller.

I want to correct a persistent false myth spread by superficial critics of our industry that lower freight rates will increase exports. In the real commercial world, with few exceptions, ocean carrier rate levels do not cause export levels either to expand or to contract. Theoretically that could occur, but it does not. It is clear that when exports are booming, demand for vessel space increases and ocean rates rise. Similarly, when exports are weak, ocean carriers bitterly compete to protect their market share of the cargo available and rates decline. There is thus a strong correlation between strong export markets and relatively high ocean rates and between weak export markets and low ocean rates. Obviously, that does not mean that high rates cause exports to move or that low rates discourage such movement. It does, however, confirm my judgment that, with few exceptions, ocean rate levels do not increase or decrease exports.

Unfortunately, many shippers still believe that depressed westbound freight rates of the mid-1980's were actually compensatory and produced a profit for the carriers. Nothing could be farther from the truth. Moreover, there is a reluctance on the part of the shipping public to accept the notion that ocean shipping like any other industry cannot operate or attract investment capital if it does not produce a profit. Without a profit, service must be either discontinued or production reduced until demand equals or exceeds supply. Despite forecasts of rising U.S. exports over the next several years, there is still

<u>little incentive for carriers to build new vessels to be placed in operation in an export market which has not, on average, produced compensatory freight rates.</u> The decision is made more complex by the stagnant import market and the almost certain knowledge that any new vessel capacity introduced into the trade will not be filled in the eastbound direction.

6. OCEAN CONFERENCES AND OCEAN COMPETITION.

Liner containership operators, including TWRA members, typically haul a multiplicity of products for many shippers, and the vessels operate on regular schedules and routes. TWRA alone publishes more than 100,000 tariff pages annually covering upwards of 20,000 commodities. This volume of constant changes in TWRA rates, commodities and points reflects competitive conditions and market demands.

Ocean carriers who are members of rate conferences face intense price and service competition from four sources: (1) charter or non-liner operators in the same trade; (2) non-conference carriers in the same trade; (3) internal competition among conference members in the trade (4) to some extent from air cargo carriers and carriers serving trades from third countries. It may surprise you that the most price and service competition is internal -- that is between conference members vying for market share.

The U.S. export trade to Asia in which TWRA operates is especially competitive. Very few of the carriers that were in the trade when I first became involved in Pacific services in

1968 are still in the trade if they are in business at all. The drop outs include, regrettably, a considerable number of American flag carriers that were excellent operators in their day. Similarly, the number of Japanese flag liner carriers in the trade has been reduced by competition from at least 11 in the early 1960s to only 3 today. Several Korean carriers, a Malaysian carrier and a Hong Kong carrier similarly could not stand the competitive heat in this trade. These carriers and many others were victims of low rates of return, bitter rate wars, and in some cases were done in by capital or management shortfalls resulting in an inability to keep up the pace in an industry marked by tremendous change and advances, enormous capital demands and furious competition all at the same time. Since 1985 the number liner operators have fallen from 35 carriers with measurable quantities of freight to 25 in the TWRA trade alone.

In my opinion the severity of price competition in this industry is so great that before long it may become predatory in nature by which I mean that ocean rates may be held well below cost and, although benignly motivated by a desire to preserve market share, will nonetheless drive less well financed competitors out of business. This will produce over concentration by further reducing the number of existing carriers significantly, although I assume that State-owned carriers like China Ocean Shipping Co. will survive. Given the large capital requirements for a liner containership service and historically

low long-term rates of return, significant new entrants will be unlikely.

Liner ocean carriers in conferences face service and price competition of different kinds. At the high end of the rate spectrum they compete with air cargo carriers for perishable agricultural commodities and high value commodities.

For lower rated, high volume commodities like grain, very little of this cargo in major trades is handled by liner carriers. Most of this cargo moves by charter vessels which are not conference members and are not permitted to become conference members under U.S. law.

Sophisticated special purpose charter vessels handle the predominant share of commodities like logs/lumber, wood pulp and paper, which typically move at low bulk rates. Other types of specialized vessels, such as refrigerated commodity carriers, compete with conference liner vessels for high value, higher rated commodities requiring temperature control and include carriers of citrus and other fruits. These carriers are not conference carriers either.

Liner conference operators directly compete with non-conference liner operators which increasingly have equipment, service and schedules approaching and occasionally surpassing conference quality. In the TWRA trade non-TWRA liner carriers have 50 percent of the liner market overall. 48 percent of agricultural exports that move via liner vessels move on non-conference liner vessels.

Because of this intense competition the difference in rate levels between conference and most non-conference carriers is generally quite small, especially in the case of agricultural commodities. Exhibit 11, which is taken from Mr. Schrier's paper and for which I supplied the basic rate data, illustrates how narrow the gap is between conference and non-conference rates on major moving agricultural products. Generally speaking the rate difference on dry cargo of all kinds is roughly 2 - 5 percent depending on the commodity and depending on the value that the market places on conference service on that commodity to that destination.

The most intense form of competition is "internal" -- i.e., competition between conference members. In most world export trades conferences do not permit their members to determine their own rates. Under the 1984 U.S. Shipping Act, conferences permit member lines to set their own prices through independent rate actions. TWRA carriers regularly do so. They set approximately 60,000 individual rates by taking independent actions in 1992, and when taken these independent rates are the real conference rates that move the cargo. Usually when this happens, other TWRA carriers "match" the independent rate, if it is lower. The result is that the "conference" rate on major moving commodities is very commonly a rate determined in the first instance by an independent rate action and then joined in by other carriers to create a new de facto conference rate. Alternatively, TWRA may

decide to make the independent rate the official tariff rate for all carriers.

I estimate that at present about 70% of the TWRA share of agricultural exports moves under rates originally established through independent actions by TWRA members.

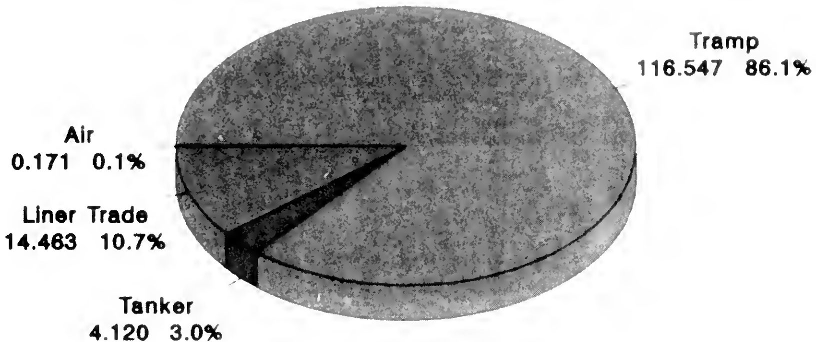
What, then, do ocean rate conferences contribute if the rates are driven by market forces in any event? Conferences help reduce extreme short-term volatility of rates in both downward and upward directions. That "stability" function is important to carriers considering whether to renew fleets at large costs. The 1984 Shipping Act may have gone too far in weakening conferences, through mandating conferences to permit unlimited independent action on very short notice, to a point in which their ability to stabilize rates has been adversely affected. In my judgment it would be a disaster for carriers and, in the long term, a disaster for U.S. exporters to weaken conferences further.

The U.S. Shipping Act requires carriers to give thirty day notice of rate increases. Conferences commonly give much longer notice and frequently limit rate increases to seasonal needs of particular industries.

Conferences contribute toward even-handedness in establishing rates as between competing exporters, especially in context of regulated tariff rates which are publicly filed and publicized.

My appearance today is my final day as TWRA Executive Director and my final day with the industry. Tomorrow, I join the ranks of the retired. My final words of advice can be and are quite disinterested: Do not destroy or weaken the conference system further, especially based on misinformation or ignorance about the industry typified by the Ferguson Report. Doing so will injure the carrier industry, and it will result in poorer service and higher rates for agricultural exporters in the mid to long-run.

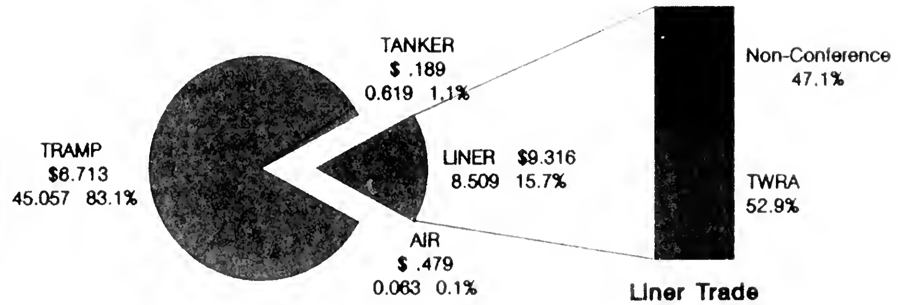
U.S. Agricultural Exports
World Trade Summary for 1992



Weight in Millions of Metric Tons

Source: U.S. Bureau of Census

U.S. Exports of Agricultural Commodities to the Far East during 1992



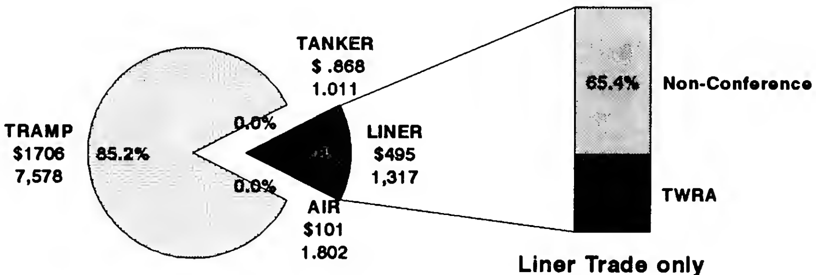
Value in U.S. Dollars (000,000)
Value in Metric Tons (000,000)

Source: U.S. Bureau of Census and Journal of Commerce PIERS

EXHIBIT 2

U.S. Exports of Seeds and Tree Nuts
(as described under Harmonized Code Chapters 12 and HS Code 080110 thru 080290)
to the Far East during 1992

All Services by Weight

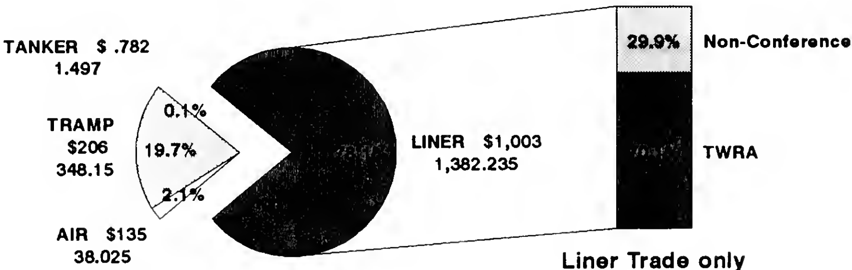


Value in U.S. Dollars (000,000)
Weight in Metric Tons (000,000)

Source: U.S. Bureau of Census and Journal of Commerce PIERS

EXHIBIT 3

U.S. Exports of Fruits and Vegetables
(As described under Harmonized Code 200410 and Chapters 07 and 08)
to the Far East during 1992



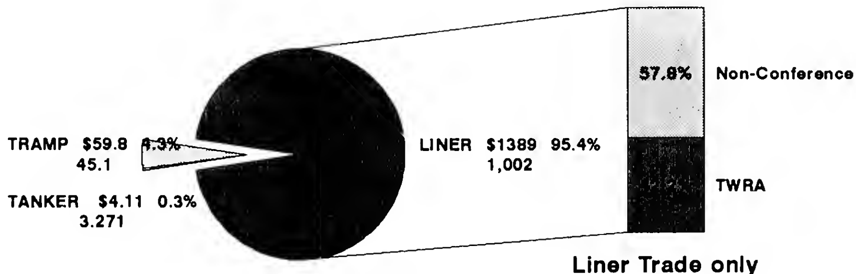
Value in U.S. Dollars (000,000)
Weight in Metric Tons (000,000)

Source: U.S. Bureau of Census and Journal of Commerce PIERS

EXHIBIT 4

U.S. Exports of Raw Cotton
(As described under Harmonized Code Chapter 52)
to the Far East during 1992

All Services by Weight



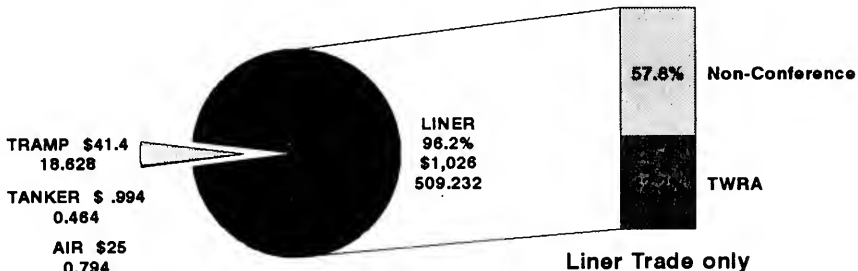
Value in U.S. Dollars (000,000)
Value in Metric Tons (000,000)

Source: U.S. Bureau of Census and Journal of Commerce PIERS

EXHIBIT 5

U.S. Exports of Hides and Skins
(as described under Harmonized Code Chapters 41 and 43)
to the Far East during 1992

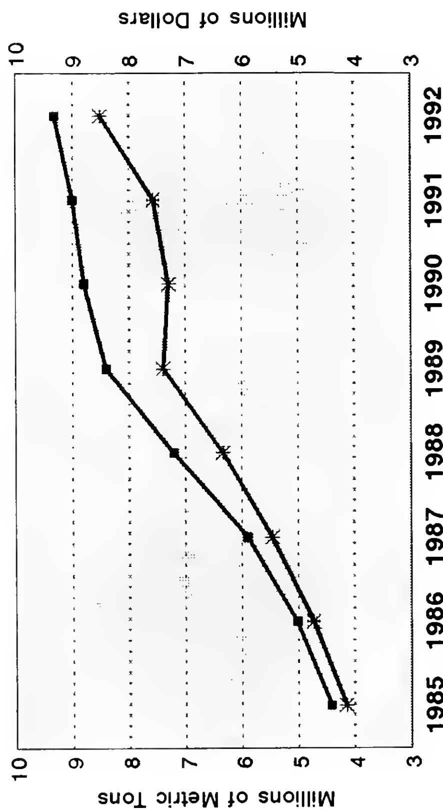
All Services by Weight



Value in U.S. Dollars (000,000)
Value in Metric Tons (000,000)

Source: U.S. Bureau of Census and Journal of Commerce PIERS

EXHIBIT 6

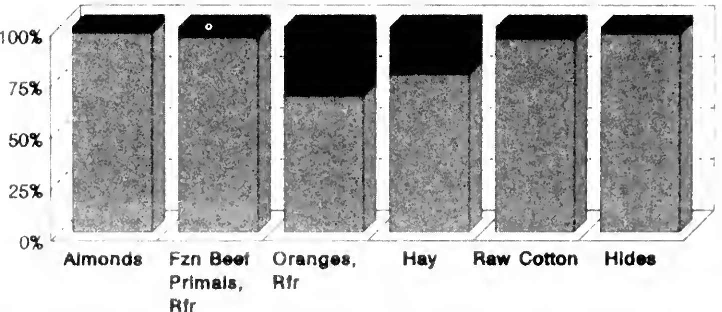


	1985	1986	1987	1988	1989	1990	1991	1992
Weight	4.149	4.728	5.457	6.335	7.394	7.299	7.567	8.509
Value	4.415	5.021	5.899	7.208	8.405	8.799	8.996	9.316

Source: U.S. Census Bureau

EXHIBIT 7

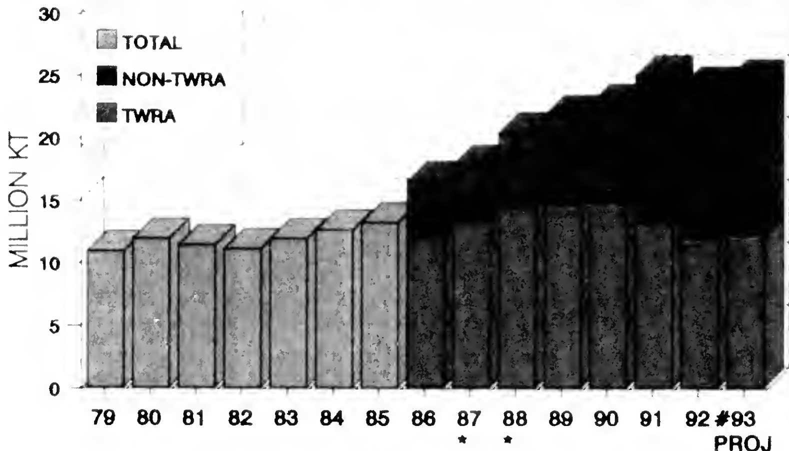
Landed Value per Metric Ton for Selected Commodities U.S. West Coast to Japan



	Almonds	Fzn Beef Primals, Rfr	Oranges, Rfr	Hay	Raw Cotton	Hides
Product F.A.S. $ Value	$3,366.05	$4,613.2	$473.12	$157.82	$1,396.07	$3,215.88
Freight	$104.07	$247.78	$240.87	$47.52	$83.88	$110.89
Landed Costs	$3,470.12	$4,860.98	$713.99	$205.34	$1,479.95	$3,326.77
Frt % Landed Value	3	5.1	33.7	23.1	5.7	3.3

Source: TWRA Tariff FMC-12 and U.S. Census Bureau

U.S. TO FAR EAST LINER EXPORTS 1979-93



	79	80	81	82	83	84	85	86	87*	88*	89	90	91	92	#93 PROJ
TWRA %								73	74	71	67	65	53	49	49
NON-TWRA %								27	26	29	33	35	47	51	51
TOTAL (Million KT)	10.9	11.9	11.4	11.1	11.9	12.6	13.2	16.5	17.8	20.4	21.8	22.7	25	24.1	24.7

1993 Projection based on 2.5% over 1992

SOURCE: CENSUS & JOC LINER TRADE REVIEW*

EXHIBIT 9

"ALL-IN" RATES PER FEU
(Major Moving Agricultural Products)
1982-1993

U.S. West Coast/Japan Conference Tariff Rates, 1982-1993

	1982	1993	Nominal Change 1982-1993	1993 (1982 Prices)	Real Change 1982-1993
Dry Products:					
Cotton	$ 2415	$ 1522	-37%	$ 1039	-57%
Kraft Bd	1998	1612	-19%	1100	-45%
Wood Pulp	1454	1124	-23%	767	-47%
Hides	1460	1996	37%	1362	-7%
Hay	2293	998	-56%	681	-70%
Almonds	2124	1701	-20%	1161	-45%
Raisins	1274	1701	34%	1161	-9%
Refrigerated Products:					
Oranges	5056	4346	-14%	2966	-41%
Beef Primal	5856	4460	-24%	3043	-48%
Simple Average	$ 2659	$ 2162	-19%	$ 1475	-45%

CPI in 1982: 96.9 (1984 = 100)
CPI in 1993 (June): 142.0
CPI ratio, 1993 vs. 1982: 146.5%

EXHIBIT 10

CONFERENCE AND MAJOR NON-CONFERENCE "ALL-IN" RATES ON SIGNIFICANT AGRICULTURAL EXPORTS TO ASIA PER FORTY FOOT CONTAINER (JULY, 1993)

COMMODITY	CONFERENCE RATE	NON-CONFERENCE RATES
A. Dry Cargo	FMC Tariff	FMC Tariff
HAY Calif. to Japan	$ 999	$ 999* - $1370
HAY, Fumig. CA to Japan	$1078	$1078* - $1370
COTTON to Japan	$1523	$1455* - $1671
COTTON to Korea	$1734	$1734* - $2036
B. Refrigerated		
BEEF Primal to Japan	$4305	$4200* - $4720
PORK Primal to Japan	$4305	$4098* - $5561
POULTRY to Hong Kong	$3045	$3024* - $3045
FROZEN CORN to Taiwan	$4655	$4462 - $4664
FROZEN VEG. to Japan	$4901	$4629* - $5000
FROZEN FRENCH FR to Korea	$3513	$3337* - $3713
LETTUCE to Japan	$4750	$4750 - $7922
LETTUCE to Taiwan	$3648	$6255
BROCCOLI to Hong Kong	$4453	$4280 - $5878
CITRUS to Taiwan	$4154	$3802 - $4075

* Rates shown are tariff rates applicable to any shipper. Independent service contract volume rates for shippers who contractually commit cargo volumes to one carrier over time are: Hay to Japan $974 - $1162; Fumigated hay to Japan $1054; Cotton to Japan $1370-$1510; Cotton to Japan $1370 - $1510; Cotton to Korea $1658 - $1696; Beef to Japan $4000 - $4600; Pork to Japan $ 4075 - 4600; Poultry to Hong Kong $2958 - $3450; Frozen Veg. to Japan $ 4524 - $4901; Frozen French Fries to Korea $3492 - $3658.

EXHIBIT 11

Mr. CONDIT. Mr. Schrier.

STATEMENT OF ELLIOT SCHRIER, MANALYTICS INTERNATIONAL, INC., SAN FRANCISCO, CA

Mr. SCHRIER. Thank you, Mr. Chairman, members of the subcommittee. I appreciate this opportunity to address you on this important matter.

My name is Elliot Schrier. I am a principal in the San Francisco-based Manalytics International, a transportation consulting firm whose antecedents go back to the early days of containerization in the transpacific trades.

You have a report I prepared as an attachment to my written testimony. You also have a copy of that testimony. I ask the subcommittee to accept it into the record.

To save you time and leave time for your questions, I will abbreviate my comments to just four major points: One, liner conference carriers face significant competition in the U.S. foreign trades. Two, tariff rates for agricultural exports to the Far East are lower now than they were 10 years ago. Three, conference carrier rate differentials over nonconference carriers for agricultural products are in the range of 2 to 4 percent. And, four, Mr. Ferguson's report is invalid for any purpose this subcommittee may have in considering liner conference services and rates.

First, regarding competition, it is plain reckless to ignore competition in a discussion of the role of liner conferences. Conference carriers face competition from three major sources. One, nonliner specialized carriers accounting for well over half of all exports, including agricultural commodities, as Mr. Gottshall's chart showed.

Two, nonconference carriers who account for almost half of the liner tonnage, again, as Mr. Gottshall showed.

Three, intra-conference carriers who frequently take rate actions under the independent action provisions of the Shipping Act. These independent action rates become the effective rates for the tonnages covered regardless of whether other conference carriers follow suit.

On any count, number of carriers, frequency of sailings or available capacities, generally there is ample competition in the U.S. foreign trade increased by the provisions of the Shipping Act of 1984. This competition extends to rates and services.

My second point regarding declining rates. It is instructive to look at actual rate history. Here is a chart based on table 1 from my testimony.

[The chart may be found at the end of Mr. Schrier's prepared statement.]

Mr. SCHRIER. It shows port-to-port tariff rates for 1982 to 1992 for nine major agricultural exports to Japan. Japan is by far the largest market for our agricultural exports in the Pacific. These are the facts in the trade, not hypothetical conjectures.

Note that only raisins and hides have a higher rate today than they did in 1982. Incidentally, there is a typographical error on page 3 of my testimony, where 1982 appears as 1992, and I ask that it be corrected.

Now then, that chart is based on table 1 in my report, and here is table 1 itself, showing constant dollars which are adjusted for in-

flation as well as current dollars. Overall, rates for these nine commodities declined 19 percent in current dollars and 45 percent in constant dollars.

The conference carriers essentially have passed on savings generated by their investments in larger, more efficient ships and shore-side facilities. The high degree of competition in the transpacific trade, including aggressive pricing brought about by excess capacities on both conference and nonconference ships, has actually forced conference carriers to pass on more of those savings than future investment considerations or prudent financial precepts would condone.

My third point is regarding rate differentials between conference carriers and nonconference carriers. Publicly available data debunk the idea which has been spread by opponents of the conference system that conference carriers charge noncompetitive prices. I have reviewed actual ocean rates of conference and major nonconference carriers that move agricultural commodities in the transpacific export trade.

I have found no support for Dr. Ferguson's claim of a substantial conference premium. The difference for agricultural commodities is really in the range of 2 to 4 percent. In almost any trade on a commodity by commodity analysis, you would see that the conference carriers generally do charge slightly higher rates than nonconference carriers. Of that, there can be no doubt.

Some of the difference reflects superior conference service which shippers consider in choosing among the many options available to them. Some of that difference reflects different conference versus nonconference marketing strategies; comparative advantages and utilization rates at various times.

In other words, the higher conference rates surely reflect superior service, whether that superiority is in service, or reliability, or sailing frequency, or transit time, or intermodal options, or equipment availability, or breath of market coverage, or availability of special services, and so forth. It is rare that a shipper has no practical alternative to the conference carriers. If there were no alternative and if the conference were charging a high yielding rate, the low barriers to entry into the U.S. foreign trades would quickly attract an alternative.

Fourth, and my last point regarding Dr. Ferguson's report. What we have here is a study with a statistically unreliable sample on which conclusions are drawn from obviously flawed data.

Dr. Ferguson started with 50 return questionnaires, of which, only 31 were, in his words, "substantially complete." Aside from all other considerations, and there are many which I treat in my report, the paucity of data, the internal contradictions and the unreproducibility of Dr. Ferguson's work should remove it from any consideration in the debate on maritime policy.

Why Dr. Ferguson chose to rely upon the memories and estimates of a small and select sample of shippers rather than on published rates to derive estimates of a so-called conference premium, I have no idea. Rates are readily published in our trades, and the shippers have complained about those published rates. They are available, and they are a basis for comparison.

Dr. Ferguson and his co-critics of the conference system would better serve their constituencies if they devoted their energy to accurate portrayal of the entire ocean transportation system, with ease of entry, frequency of exit, profit levels, capacity availability, technological innovation, rate stability, individual commodity rates, and so forth. Such an approach surely would focus on the actual rate structures that are geared to move all of the cargo in our foreign trades.

These rate structures support economies of scale in ships and shipping systems. They produce a reasonably fair sharing of the relatively high fixed cost of ocean transportation, and that sharing particularly benefits the lower-valued agricultural exports.

I thank you for your invitation and your attention. If you have any questions at this time, I would be happy to answer them without making a speech.

I have copies of my chart which can be entered into the record.

Mr. CONDIT. Without objection, they will be entered into the record. And we appreciate your comments and we will get back to you with some questions.

[The prepared statement of Mr. Schrier follows:]

OCEAN RATE CONFERENCES IN UNITED STATES TRADES:

THEIR EFFECT ON UNITED STATES AGRICULTURAL EXPORTS

Elliot Schrier

Manalytics International, Inc.

Sept. 27, 1993

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I. SUMMARY

Introduction

This report is a preliminary study prepared at the request of major containership operators in United States Pacific and Atlantic trades who are members of ocean rate conferences. The Report and Manalytics' charter to prepare it address three basic issues:

(1) What are the effects of ocean rate conferences upon the movement and growth of United States agricultural exports and upon the ocean carrier industry that must move these exports?

(2) Are the methods used and the conclusions reached in the report of Dr. Allen R. Ferguson ("Maritime Policy and Agricultural Interests: Impacts of the Conference System") valid? If valid, why and to what degree? If invalid, why and to what degree?

(3) What is the import and validity of other estimates concerning the effects of the conference system on ocean freight rates which have been referenced in Dr. Ferguson's report and which also form the basis for estimates appearing in the National Performance Review?

This report was prepared by Elliot Schrier and his associates. Mr. Schrier is a principal in Manalytics International, Inc. of San Francisco. He has 30 years of experience in the ocean carrier industry, and in analyzing the industry's structure, the cargo it carries and the manner in which ocean rates are set.

Mr. Schrier joined Matson Navigation Co. in 1963 to lead its research and planning efforts in domestic and international containerization. Since then, he has been continuously involved with economic and operational analysis of maritime issues, performing studies for ports, carriers, shippers and governmental agencies, including the Maritime Administration, Federal Maritime Commission, American President Line, Sea-Land Service, The Port of Oakland, the Port of Anchorage, Dole Foods, Lipton Tea, and Tasman Pulp and Paper. A sampling of papers prepared by Mr. Schrier is attached.

Conclusions

The conclusions reached in this report differ sharply from Dr. Ferguson's. The report concludes that:

1. Liner rate conferences have no adverse effects on the level of U.S. exports of agricultural commodities; conference carriers' rates on agricultural products are low compared to both import rates and export rates on other commodities -- barely above the level of non-conference rates and lower than they were a decade ago.

2. The most critical need of exporters of all kinds is that adequate, efficient, fast and dependable international transport service be in place to handle all needs, including peak demands; conferences assist in assuring that high-quality service and adequate capacity exist to handle these cargo demands.

3. By contributing to stabilization of rates, conferences encourage investment and innovation; the conference carriers have led the introduction of new technology for the past two decades.

4. Dr. Ferguson's conclusion that conference pricing adds a substantial "premium" (estimated to be 18 percent) to agricultural export freight rates is undocumented, unscientific, and simply false: a comparison of actual transpacific Westbound Rate Agreement (TWRA) rates with rates of independent carriers serving the same trades shows a differential of only about 2-4 percent.

II. COMPETITIVE CONTEXT OF OCEAN LINER RATE CONFERENCES

Ocean rate conferences are associations of liner common carriers. Liner carriers operate regularly scheduled advertised services on regular routes and carrying the varied commodities of many shippers. In nearly all cases in major U.S. trades, conferences consist of operators of capital-intensive, technologically advanced containership systems providing sophisticated, high-speed services at the high-quality end of the carrier service spectrum.

Competitive Environment

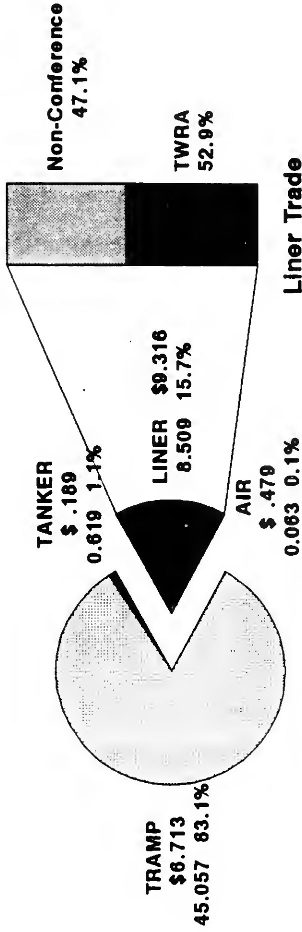
Evaluation of the effects of liner conferences necessarily must consider the competitive environment in which they operate. It is important to understand that operators of containerized services who are members of conferences never have even a near monopoly in any U.S. trade.

First, most of the world's fleet consists of non-liner carriers, such as grain carriers, who are not and cannot be liner conference members. Figures 1 and 2 show the relative shares of liner and non-liner services carrying agricultural exports in all U.S. trades and in the transpacific trade. Conference carriers compete directly with many sophisticated specialized non-liner carriers of chilled or frozen meats, fruits and vegetables, forest products, steel products, edible oils and autos. In the transpacific trades, this competition is extremely significant.

Second, conference carriers compete directly with non-conference liner carriers. In the trade to Asia -- the largest U.S. export market -- the members of TWRA compete with eight major and several smaller non-conference liner carriers,

Figure 1

Figure 2



and the conference has only a little more than half of the entire liner container market. Figures 3-6 show the conference/non-conference breakdown for the transpacific liner trade as well as non-liner shares for certain major moving agricultural commodities.

Finally, there is strong internal competition within conferences among members, especially in U.S. trades where conferences are required by law to permit all members to set rates independently and independent rate actions are taken on a large scale. The tens of thousands of independent rate actions taken annually by conference members show the level of internal competition in the conferences.

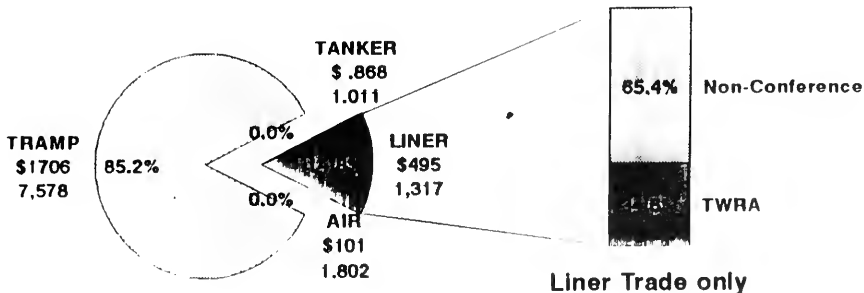
The relevant capacity pool in which conference members compete is large and complex. It is made up of U.S.-flag, second-flag (trading partner) and third-flag (cross trader) liner and non-liner operators capable of carrying containerizable cargoes in the foreign commerce of the United States on full cellular containerships, combination container-bulk ships, roll on/roll off ships, barge-carrying ships and specialized ships.

Conference members compete on price and on service with themselves and with non-conference carriers serving any coast of the United States. Mini-land-bridge, relay, feeder, around-the world and other multi-coastal services make the coast of loading or discharging within the United States (or even Canada) of relatively little competitive consequence. Furthermore, the high-value end of ocean cargo is the low-value end of air cargo, and there is direct competition between the two modes - as well as cooperation in sea/air combination movements.

Figure 3

U.S. Exports of Seeds and Tree Nuts
(as described under Harmonized Code Chapters 12 and HS Code 080110 thru 080290)
to the Far East during 1992

All Services by Weight



Liner Trade only

Value in U.S. Dollars (000,000)
Weight in Metric Tons (000,000)

Source: U.S. Bureau of Census and Journal of Commerce PIERS

Figure 4

U.S. Exports of Fruits and Vegetables

(As described under Harmonized Code 200410 and Chapters 07 and 08)

to the Far East during 1992

All Services by Weight

Value in U.S. Dollars (000,000)
Weight in Metric Tons (000,000)

Source: U.S. Bureau of Census and Journal of Commerce PIERS

Figure 5

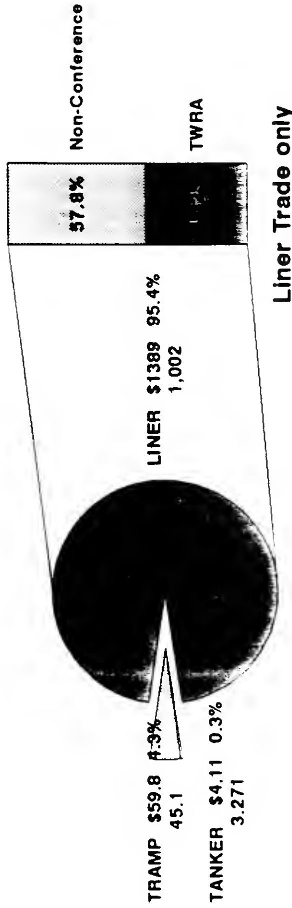


Figure 6

There is an overlap of identical cargo that goes by air and liner, and by liner and non-liner. And there is an overlap between liner and non-liner service on the same ship. Although the dominant ship type used in non-liner service is different from the dominant ship type used in liner service, some ships operating in non-liner service are indistinguishable from liner ships, and vice versa. It is not ship type that defines service mode. A ship may offer non-liner service in one direction, liner-type service in the opposite direction. Part of a ship may be dedicated to non-liner cargoes and part to non-liner-like cargoes.

Neo-bulk operators have created a new service largely out of formerly liner commodities that now move in sufficient volume between port pairs to warrant a specialized service. The very term "neo-bulk" - new bulk - suggests that shift. On their front haul, neo-bulk operators offer a specialized service to major large-lot shippers that the liner operators have difficulty in matching. On their backhaul, they can offer reduced rates to major small-lot shippers that effectively skim the cream in the liner trade. Generally, the cargo moves in liner service when the lot size is small and in non-liner service when the lot size can fill a hold or a ship; there is, however, a broad area of overlap between the two modes. While refrigerated cargoes move largely in liner service, the volume of refrigerated trade has grown to the point where the trade can support a ship designed to carry nothing but (or largely) refrigerated cargo. As another example, forest products also once moved largely in liner services. Development of the open-hatch ship provided an attractive non-liner alternative to shippers of forest products, and most forest products now move in non-liner service.

Membership in liner conferences is voluntary, and a liner conference in United States trades must permit its members to enter and exit at will. In consequence, most "conference" trades have substantial non-conference liner competition. Even assuming there were no rate competition among conference carriers (contrary to reality), actual and potential non-conference competition assures that conference carriers do not control ocean rates and seriously inhibits their ability even to show price leadership.

Service Innovation In The Liner Sector

Because of the long life of ships, containers, terminal equipment and inland rail equipment, decisions in the ocean liner industry must be made and investment risks taken to reflect anticipated trade growth over 10-20 years. The conference system encourages carriers to make such investments by seeking to reduce rate volatility which increases investment risk.

Ocean conferences are almost as old as steamship companies themselves. They have existed in the major international trades for over 100 years. They were formed to meet a serious commercial requirement: to stabilize rates and earnings so carriers could offer long-term, stable service. This stability has encouraged investment and technological innovation in ocean shipping, resulting in lower rates and better service by any measure.

Without this stable environment, the conference carriers would be less sure of what is to come, and would instead focus solely on the short term. With a longer term view, the carriers can more safely commit capital and resources to the development of service innovations. These innovations, in turn, considerably benefit the shippers and consignees of freight who use the conference members and, as the innovations spread, non-conference carriers. The more notable of these innovations include:

- Doublestack trains
- New ship designs
- Improved service times
- Larger containers
- Improved refrigerated containers
- Chassis designed for overweight containers
- Automated tracing and tracking systems

Doublestack trains

Conference members pioneered the development and use of doublestack train service in the United States. The concept of double-decking containers on the train - without the need of chassis or wheels in transit - permits significant economies. Five conventional intermodal cars, for example, some 445 feet in length, become a stackcar just 268 feet in length. This shortens the overall train length, reduces the weight of the train, and creates significant fuel and operational economies. These economies, in turn, have been passed on to the shipper.

Further, the physical dynamics of the stacktrain create a lower load center on the cars and improved coupling. These factors combine to produce a smoother ride and far less damage - even lower than truck - to the product carried inside.

New ship designs

Conference members have pioneered the technology of the newest classes of large, fast ships, particularly those deployed in the Pacific. While it is true that non-conference carriers have also purchased new ships, they have benefited from the designs and innovations that the conference members have created in their earlier work. Among the innovations in new ship design and technology that have benefited shippers are:

- improved ship stability reducing damage at sea and overboard containers;
- improved air circulation in the holds, particularly valuable for agricultural commodities in vented containers; and
- Lower unit costs

Improved transit times

These new ships, coupled with stacktrain and port improvements and more frequent sailings, have reduced the transit times between inland origin and destination points significantly over the past twenty years, in some cases by over a week. These savings in time have benefited shippers in inventory carrying cost reductions, and improvement in on-time reliability for shipments to customers.

Larger and specialized containers for agricultural products

Conference members have pioneered the use of larger containers, both in terms of height (hi-cube containers) and length (45' and even 48' containers). This increase in payload has resulted in reduced freight rates per ton, and it has allowed shippers who sell their products in container-load lots to increase the size of their orders. Specialized containers to carry unitized lumber and other agricultural products, as well as container-bag systems for grain, have also been conference carrier innovations.

Improved refrigerated containers

Agricultural shippers have been the specific beneficiaries of improved reefer technology, again largely due to the pioneering work of the conference members. Electronic controls and air circulation technology improvements have been initiated by the conference carriers and then manufactured by the equipment producers. They have also led in the support and introduction of new technologies for improved quality of perishables at outturn, such as controlled atmosphere. Shippers and non-conference carriers alike have benefited from the work of the conference lines in this regard.

Chassis designed for overweight containers

Agricultural shippers in particular have been troubled with fines and delays on overweight containers. Conference members have taken the initiative and designed and built special chassis which will allow heavier containers to be transported safely over the highways. Without this willingness to innovate and pioneer, significant losses would still be experienced by shippers and consignees.

Automated tracing and tracking systems

There are two parts of the automation that have been initiated by conference members: automated physical systems which monitor container movement past checkpoints and/ or by satellite; and systems which are computer software focused that deliver up-to-the-minute status reports on the current position and expected arrival date of containers at destination. These systems combine to add certainty to the transportation process, and enable the shipper to monitor and speed the distribution process.

Price Competition

The enormous productivity gains achieved by the efficient containership operators that have survived the container revolution in the industry have been largely passed on to cargo shippers in lower rates. That is the case despite major increases in the cost of vessels and container fleets. Misperceptions about liner conference rates abound in the adversarial atmosphere created by conference critics. A look at the recent history of the rates of U.S. agriculture exports to Japan (the largest consuming country) should replace hypothesis with fact.

Note that in Table I on the following page, the average nominal rate (that is, in current dollars) for the nine largest moving agricultural exports to Japan declined 19% from 1982 to 1993. The real rate (that is, adjusted for inflation) declined 45%. The high degree of competition in the transpacific trade, including aggressive pricing brought about by excess capacity on both conference and non-conference ships, actually forced the conference carriers to pass on more of the savings generated by

TABLE I

"ALL-IN" RATES PER FEU
(Major Moving Agricultural Products)
1982-1993

U.S. West Coast/Japan Conference Tariff Rates, 1982-1993

	1982	1993	Nominal Change 1982-1993	1993 (1982 Prices)	Real Change 1982-1993
Dry Products:					
Cotton	$ 2415	$ 1522	-37%	$ 1039	-57%
Kraft Bd	1998	1612	-19%	1100	-45%
Wood Pulp	1454	1124	-23%	767	-47%
Hides	1460	1996	37%	1362	-7%
Hay	2293	998	-56%	681	-70%
Almonds	2124	1701	-20%	1161	-45%
Raisins	1274	1701	34%	1161	-9%
Refrigerated Products:					
Oranges	5056	4346	-14%	2966	-41%
Beef Primal	5856	4460	-24%	3043	-48%
Simple Average	$ 2659	$ 2162	-19%	$ 1475	-45%

CPI in 1982: 96.9 (1984 = 100)
CPI in 1993 (June): 142.0
CPI ratio, 1993 vs. 1982: 146.5%

their investment in larger, more efficient ships and shoreside facilities than future investment considerations or prudent financial precepts would condone.

It is preposterous to draw abstract, theoretical conclusions about conference and non-conference rates, about how price competitive or non-competitive an industry is, or about whether a group of competitors can effectively set price premiums. Instead of speculating from economic theory or from ambiguous and statistically meaningless surveys, as Dr. Ferguson did, one should examine actual conference and non-conference rates (most of which are public) and examine the competitive conditions actually prevailing.

The combination of open entry and exit and independent action within rate conferences in U.S. trades makes concerns about a so called "conference premium" grossly misplaced. It is largely imaginary. In the case of many export commodities, including major moving agricultural commodities, rates levels are determined in the first instance by non-conference rate competition, which produces narrow gaps between conference and non-conference rates. If the conference-set rate does not reflect what the market dictates, independent rate actions by conference members will do so, and the conference rate that actually moves the cargo will quickly become the rate set by an independent action. Cargo shippers know this and use their cargo offerings as leverage to cause conference carriers to take independent action. Further, service contracts -- a device by which a competitor can "lock up" a shipper's cargo for long into the future -- put severe competitive pressure on conference carriers, whether or not they offer service contracts themselves.

We have reviewed actual ocean rates of conference carriers and major non-conference carriers that move agricultural commodities in the transpacific export trade, and we have found no support for Dr. Ferguson's claim of a substantial "conference premium". Table II on the following page summarizes the results of our review.

In a few cases, non-conference rates are higher than conference rates; sometimes they are the same. In nearly all cases, the actual difference between conference and non-conference rates is slight. That differential appears to represent the value assigned by the market to the service quality edge which conference carriers have over non-conference carriers, especially in handling perishable agricultural commodities.

Rates differ among non-conference carriers. Sometimes non-conference rates include special low rates for a single volume shipper which contractually commits its cargo over time to a single carrier. These rates cannot be fairly compared with conference or non-conference tariff rates applicable to all shippers, but even a comparison between conference tariff rates and non-conference service contract rates reveals only a modest rate differential and occasionally reveals a non-conference service contract rate that is higher than the corresponding conference tariff rate.

Comparing conference tariff rates to the lowest tariff rate charged by the major non-conference carriers in the transpacific trades, the conference/non-conference rate spreads (1) are small and (2) vary considerably on major moving agricultural commodities, reflecting competitive considerations and the perceived value of the

TABLE II

CONFERENCE AND MAJOR NON-CONFERENCE "ALL-IN" RATES ON SIGNIFICANT AGRICULTURAL EXPORTS TO ASIA PER FORTY FOOT CONTAINER (JULY, 1993)

COMMODITY	CONFERENCE RATE	NON-CONFERENCE RATES
A. Dry Cargo	FMC Tariff	FMC Tariff
HAY Calif. to Japan	$ 999	$ 999* - $1370
HAY, Fumig. CA to Japan	$1078	$1078* - $1370
COTTON to Japan	$1523	$1455* - $1671
COTTON to Korea	$1734	$1734* - $2036
B. Refrigerated		
BEEF Primal to Japan	$4305	$4200* - $4720
PORK Primal to Japan	$4305	$4098* - $5561
POULTRY to Hong Kong	$3045	$3024* - $3045
FROZEN CORN to Taiwan	$4655	$4462 - $4664
FROZEN VEG. to Japan	$4901	$4629* - $5000
FROZEN FRENCH FR to Korea	$3513	$3337* - $3713
LETTUCE to Japan	$4750	$4750 - $7922
LETTUCE to Taiwan	$3648	$6255
BROCCOLI to Hong Kong	$4453	$4280 - $5878
CITRUS to Taiwan	$4154	$3802 - $4075

* Rates shown are tariff rates applicable to any shipper. Independent service contract volume rates for shippers who contractually commit cargo volumes to one carrier over time are: Hay to Japan $974 - $1162; Fumigated hay to Japan $1054; Cotton to Japan $1370-$1510; Cotton to Japan $1370 - $1510; Cotton to Korea $1658 - $1696; Beef to Japan $4000 - $4600; Pork to Japan $ 4075 - 4600; Poultry to Hong Kong $2958 - $3450; Frozen Veg. to Japan $ 4524 - $4901; Frozen French Fries to Korea $3492 - $3658.

conference service advantage. On most agricultural commodity movements we reviewed, the conference rate is somewhat higher, ranging from a differential of under 1 percent over non-conference (poultry to Hong Kong) to 8.5 percent (citrus to Taiwan). In general, the rate differential between the conference tariff rates and the lowest of the corresponding non-conference rates is about 2 to 4 percent.

Other Evidence of Competition

On every U.S. trade, there is heavy competition and excess capacity. Included among this excess capacity is enough unused non-conference capacity to exert adequate pricing discipline in the industry. With a wide range of alternatives, why would shippers, who have both sophistication and leverage, pay the premium? If somewhat higher conference rates were deemed too high for the premium service offered or exceeded the market value of the service premium provided by conference carriers, cargo shippers would and could fill non-conference vessels before giving cargo to conference carriers. However, they are not doing so. Since non-conference carriers in the export trade to Asia have substantial excess capacity, the marketplace must believe that the conference rate differential over non-conference carriers is a fair exchange for perceived better service.

The decline of the TWRA's share of U.S. agricultural exports to Asia illustrates the results of this competition. Worldwide, 86% of U.S. agricultural exports are carried by non-liner operators, only 11% by liner operators (45% by value) (Figure 1.) In the transpacific trade, non-liner operators account for 83% of the tonnage, liner operators 16%. Of that 16%, TWRA accounts for 53%, non-

TABLE III

MANALYTICS 1987 SURVEY

OF

LINER CARRIER PROFITABILITY

CARRIER PROFITABILITY

Carrier	Profits/Revenues (%) 1984	1985	1986	Profits/Assets (%) 1984	1985	1986
1	0.5	0.7	0.1	0.4	0.6	0.1
2	11.2	1.8	(0.5)	11.5	1.8	(0.5)
3	(2.7)	2.8	(9.0)	(2.5)	3.8	(13.3)
4	0.3	(1.2)	6.1	0.4	(1.4)	6.3
5	(5.2)	(2.1)	(6.5)	(3.8)	(1.9)	(5.9)
6	(4.1)	(2.9)	(5.4)	(3.3)	(2.7)	(5.0)
7	3.3	3.0	1.8	3.4	3.1	1.5
8	2.5	2.3	1.9	3.3	2.9	2.1
9	4.5	0.9	(3.1)	4.6	0.8	(2.4)
10	(loss)	9.7	5.5	(loss)	12.3	6.6
11	(7.5)	2.6	5.4	(8.8)	3.3	7.0
12	(loss)	(9.0)	(6.9)	(loss)	(7.4)	(5.5)
Total With Losses	2.80*	8.60	(10.60)	5.20*	15.20	(9.0)
Average With Losses	0.28*	0.72	(0.88)	0.52*	1.27	(0.75)
3-Year Average With Losses		0.04*			0.35*	
Total Without Losses	22.30	23.80	20.80	23.60	28.60	23.60
Average Without Losses	3.72	2.98	3.47	3.93	3.58	3.93
3-Year Average Without Losses		3.39			3.81	

(* Two carriers that had losses in 1984 did not provide the size of their losses in that year; to that extent, the returns are overstated.)

conference carriers 47%. (Figure 2.) On a comparable basis, in 1986 the conference accounted for about 76%.

One measure of the competition in ocean transportation generally and within the conference system specifically is the number of carriers who have left the trade since containerization became the industry norm. In that period, more than 20 carriers ceased to serve U.S. exporters in the trans-Pacific trades, 5 of them U.S.-flag carriers. The main reason the carriers left the trade is low profitability of liner operations generally.

In sharp contrast to the fanciful but attention-grabbing figures of conference critics, the liner carriers in most trades have not been incurring large profits. A few years ago, Manalytics surveyed profits as a percent of revenues and of assets among liner carriers throughout the world. For the years 1984, 1985 and 1986, the average profit for the twelve carriers was only 0.35% of assets employed. Even if one counts only profitable years, eliminating loss years, the profit averaged only 3.81% of assets employed. (Table III.) More recently and through this year at least, the carriers in the North Atlantic trade are generating negative returns on assets. Support for technological innovation, improved service and, ultimately, ship replacement depends on the prospects for success in the eyes of investors and lenders. With returns like these, the prospects will appear dim at best.

Even the carriers on the relatively more financially attractive trades, such as the transpacific trades, are not basking in excess profits. For example, American President Companies ("APC"), whose major component is American President Line

("APL"), generated a net income, in both 1991 and 1992, of only $68 per FEU, and this is following two years of net losses.[1/] How can an industry where the successful, such as APL, have a profit margin, following annual losses, equal to about 2% of revenues be "guilty" of creating a "conference premium" equal to (at least) 15% of revenues (as charged by the DOJ) or 18% of revenues (as charged by Dr. Ferguson)?

In fact, while there is generally a difference between the rates charged by conference and non-conference carriers, as we have seen, that difference is small. Some of that difference reflects superior conference service, which shippers consider in choosing among the many options available to them. Some of that difference reflects different conference vs. non-conference marketing strategies, comparative advantages, and utilization rates at various times. But it is abundantly clear that none of that difference gets translated into excess profits: the U.S. liner system is too competitive and too customer-driven, entry by new carriers and capacity expansion by existing carriers is too prevalent, shipper sophistication and leverage is too powerful, and shipper options are too numerous for that to happen.

In almost any trade, a commodity-by-commodity analysis would show that conference carriers generally charge slightly higher rates than do non-conference carriers - or, conversely, non-conference carriers generally charge <u>slightly</u> lower rates than conference carriers. There is an exception: some government-controlled non-

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1/ Source: APC Annual Report, 1992, page 8; net income divided by import, export, intra-Asia, plus domestic stacktrain FEU.

conference carriers sometimes charge significantly lower rates than either conference carriers or other non-conference carriers; an example is China Ocean Shipping Company in the transpacific trades.

The higher conference rates surely reflect superior service - whether that superiority is in service reliability, sailing frequency, transit time, intermodal options, equipment availability, breadth of market coverage, availability of special services (such as for temperature-sensitive commodities, garments on racks, auto parts, and oversized cargoes), etc. It is rare that a shipper has no practical alternative to the conference carriers. If there were no alternative, and if the conference were charging a high-yielding rate, the low barriers to entry in the U.S. foreign trades would quickly attract an alternative.

On any count -- carriers, sailings, or capacities -- there is ample competition in the U.S. foreign trades, increased by the provisions of the Shipping Act of 1984. Given that competition, current policy recognizes the special characteristics of liner service:

- the common carrier obligations and commitments of year-round regularly scheduled service;
- the enormous difference between average liner ship size and average liner shipment size;
- the high fixed cost/low marginal cost of the service;
- the substantial economies of scale for modern merchant ships;

- the combination of low unit costs and high service frequencies and port-pair combinations that today are possible only through inter-carrier cooperation;
- the prevalence of carriers with varying degrees of governmental ownership or direction and differing incentives with regard to commercial profit and loss criteria; and last but not least
- the American shippers' need for rate predictability and equity.

If current policy were changed and conference rate-making were prohibited, the short-term consequences would likely involve a transfer from carriers to shippers, followed by carrier bankruptcies and capacity and service contractions. Once the dust settled, the longer term consequences would be fewer but larger carriers, lower service and a tighter rate structure. Average rates would be higher, and commodities at the lower end of the rate spectrum (such as most agricultural products) might be priced out of the market. Given the choice, shippers probably would prefer the predictability and stability of conference rates and services even if it costs a few dimes more per ton.

III. RECENT CRITICISM OF CONFERENCE RATEMAKING

A 1993 draft USDA report, prepared by Dr. Allen R. Ferguson, asserts that a "'cartel premium' attributable to conference market power amounts to 18% of the cost of ocean transportation." This allegation is cited as if it were fact in the National Performance Review, where it is joined with a Department of Justice "estimate," derived from no independent research, that the current regulatory system "raises shipping prices at least 10 to 15 percent." The National Performance Review then claims that there exists an excess shipping cost, attributable to shipping conferences, for the entire U.S. liner service trades of at least $2 to $3 billion per year, repeating uncritically an extrapolation from the DOJ "estimate."

Focusing on a selection of agricultural export trade in five commodities on each of three U.S. trades, Dr. Ferguson asserts that, if the alleged conference premium were eliminated, agricultural shippers would gain $239 million per year in transportation cost savings, or, by increasing exports because of a lower landed cost in the destination countries, they would gain $400 million per year in increased revenue on those trades in those commodities. This figure has also been repeated as if it were fact by the National Performance Review. Neither the DOJ estimates nor the Ferguson report have any reliable empirical evidence to support the statistics which they trumpet, and their claims are contradicted by both economic theory and common sense, to say nothing of actual rates charged by conference and non-conference carriers which are readily available from government or industry sources.

The DOJ estimates and the Ferguson report are not credible on their face. For example, the DOJ figures of $2 to $3 billion per year, when averaged over the approximately 5.13 million FEU moved in the U.S. liner trades in 1992 by both conference and non-conference carriers, represent approximately $400 to $600 per FEU. If these excess profits were to be spread over only the members of the various conferences whose allegedly anti-competitive actions and higher-than-non-conference rates create these excesses, the DOJ figures would represent $550 to $830 per FEU.[2/] Yet the average rate for moving a forty-foot box of dry cargo from the U.S. West Coast to the Far East is only $1450-1500.

Lest anyone think the FEU figures are an unfair distortion and exaggeration of their authors' intent and meaning, a review of their works will indicate quite the opposite: the DOJ calculation, which is quoted by the National Performance Review, claims that its estimate is "CONSERVATIVE" (emphasis in the original) because it derives from the impact of only a "modest" pro-competitive reform. (See Attachment to the Fones Memo.) Dr. Ferguson refers to his findings as understated because they do not include the likely even more important factor of the "conference umbrella" raising every carriers' rates.

The figures promulgated by the critics of the conference system represent a serious disregard for legitimate, scientific method and valid quantitative research and

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2/ These calculations are based on the DOJ's estimated conference market share of 70%. [Source: Fones, Memorandum to Maritime Revitalization Working Group, April 27, 1993, page 3.]

inference. The Ferguson report and the DOJ "estimates" reflect the incorrect presumption that, if an industry is permitted an antitrust exemption, then that industry is automatically a "monopoly" or a "cartel" and invariably produces anti-competitive market results. A more open-minded approach would first identify, and measure, the degree of competitive structure, behavior, innovations, improvements, efficiencies, and overall performance in the trades. Then it would seek to examine whether the residual variance from the classical, competitive model is significant and whether there is a reasonable alternative structure.

The critics of the liner conferences continually cite and cross-reference each other, as if a supposedly independent citation to an alleged fact gives credibility to both the referrer and the referent. In truth, there is no relevant corroboration for the recent figures offered by Dr. Ferguson or the DOJ. Their two figures stand alone, unsupported by other studies. (See Figure 7)

The Ferguson Study

Dr. Ferguson's report is a seriously flawed document, with internal inconsistencies, a statistically insignificant database and anecdotal estimates paraded as hard facts. Basically:

* Ferguson has inadequate data to reach <u>any</u> conclusions.
* Ferguson's conclusions are inconsistent with actual conference and non-conference rates, which he did not consult.
* Ferguson's data and the minimal external data cited do not support his own estimates.

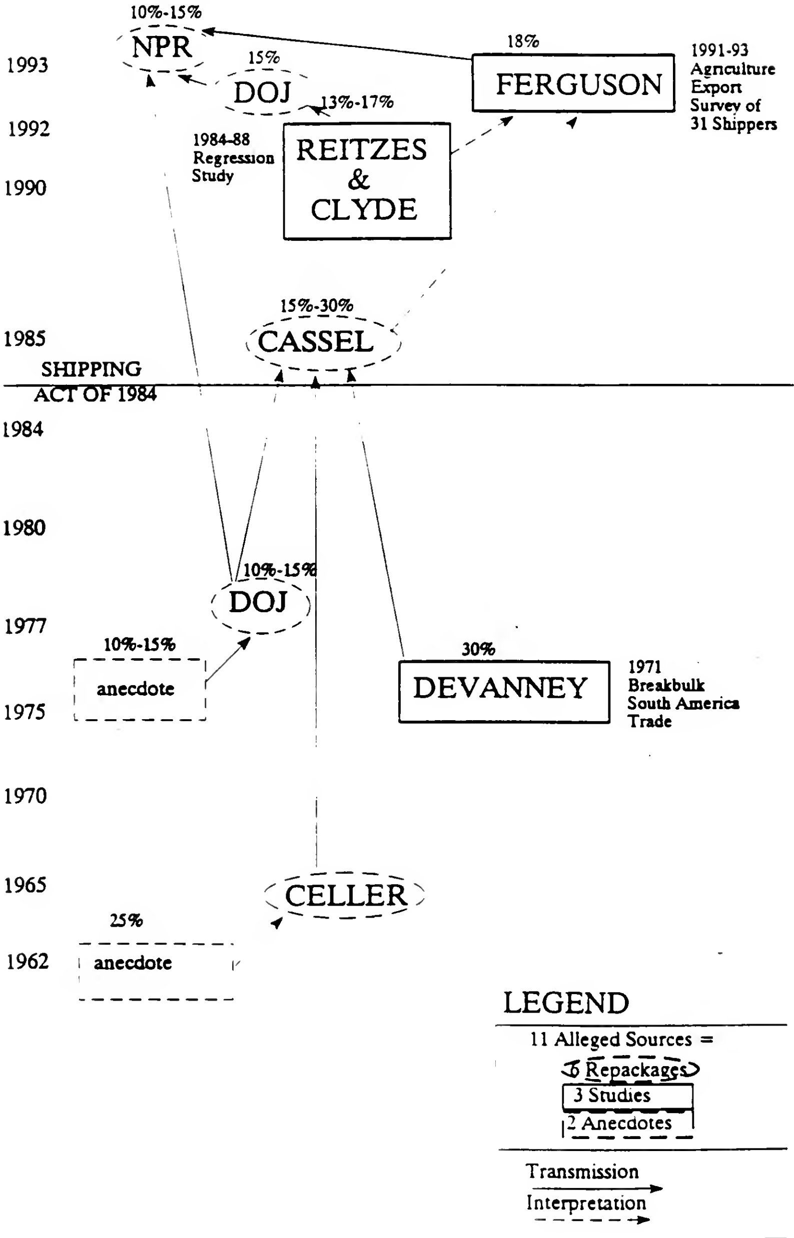


Figure 7

* Ferguson's model (method of estimating) cannot support his estimates even if data were available.

Dr. Ferguson's draft report is difficult to critique in part because there is so little documentation, internal support, or underlying detail. The essence of the report is his conclusion regarding the "conference premium" -- derived, he claims, from his review of survey questionnaires returned by a very small number of shippers, and his judgmental determination of what the premiums are. Dr. Ferguson himself warns repeatedly throughout his paper that the data are flawed, the sample size is statistically insignificant, the reasoning is uncertain, and the conclusions are speculative.

This report simply does not reflect legitimate research. Dr. Ferguson presents no verifiable facts from which a third party could corroborate his results. He presents no base data with which we could evaluate his conclusions. We are not given the completed questionnaires, and we do not know what the survey respondents believed were the actual rates available in the trade; thus no one (including Dr. Ferguson) can evaluate whether their responses were reliable or mistaken.

Data Collection

Dr. Ferguson's research design for collection of data is so fundamentally flawed that such research cannot be used for any sensible conclusions regarding how conference rates compare to any other rates, actual or hypothetical. In short, his survey design did not elicit any statically significant data from which an inference

could be drawn that conference prices include a premium reflecting market power, much less measure the size of the alleged premium.

The primary flaw is his exclusive reliance on questionnaire responses which neither he nor anyone else can verify. Respondents were asked to draw conclusions about how much conference rates for the goods they shipped differ from other rates but not to provide any information or documentation to support their answers. Dr. Ferguson never gathered data from his respondents on rates actually paid to each carrier, volume, date of shipment, etc. Further, he inexplicably never examined filed and published tariff rates and public data bases, discussed above, that provide objective, verifiable data that contradict his conclusions.

The sample of the shipper population from which the responses were obtained was both non-random and highly biased -- two independent reasons why no valid conclusions can or should be drawn from the study. The Agricultural Ocean Transportation Committee ("AGOTC"), whose members were polled, is a political opponent of conferences and the conference system, and it distributed the surveys with a cover letter soliciting "ammo" to use before Congress in attacking current regulation of ocean shipping. Moreover, the size of the sample was extremely small (only 31 shippers answered the questionnaire fully), suggesting that only the AgOTC

"faithful" responded to the call. Dr. Ferguson acknowledges that the size of his sample is insufficient but nonetheless proceeds to generalizations based upon it.[3/]

The two or three survey questions on which Dr. Ferguson's findings are based are so ambiguous, particularly to an informed respondent, that the answers, unsupported by quantitative data, have no meaning -- either to Ferguson or to the reader of his study. First, respondents were asked to state or estimate the "difference between [the] conference tariff rate and any other rate you used in 1992 for comparable service." A response could have compared any of the following: (1) rates which were in effect at different times; (2) conference tariff rates (which may have moved little or no cargo) with lower conference independent action rates (which did move cargo); (3) conference tariff rates with conference service contract rates; (4) conference tariff rates with non-conference tariff rates; (5) conference tariff rates with non-conference service contract rates; or (6) conference tariff rates with charter rates. Second, a respondent could have construed the imprecise term "comparable service" in any of a number of ways. Finally, the questionnaire permitted replies using estimates instead of actual rates without any limits as to the accuracy of such estimating. The respondents most likely approached the questionnaire with the intention just to fill it in, not to research the answers.

3/ Dr Ferguson does not report on sample variances. Given the very small size of his sample, such variances would very likely have shown that his conclusions have no statistical significance or reliability.

It is peculiar that Dr. Ferguson would attempt to find a premium in conference tariff rates through an opinion poll. All carriers in the foreign commerce of the United States must, by law, file their rates with the FMC, and (except for a few "exempt" products) those rates are published. So why rely on shippers' memories instead of comparing for a given time conference tariff rates, conference service contract rates, conference member independent rates, and non-conference carrier tariff and service contract rates?

Use of Data Collected

Dr. Ferguson uses the survey responses to estimate what he terms the "conference premium" -- the amount by which conference rates supposedly exceed a hypothetical "competitive" rate. Even if there were no deficiencies in his sampling and all responses were presumed accurate, such conclusions cannot be drawn from the information that the questionnaires gathered.

First, the questionnaire is worded so as to invite a comparison between the respondents' memory of conference tariff rates and best rates obtained. Since all rates for every carrier vary over time, this selective comparison is illogical, uninformative, and invalid: any carrier will have some rate that is better than its own or some other carrier's average rate.

Second, the questionnaire permits comparison of conference tariff rates to other conference rates, including independent action rates or conference service contract rates, as a measure of "conference premium." This compares the conference to itself! Where independent action rates exist alongside conference-wide rates, very

often no significant volume of cargo moves on the conference-wide rate, which remains virtually an irrelevant "paper rate" applicable only to the conference carriers who do not actively compete for the cargo in question.

Third, Dr. Ferguson makes no attempt to test his hypothesis of an 18 percent "conference premium" by comparing actual current, published conference rates to the rates of the independent liner carriers with whom the conference carriers compete. As we have seen, the actual differential between conference rates and the rates of independents is very small (about 2 to 4 percent) in the transpacific export trade which we examined. Dr. Ferguson's report offers no explanation of how his hypothetical figure can be reconciled with the actual rates as observed in published tariffs on file at the FMC.

Errors and Anomalies in the Data Reported

Ferguson's reported overall quantitative summary cannot be derived from his individual commodity/trade results. Throughout his study, results with respect to specific commodities are reported which, if not flatly impossible, seem most unlikely.

Some of the reported results are literally impossible. For example, for the largest volume (dollar value) on which Ferguson reports, wood exports to Japan, he gets a "conference premium" equal to 12.5% of the c.i.f. price, and an "ocean transport cost" of only 12% of the c.i.f. price. This premium is logically impossible, since the part cannot exceed the whole.

Some of Ferguson's individual commodity results are clearly erroneous to anyone with knowledge of the industry. A large part of the calculation of the total

impact of the "cartel premium" appears to be derived from figures on wood exports to Japan. More than half of those exports ($0.65 out of $1.31 B, or 57%) are wood chips. (See his Table V.) Wood chips move almost exclusively in non-liner service. There can be no "cartel premium" on wood chips, but Ferguson gets one by applying numbers that must have come from lumber shippers (if they are shipper responses at all). Consider that the value per metric ton of chips is around $50 (per PIERS). An ocean freight rate of 12% (as reported by Ferguson) is therefore $6 per ton. A full container with 20 tons would be rated at $120—a ridiculously low rate for liner shipping. Yet Ferguson presumes that it has some relevance to liner service.

Ferguson's data on cotton to Europe show an ocean rate of .006 times the c.i.f. value. Cotton is valued at $1,680 per ton f.o.b. (PIERS); therefore, an ocean rate of .006 would be $10 per ton, or $200 per container. Ferguson's "conference premium" of .55% of c.i.f. value would amount to $85 per ton or $1,700 per container -- $1,500 more than Ferguson's ocean freight rate. This sharply overstates the measured "conference premium" because the ocean freight rate is clearly understated.

For one particular commodity, a strange set of assumptions was made by Ferguson. For treenuts to Taiwan, Ferguson apparently had no data, so he used the Japanese ocean cost as a ratio of c.i.f. value (footnote 26). Why? Are the two trades are similar? Then, again for treenuts to Taiwan, for the conference premium, again with apparently no data, he used the service contract discount for the European Community (footnote 27). Why switch the numerator in the ratio to the European

Community, while the denominator stays in the transpacific area? Service contracts, individually negotiated, are unique as to time and trade and place and participants.

Our Table IV reproduces some date from Dr. Ferguson's Table V, V-A, and V-B. Column one of Table IV is the ocean transportation cost (actually paid) as a percent of c.i.f. (which we assume is the same as landed cost). Column two is the conference premium calculated by Dr. Ferguson from the survey returns as a percent of c.i.f. Column three is the ratio of conference premium to the ocean cost expressed as a percent (column two divided by column one).

Looking at Column three, there are fifteen line items, ranging from 8 percent to 104 percent. Two of the fifteen cases are questionable: wood to Japan, where the conference premium is 104 percent of the transport cost; and European Community cotton, where the ocean transport cost is a ridiculously low 0.6 percent of c.i.f. A simple arithmetic average of the remaining 13 cases yields a conference premium of 18.3 percent. Lacking any indication of Dr. Ferguson's report as to the derivation of the 18 percent he uses, we believe he may have followed the logic we just described.

As noted above, Dr. Ferguson's estimate of an alleged "conference premium" of 18% on the export of agricultural commodities (Finding #1, page 3) cannot be derived from the individual commodity by route data he has presented. Of the 5 premiums he calculates as "Reductions in ocean costs as % of ocean costs," only two -- 20% for Fruits and Vegetables and 30% for Seeds, Treenuts -- can be derived from his data in Tables V, V-A, and V-B.

TABLE IV
FERGUSON'S SAMPLE DATA: ANALYSIS

Country	Commodity	Ocean Transportation Cost % of CIF	Alleged "Conference Premium" % of CIF	Alleged "Conference Premium" ÷ Ocean Transport Cost %
		1	2	3=2÷1
Japan	Wood	12.00	12.50	104
	Fruits & Vegetables	30.00	6.00	20
	Cotton	7.00	0.06	1
	Cattle Hides	6.00	0.77	13
	Treenuts	3.00	0.90	30
European	Forest Products	13.30	1.41	11
Community	Fruits & Vegetables	30.00	6.00	20
	Seeds	30.00	7.50	25
	Treenuts	4.10	1.23	30
	Cotton	0.60	0.55	92
Taiwan	Solid Wood Products	14.00	2.66	19
	Fruits & Vegetables	62.00	12.40	20
	Hides & Skins	6.00	0.96	16
	Treenuts	3.00	0.90	30
	Cotton	9.20	0.74	8

Dr. Ferguson then measures the impact of the alleged "conference premium" as $239 million of freight charges. (Finding #2.) That $239 million figure also cannot be derived from the data he has presented. Of the 5 ratios he shows in his Table II under minimum gain as percentage of revenues, none can be derived from his Tables V, V-A, and V-B.

Then in his Finding #3, Dr. Ferguson adds in the estimated revenue gains from increased export sales, to reach his total impact of $400 million. That $400 million figure also cannot be derived from the data he has presented. In his Finding #3, Dr. Ferguson claims to be "[a]dding the estimated increase in the volume of exports expected to flow from reduced delivered prices" to reach his total impact of $400 million. His equations, at page 28, however, also show a summation being performed. To have performed such a summation would mean Dr. Ferguson has committed a logical error; it would mean he has double-counted, because the exporters cannot both save the freight expense (put the dollars in their pockets as increased revenue) and also pass the same dollar savings on to their customs in order to increase sales. (As the saying goes, you can't have your cake and eat it.)

Dr. Ferguson dismisses as "insignificant" (p. 18), yet without explanation, that shippers in *his* own survey *preferred* the service quality of the conference carriers, by a ratio of almost 3:2. As noted above, the slightly more expensive conference carriers usually deliver a higher quality of service to the shipper. Coupling that higher service level with the rate and capacity stability that conferences contribute the conferences earn any premium that may exist.

Ferguson has admitted to a very low response rate to his questionnaire survey, on which he based his entire study. He reported that

> "The most obvious deficiency in the study is the paucity of data. The total number of responses on which the findings . . . are based is only 31. Since the responses do not constitute a statistically reliable sample, the results cannot be expanded to produce significant estimates of the total costs to the American economy of conference practices." (p. 18)

He may well have sent out hundreds, if not thousands, of questionnaires, which suggests that a great many shippers may be content with the system as is, and therefore did not bother to answer a questionnaire sent out by a group and author avowedly opposed to conferences.

The DOJ "Estimates"

We turn now to a critique of the study underlying the DOJ "estimates" which have been repeated uncritically in the National Performance Review, and other sources on which DOJ or Ferguson have relied as support for their estimates of conference premiums.

1. Reitzes & Clyde, *Empirical Analysis of the Structure of Freights Rates in Liner Shipping* (1992).

The DOJ "estimates" appear derived exclusively from a 1-page summary prepared by a DOJ attorney, Roger W. Fones, and sent to the Maritime Revitalization Working Group in April 1993. His interpretation of one minor finding from a simplistic study performed by economists from the DOJ and the FTC is unwarranted.

The authors of the referenced study are James Reitzes and Paul Clyde; their paper is also cited by Ferguson as support for his conclusions.

Reitzes & Clyde never drew the "conference premium"/"conference market power" conclusions for which Mr. Fones and Dr. Ferguson have argued. Notwithstanding these later unscientific attempts to extrapolate from their work, they never attempted to measure or calculate a "conference differential." Importantly, the DOJ "estimates" have no independent empirical basis.

The Reitzes & Clyde study is based entirely on the observation that, in 1985 and part of 1986, the transpacific westbound conferences allowed members to negotiate independent service contracts. It attempts to correlate econometrically fluctuation in rates with changes in the conference agreements.

This study was so poorly designed that it "explained" a mere 16% of the rate fluctuations it was examining. In statistical terms, their econometric equation had what is called an "R-squared" of 0.16. Thus, in fact, their model "explains" virtually nothing. It is a fundamental, practical, statistical rule that, in econometric studies, if one fails to explain 5/6 of the changes, such as changes in rates over time, no important conclusions about individual factors can be derived. Simply put, statistically, the DOJ's estimates, based on the Reitzes & Clyde study, have no practical merit.

Furthermore, two major misspecifications invalidate even the meager results Reitzes & Clyde obtained regarding the impact of independent service contracts. First, the study's independent action analysis misspecified and reversed the correct

causality: prior to 1985, the rates had already been falling steadily for two or three years because of a short-term demand/supply imbalance in the transpacific trades. Thus, the low rates were not caused by independent service contracts. Nor was the subsequent rate recovery, which followed upon the trade's economic upturn, caused by the absence of independent service contracts.

Second, the model's poor explanatory power arises because the underlying economic variables are disregarded and are replaced by an *average* yearly impact, which averages economic conditions *over all twenty* U.S. liner trade routes covered. Reitzes & Clyde report that in their model, "the inclusion of the variables, $YEAR_t$, was intended to capture yearly rate changes that resulted from changes in those factors affecting the *overall* demand for and cost of ocean-shipping services . . . (such as) changes over time in exchange rates, interest rates, labor costs, and the level of economic activity." (Emphasis added) The clear deficiency in this model is its failure to consider the distinctive demand and supply conditions *on each particular trade route*.

Most important but overlooked by Reitzes & Clyde's discussion of service contracts, which is derived only from the transpacific trades, is that the transpacific trades were very atypical in that 1984–1988 era, because they had the widest swing between the trade recession of 1984-86 and the trade boom of 1987-88. For the sum of the Far East outbound trades plus the South Far East inbound trades - - where independent service contracts were not present in 1987/88 - - the ratio of boom to bust was over 50%. In the U.S. North Atlantic trade with North Europe and Italy, as

reported by FMC, the 1987-88 annual cargo volumes exceeded the 1984-86 annual cargo volumes by only 5%.[4]

Thus, what Reitzes and Clyde picked up in their poorly specified model was the unique economic bust/boom sequence in the transpacific trade, generally reflected in rate changes. It is this geographically specific impact that Reitzes & Clyde misspecified as the impact of disallowing independent service contracts.

There is a striking "result" in the Reitzes and Clyde study which ought to be of great significance to the members of this subcommittee. While the correctness of the exact figures in their study must be seriously questioned, the rate structure feature of the liner trades, which Reitzes and Clyde also identified, is clearly a fact of life. Simply put, what this means is that certain groups of commodities pay lower freight rates than others; agricultural commodities generally are in the former group.

In conclusion, Dr. Ferguson misrepresents Reitzes and Clyde. He claims that "they calculated a conference differential of between 12.8% and 16.8%" (p. 10) and that they found an increment of rates "attributable to conference market power." They did not. Although Reitzes and Clyde did discuss conferences and market power, they did not use the terms "market power" or "conference differential," or calculate such a differential when they discussed their findings related to independent action on service contracts. It is Dr. Ferguson who has manipulated their figures to draw his conclusions. These conclusions do not appear anywhere in their study. Dr.

4/ Source: FMC data, published in FMC Section 18 Report on the Shipping Act of 1984 (1989); it is updated through 1988.

Ferguson may well choose to infer whatever he chooses from their study, but he should not attribute his conclusions to them.

2. Cassell, *Exemption of International Shipping Conferences From the American Antitrust Laws: An Economic Analysis*, 20 New Eng. L. Rev. 1 (1985).

The only other publication which Ferguson cites as support for his attempted quantification of "conference premium" is a 1985 law review article written by a 1984 law school graduate. Cassell did no research; he merely cites the opinions of others and reports an "excess price" range of from 15% to 30%. His 30% figure is from Devanney, et al., the only one of his sources which conducted empirical research.

3. Devanney et al., *Conference Ratemaking and the West Coast of South America*, 9 J. Transp. Econ. and Policy 156 (1975).

The Devanney study, done in 1975, covering data from 1971, looked only at the tiny, non-containerized (breakbulk) trade between the U.S. East Coast and the West Coast of South America. Any attempt to apply conclusions drawn from Devanney to the major U.S. liner trades of today is particularly egregious when one examines the specific situation that Devanney studied, and the methodology employed as the basis for his conclusions. In a very important sense, the Devanney paper actually represents a repudiation of Dr. Ferguson and the DOJ.

First, whereas Dr. Ferguson, seconded by the DOJ, alleges that the difference between actual rates paid and published tariff rates measures an alleged conference premium, Devanney, based on an interview with one of the 4 operators on the route,

acknowledged that the actual revenue that the conference was earning was 15% below the figures derived from the tariff, because the cargo actually moved at "negotiated rates", a factor that Devanney took into account in his conclusions. (Devanney at 163, 169.)

Second, the Devanney estimate of excess freight costs associated with conferences was based on an elaborate cost model, whereby the authors undertook the serious and meaningful effort of conceptually designing and measuring an "efficient liner system," and then compared it to the one that was actually in place at that time in that particular trade. In their proposed model, they replaced the existing 25 small ships with a fleet of from 8 to 11 ships "considerably larger and considerably slower." (Id. at 176.) Thus, Devanney directly undertook research to try to measure the cost-based inefficiencies in that trade, in marked contrast to Dr. Ferguson's efforts.

4. Antitrust Subcomm. of the House Comm. on the Judiciary, *The Ocean Freight Industry*, H.R. Rep. No. 1419, 87th Cong., 2d Sess. 285 (1962) (Cellar Report).

After citing Devanney, Cassell quotes a 25% figure based on a single statement from a single shipping line executive quoted in the Celler report from 1962 -- over 30 years ago -- which report, whatever its merit at the time, has long been taken into account in subsequent congressional study and action on the U.S. liner trades.

5. U.S. Dept. of Justice, Report on the Regulated Ocean Shipping Industry (1977).

Cassell cites the 1977 DOJ figure of 15% as representing the difference between what conferences and independents charge. The DOJ was, therefore, referencing the trades of 16 or more years ago, or at least seven years before the pro-competitive features of the Shipping Act of 1984 were put into effect. Moreover, no empirical study of conference ratemaking was conducted for this 1977 DOJ report, and it identifies no source for the figures that it states. Cassell, in his reference, qualified the DOJ's 1977 anecdote-based comparison as possibly an *overstatement*, since the DOJ itself noted that the independents provide inferior service. (20 New Eng. L. Rev. at 18.) However, Cassell then took it upon himself to render a judgment that the 15% "more likely understates the magnitude since independents may raise their rates above the competitive level because of the rate umbrella of the conferences," although Cassell cites no empirical observations, and only relies on the opinions of other authors stated in 1973 and 1969. (Id.) Ferguson also believes in this alleged, but never measured, "umbrella effect."

In sum, there is no corroboration in the prior literature for the estimates which Dr. Ferguson and the DOJ have announced to the National Performance Review, this Subcommittee and the press.

SELECTED PAPERS BY ELLIOT SCHRIER
MANALYTICS INTERNATIONAL, INC.

1. "Some Thoughts on Demand, Capacity and Rates," February, 1993; the Agricultural Ocean Transportation Coalition, San Diego, California

2. "The Outlook for the Container Industry," November, 1989; Cargo Systems Fifth Container Conference, Hamburg, Germany

3. "Trends in Ocean Transportation," October, 1988; The Singapore National Shipping Association, Singapore

4. "Container Shipping," December, 1987; Cargo Systems Third Container Shipping Conference, Amsterdam, The Netherlands

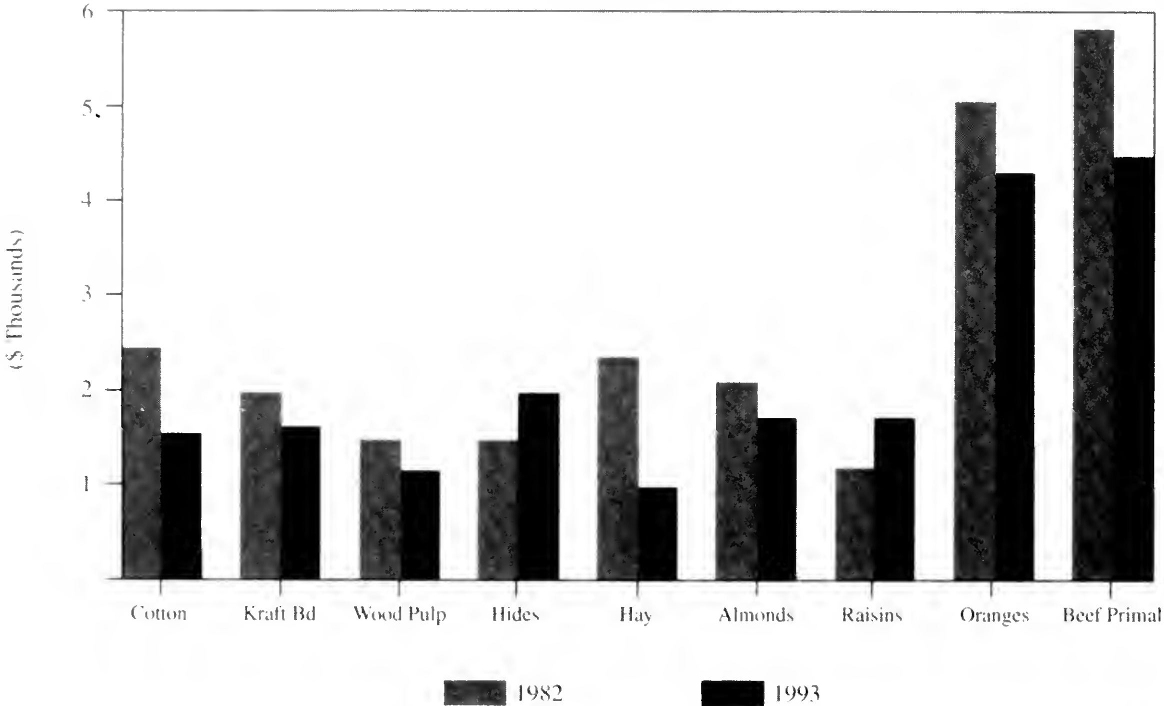
5. "Megatrends in International Maritime Policies," October, 1984; The Port of Oakland Conference on Megatrends in International Commerce, Oakland, California

6. "International Maritime Transport Services: The Outlook for Liberalization," June, 1984; The Trade Policy Research Centre, Wiston House, London, England

7. "Forces Shaping International Maritime Transport," March, 1984; The World Economy, Volume 7, No. 1, pp 87-102

8. "The UN Liner Code: A Symptom, Not a Cause," November, 1983; The Center for Ocean Management Studies, University of Rhode Island, Kingston, Rhode Island

9. "Liner Conference Policy: Organization and Environment," March/April, 1980; Transport 2000, pp. 14-16


Comparison of "All-in" rates per FEU
U.S. West Coast to Japan
($ Thousands)
6
5
4
3
2
1
Cotton
Kraft Bd
Wood Pulp
Hides
Hay
Almonds
Raisins
Oranges
Beef Primal
1982
1993
Source: TWRA

Mr. CONDIT. Mr. Greenberg.

STATEMENT OF JOEL GREENBERG, DIRECTOR OF WESTBOUND PRICING, AMERICAN PRESIDENT LINES, OAKLAND, CA

Mr. GREENBERG. Mr. Chairman and members of the subcommittee, I would like to thank you for this opportunity to address the subcommittee. My name is Joel Greenberg. I am director of export pricing for American President Lines. I have been employed by APL for 13 years, and I have 30 years experience in the transportation industry, both international and domestic.

APL is a California-based company, running 23 vessels in a transpacific trade under the American flag. I prepared a written statement for today's proceedings and would ask the committee to accept that statement.

Mr. CONDIT. Without objection.

Mr. GREENBERG. To save time, I will dispense with reading my statement, and will address four points which I believe are pertinent to today's hearings. They are: Industry efficiency, competitive pricing, how we negotiate rates in the transpacific trade, and the impact of conference ratemaking on export volume.

First is industry efficiency. Critics, such as Dr. Ferguson, describe our industry as being inefficient, resistant to change, and one that maintains excess capacity by monopoly pricing. This view does not accurately portray our industry.

Our industry has made huge gains in productivity, increased efficiencies of operation, developed larger, faster vessels, and more efficient terminals. We have pioneered automation and we have developed systems that track cargo in our system throughout the world.

The gains achieved by the carriers have not been wholly retained in the pockets of the carriers, but most have been returned to the shippers and customers in the form of rate reductions. Further, individual companies such as APL have developed and introduced new systems and technology that have resulted in new markets being open for agricultural shippers.

For example, APL developed the technology to convert chilled beef from air cargo to ocean cargo. This opened the market in Japan for chilled beef, and reduced the cost for the shipper and the purchaser.

We have also developed technology to move fresh fruits and broccoli from California to Asia. This technology was developed individually by APL and jointly with USDA, the U.S. military, and universities such as U.C.-Davis.

I have a list that I will add to the record of other improvements.

The second area is competitive pricing. I would like the subcommittee to bear in mind that shippers of agricultural products have a number of options available. They ship their products in the transpacific trade. As nonconference carriers have sufficient empty space available to handle additional cargoes, the shippers have, to a large extent, made the business decision to remain with the conference carriers because of the combination of price and service offered by the conference carriers.

The conference carriers, for the most part, compete against State-controlled carriers. They compete against carriers controlled by

conglomerates. They compete with outside members, people that are not part of the conference, and they compete among themselves inside the conference. All of which are competing for the same business, moving in the same trade lanes.

So, it is highly competitive. And it is important to note that the shippers decide what they are willing to pay, and who they are going to use. It is their decision. If the spread between the conference and the nonconference carriers were as great as Dr. Ferguson described, a larger portion of the cargo would certainly move on nonconference carriers.

No. 3, how does the conference negotiate rates? We use several different methods to create rates. First of all, we use seasonal rates on commodities. We meet with the shipper groups to learn about their cargo needs, their competitive factors. From these meetings, such as the cotton shippers, we develop rates that are agreed to by the shippers and carriers, and are held for the entire shipping season. They don't get an increase.

We do business by commitments whereby individual carriers meet with individual shippers, negotiate rates for the coming season or for a prescribed time. These rates are then either published as group rates in the conference or the rates are published as independent actions.

We publish group rates. This is where the members of the conference meet once a week, take the input from the shippers and from their sales people and decide jointly on rates. We also negotiate rates through independent action that are adjusted by a specific carrier for a specific piece of business at a specific time.

In 1993 year to date, TWRA members have done over 30,000 IA's. All of the above methods are used to satisfy customer requirements, to meet their pricing demands, and to move cargo.

My fourth point is the impact of the conference ratemaking on export volume. In my experience as director of export pricing, I haven't seen any instances where transportation costs have prevented cargo from moving. We are in the business of moving cargo. The transit cost segment is too small a portion compared with other factors to really affect cargo movement.

Thank you.

Mr. HORN [presiding]. Thank you, Mr. Greenberg.

[The prepared statement of Mr. Greenberg follows:]

BEFORE THE SUBCOMMITTEE ON INFORMATION, JUSTICE AND AGRICULTURE
COMMITTEE ON GOVERNMENT OPERATIONS
UNITED STATES HOUSE OF REPRESENTATIVES

Statement of Joel Greenberg, Director of Westbound (Export) Pricing, American President Lines
September 30, 1993

Mr. Chairman and members of the Subcommittee. Thank you for the opportunity to address the Subcommittee.

My name is Joel Greenberg. I am director of export pricing in the United States/Asia trade for American President Lines. APL is an American company. Its parent company is publicly held. I am pleased to report that APL is widely recognized as the premier multi-modal containership operator in the trans-pacific trade. Its service is the model that is most copied by our foreign competitors.

I have been employed by APL for thirteen years. I have thirty years experience in the domestic and international transportation industry. One of my chief responsibilities at present is the pricing of ocean transportation of United States agricultural exports moving to Asia -- a large, growing and important market both for APL and agricultural exporters.

Agricultural exports are a very significant part of APL's export business, and APL is an aggressive competitor for these products. We have to be. The ocean carrier industry is intensively competitive in pricing and that is particularly so in major export trades like the trade to Asia. Price and service competition among ocean carriers is at its most intense in the agricultural product sector of the export market.

Most agricultural products not requiring costly refrigeration move at ocean rates that are at the extreme low end of the ocean rate spectrum. They are in a sense subsidized by higher rated import cargoes on which rates are generally higher, reflecting higher vessel utilization and cargo value in import trades. Given the high costs of transporting refrigerated cargoes even the substantially higher rates on these commodities are a bargain. Adjusted for inflation ocean rates on agricultural exports today -- including refrigerated commodities -- are substantially lower than they were two decades ago. Some of these rates on agricultural commodities are lower today than they were ten years ago even without adjustment for inflation.

Why is this so? There are two basic reasons in my judgment.

First, ideological critics of our industry, like Mr. Ferguson, who seem to know very little about it describe our industry as inefficient, moribund, resistant to change, or as fecklessly maintaining excess capacity by monopoly pricing. Nothing could be farther from the truth. Led by carriers like APL the liner containership industry is highly dynamic. It has achieved huge productivity gains and efficiencies over the last twenty years, by improvements such as containerization, larger vessels and more sophisticated fleet deployment systems, multi-modal operations, automated terminals and electronic data interchange.

Second, ocean carriers have passed these productivity gains on to their customers through: (a) greatly reduced rates,

especially on American exports and especially on agricultural commodities, reflecting the intensely competitive nature of pricing in the industry and (b) vastly improved service, ranging from faster transit times, multi-modal coordinated service to and from inland points to highly sophisticated and costly specialized equipment which allows American fresh produce and fruit to appear on Asian tables in perfect condition. Similarly, companies like APL have helped agricultural exporters develop new markets by working with them to provide new technology and expertise.

The only other industry I can think of that may have outstripped ours both in achieving enormous productivity gains and passing most of them through to customers in the form of both lower prices and better product is the personal computer industry.

In our industry, as in the computer industry, rapid modernization has come at a terrible price for many carriers. The inefficient, the undercapitalized and the timid have been eliminated. APL, for example, is one of the few ocean carriers that was a participant in the trans-pacific trade in the early 1960s that is still there. Most of the others, including many lower cost Asian carriers and some operationally excellent American flag services, have gone out of business, left the trade or been merged into larger surviving companies. APL is a survivor because it is an innovator, because it built sophisticated inland/ocean intermodal networks and because it invested heavily in capital equipment.

Ocean carriers in my judgment have passed along too large a portion of their productivity improvements in the form of lower rates. Doing so creates the risk of long term return on investment that may jeopardize future investments. Those investments are necessary to keep pace with the anticipated growth of international trade, to achieve further increases productivity and service and to beat our foreign competition. Most ocean carriers are gravely and legitimately concerned that bitterly competitive pricing conditions in the industry and consequently low rates could inhibit future capital investment necessary to maintain productivity improvement and ever better service.

I also ask the Subcommittee to bear in mind that companies like APL compete head-to-head with State-controlled carriers, carriers affiliated with large foreign manufacturing and exporting conglomerates, and foreign carriers having lower capital, labor and other costs. We have been the productivity leaders, but we can only maintain our edge by innovation, good management and first class capital equipment. An adequate return on investment is essential to that end. Fair rate levels and reduction of price volatility and instability are indispensable to an adequate return and to our ability to attract capital and increase productivity and efficiency.

APL is a member of ocean rate conferences. Conferences share a common purpose with agricultural cooperatives. Both seek to stabilize prices and have an antitrust exemption to do so.

Conferences which face far more competition, however, are much less effective in doing so. APL participates in conferences because (1) we believe that conferences assist to some degree in reducing short term rate volatility and (2) because conferences appear to be the only means, other than direct marketplace intervention by the governments of the main maritime powers, by which predatory rate wars and the destruction of national merchant marines and investments therein can be avoided.

Critics of conferences, including Mr. Ferguson, seem to have no understanding of the realities of conference pricing and of its actual effects. I am not an economist. I am a practical businessman, and I know my industry. Here is what I have observed:

1. This industry is intensely, often bitterly, competitive both on the basis of price and on the basis of service. Conference rates are set in the first place to reflect competitive conditions including prices and rates from third country sources of supply. They also reflect in many cases rates negotiated with shippers which reflect competition in the marketplace. Conference members also compete directly with charter operators and with non-conference container carriers who have nearly half the trans-pacific <u>liner</u> (non-charter) market alone. But conference members like APL also compete with other conference operators, and it competes with them on price. Most major moving agricultural exports moving on conference vessels move at rates set by independent actions of conference members,

so that the conference rate is often determined by independent actions of members or is determined by pricing action by non-conference carriers which conference members "meet" with independent rate actions. In the U.S. export conference to Asia alone, during the first seven months of 1993 over 30,000 rates were set or adjusted by independent carrier actions. These, in turn were followed by over 24,000 more independently set rates to meet that competition.

2. As non-conference competitors have upgraded their services to compete with ours there is very little room for us to price our services above non-conference or even above charter carrier levels. In fact, the gap between rates of major non-conference carriers and conference carriers on heavy volume agricultural commodities is very narrow and getting smaller. The notion of a conference pricing premium that adds up to 18 percent or anything remotely approaching that amount is, in my professional judgment and in my experience, absurd.

3. As I pointed out above, our industry is extremely lean and highly efficient. It has vastly improved both productivity and service quality simultaneously, while passing most of the savings through to customers. If the conference system is supposed to protect the inefficient, reduce innovation or prevent low prices for customers that reflect real market conditions, as our critics claim, by that standard it is a total failure. I suggest instead that without the conference system these efficiency gains and the very high quality of service provided to

agricultural exporters paying the lowest rates would have been substantially reduced. Fewer carriers would have been willing to risk the necessary large investments to bring these rapid improvements about.

4. Vessel overcapacity in export trades, which is largely responsible for unduly low rate levels, is not the result of industry inefficiency. It certainly is not an indicator of monopoly pricing or some imaginary "conference premium" in pricing. Capacity must be adequate to handle peak cargo movements in the trade direction that has the largest volume. In major U.S. trades, that is the import trade. Almost by definition having capacity available that is adequate for peak import moves causes overcapacity and unduly low rates in U.S. export trades where there is usually less cargo volume. There are also export bulges that cause vessel space to be short. If carriers do not have excess capacity in a trade most of the time, they will be unable to transport these export bulges when they occur. Agricultural exporters would be badly hurt if there were not standby capacity to handle seasonal or other export peaks. Further, carriers must plan new vessels years in advance in anticipation of trade growth during the 15-20 year life of vessels. New vessels must therefore have capacity that is adequate to handle future trade needs anticipated for the next fifteen years and also must be large enough to lower costs per cargo unit if the carrier is to survive.

Finally, in my experience and based on my frequent contacts with exporters and importers, ocean rate levels rarely cause cargo to move or prevent cargo from moving. In my many years with this industry, I have encountered no instance of cargo prevented from moving by ocean rates. Cargo moves because there is foreign demand for the product at the price and at the exchange rate. Ocean rates rise or fall to reflect supply of and demand for vessel space. When times are good for exporters (high sales) times tend to be good for carriers (higher rates).

Carriers and agricultural exporters are in the Pacific export trade together. They need each other and have basic mutual interests. These interests are best advanced in exporters recognized that carriers must make a reasonable return on investment just as agricultural exporters must. Just as many agricultural exporters export as cooperatives or associations having exemptions from the U.S. antitrust laws ocean carriers require the conference system to justify future investment.

Mr. HORN. Mr. O'Donnell.

STATEMENT OF FRANCIS O'DONNELL, DIRECTOR, CONFERENCES AND PRICING, ATLANTIC DIVISION, SEA-LAND SERVICE, INC., EDISON, NJ

Mr. O'DONNELL. Thank you, Mr. Chairman. My name is Francis J. O'Donnell. I am the director of pricing conferences for the Atlantic division of Sea-Land Services.

I would like to thank you for the opportunity to appear before you today. I believe we share the common objective of promoting and growing U.S. agricultural exports. I have submitted a statement for the record and I really won't repeat that now. I do, however, have a few additional comments.

Sea-Land is the largest ocean carrier in the world. We own and operate over 60 vessels worldwide, most of which are American flagged. We pioneered the entire concept of container shipping. We are also the largest container carrier serving the United States and carry more cargo in and out than anyone. We serve Asia, Europe, South and Central America, the Mideast and Indian subcontinent.

In addition, we have domestic services to Alaska, Puerto Rico, and Hawaii. As all carriers serving the United States agriculture, we are aware all agricultural commodities represent a significant and important portion of our volume.

At Sea-Land, we dedicate a great deal of human and financial resources to the carriage of this cargo. This includes such innovations as dry bulk containers for movement of bulk commodities through diverse interior locations, atmospheric-controlled refrigerator containers which allow the expansion of exports on highly perishable commodities.

To further illustrate the importance of agricultural commodities, the Atlantic division of Sea-Land that I represent manages its business by developing a strategic marketing plan. In this plan, we have segmented the entire export market into 29 strategic commodities. No less than 12 of these are agricultural.

Mr. Ferguson's report claims that agricultural exports are harmed by conference and carrier freight rates. That is simply not true. As a point of fact, our revenue per container has dropped significantly this past year on six of our agricultural strategic commodities.

I am in the market every day. It is highly competitive and shippers have many choices in who and how they export their products.

In addition to conference carriers, there are nonconference carriers, there are freight bulk carriers, there are ways to move cargo across the Canadian border to go to either Asia or Europe and so on. We must aggressively market our service in order to stay in the market.

What is of great concern for us and has cost carriers and exporters millions of dollars is the imposition of trade barriers that inhibit U.S. agricultural exports and deprive the exporters of more opportunities.

As a final comment, we noted in some earlier testimony and statements, concerns about recent increases in rates on certain fruits and nuts to Europe. These people are our customers and we are certainly sensitive to those comments, but we feel we must put

them in perspective. I will cite two examples, and they are representative of the entire market.

On January 1, 1984, the base rate to move a 20-foot container of raisins to Europe was $1,870. On September 1, 1993, it was $1,160. The 40-foot rate on almonds on January 1, 1984, was $3,015. Today it is $1,750, and both of these current rates are further discounted in service contracts.

During this same period of time, many carriers either went out of business completely or abandoned the west coast trade. Included in them, and with one exception these are all conference carriers, United States Lines, Johnson Scanstar, Westwood, and ICT. In fact, in 1992, the TAA carriers reported a collective loss of over $400 million, with no single carrier making a profit in the Atlantic. Thank you.

[The prepared statement of Mr. O'Donnell follows:]

SEPTEMBER 30, 1993

BEFORE THE SUBCOMMITTEE ON
INFORMATION, JUSTICE AND AGRICULTURE
COMMITTEE ON GOVERNMENT OPERATIONS
UNITED STATES HOUSE OF REPRESENTATIVES

STATEMENT OF FRANCIS J. O'DONNELL
SEA-LAND SERVICE INC.

Mr. Chairman, members of the Subcommittee. Thank you for this opportunity to appear before you. I hope that this statement, and my responses to any questions you may have, will be of assistance to you.

My name is Francis J. O'Donnell. I presently serve as director, conferences and pricing, atlantic division, eastbound, for Sea-Land Service Inc. Sea-Land is a U.S. Corporation and a member of the CSX group of companies. I have been employed by Sea-land for 28 years and have been actively engaged in its operations in the transatlantic trades for the past 13 years. In my present position, my responsibilities include all conference pricing activities, rate levels and regulatory matters for the Atlantic Division.

I am particularly familiar with the U.S. Export trade to Europe including the agricultural commodity market. I will primarily focus on that trade here.

Sea-Land is among the leading containership operators in the world. It pioneered the containerized transportation of cargo by sea along with the intermodal systems to which such transport gives rise. Today, as ever, Sea-Land stands in the forefront of the introduction of new technologies, innovations and advancements in the integrated intermodal transportation of cargo by sea and land.

Sea-Land is a major operator in both the transpacific and transatlantic trades and a member of various ocean common carrier associations ("Conferences") organized in those trades pursuant to the Shipping Act of 1984. In the trade from the U.S. to Asia, Sea-Land is a member of the Transpacific Westbound Rate Agreement ("TWRA") and in the trades from the U.S. to Europe, it is a member of the Western Mediterranean Rate Association ("WMRA") and the Trans-Atlantic Agreement ("TAA").

Transportation competition for containerizable U.S. exports to Europe, including the broad range of agricultural commodities which move in that trade, is extremely sharp and multifacted. Carriers serving the direct trade who are not members of WMRA and TAA such as Star Shipping; Atlanticargo Line; Lykes Bros; ABC Container Line; Independent Container Line; Farrell Lines;

Croatia Line and Evergreen Marine Corp. are formidable competitors as, also, are carriers serving competitive gateways such as Cast Line and Canada Maritime over Montreal. Additionally, agricultural reefer commodities such as grapefruit are also transported by contract carrier reefer vessels, and certain forest products, logs and woodpulp for example, are also transported by break bulk carrier. I should add here that competition among the members of WMRA, and among the members of TAA, as well as between various WMRA and TAA members, is also extremely keen and manifested in many ways including the use of independently established rates.

Owing to intensive carrier competition and the fact that the supply of ship capacity exceeds demand, transportation rates to Europe are constantly under downward pressure. Frequently, over the years, many of those rates have dropped to non-compensatory levels and, in various cases, to levels which have been insufficient or barely sufficient to cover variable costs.

In the face of these adverse market conditions, Sea-Land has constantly and successfully strived to reduce operating costs, achieve gains in efficiency and enhance the quality of the services it offers to the shipping public. Yet, notwithstanding these efforts, results are not satisfactory and further

improvements on both the cost and revenue side of the ledger are essential if Sea-Land is to accumulate and attract the capital necessary to ensure its viability over the long term.

The Shipping Act of 1984 has operated to promote a competitive environment for shippers while, at the same time, affording carriers opportunities to (i) achieve major efficiency gains by means of the rationalization of services and (ii) mitigate the revenue effects of the cyclical market demand surges and depressions which characterize international commerce by means of cooperative ratemaking agreements. The Shipping Act furthermore serves to establish a code of ethical practice governing the conduct of common carriage in the oceanborne foreign commerce of the U.S. It is Sea-Land's view that the Federal Maritime Commission (FMC) is to be praised for its administration and enforcement of that statue.

With specific reference to the export of agricultural commodities in the trade from the United States to Europe, prevailing transportation rates are competitive and reasonable. The real problem which confronts Sea-Land, its WMRA/TAA colleagues and the other containership operators with whom it competes in the trade to Europe is that the level of such

competitive market rates has too long been too low to contribute to compensatory earnings by any of them. I suppose that if there were an oversupply of some product, and independent exporters reduced prices to non-compensatory levels to maximize market share, Professor Ferguson would conclude that the difference between those prices and marginally higher non-compensatory prices quoted by a larger Export Trading Company ("ETC") constituted an "ETC premium". But I must say that such a conclusion appears to be amiss. It seems to me that the relevant circumstances do not describe a "premium" to any seller but a windfall to buyers.

I believe that it may be further useful to report to this Subcommittee that in all the years I have been engaged in the ocean shipping industry, I have rarely if ever seen rate-cutting by carriers result in the movement of greater volumes of cargo. Such pricing activity may in the short run lead to shifts in relative market shares as between carriers but it does not by itself occasion increased demand for the product in question. This is so because the difference between fair, reasonable and compensatory ocean freight rates and those which have been reduced to non-compensatory levels owing to aggregated competitive conditions is generally so small a fraction of the

landed value of a commodity in an overseas market as to have no consequential effect on its ultimate selling price to consumers. All of my practical experience in this business therefore leads me to question the validity of Professor Ferguson's apparent assumption that every dollar saved by virtue of ocean carrier price cutting will be, without more, translated into an increase in demand for a given product abroad and thereby multiply its exportation.

Sea-Land competes for the carriage of a broad range of agricultural commodities exported from the United States to Europe. These commodities include cotton; tobacco; seeds; tree nuts and peanuts; dried fruit; fresh fruit and vegetables; packing house products; citrus and citrus juices; forest products such as woodpulp, kraft liner board, lumber, plywood and veneers and nursery products such as ferns and other foliage. We need to carry these cargoes to fill our ships, balance our eastbound/westbound moves and equipment, maintain market share and earn revenue. I wish to assure you that Sea-Land is an effective competitor and a highly efficient, reliable and modernized operator. Any notion that Sea-Land's rates for the transportation of those commodities exceed competitive market

prices, or that they exceed fair, just and reasonable levels, is simply mistaken. I know. I am in the front line trenches of the marketplace everyday and I can tell you that it is no picnic. It is a challenging and difficult struggle. Sea-Land nevertheless aims to meet that challenge and overcome those difficulties and to continue to provide the very best service to its shipper patrons.

Mr. Chairman, Sea-Land focuses a great deal of effort on serving its agricultural customers: from ensuring proper equipment availability, to improving containers' temperature and atmosphere controls, to ensuring intermodal connections and door-to-door service. I know our competitors in the liner industry do too.

We have an obvious and real interest in expanding U.S. agricultural exports because that would increase our business as well. Because our nation imports more than it exports, we have unused capacity in our export trade lanes which we're constantly working to fill. We have no incentive to price our services in a way that reduces our markets or business.

The real obstacles to U.S. agricultural exports are not in shipping, where service is good and rates are competitive, but in

foreign trade barriers, quotas and duties on agricultural products, unnecessary product inspection requirements, and other foreign market protections.

I wish to again express my appreciation to the Subcommittee for this opportunity to appear before it. Mr Chairman, I will be most pleased to endeavor to answer any questions you or the members of the Subcommittee may have.

Thank you.

Mr. HORN. Thank you, Mr. O'Donnell.

When Ms. Morley testified as manager of the transportation division for Blue Diamond Growers, which was exporting almonds to Europe, and you are handling the east coast trade, she said, the message was basically "take it or leave it," re: almonds.

Now, you say you make a lot of independent actions beyond the conference tariffs. I take it almonds isn't one of them, although I see tree nuts referred to and I am assuming that includes an almond, in your testimony.

Mr. O'DONNELL. Right. I am disappointed that Ms. Morley feels that it was "take it or leave it." We know that the contract that was negotiated with her was not entirely to her satisfaction, but it was the result of some back and forth and concessions on the part of the carriers as well.

Mr. HORN. Well, isn't the basic judgment anybody in a cartel makes that, hey, it is what the traffic will bear, we have got them over the barrel. They have got to get them there for a certain Christmas season or whatever and let them go pay the full rate; isn't that basically the attitude? Are we kidding ourselves?

Mr. O'DONNELL. Mr. Horn, I think that it would be more fair to state, we do take into account constantly all the market conditions, all the competitive conditions, as well as the—our own economic and financial interests, and we certainly try to recognize those of the shipper.

The shipper, at all times, is our customer. I mean, these situations change year to year, month to month, but the person who is our customer this year is going to be our customer next year, we hope, no matter what the freight rate issue is.

Mr. HORN. Well, from the testimony you heard, do you think the growers are very happy with the way they were treated in that circumstance?

Mr. O'DONNELL. Doesn't sound so.

Mr. HORN. No, you are right, it doesn't.

Mr. Greenberg, you mentioned that over 30,000 instances of independent action have occurred in the year to date. Other witnesses have suggested that carriers may face retaliation if they file independent action.

Ms. Morley related difficulty getting almonds through the Atlantic conference. Is there a difference between the Atlantic and Pacific conferences with regard to independent action?

Mr. GREENBERG. I really can't speak for the Atlantic, but I can tell you what happens in the Pacific. I do the Pacific daily rates every day of the week. Yes, there is retaliation.

Remember, when you take an independent action, you could, to a large extent, be taking that action to get somebody else's business. The carrier that loses that business is not inclined to sit back and lose the business. They may go back and either match the rate or cut it again.

In the transpacific, we do a lot of business on independent actions. There is nothing wrong with it. It is allowed in the conference, in the FMC rules, and the Shipping Act of 1984. We do it for a variety of reasons. We may have certain advantages for a particular piece of business in which we are interested that other car-

riers may not necessarily have an interest. We will take an independent action to get that business.

We may be looking for a certain type of freight, where other carriers may not. When you go after somebody else's freight, yes, there could possibly be retaliation, or it could become group action. But we have done 30,000 so far this year, and I believe last year, with matches, we did close to 100,000, if not more.

Mr. HORN. Any other members want to comment on that.

Mr. Gottshall.

Mr. GOTTSHALL. Yes, I would like to comment on that on sort of the administrative. The 30,000 that has been mentioned is a message to us and that is one tariff, one item. Actually, if you look at it individually like one action, it may actually be six or seven rates that are changed as a result of that action, so in effect, independent action frequently is probably closer to 180,000 instances a year.

In many cases, independent action is taken by a carrier because it is, as Joel pointed out, it is simply a piece of business he wants to handle or is capable of handling, and this is very true with inland ports. Not everybody wants to hold themselves out to have a rate from Wichita or some other location, so independent action is taken to facilitate that.

The other thing that independent action is used for, as I indicated a couple of years ago, we had very full ship syndrome. I mean, you couldn't get space and some carriers took independent action to raise rates themselves over and above what the group rate was because they were not interested in handling a piece of business, so it is a two-way street.

But independent action is a very—it is almost our way of doing business in the Pacific trade.

Mr. HORN. Let me get to a bigger question and some of you, especially Sea-Land, might be able to answer this.

We read in the papers that the last of the American-flag line is dwindling and our carriers are going to be foreign registered. What is the feeling now in the shipping industry?

Does it matter at all if the American flag hangs over any remaining ships? It does to a lot of people in the port of Los Angeles and the port of Long Beach who work there for a living. It does for a lot of people that are on board those Jones Act and other ships.

I am just curious. You are two young charging executives. What is the feeling?

Mr. O'DONNELL. Well, thank you for the young part.

Mr. GREENBERG. Sounds good.

Mr. HORN. When you are 62, everybody is young.

Mr. O'DONNELL. Well, certainly it matters to Sea-Land, and while I would not be the one at Sea-Land to address these issues in a very comprehensive basis, we have announced that—and stated many times, we prefer to remain American flag, but have announced plans to reflag certain of our vessels in the Marshall Islands, and Congress has delayed that action until 1995, but I think our position has consistently been, if maritime reform legislation comes forth, that decision would be reconsidered.

Mr. HORN. And what is the maritime reform legislation that you most want?

Mr. O'DONNELL. It relates to subsidy.

Mr. HORN. You want more——

Mr. O'DONNELL. It relates to subsidy and some other reforms, Congressman, and I would say that I am not really the perfect spokesman for Sea-Land on those issues.

Mr. HORN. Let's ask the staff to pursue that with Steve, and since we are talking Sea-Land, and since we are talking about the commission and tariffs, and so forth, what exactly is sought in terms of legislation or proposals or change in Federal policy that would be helpful for us to get an understanding of how the Commission is involved.

Mr. Chairman, it is all yours. The witnesses have completed their testimony.

Mr. CONDIT [presiding]. Have you had a series of questions, Mr. Horn?

Mr. HORN. Yes.

Mr. CONDIT. Well, I will pick up with Mr. Schrier and if you have responded to any of my questions, you can just indicate and I will pick them up in the record.

Were you and any other economists sharing your views consulted by the National Performance Review on—or USDA regarding their recent studies of the industry?

Mr. SCHRIER. No, sir.

Mr. CONDIT. Mr. O'Donnell, your testimony contains an analysis of carrier competition for trade with European communities. Presently, negotiations for both—for the GATT, has the potential to profoundly affect agricultural exports to that market. How might this affect Sea-Land?

Mr. O'DONNELL. Chairman, if anything, that reduces the amount of cargo or exports moving to Europe that would affect Sea-Land.

Mr. CONDIT. I want to come back to Mr. Schrier for a moment, too.

Do you have any idea, I mean, why you weren't consulted or involved in the National Performance Review process, why you weren't asked any questions?

Mr. SCHRIER. No, sir, I have no understanding of the selection process or anything else.

Mr. CONDIT. Mr. Greenberg, you testified that you aggressively pursued agricultural business. Does that include negotiations with shippers for independent action outside your conference affiliation? And I guess that goes to the question that we asked earlier to Ms. Morley about independent agreements, that they had the ability to do that. Can you respond to those?

Mr. GREENBERG. If it is independent actions you are talking about, we do those where we are a conference carrier as a conference member. We can take independent action any time we want.

Service contracts in the transpacific trade, if that is what your are saying, independent agreements, no, we do not do those. We would rather keep the cost of cargo in the tariff as a common carrier open to anybody who wants to ship that commodity. We don't negotiate private agreements.

Mr. CONDIT. You don't do private agreements, although nothing prohibited you from doing private agreements? That is a proprietary decision or——

Mr. GREENBERG. This is a decision we have made in the trade lanes, in which we are not subject to conferences. We will not do private agreements. We would rather keep all rates we do as a common carrier open for anybody that moves that commodity.

Mr. CONDIT. The Gore National Performance Review team has called for creation of a commission to study maritime policy and subsidies. Is this necessary, in your view, and at the same time, while you respond to this, everybody can respond to it, has the industry been studied enough?

You might also answer what you thought of the proposal by Dr. Ferguson and his recommendations. I would like to hear your comments about those as well.

Mr. SCHRIER. I will pick up at the start of that.

When we talk about maritime policy, Dr. Ferguson touched on it and others have, too, there are two major aspects of maritime policy that are being discussed. One has to do with the promotional aspects, the regulations affecting the U.S. carriers, specifically.

The other has to do with the regulatory aspects which, to some extent, not entirely, are flag-blind. They treat all carriers alike and subject all carriers to the same regulations.

I think the most recent studies, and in particular the Advisory Commission, have studied the regulatory aspects pretty much, and I agree with Chairman Hathaway that we should wait a few more years before we open that can of worms again. It wasn't resolved to anybody's satisfaction.

We do have the status quo, and I think we should wait a while before we continue on that one. But on the promotional aspects, there has not been a comparable detailed look at all of the aspects, and the NPR might be right in suggesting some type of a top-to-bottom look at all aspects.

On the other hand, those commissions take a long time forming, a long time operating and a long time reporting, and I am not so sure that the American flag carriers, with their ship replacement programs and other considerations, can really wait that long to take action.

Mr. CONDIT. Mr. Gottshall.

Mr. GOTTSHALL. Yes, I will just address the portion that relates to a regulatory review for ocean conferences. We have been through, over the years, several different reviews. We had the Alexander review in 1916.

We had the—I think it was the Bonner report in 1961 and the latest one was 1984—or as a result of the 1984 act. Very comprehensive reviews, very open, public hearings, everything that is proposed.

I don't think anything has changed since that that would warrant the time and the money to have another review, at least at this time. Maybe it is good every now and then, but I don't see it as being necessary in the current environment.

Mr. CONDIT. Mr. Greenberg.

Mr. GREENBERG. I would say regulatory, we just finished one last year. We need some more time—actually as an industry, we should let a little more time pass. If we need another review in a few years, then take a look at it again in a few years.

On subsidies, I am really not the person to speak to that issue.

Mr. CONDIT. Mr. O'Donnell.

Mr. O'DONNELL. Mr. Chairman, we do not think we need another review, but if there is going to be a review, if there is going to be a commission formed, we would like to see it treat our industry the way it did the airline industry and report back, I think, in 60 days.

Mr. CONDIT. Let me reach out just a little bit. This may be beyond what we have heard this morning in testimony, but as I interpret Dr. Ferguson's recommendations, it sort of makes the Federal Maritime Commission somewhat irrelevant and if it continues to exist, would be duplication of functions that could be done someplace else.

If we were to follow through with those recommendations, what would happen, in your opinion? That would be the elimination of the Maritime Commission; the Department of Transportation would pick up whatever responsibilities; any thoughts?

Mr. SCHRIER. We have a lot of eager respondents here on that one.

Mr. CONDIT. Pardon?

Mr. SCHRIER. We have a lot of eager respondents here on that one. You can see that.

I think the focus that Dr. Ferguson took on the reallocation——

Mr. CONDIT. He did not say what I just said. I am going a step beyond what I thought his recommendation——

Mr. SCHRIER. No, but he did suggest the reallocation of the functions amongst the Department of Justice, Department of Agriculture, Department of Defense, and I think he left out the Department of Transportation by oversight. I don't think that is the issue as to who does the regulation. I think the question is, what regulation is done.

To abolish antitrust immunity, to eliminate conferences, to take the completely free market approach as some of the conference critics have called it, would of necessity change the entire regulatory picture in the U.S. foreign trades. Where we now have, I think it was Ms. Morley said, 80 percent of the carriages in foreign carriers, we might well have 100 percent, in which case, there would be no mechanism such as we have in the FMC, and as Chairman Hathaway discussed this morning, no mechanism to protect the interests of the U.S. shippers that we have now, both through the regulatory system and through the presence of very significant competition in American President Lines, Sea-Land and a few others.

Mr. CONDIT. Any other comments?

Let me just caution you, I understand your comment about it is a matter of the policy and who promotes the policy or who is in charge of it, that probably is your main concern. For us sitting on this side of the table, when we look at reinventing government, we look at places where we can combine overlapping jurisdictions or where we might be able to reduce departments or agencies that can perform somewhere else and lessen the cost to the taxpayers.

I know that is not your point, but that is, if you were looking from our side, you might be looking at that.

Mr. O'DONNELL. Mr. Chairman, we certainly would support retention of the Federal Maritime Commission. I wasn't sure of your question when you first asked it. We have—I personally have found over the years, in spite of some of the testimony that we heard

today, that they have been a very tough and effective regulator, but we have found them to be generally fair and we haven't seen any system that is better.

Mr. GOTTSHALL. I would like to make a comment, too. The system of regulation and exemption from the antitrust laws is a worldwide phenomena, unlike some people like to discuss. Canada has a law; we file tariffs in Canada. In every country in the world, of every major country, there is somebody responsible for the maritime affairs, and whether that is the ministry of transport, in the case of Japan, or whether it is in the Korean Maritime Port Authority, which is an independent agency in Korea, or whether it is under the jurisdiction of the Korea Maritime Port Authority [KMPA], as it is in Taiwan, it makes no difference. Everyone has a little unit that handles it.

So even if the FMC were abolished for the sake of argument, you would still have some kind of unit at DOT that would absorb the work. And right now there does not appear to be an overlap between what DOT does and the FMC does.

They appear to be two totally separate things. The more important thing would be that you put them all under one roof.

Mr. CONDIT. What would it be like if you combined the FMC and the Maritime Administration? Would that work?

Mr. GOTTSHALL. It used to be together but they decided to take it apart to have the independent ability of the Commission to act alone, as opposed to the promotional aspects for the American-flag carriers, which MARAD handles, but presumably, if you had no American-flag carriers, you wouldn't have a promotional problem, so.

Mr. CONDIT. Mr. Greenberg.

Mr. GREENBERG. One of the aspects of FMC everybody glosses over is the fact that FMC does keep the playing field fairly level. We have, and the shippers have, the ability to go to the FMC and get a fair hearing on what is occuring.

We can also request help from the FMC, as U.S.-flag carriers, when we face discrimination in foreign countries, when we can't truck in Korea, or are not allowed to have an NVO in Korea, and so on. The FMC has a lot of power to help us get these things accomplished.

Mr. HORN. You want to translate NVO for us?

Mr. GREENBERG. Nonvessel-operating carrier. Chairman Hathaway mentioned this subject as something they accomplished in Korea recently, getting Korea to accept U.S. nonvessel-operating common carriers as we do with the Korea NVOs.

Mr. HORN. How often, if I might, Mr. Chairman, have you asked the Federal Maritime Commission to be of help? Do you recall asking them for anything?

Mr. GREENBERG. We have made requests on Taiwan trucking, Korean trucking, problems in China. In fact, there are a couple of things they are working on right now in the PRC.

Mr. HORN. Have they been helpful?

Mr. GREENBERG. Absolutely.

Mr. HORN. What did they do for you?

Mr. GREENBERG. The FMC has a statutory tool "Section 19" that is used to ensure fair treatment for U.S. carriers. Basically, it says

we may bar your vessels from calling U.S. ports. That is a very, very large club.

Mr. HORN. And they have issued those, correct?

Mr. GREENBERG. They have threatened, and as a result we have had the ability to get trucking in Taiwan and other things in Korea, yes, sir.

Mr. HORN. That is good to know something works in government. You have made my day, and only 5 hours into it.

Mr. CONDIT. Well, something will destroy it before the day is over, I am sure.

Mr. Gottshall, you testified that your rates were 1 to 5 percent higher than the nonconference carriers. What is the range for agricultural cargo?

Mr. GOTTSHALL. In many cases, it is less than 1 percent. For example, on hay, I think there is only about a half a percent difference between ourselves, and that is a major-moving agricultural commodity.

On the refrigerated commodities, it will vary. In some cases, we are dead even because that is what the marketplace demands. In other cases, where there is a particular service or skill offered by the conference carriers, the rate may be a little higher.

For example, most of the entrants into the refrigerated segment of the market, which in the transpacific, is relatively large, it is approximately 120,000, 40-foot containers a year move, and probably 95 percent of those are agricultural commodities.

But in some of the areas such as in chilled beef, which as Mr. Greenberg indicated, there are elements of expertise that the carriers in the conference have developed because of longer service and those may be higher priced in independent carriers. In fact, some of the independents don't even offer the service.

Mr. CONDIT. Mr. O'Donnell, you are skeptical that a dollar saved by the price cutting will result in an increased demand for products; are you suggesting that the shippers would simply increase their profit margin if transportation costs fall?

Mr. O'DONNELL. I think some of them certainly would. I don't think my point was that our view is the freight rates are not a significant part of the entire export price.

Mr. CONDIT. Mr. Greenberg, you stated that import cargo rates are generally higher. Would you—would that statement apply to comparable agricultural import cargo as well?

Mr. GREENBERG. There is relatively little import agricultural cargo coming from Asia. You have some Century pears, some Mandarin oranges and seafood. When the reefer container is used, rates are higher on those commodities.

Mr. CONDIT. Mr. Gottshall, you have suggested that the elimination of the antitrust exemption would result in the elimination of American and developed nations' carriers. How would you react to an U.S. subsidy policy based on reciprosity—if it is workable? Could it solve the problem?

Mr. GOTTSHALL. I think the idea of keeping in developed countries' vessels is a good one. I have to take sort of a neutral position because I also represent other flag carriers besides American carriers, although my background was with American-flag carriers. I think it is a very good thing to have is to have a national flag car-

rier. I think that is a matter of national policy, and to the extent that that maintains a presence and the ability to negotiate with other governments because of that carriage, I think it is helpful to the U.S. Government.

Mr. CONDIT. Mr. Schrier, the USDA's testimony deflects criticism of Dr. Ferguson's report by drawing comparisons to other studies. Can you cite any opposing body of work to refute the other samples given by the USDA?

Mr. SCHRIER. The one area in which I agree completely with Dr. Ferguson is there hasn't been a good quantitative analysis of the subject that he professes to have studied. And I know of no good analysis that has been done behind any of the citations in the NPR or any other group, including any of the carriers side.

Mr. CONDIT. Mr. Greenberg, you said in your testimony that APL must compete with the State-controlled carriers. Do you consider some of the U.S. policies as offsetting these unfair competitions?

Mr. GREENBERG. I would say no, sir. When you are competing against a State carrier such as COSCO, you are competing against a carrier that has virtually no profit motive. They are in business to gain hard currency, and will price to do so.

They have advantages in their own country that we are still fighting to get, for example, acceptance of our tariff. I don't see where U.S. policy would offset that since any carrier calling here falls under U.S. policy.

Mr. CONDIT. Mr. Horn, do you have any additional questions you would like to ask.

Mr. HORN. I would like to ask one of Mr. Gottshall.

I found your testimony very thorough and I notice on page 11, under point 6, ocean conferences and ocean competition, you note, ocean carriers or members of rate conferences face intense price and service competition from four sources. And it is your fourth source that interests me, to some extent from air cargo carriers and carriers serving trades from third countries. I am interested in the air cargo carriers. To what extent, if any, to your knowledge, do the carriers that compete with you have an antitrust exemption?

Mr. GOTTSHALL. Well, of course, the air carriers are mostly on bilateral arrangements with the—between the United States and the other countries and the rates are somewhat fixed. That is my understanding. Now, we do have—we put this in because we do have some refrigerated commodities which we compete with the—cherries is one. I think Mr. Greenberg mentioned chilled beef was another. There are some commodities that we do compete with the air carriers on.

Mr. HORN. But to your knowledge, do they have antitrust exemptions, in our sense of the word, if they are foreign carriers, or are there any U.S. carriers we deal with?

Mr. GOTTSHALL. Keep in mind, you don't have an open-skies policy as much in Asia as you do in Europe, so there is limitations on landing rights and with the capabilities to carry cargo between the United States and certain Asian countries. So there is more of a limitation than there is in Europe.

Mr. HORN. Well, in what sense are they providing the competition? Is it strictly price?

Mr. GOTTSHALL. Price competition.

Mr. HORN. And, obviously, they are getting it there a lot faster?

Mr. GOTTSHALL. Lot faster.

Mr. HORN. You have got a perishable commodity. That is obvious. So it is only price competition you are thinking of, per unit carried of equivalent weight?

Mr. GOTTSHALL. Well, it is price competition but it is also very deep surface competition, because what you may have to do, cherries, the Japanese would not buy because they felt they were going to be damaged if they came any way but by air. There was new packing and a lot of work done by the ocean carriers to develop a way of handling cherries in refrigerated containers that would withstand the transportation and still deliver a product with good shelf life on destination.

That is just one of the commodities. So there is constant work in trying to innovate and to try and carry the cargoes that are available at a lower cost to the shipping public.

Mr. HORN. OK, but I want to get a fix in my mind, are these U.S. carriers in competition or primarily foreign air carriers?

Mr. GOTTSHALL. They can be both. Airlines, JAL, you know.

Mr. HORN. I would like to get an idea as to the proportion of trade between the foreign air carrier and the U.S. air carrier that is in competition with you.

Mr. GOTTSHALL. Joel, have you—perhaps he has a better fix on that.

Mr. GREENBERG. The largest U.S. air carrier, I believe, is probably Federal Express Flying Tigers. I am really not sure how much other cargo is handled by U.S. airlines. I know Northwest has some freighters crossing the Pacific. I don't think UAL offers freighters, and when you fly into Tokyo or Hong Kong, most of the freighters you see there are JAL, ANA or Northwest.

Mr. HORN. Do you feel those air carriers are competing with each other or are they simply one on one competing with you?

Mr. GREENBERG. On imports—exports, I really don't know right now. But on imports, at this time of the year, it would be difficult to get space on an airline coming from Hong Kong. They are "chock-a-block." Outbound, they would probably face the same situation we do, where you are heavier on the inbound leg than the outbound leg. I imagine they would probably have some space.

Mr. HORN. As you know, in the U.S. domestic travel we have intense competition. I realize you are not air cargo experts, but do you feel we have intense air competition?

Mr. GREENBERG. There are times when we are a very good client of the air cargo. When we screw up a piece of freight and we have to fly it in, you are not going to get much of a deal. You call each airline and you get pretty much the same price.

Now, I know there is no conference, and I know nobody is publishing the rates, but they all seem to have the same numbers.

Mr. HORN. Like lemons, they all seem to go to the same price, over the same cliff.

Mr. GREENBERG. Where we are real heavy, it is real expensive.

Mr. HORN. But it is business.

Mr. GREENBERG. It is business, yes, sir.

Mr. CONDIT. Thank you.

Mr. HORN. Mr. Gottshall, one last question for you. Your testimony states that rate wars resulted in the reduction of operations worldwide. Given that conference agreements are also in place worldwide, why have these rate wars persisted?

Mr. GOTTSHALL. That is a good question. I think we have got the lemon answer over here earlier and I think that is very relevant. What happens in any trade is that as capacity—as you get into an overcapacity situation, there is a tendency to try, and think you can resolve it by cutting the rate to fill the capacity, and all that has ever been—all that has ever happened is the cargo is simply transferred from one carrier to the other and the rates tumble downward. But the thing that conferences do for you, though, is the time they say: Enough is enough, we have bottomed out, nobody is making any money, people are losing money, we are on the verge of bankruptcy, let's see what we can do to stabilize the situation and then build from there.

I think that, you know, this is just one of the things that conferences have value, otherwise it goes down to the bottom and, at that point, there is immediate bankruptcies. And the irony is, in our business, when carriers go bankrupt nowadays, in the airline business, the airlines we used are chapter 11 lines. But in the international business, when the carrier goes bankrupt, that vessel actually leaves the trade for a period of time because worldwide, the bankruptcy laws of the United States are not respected and if a vessel—if somebody files chapter 11 here and the ship calls in Hong Kong and a guy owes for fuel oil in Hong Kong, they have got leave put on the vessel.

Mr. CONDIT. They just hold the vessel?

Mr. GOTTSHALL. They just hold it. I mean when U.S. lines went bankrupt in 1987, I believe, when they went bankrupt, they had 12 vessels on a worldwide basis. They filed in the United States. They attempted to operate and by the time 2 months was over, they had all of their vessels tied up at various places, whether it was the United States or Singapore, Hong Kong, and those vessels were not used again for approximately another 2 years.

So it is not the case where you keep going, you know? You will have a—if there is a crash and carriers do go bankrupt, it can cause a short-term capacity situation.

Mr. CONDIT. Well, that concludes our questions. It concludes this hearing. I do want to thank you gentlemen. You have been very kind and we apologize to you for going in and out. We have had votes all morning and we have tried to be considerate of your time and tried to operate efficiently. So we appreciate very much, your patience with us.

We will leave the record open for 10 days. We may have some additional questions we would like to ask you to respond to, if you would be willing to do that, we would appreciate it very much.

Thank you all and thank the audience very much.

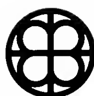
I would also like to thank my colleague, Mr. Horn for sticking with me for the entire hearing, very constructive member of the committee, and I appreciate it very much.

This meeting is adjourned.

[Whereupon, at 12:52 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD



THE
NATIONAL
INDUSTRIAL
TRANSPORTATION
LEAGUE

STATEMENT

OF

THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE

BEFORE

COMMITTEE ON GOVERNMENT RELATIONS

U.S. HOUSE OF REPRESENTATIVES

ON

IMPACT OF U.S. SHIPPING POLICY

ON

U.S. INTERNATIONAL COMPETITIVENESS

SEPTEMBER 30, 1993

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Introduction

The League is the oldest and largest broad-based national association of shippers. League members include many of the largest industrial and commercial concerns in the United States, as well as numerous smaller shippers. The League also represents groups and associations of shippers in national and international transportation. In general, our members are substantial users of all modes of transportation, including ocean common carriers. League members export and import substantial quantities of products from points all over the world, and are, therefore, greatly affected by maritime policy. In essence, League members are the customers of the ocean transportation system.

Applicable Policies of the League

The League's *Transportation Policies* are the guiding principles relied upon by the League in determining the League's involvement in transportation matters. The policies are approved by the membership and may be changed or revoked only by them. There are a number of League policies that are directly applicable to maritime reform. The League believes that the objectives sought by the 1984 Shipping Act have not been fully met and that today's global commercial environment requires changes in the law to accomplish the goals sought by the architects of the Act.

At its 1992 Annual Meeting, the League membership approved support for a series of new policies which would accomplish these objectives. These are enclosed as Appendix A. Reform of ocean carrier contracts and the creation of a responsive ocean transportation system are the major goals of these policies. Briefly, our policies favor a minimum of economic regulation in the maritime industry; elimination of tariff, service and contract filing requirements currently required by the '84 Act; removal of antitrust immunity for collective ratemaking; and, establishment of carriers' unrestricted right to enter into service and loyalty contracts with their customers. The League believes that contracts should be able to be kept confidential, and that parties to a contract should have the ability to modify them by mutual consent. Additionally, our policies stipulate that conferences should remain open if they are permitted to be continued by Congress; and, that there should be an end to conference barriers which hamper shippers' associations. Finally, the League believes that common and contract carriage should be separate transportation functions, though they may, in fact, be provided by the same suppliers.

The Need To Reform the U.S. Maritime Industry

As noted above, the League strongly favors a minimum of economic regulation in the maritime industry, primary reliance on the forces of competition to encourage responsive and innovative pricing and service practices, and the use of contracts to provide rate and service stability to increase shipper and carrier productivity. The United States must have a modern and efficient ocean transportation system if U.S. businesses are to have the opportunity to compete in the world marketplace. A truly efficient ocean transportation system must be one in which shippers and carriers are afforded the legal right to negotiate price and service levels on a fair basis. This environment will not only enhance the ability of U.S. industry to meet customer needs, but it will result in increased economic vitality to the carriers serving the U.S. trades.

U.S. companies today are generally not allowed to negotiate transportation contracts with individual ocean carriers. They are forced under most circumstances to deal with an organized conference of carriers which, in many instances, does not understand the importer's or exporter's particular needs. These practices are in direct contrast to foreign companies that can and do enter into such arrangements. Thus, foreign companies have a competitive advantage in entering foreign markets, leaving U.S. companies at a distinct disadvantage.

Although many sectors of the U.S. maritime community have complained that changes to the current ocean transportation system will bring about a loss of jobs in their particular segment of the industry, the League believes that precisely the opposite is true, since maritime reform will help stimulate the use of ocean carriage. Moreover, maintenance of the status quo will tend to force U. S. companies to relocate their industry's factories and facilities out of the U.S., so that they can be closer to their world markets and avoid a complex ocean transportation system. This will result in a loss of U.S. jobs.

The League takes strong exception to the comments by some maritime interests that contract confidentiality, limitations on antitrust immunity for collective rate action, and elimination of the filed tariff, or rate, doctrine would destroy the U.S. ocean transportation system. To the contrary, such changes would strengthen ocean carriers' ability to competitively price their services. U.S. shippers, then, would be more competitive in global markets as carriers are free to respond to customers' competitive needs.

The Shipping Act of 1916, as amended in 1984, specifically exempts ocean transportation from U.S. antitrust laws and subjects them to a scheme of regulation. Carriers under the current regulatory regime are granted antitrust immunity to form "conferences" which can jointly fix the prices of ocean transportation, pool revenues and profits, control cargo capacity, allocate ports, and deny contracts to U.S. exporters/importers. They are nothing more than legalized cartels, which are stifling progress.

While the '84 Act was intended to bring about procompetitive enhancements, just the opposite has occurred. Aggressive use of antitrust immunity by ocean carriers through the conference system, whose power is strengthened by an inflexible regulatory regime, has resulted in a tremendous disadvantage to U.S. business and consumers. One example of the monopolistic power exhibited by the conferences is being documented by the Commission of European Communities (CEC) on the operations of the Trans-Atlantic Agreement (TAA). This conference, which was created last year, controls nearly 90 percent of the U.S./North Atlantic trade. Complaints have been lodged against the conference by various European Shipper Councils. In its own letter to the CEC, the League noted the TAA creates an anticompetitive and highly discriminatory arrangement by carriers that comprise a large majority of the Trans-Atlantic marketplace. The League declared that the conference has resulted and continues to cause substantial harm to U.S. shippers. We specifically cited the unreasonable and unjustifiable rate increases to shippers on numerous commodities and noted that the conference unduly and unreasonably interferes with the ability of shippers to enter into sound commercial contracts with carriers. Also, the League observed that the TAA results in unfair discrimination against small shippers by placing unreasonable cargo thresholds in qualifying for service contracts. A complete copy of the League's views regarding the TAA is attached as Appendix B.

Although opponents of change to the U.S. maritime industry have stated that change would cripple the ability of ocean carriers to survive, this is the same argument that was made by various sectors of the domestic freight transportation industry when efforts were begun to deregulate the motor carrier and railroad industries in the late 1970s. The railroad industry prior to 1980 was in dire economic straits. The passage of the Staggers Rail Act in 1980 brought about many of the reforms that we today advocate for the U.S. ocean transportation industry. Today, rail shippers and carriers enjoy the use of true business partnerships and the rail industry enjoys near-record prosperity.

We must have the courage and foresight to not only preserve a U.S. maritime industry vital to the needs of U.S. citizens but to help it prosper through changes which have proven so successful in our domestic freight transportation system. The reforms we support will accomplish this by allowing carriers serving the U.S. trades to be more responsive to customer needs. This in turn will help stimulate increased production and employment for U.S. workers in a multitude of U.S. industries.

Moreover, in contrast to the cries for help that we hear from other segments of the maritime community, the reforms we propose will not cost one penny of taxpayers money.

The Need for a U.S. Flag Fleet

Over the past year and a half, there has been considerable public debate over what can be done to continue the existence of a U.S. flag fleet. U.S. shippers strongly support efforts to maintain a U.S. flag presence, since it is in their best interest to see that these carriers can viably operate to service their needs. But a U.S. flag fleet must be economically viable and operationally efficient to remain in business for the long term. While government support may be required in the interim to maintain the existence of U.S. flag ships, it must never be considered the final solution for the fleet's continued operations. The League strongly believes that a continued U.S. flag fleet depends on fundamental reforms to the 1984 Shipping Act. These changes, if enacted, would allow U.S. flag shipping to compete like any other business without continued government assistance.

Thus, the changes that we seek, Mr. Chairman, will not only allow the U.S. flag fleet to survive, but will increase its economic viability as well. If these reforms are not made, continued government handouts will only prolong the inevitable eventual demise of a U.S. flag fleet.

Legislative Reforms are Necessary Today

The League has been and remains today an active participant in a coalition of over 98,000 U.S. exporters and importers that are calling for amendments to the '84 Act. Known as the Alliance for Competitive Transportation or ACT, the League supports its goals of bringing about, at a minimum: (1) limits on the amount of ocean cargo capacity allowed to be aggregated into conferences; (2) a prohibition on conferences interfering with contract negotiations between an individual ocean carrier and the U.S. importer or exporter; and (3) the end to the Federal Maritime Commission's contract filing requirements, so that terms of ocean contracts could remain confidential, just as they are everywhere else in the world.

Summary

In conclusion, Mr. Chairman, the League strongly favors a minimum of economic regulation in the maritime industry, primary reliance on the forces of competition to encourage responsive and innovative pricing and service practices, and the use of contracts to provide rate and service stability so as to increase shipper and carrier productivity. The changes we seek do not simply concern the needs of the transportation community, but rather they concern the need to have a U.S. economy that will have the ability to compete with other countries in the world marketplace. This will require a national maritime policy that recognizes that we have an ocean transportation system which is capable of providing cost efficient and effective service. Such a system will only be fully realized when the constraints of a regulated environment are eliminated and the creation of true partnerships between shippers and carriers are allowed to proceed. It is clear that current policies are not improving the health of the U.S. maritime industry. There is no reason to continue pouring money into policies that are failing, so the League urges the bold reform steps such as we have outlined.

APPENDIX A

MARITIME POLICIES
OF
THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE

I–1 **Economic Regulation.** The League supports a minimum of economic regulation for the maritime industry.

I–2 **Antitrust Immunity.** Antitrust immunity for collective ratemaking should be removed. All ocean carriers and/or their asset sharing agreements should be subject to all antitrust laws.

I–3 **Pooling and Talking Agreements.** The League opposes pooling and talking agreements, including cargo preference and/or cargo sharing laws or agreements, which could result in restricting or eliminating price and service competition for shippers.

I–4 **Ocean Tariff and/or Contract Filing.** The League supports the elimination of the tariff, service, and contract filing requirements as prescribed by the Shipping Act of 1984.

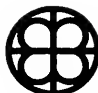
I–5 **Service, Loyalty, and Time–Volume Contracts.** The League supports the unrestricted right of shippers and carriers to enter into various forms of contract carriage. In addition, it supports the confidentiality of these contracts, and the ability of the contracting parties to modify these contracts as mutually agreed.

I–6 **Transport Methods.** The League supports the separate concepts of common and contract carriage, both of which could be provided by the same supplier.

I–7 **Shipper Associations.** The League supports the unrestricted right of a carrier in a conference to take an independent action on rates, service, or contracting options on not more than 10 days notice to the conference.

Effective November, 1992

APPENDIX B



THE
NATIONAL
INDUSTRIAL
TRANSPORTATION
LEAGUE

July 29, 1993

Mr. John Temple Lang, Director
Office of the Director General for Competition
Commission of European Communities
Avenue De Cortenberg 150
B1040 Brussels, Belgium

Subject: Case n° IV/34.446 - Trans-Atlantic Agreement (TAA)
Initiation of the proceedings and communication of the Commission's Statement of Objectives

Dear Mr. Lang:

This letter outlining views and concerns related to the Trans-Atlantic Agreement (TAA or Agreement) is submitted on behalf of The National Industrial Transportation League (League) to the Commission of European Communities (Commission or CEC). The League understands that the Commission is currently investigating complaints lodged by various Shippers Councils against the shipping line members of the TAA, alleging that by entering into this restrictive Agreement, these shipping lines have infringed Article 85(1) of the Treaty establishing the European Economic Community (EEC) and have abused their dominant position as prohibited by Article 86 of the EEC Treaty. The League understands that the CEC is considering whether to adopt interim measures against the TAA, pursuant to various articles and regulations within its authority.

As set forth in more detail below, the League believes that the TAA creates an anti-competitive and highly discriminatory arrangement by carriers that comprise a large majority of the transatlantic marketplace. This arrangement has resulted and continues to result in substantial harm to shippers. Among other things, the TAA has caused a radical and harmful change in the structure of transatlantic transportation; imposed.unreasonable and unjustifiable rate increases of shippers of numerous commodities; unduly and unreasonably interfered with the ability of shippers to enter contracts with carriers to implement sound commercial arrangements; and has resulted in unfair discrimination against small shippers. Thus, the League concurs in the views expressed in the CEC's Statement of Objections regarding the TAA.

The League respectfully requests that its views be considered by the Commission as it reviews this matter in more detail. The League's comments are not confidential.

IDENTITY AND INTEREST OF
THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE

The National Industrial Transportation League is an association of shippers whose offices or facilities are located in the United States and who are engaged in all types and sizes of commercial and industrial enterprises. The League has over 1200 shipper members, consisting of

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Chairman Robert M. Corcoran, General Manager of Traffic, U S Steel Group, USX Corporation
First Vice Chairman Roger W. Wigen, Manager of Transportation Policy and Industry Affairs, 3M
Second Vice Chairman John L. Amos, Manager of Traffic and Logistics, Bechtel Corp.
Third Vice Chairman Gerald De Peppe, Purchasing Support Director, ARCO Oil and Gas Company
Treasurer William A. McCurdy, Jr., Logistics and Commerce Counsel, E. I. du Pont de Nemours & Co.
President Edward M. Emmett

some of the largest industrial and commercial concerns in the United States; it also includes among its membership relatively small shippers. The League also represents groups and associations of shippers in national and international transportation. League members include industrial or commercial enterprises who are headquartered both within and outside of the United States, and numerous League members have facilities within countries who are members of the European Economic Community.

In the course of conducting their business activities, League members are substantial users of all modes of transportation, including ocean common carriers that are members of the TAA. League members export and import massive quantities of goods both from and into the United States from points all over the globe, including the ports covered by the Trans-Atlantic Agreement. League members ship substantial quantities of goods from countries who are members of the EEC into the United States in transatlantic ocean transportation. Thus, League members are substantial users of carriers covered by the TAA, and are directly affected by the operation of the TAA.

As a nationwide association of shippers, the League is sensitive to the problems of shippers in the transportation industry. The League often takes action on issues of general transportation importance which are of actual or potential concern to the interests of League members. Such an issue is the effect of the Trans-Atlantic Agreement upon the League's membership and upon shippers generally. In fact, the League has participated actively before the Federal Maritime Commission of the United States regarding the potential effect of the Trans-Atlantic Agreement upon shippers.

THE LEAGUE'S OBJECTIONS TO THE TRANS-ATLANTIC AGREEMENT

There are numerous provisions of the TAA that the League believes have resulted and will result in substantial harm to shippers, and from which the League believes that relief should be given.

First, the Capacity Management Program of the TAA, contained in Article 18, is discriminatory and results in unreasonable and unfair rate increases. Under this program, the parties to the TAA have agreed to reduce their combined capacity an average of 20.45 percent over the first eight years after the Agreement goes into effect. Parties to the Agreement are assessed stringent penalties if they offer shippers cargo capacity above the specified reduced amounts. The capacity amounts set forth in the Agreement can only be changed by the unanimous consent to all parties to the Agreement.

As is clear from the above description, this program -- which is at the heart of the TAA -- is not a capacity "management" arrangement at all, that is, an arrangement that is intended to increase efficiencies in ocean transportation. Rather, it is a bald capacity non-utilization agreement, created in order to radically limit the current capacity in ocean transportation in the westbound transatlantic service and therefore restrict competition. The League believes that the program is intended to effect, and has in fact effected, a substantial and unwarranted increase in the price of transportation for a significant number of commodities by artificially restricting the availability of ocean transportation. Moreover, under the program, TAA members can avoid their common or contract carrier obligations by claiming that to fulfill these obligations would be inconsistent with the Capacity Management Program of the TAA.

Since TAA members comprise such a large percentage of the existing transportation marketplace in transatlantic service, such price increases cannot be avoided or moderated by use of

other carriers or modes of transportation. In fact, because TAA members together possess considerable market power, they are in a position to exert pressure to discourage potential competition: the framework of the industry is such that a potential competitor would probably find it easier to cooperate with the TAA rather than to create a competitive alternative. In effect, TAA members have created and maintained a dominant position in the transatlantic market by entering the Agreement, and have abused that dominant position by unjustifiably and arbitrarily reducing the capacity of the ocean carriers in transatlantic service. It is particularly important to note that these reductions in capacity and competition have been accompanied by no concomitant gains in transportation efficiency, in cost reduction, or in the quality of transportation service. Indeed, to the contrary, the TAA establishes an extremely complex and expensive bureaucracy simply to administer and police its provisions.

Second, the TAA has unjustifiably interfered with the ability of carriers to enter into ordinary and sound commercial arrangements. Specifically, under the TAA, all contracts can only be for a maximum term of one year commencing on January 1 and terminating on December 31 and can provide for a minimum cargo commitment of 250 twenty foot equivalent container units (TEUs). Shippers can in effect negotiate only with the TAA contract committee. No meet or release or most favored shipper type clauses are permitted under any forms or any circumstances, and the Agreement establishes shippers' de minimis liquidated damages to be not less than $250 per TEU. The TAA limits carrier/shipper contracts for the same cargo to one contract.

These and other limits to shipper/carrier contracting are inappropriate and harmful. For example, limiting a contract to one year and within only certain dates is inflexible. It ignores shippers' seasonal requirements, and greatly increases transaction costs, since contracts must be renegotiated frequently. Similarly, meet or release or most favored shipper clauses are ordinary and useful commercial arrangements, and similar arrangements are used in many other industries. There is no sound commercial reason for restricting the freedom of shippers and carriers to contract in the context of transatlantic ocean transportation. The League believes that both shippers and carriers are well served by the ability to negotiate and agree upon arrangements that meet the commercial and business necessities of both parties, and artificial restraints upon such ability result in positive harm.

Finally, various provisions of the TAA are unduly discriminatory against small shippers. Specifically, the requirement of 250 TEUs as a minimum commitment for a service contract precludes small shippers from having access to service contracts. Thus, such shippers are at a severe competitive disadvantage, since the differences in price between a tariff and a service contract is often considerable. Moreover, even larger shippers are adversely affected by the minimum volume requirement, since if a shipper desires to enter into more than one contract covering different commodities, the 250 TEU minimum must be met for each contract. This requirement clearly and unjustly discriminates between two shippers transporting a similar total volume of goods, but under different contract arrangements. Such discrimination would be unjustified by differences in the cost of transporting these goods, since the cost of transporting the two commodities under separate contracts may not be appreciably different from the cost of transporting a single commodity with a similar total volume.

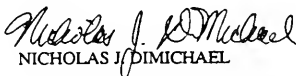
****

For all of the above reasons, the League believes that the TAA results in substantial harm to shippers. The League appreciates the opportunity to make its views knows to the Commission.

Sincerely,

EDWARD M. EMMETT

President



NICHOLAS J. DIMICHAEL

Attorney for The National Industrial Transportation League

cc: Howard A. Levy, Esq.
H. L. Holden
French Shippers' Council
British Shippers' Council
German Shippers' Council
European Shippers' Council
Spanish Shippers' Council

AFE, INC.
ALLEN R. FERGUSON, President

April 12, 1994

Representative Gary Condit
of California
U. S. House of Representatives
The Capital
Washington, D. C.

Dear Representative Condit:

You showed great interest in my September 30th testimony on maritime policy before your Sub-committee on Information, Justice, Transportation and Agriculture of the House Committee on Government Operations.

You may remember that my Report and testimony were severely criticized by shipping interests and their spokesmen on the grounds that my estimate of the conferences' monopoly premium was totally incredible. Extravagant criticism followed in some of the trade press.

That has irked me for some time, and, finally, I have gotten down to examining third-party estimates of conference rate differentials. The differentials I have examined constitute estimates of the conference premium.

The attached Note summarizes what I have found in public sources. All but one of the indicators show that my 18%, while obviously not precise, is in the right ball park. I think the attacks are refuted for anyone who will take the time to look objectively at the available data.

I hope you find this of interest. I would be happy to see you to make any use of the Note that you might think appropriate.

Sincerely

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PUBLISHED INDICATORS OF THE IMPACT OF THE CONFERENCES

Allen R. Ferguson

Allen Ferguson Economics, Inc.

April 12, 1994

afe, inc.

PUBLISHED INDICATORS OF THE IMPACT OF THE CONFERENCES

Allen R. Ferguson

A. Purpose

My Report, "Maritime Policy and Agricultural Interests: Impacts of the Conference System", performed for the Department of Agriculture, was intemporately attacked. I had presented a preliminary estimate that, for several major agricultural trade segments, the conference system imposed a cartel premium equal to roughly 18% of ocean transportation costs.

That apparently frightened many maritime interests. In Congressional testimony, Chairman Hathaway of the Federal Maritime Commission (FMC) stated that "the so-called 18% 'monopoly premium' ... is ... meaningless." In the same hearing Mr. Elliott Schreier, of Manalytics International Inc. referred to my figures as "fanciful but attention grabbing" and stated that my conclusions were "inconsistent with actual ... rates" and "unsupported by other studies". Mr. Joel Greenberg of American President Lines, "a conference premium that adds up to 18 percent or *anything remotely approaching that amount* (emphasis added) is ... absurd."

Austin Schmitt, FMC's chief economist and director of its Bureau of Trade Monitoring is quoted by American Shipper, (November, 1993), as saying, "We know there is no 18 percent premium." According to Ronald Gotshall, then managing director of TWRA, "The numbers [are] ... contrary to our day-to-day experience of the market..." Further, Mr. Schreier insisted that any differential is no more than "about 2 to 4 percent"

Although Mr. Schreier's "2 to 4 percent" was based on an inappropriate definition of "conference rates", it is worthwhile to see how it and my 18%, as alternative broad generalizations, stand up against the readily available published information.

There are difficulties in obtaining accurate estimates of average conference rates. The difficulties in obtaining average *competitive* rates are vastly greater, because, to the extent that a conference, or any other cartel controls its market, competitive prices are obliterated. One must use indirect measures. It is the difference between the conference rates and rates that would exist under competitive conditions that constitutes the "cartel premium".

My study was based on unpublished information obtained from individual agricultural shippers. In this Note, I use a top-down approach based on published estimates of over-all impacts of the conferences. The aim here is to determine a range of general estimates of the magnitude of the conference premium, specifically to show whether my 18% of ocean transportation costs is in fact "absurd", "fanciful", "meaningless" and unsupported by other data.

To jump ahead: it is none of those things.

At present, there is an unusual mine of publicly available information on the Atlantic trades, in factual information presented in the Commission of the European Communities' "The Transatlantic Agreement: Statement of Objections" (EC). Here, I lean on that source as well as on publications of the Federal Maritime Commission and the trade press.

B. Results --The Atlantic Trades

My results are shown in the Table. Because of the difficulties in determining precise competitive rates, most of the published estimates and calculations based on them are expressed as ranges. There are two broad divisions in the Table: THE ATLANTIC TRADES and THE PACIFIC TRADES. The main panels under the Atlantic Trades are "Concurrent Rate Differentials" and "Before-and-After Differentials".

1. Concurrent Differentials

Two comparisons of different sets of contemporaneous rates are possible. The first compares rates charged by two classes of TAA members; the second compares Independent Action rates and conference tariff rates.

TAA set up a two-tiered rate system, for its insider "Structured" and its outsider, "Unstructured" members. (In addition, there are independent carriers, such as Lykes Brothers, ABC Lines and the Mexican carrier.) Unstructured carriers are explicitly authorized to undercut the insiders' rates by $100 per TEU. This is an extraordinary admission by TAA that it has monopolistic power. Further, in itself it provides a hint of the cartel premium. That "hint" is in fact less than the actual premium, because independent carriers charge even less than does the lower tier of TAA members. By definition, the cost of viable outsiders sets the upper limit on the competitive price; subtracting it from the cartel rate provides a lower-bound estimate of the conference premium.

TAA rates, then, are more than $100 per TEU above the competitive price. The size of the conference premium in percent depends, obviously, on the average rate per TEU. In the Table, I use two estimates of that averagee rate, one by Drewry for European rates (cited in EC footnote 14) and one from Schreier (Congressional testimony, September 30, 1993). Although Schreier's rates pertain to the Pacific trades I used a weighted average of them, $1323, as an alternative to Drewrey's. I calculate (Table, Line 1) the differential as lying between 7.56% and 12.5%. On November 11, 1993, The Journal of Commerce, opined that the second-tier rate is "at least 10% less than TAA's traditional conference carriers ...", an appraisal entirely compatible with the figures in

the Table, whose arithmetic average is 10.03%.

In addition to the discount TAA authorizes for unstructured carriers, two other kinds of discounts are common: Independent Action Rates (IA) and rates under Service Contracts (SC). IA rates are by definition not conference rates; hence, in its Section 18 Report, FMC excludes them from conference rates. An Independent Action rate proposed by a rational, profit seeking firm is a rate at which it expects to maximum earnings. Hence, an IA rate provides another quantitative measure of the upper bound of the competitive rate for a particular traffic. This logical inference is somewhat reinforced by FMC, which states that the number of IA rates reflects the level of competition from independent carriers.

In the Summary of its well-known 1988 Survey of Shippers, FMC shows that of 57 commodities on which both conference and IA rates were in effect in 1987, 63.6% involved discounts of more than 10 percent. More than half, 50.8% showed discounts of between 11 and 25%, and 12.7% of the responses showed more than 25%. The second line in the Table shows FMC's minimum, maximum and weighted average discounts: 10%, 25% and 16%, respectively. Also, tables in FMC's Section 18 Report indicate that most IA discounts exceeded 20%.

The economic significance of the differential between service contract and general tariff rates is less than obvious and may vary from case to case in an unsystematic manner. Consequently, they are excluded from this discussion.

2. Before-and-After Rates

Obviously not all rate increases from one year to the next are monopolistic. In some cases, however, such increases are evidence both of monopolization and of the size of the monopoly or cartel premium. In both the Atlantic and the Pacific trades, average rate increases in recent years provide such evidence.

Rate increases in response to unfettered market forces are not monopolistic. However, TAA was established in 1991 and 1992, a period of falling energy and capital costs, of no substantial growth in wages, and when directional balance in trade flows was achieved --all factors tending to reduce ship operating cost. In addition, rather than being pressured to raise rates by expansion of demand, the carriers faced a decline in inbound traffic of 35%, according to FMC's Annual Report, 1992.

Obviously, it was not market forces that precipitated TAA's rate increases.

TAA's rate increases followed creation of a new super-conference.

In a speach delivered in February, 1993, the conference

manager, Mr. Holden, took credit for them.

The FMC accepted the idea that the conference was intended to increase rates.

The cartel took steps to prevent the full play of competitive forces. It reduced the amount of members' capacity that was to be utilized in the trade and restricted the amount by which the second level carriers would under-cut the core conference rates.

In order to show that TAA's rate increases included a substantial cartel premium, one must show that the prior rates were at or above what competitive rates would have been at that time. The carriers and FMC both contend that there was persistent excess capacity in the North Atlantic, inspite of "fierce competition". Actually, competition would have forced rates down or capacity out of the market until the capacity that remained was efficiently employed. The existence of excess capacity is strong evidence that rates are greater than the competitive level.

Whereas it is, thus, easy to assure that TAA's increases were not competitive reactions to market forces and that they embodied a cartel premium, to measure the premium is another matter. It is difficult to determine the actual average increases, because of the complexity of rates; thousands of rates and amendments are filed every year -- in 1992, 795,000 pages of tariff amendments were submitted to FMC. TAA's first tariff (TAA FMC #3) also changed the basis on which rates were applied; it introduced new classes of commodities and imposed increases per container that were progressively greater the lower the rates previously charged each class.

The Table, line 3, shows a percentage estimate published by the Journal of Commerce, a minimum of 26.5% and a maximum of 100%. Drewry, cited by European Commission, estimated average east-bound rates in 1992 at $800 per TEU and west-bound at $700; He predicted 1994 levels of $925 and $1100, respectively, increases of 15.6% and 57.1% (line 4).

Absolute increases in dollars per container have been estimated by the European Commission and by TAA officials. The European Commission reported no precise average rate increases (because of the "complexity"), but said that on January 1, 1993, rates were raised by $200 to $400 per TEU and $300 to $600 per FEU. After reviewing specific, undisclosed data on rate increases, the Commission stated that the 1993 increases "actually implemented were very substantial" and "... [A] large number of shippers were faced with very large price rises, generally between 30% and 100%,." TAA's 1994 Business Plan announced a further increase to be effective January 1, 1994: of from $60 to $150 per 20-foot and up to $190 per 40-foot container (the maximum east-bound increase

was $120).

By combining Drewry's and Schreier's 1992 adjusted average rates with the European Commission's predicted increases, one can calculate expected percentage changes (line 5). Drewry's east-bound rate per TEU, $800, produces estimated percentage increases of some 32% to 69%. Schreier's rate, $1323, produces estimates of from nearly 20% to over 41%.

TAA asserted that its rate increases lowered its members losses by $250 million in 1993 and were expected to reduce them an additional $150 million in 1994. The European Commission stated that in 1992 transatlantic trade between Northern Europe and the United States amounted to 1 million TEU in each direction. Thus, a gain to the TAA carriers of $400 million implies an increase of $200 per TEU or $250 per FEU. Using Drewry's average rates east-bound of $800 per TEU, this amounts to an increase of 25%, using Schreier's average rate it amounts an increase of to 15%, (line 6).

C. Results -- The Pacific Trades

There is no readily available source on the effect of the Pacific conferences comparable to the European Commission's data on TAA. However, a careful estimate appears in Appendix F to the ACCOS Report. Reitzes and Clyde examined the Taiwan and the inbound Japan trades to test, among other things, "whether liner conferences have market power". They found "that port-to-port rates were $383 [or in another calculation $503] lower per container ... on those Asian trades [when the conferences permitted] ... independent action on service contracts" [than those rates were when such action was precluded by the conferences.]. They found that the average freight rate per container was nearly $3,000; their differentials, i. e. the "cartel premium", of $383 and $503 are 12.8% and 16.8% of $3,000. If Schreier's weighted average rate of $1323 is used, the cartel impact is raised to a minimum of 28.9% and a maximum of 38% (line, 7).

Before summarizing, I should point out that these calculations tend to understate the magnitude of the cartel premium, in part because they ignore non-rate sources of increased shipper costs. For example, eliminating some services and imposing supplemental charges for using particular ports, as well as raising the minimum volumes eligible for SC's also increased shippers' costs. These actions add some unmeasured increment to the cartel premium.

D. Conclusions

The purpose of this note was to show whether my earlier finding that the conference system imposed a cartel premium equal to some 18% of total ocean transportation costs of my sample commodities was "meaningless", "fanciful", "unsupported by other

studies", as vigorously alleged. Also I sought to compare its plausibility with that of Mr. Schreier's "2 to 4 percent".

The minimum and unweighted (except for line 2, for which weights were available) average estimates of the cartel premium as a percent of liner rates are:

		Minimum	Average
1.	TAA's 2-tiered system	8%	10%
2.	FMC Shipper Survey	10%	16%
3.	Journal of Commerce	26%	76%
4.	Drewry	16%	36%
5.	European Commission		
	With Schreier's rate	20%	31%
	With Drewrey's rate	32%	51%
6.	TAA's Claim	15%	20%
7.	Reitzes and Clyde		
	Unadjusted	13%	15%
	With Schreier's rate	29%	34%

Leaving aside the estimates based on TAA's two-tierd rate differential which are demonstrably too low, the lowest *minimum* is more than double Schreier's *maximum* of 4%. All but two of the minima are more than three times greater than Schreier's maximum. The weighted average of FMC's IA differential is 16%, four times Schreier's upper bound; no average value is less than three times Schreier's figure. The maximum values in the Table are, of course, far greater, ranging up to 100%; the lowest of the maxima is four times the Schreier's 4%; all the others are at least six times Schreier's maximum.

This note does not present any solid estimates of the conference premium. It does include all the publicly available estimates of which I am aware. It does show that an estimate of some 18% is by no means unreasonable.

ADDENDA

Partly as a consequence of criticisms by shippers' witnesses I have reexamined the analytic model and the calculations that underlay some of my testimony of September 30, 1993. As a consequence, I have made a number of changes in figures presented in my testimony and in Table III of my USDA Report. In general, the changes do not affect the totals or the over-all magnitudes; they do affect the reported distribution of costs or gains between exporters and importers.

I find that the following changes are required:

On page 30, of his statement Dr. Schrier accuses me of double counting.

> Table III as submitted in the draft of my USDA Report should be replaced with the revision attached. In light of the objective of estimating only rough general magnitudes, the numerical changes are negligibly small. The more significant change is in the interpretation of the figures. The division of the gain between importers and exporters is estimated to be as shown in the revised Table III. Although considerably less than the initial estimated impact on agricultural exporters, the predicted loss is still a very large annual cost, $168 million or 3.4% of the value of exports of the small fraction of agricultural shippers examined.
>
> It is to be noted that Dr. Schrier's criticism that I had double counted was partially correct. The cost of the cartels to exporters was over-stated, but the cost to the trade as a whole was not.

Dr. Schrier and Chairman Hathaway engage in lengthy criticisms of my data base. As I pointed out in both my Report and my oral Testimony, the data are very limited. In general data in this area are abysmal. My Study was designed strictly as an effort to get general indicators of gross magnitudes, using the shreds of information that are available or obtainable. Weak as they are, they are the only contemporary data I know that pertain directly the key problem.

Dr. Schrier and Mr Gottshall present identical tables comparing various FMC rates. Neither of them provides any explanation of why those few rates were selected. They obviously are not a random sample of rates. The witnesses did not define "conference rates" or "non-conference rates". Perhaps more important they neglect two crucial factual matters. Their conference rates may include independent action rates; it seems likely that they include conference tariff rates induced by the pressure of members' independent actions rate. To the extent that they include such rates they obliterate the distinction between what might be considered "normal conference rates" and more competitive rates. That is the distinction that must be estimated,

however crudely. Further, they do not indicate to what extent the "non-conference rates" reported have been filed by carriers who, while not formally members of the conference, operate under talking agreements or other cooperative arrangements with the conferences. Referring to any such rates as if they are created independent of the conference again blurs the essential distinction.

Mr. Gottshall (p 11) stated that TWRA alone files 100,000 tariff pages per year, and that members filed 60,000 independent action rates in 1992. The problems identified in the preceding paragraph plus the enormity of the filings, means that any simple analysis of FMC tariffs (such as those presented by Schrier and Gottshall) is at best inadequate and perhaps irrelevant to the question at hand.

My estimates of the conference premium, while also short of ideal, were obtained by asking the people who pay the freight. This is one of the few possible (the only?) ways to get <u>any</u> estimates, because no one but the shippers know what rates were actually used by them, what alternative rates they knew of and whether the service available at alternative rates were in fact comparable for their own purposes to those available at conference tariff rates. The questions were objective, referring to rates actually experienced and those actually published.

Without regard to disputation over defining and measuring the conference premium, FMC could well have gathered data on the ratio of ocean cost to commodity price. So far as I know, it has never done so.

It is highly desirable that more extensive efforts be made to determine the size of any conference premium and the ratio of ocean cost to commodity price.

Dr. Schrier, page 27-30, comments, that it was impossible to obtain some of the results shown in my Report from the data presented, were often technically correct, but in the end insignificant. A typographical mistake in Table V, where a decimal point was misplaced, accounts for the error he found concerning forest products to Japan. The error in cotton to Europe similarly originated from a clerical error in Table V. In both cases the calculations incorporated the correct values, so these errors had no effect on the reported results of the Study.

There is no excuse for such errors, and I make none. Indeed, I apologize for the fact that they were in the draft Report that was made available to the Sub-Committee. However, these errors do not affect the findings.

I can not refrain from recording my amusement over the fact that Dr. Schrier, in the midst of castigating me for numerical errors, was able to conclude that .65 is 57% of 1.31 (page 28, line 2).

On page 29, Dr. Schrier points out that I did not show the derivation of the 18% in Table III. I felt that the calculation should be obvious. The 18% was derived as the average of the ratios of the conference premium to transportation cost for each commodity-market set, weighted by the value of exports of each commodity group.

On page 32, Dr. Schrier essentially accuses me (and Mr. Fones of the Department of Justice) of misrepresenting the conclusions in Appendix F to the ACCOS Report, by Reitzes and Clyde. He stated that "they never attempted to measure or calculate a 'conference differential'." In fact what they undertook to test was, among other things, "whether liner conferences have market power" (page F-1). They found "that port-to-port rates were $383 [or in another calculation $503] lower per container ... on those Asian trades [when the conferences permitted] ... independent action on service contracts" (p F-2). That is what I call a "cartel premium" or "conference differential".

Also with regard to Reitzes and Clyde, Dr. Schrier states that I "misrepresented" them and that I "claim[s]" (sic) that "they calculated a conference differential of between 12.8% and 16.8%". What they state is that the average freight rate per container was nearly $3,000; their differentials of $383 and $503 are 12.8% and 16.8% of $3,000.

The changes in Table III also dictate some changes in Section V, "Costs," of my paper, "Reform of Maritime Policy: Building Blocks for an Integrated Program."

1. The first sentence of the paragraph beginning "The conference system (exempt) ..." should be changed to read:

> "The conference system (exempt from antitrust laws) produces monopoly rents for ocean liner companies that cost American exporters as a group an estimated $2 to $8 billion per year."

2. The immediately following paragraph, "1." should be changed to read:

> "1. The conferences' "cartel premium" amounts to some 18% of the total cost of ocean transportation. The annual burden on the small portion of agricultural trade analyzed equals $406 billion or 7.7% of the value of that trade."

3. The paragraph beginning "These estimates indicate..." should be changed to read:

> "These estimates indicate that the present maritime policies *in toto* generate annual costs of between $5 and $15 billion. Additional costs of comparable magnitudes are imposed on American consumers and manufacturers who use imported inputs."

Table III
(Revised October 15, 1993)

Elimination of Conference Market Power:
Estimated Impacts on Costs
for the Sample* of Agricultural Exports

Reduction in Ocean Transportation Cost (Given current volume of exports)		18.0 per cent

....

	Increased Value of Trade (millions of Dollars)	Percent of Current Value of Trade in fob Prices
Gain in U. S. Trades:		
IGNORING EXPANSION OF EXPORTS:		
Minimum Estimate	$238	4.7%
INCLUDING EXPANSION OF EXPORTS:		
Expected Impact on Agricultural Exports	168	3.4
Total Expected Impact	406	8.1

* Three markets, six commodity groups

COMMENTS ON SOME SHIPPER TESTIMONY

It has not been possible to review the written statements of the shipper witnesses in any depth. I shall make only three brief comments.

1. As I mentioned orally in response to a question by the Chairman, analysts describing real rate changes often make the mistake of adjusting nominal (current dollar) rates using the CPI (the Consumer Price Index). That error was made by both Dr. Schrier and Mr. Gottshall in identical tables. Changes in rates over time are relevant to the question of whether a market is competitive or somewhat monopolized. In a competitive market rates tend to move with the unit cost of producing the goods or services sold. The CPI is frequently used to approximate change in that cost.

The CPI, historically, and moire descriptively, called "the cost of living index", as they showed, rose 46.5% between 1982 and 1993. That has nothing whatsoever to do with trend in the cost of producing liner service.

To show how the cost of living of urban consumers changes the CPI contains heavy weights on the prices of housing, consumer transportation (largely the cost of automobiles), food and clothing. No liner company spends much on any of these items.

Interest, wages (ashore and afloat), fuel are among the prices that are important in producing ocean liner services. I have no data readily at hand on maritime and other relevant wages over the period. However, <u>The Economic Report of the President</u> shows that between 1982 and 1990 the average price of fuels <u>fell</u> 17.2% and yields on Moody's Baa bonds <u>fell</u> by 65.9% (5.75 percentage points from 16.11%). Further, as the shipper witnesses pointed out massive innovations occurred during the period, increasing productivity, that is reducing the cost of producing any given service. All those cost factors should be incorporated in any index designed to show whether real rates have risen or fallen.

I have made no study of the trend in real shipping rates, but neither have the shippers' witnesses --so far as their statements reveal. There appears a reasonable chance that real rates rose during their period. Certainly, they did not fall by 45%.

2. None of the shipper witness presented any evidence that conference rate setting generates any economic benefits.

3. They make a great deal of the fact that rates of return in shipping are low. That appears to be true. It says very little about whether the industry is competitive.

Unrestricted monopolies create high profits in theory and, in many cases, in practice. Cartels often do not. There are three

pieces of evidence presented by the shippers that indicate that the cartel rates are and have been above competitive levels. First, there is chronic excess capacity according to Chairman Hathaway (page 5): that means that prices are not being allowed to drop to the competitive level at which capacity would be efficiently utilized --perhaps through withdrawing some from the market. Second, as in other cartels, for example airlines and motor carriers before deregulation, internal competition appears to take the form of service competition. Such non-price competition has often driven costs up, to above the free-market level; in fact, all profits tend to be eroded away. Third, the shipper witnesses pointed out that TWRA's market share has declined in recent years. That does show that they have not been able to protect whatever market power they have from some erosion. What it also shows is that TWRA held prices above the competitive level for years. Otherwise other carriers would not have been able to enter the market or expand service to attract some of its custom.

ADDITIONAL MATERIALS SUBMITTED for the RECORD

1. Ocean Liner Antitrust Exemption: Economic and Agricultural Impacts, Allen R. Ferguson, August 1, 1991.

An issue that underlies not only my testimony, but any discussion of the economics of the current toleration of the liner cartels is whether they do, in fact, possess and exercise monopolistic power.

That issue was sharpened in the present context by Dr. Schrier, who at page 22 of his written statement said, "The Ferguson report and the DOJ 'estimates' reflect the incorrect *presumption* that, if an industry is permitted an antitrust exemption, then that industry is *automatically* a 'monopoly' or a 'cartel' ..." [emphasis provided. There is no such presumption of automatic monopolization. There is a *conclusion* to that effect based on most of the academic work in the area and the available evidence.

Further, Dr. Schrier, admonishes that economists analyzing the conferences should, inter alia examine whether "there is a reasonable alternative." Further, Mr. Gottshall reiterated the common lament that the alternative to regulation is worsening of competition through the elimination of most of the incumbents -- this was urged in opposition to motor carrier, rail, air and telephone deregulation.

Both these points are addressed in the attachment. Evidence that the conferences have frequently monopolized the trades is presented in pages 7 through 18. The issue of whether there is a competitive, technically a contestable, alternative to the conferences is addressed in pages 19 to 23.

2. An "Op Ed" of mine that appeared in the Journal of Commerce on August 11, 1993.

3. An article commenting on an early draft of my Department of Agriculture Report that appeared in the same journal on July 9, 1993.

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Attachment 1

THE OCEAN LINER ANTITRUST EXEMPTION:

ECONOMIC AND AGRICULTURAL IMPACTS

Allen R. Ferguson

August 1, 1991

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Prepared Under Contract #53-6395-1-75 for the
Transportation and Marketing Division
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I. INTRODUCTION

This Report is submitted in partial fulfillment of a contract between the United States Department of Agriculture (USDA) and Allen Ferguson Economics, Inc. It is to be the basis of testimony before the Advisory Commission on Conferences in Ocean Shipping.

The Commission's mandate is to study specifically, "... whether the nation would be best served by prohibiting conferences or by closed or open conferences." It is to that issue that the present Report is addressed. Little emphasis is placed on the antitrust exemption for ports and marine terminal operators, on TFE (tariff filing and enforcement), or on the issue of mandatory mass/volume rates.

The following hypotheses are tested:

- o The Conferences have monopolized at least some trades that are important in American commerce and to farm exports in particular;
- o Doing so is facilitated by the antitrust exemption in the 1984 Act;
- o Removing that exemption would promote the interests of American farmers and of the Nation in general.

The results of any evaluation of the Act or its antitrust exemption will depend most particularly on the criterion used. There are three possible criteria, the well-being of: the conferences and their members; the U. S. liner fleet; American trade or, more accurately, the American public at large. In this report, I employ the last of these.

The report is limited by time and resource constraints such that it has proven impossible to undertake gathering new data. Instead, it focuses on analyzing and interpreting information presented in the sources referred to in the Bibliography. It contains the following sections:

I. Introduction

II. General Characteristics of Conferences, where a minimal description of the conference system is presented, sufficient only as a foundation for the rest of the analysis and an outline of the chief shipper concerns about the system;

III. Evidence of Monopolization, where five strong indicators that the liner markets are, at least in part, monopolized are presented;

IV. Consequences of Eliminating the Antitrust Exemption, where it is shown that elimination of the conference system could be expected to be followed by effectively competitive (contestable) markets.

V. Counter Arguments, where arguments explicitly in opposition to removing the antitrust exemption are addressed.

VI. Summary and Policy Conclusions

II. GENERAL CHARACTERISTICS OF CONFERENCES

A Nature of the Conferences

According to the Federal Maritime Commission (FMC), "Conferences are agreements among ocean carriers to restrict competition, regulate and rationalize sailing schedules and ports of call, and sometimes to arrange for the pooling of cargoes or revenues.... Procedures to combat competition from independent operators and various tying arrangements with shippers may also be included in agreements."[1]

The conferences are cartels of ocean liner companies. Conferences have been in existence for over a century but, like most cartels, individual liner conferences are short-lived.

The vast majority of members of the conferences serving the American foreign trades are foreign corporations.[2] In 1988, foreign carriers handled an estimated 82.8% of American oceanborne foreign trade, by weight, and 78.9%, by value.[3] A substantial number of independent operators also serve the American trades although a large, but unknown, fraction of them are essentially feeder operators.

After passage of the 1984 Act, a number of Super Conferences have been established by merging earlier ones of narrower scope.[4] In this way a single conference regulates trade on a multiplicity of routes. Further, the FMC has permitted "talking agreements" both between conferences, and between conferences and "independent" liner companies.

B. Legal Status

American antitrust laws would normally expose businesses that pursued conference practices to civil or criminal action. However, beginning with the Shipping Act of 1916, special exemptions from antitrust challenge have been granted to ocean liner companies. The most recent amendment to that Act is the Shipping Act of 1984. Under it, all the actions indicated above are legal.[5]

Some protections from monopolistic abuse are provided in the 1984 Act. Two are of particular importance here: the requirement that conferences grant members the right of Independent Action (IA)[6], and the legalization of Service Contracts (SC's). The Act also explicated the legality of conferences' publication of intermodal rates. In addition, conferences in American trades must be open, and the FMC

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1 FMC, 23. For form of footnotes and abbreviations of references see "Citations" at end of text

2 For a list of conferences and membership, by nationality cf FMC, Chapter 10, Appendix B, 334-373.

3 FMC, 77.

4 Waage-Nielsen, 48

5 There are many descriptions of the conference system and of the American legislation supporting it. For example, FMC, 23-28; GAO, 4-10; Ferguson, 91.

6 "Independent Actions" by conference members are not entirely independent. They must be filed on 10 days' notice and must be submitted to the conferences, where they may be discussed by the other members.

was given authority to disapprove agreements under narrowly specified circumstances.[7]

FMC's authority to disapprove proposed agreements has been used sparingly. FMC interprets the Act to mean that agreements are beneficial absent persuasive evidence of substantial net damages. In its discussion of Section 6(g), FMC focused not on the level of rates or service but on increases or decreases therein, respectively.[8] Overtonnaging is considered a justification for restrictive practices.[9] The Commission has found that conferences have the authority to prevent the use of IA on loyalty contracts. In the view of the Department of Justice, FMC approval of agreements is pro-forma,[10] but FMC contends that its informal pressures have prevented the filing of agreements that would have been disapproved.

C. Interests of American Agriculture

As shown in Table 1, vast amounts of U.S. farmers' products are exported, much by ocean liner. More than half of the U.S. production of cotton, hides and skins, and tobacco is exported by ocean liner.

Transportation charges often comprise a substantial fraction of landed cost: on exports to Japan, 37% in the case of alfalfa, 5% for cotton.[11] In addition, 15% in the case of forest products and 35% for fruits and vegetables.[12] Consequently, farmers have a substantial interest in ocean liner rates and services. If conferences raise rates on agricultural exports, the U.S. farm community is hurt.[13]

Agricultural representatives have traditionally, as well as recently, opposed the conference system.[14] Many of agriculture's concerns were identified by the Department of Agriculture's Office of Transportation, in both its Surveys and its Focus. Although those studies emphasized the 1984 Act, not the conferences, many of the points raised pertain directly to that system, and often reflect views of non-agricultural shippers, as well. A major issue addressed in this Report is whether the farmers' and other shippers' concerns could be alleviated by elimination of the antitrust exemption.

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7 The Merchant Marine Act, 1936, The Shipping Act of 1984, and Relatad Acts, Section 6(g).

8 FMC, 113-118.

9 FMC, 118 & pessim

10 DOJ, 1.

11 Neenen, Table 5, 13.

12 Cit to be provided.

13 According to Neenan, 23, varying but lerge percantages of survey respondents reduced exports or suffered lower profits as a consequence of conference freight rate increases.

14 Cf, for example, Crouch, 48, where he reported that exporters of cotton were subjected to penalties for not using conference ships, or forced to spread shipments among conference carriers rather than being free to make their own choice of liner company, even within the conference membership

Table 1

Agricultural Commodities Exported on Liner Vessels

	$ Billions/Yr	% of Total U.S. Production	Thousand Long Tons/Yr
Fruit & Vegetables	2.34	20.9%	2,355
Cotton	2.10	51.3%	1,484
Meat	1.89	2.1%	722
Forest Products	1.79	NA	2,803
Hides & Skins	1.45	78.8%	596
Tobacco	1.25	55.4%	240
Animal Feed	0.42	6.1%	2,049
Other (Misc.)	2.63	NA	3,296
Total	13.87		13,545

Sources:

United States Oceanborne Foreign Trade Routes, U.S. Department of Transportation, Maritime Administration, April 1991.

Foreign Agricultural Trade of the United States, U.S. Department of Agriculture, Economic Research Service, October 1990.

Desk Reference Guide to U.S. Agricultural Trade, U.S. Department of Agriculture, Foreign Agricultural Service, Handbook No. 683, March 1990.

Foreign Agriculture 1989, U.S. Department of Agriculture, Foreign Agricultural Service, October 1989.

Agricultural Statistics, U.S.Department of Agriculture, Washington, D.C., 1989.

The main criticisms raised in the two USDA studies include:[15]

1. Conference rates or increases in them have been excessive [N25, F33, F39, F48] and conference procedures and control reduce marketing flexibility [F29, F47]. Consequently, mandatory IA and IA on both SC's and loyalty contracts are highly desirable. [N28, N31, F22, F27];

2. Rate instability is excessive, particularly for shippers who must sell on future contracts. Hence, unrestricted opportunity for forward contracting for ocean service is important [N21, F23, F27];

3. The high conference rates protect inefficient ship operators [F39, F46] and conference practices contribute to excess capacity [F32, F42] which has been a source of what some respondents considered to be excessively depressed rates [F16, F41-2];

4. Rates are sometimes discriminatory [F25, F33];

5. A majority of agricultural shippers who expressed an opinion on the matter would prefer the elimination of conferences [N24] and some oppose super conferences [F44].[16]

The discussion to this point provides the rationale for the subsequent analysis. Would removal of the antitrust exemption alleviate shippers' problems? If, in fact, the conferences exercise market power, if that power is dependent on the antitrust exemption, and if the alternative to the conferences is competitive markets, then the answer to that question is "Yes".

Competitive rates would closely reflect costs, and would, presumably, be lower. Rates would be adjusted by market forces until much of any existing excess capacity was eliminated and, subsequently, until adequate new capacity was added, as trade flows expanded or technological changes made fleets obsolete.

IA and SC's, including forward contracts, would not be collusively constrained, but could be freely established through carrier-shipper negotiation. Uneconomic discrimination would tend to disappear and hence the need for filing tariffs as a means of preventing undue discrimination would tend to be eliminated. Similarly, mass/volume or lump-sum rates might be introduced, not through fiat but through the impact of supply and demand.

In Section III, I pursue this reasoning and explore whether there is monopoly in the liner industry. In Sections IV and V, I explore whether removing the exemption would lead toward increased national economic well-being.

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[15] Among issues raised but not discussed here are the questions of secrecy in SC's, and variability in and excessive accessorial charges. In this discussion the figures in brackets refer to pages, "N" standing for Neenan and "F" for Focus.

[16] A majority of those with an opinion expressed a seemingly contradictory preference for the preservation of TFE [35], and some opposed the perceived prevalence of rebating [36-7]. Presumably, these are second-best preferences based on the assumption that the conference system will survive largely in its present form.

III. EVIDENCE OF MONOPOLIZATION

Literally "monopoly" means, from the Greek, one seller. Groups of sellers, colluding, can exercise monopoly power, that is, can monopolize a market. Monopolization involves restraining competition beyond normal business practice so as to acquire a monopoly position and exclude rivals from the market. [17] What is relevant here is not whether the conferences are technically "monopolies" but whether they monopolize. If they do, agricultural and other shippers are denied the benefits of competition.

When liner markets (like any markets) behave competitively:

- prices (rates) reflect the cost of providing the service;[18]
- costs are minimized both through pressure on operating costs of individual carriers, and through the elimination of inefficient firms and services and the entry or expansion of efficient ones.

The persistence of either of the following is, by definition, strong evidence of the presence of monopolization:

- prices above the competitive level: a competitive price equals either the lowest cost at which incumbents could produce the output demanded in the market or the cost of actual or potential viable entrants into the market;[19]
- excess capacity: in competitive markets prices do not attract more than the efficient amount of capacity and, where excess capacity exists, because of extraneous or transient events, prices are driven down to a level at which the excess is removed.

There are several, more commonly cited indicators of monopolization:

- consolidation: a small number of independent sellers and larger market share of some of them is widely regarded as a potential source of market power;
- patterns of prices over time: rate increases that are not explained by rising costs or growing demand indicate the exercise of market power;
- discriminatory rates: persistence of rate differentials not related directly or indirectly to cost are incompatible with competition.

Monopoly need not be permanent or uninterrupted to be economically wasteful. Extended periods during which prices lie above the competitive level impose excessive costs

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[17] For example, Scherer, 450. Technically, monopolization consists of restricting the attainment of competitive prices and quantity and quality of output, as would be achieved in either competitive or contestable markets. Because contestable markets produce competitive results, "competition" and its derivatives are frequently used in this Report to include contestability and its derivatives.

[18] In natural oligopoly, with economies of scale and scope, some prices should, if firms are to survive, exceed marginal cost where price elasticity of demand is relatively low, according to the principles of Ramsey pricing. A discussion of that is beyond the scope of this paper.

[19] This definition is consistent with the Department of Justice, "1984 Merger Guidelines", but see footnote 21 below.

upon customers, reduce output and may attract excess capacity.

The remainder of this section presents evidence as to whether, under the conference system in American international liner markets, these indicators of monopolization are found to be important.

A. Rates: Does the Level of Conference Rates Reflect Monopoly Power?

One of the acknowledged purposes of conferences is to set rates above the competitive level. The FMC staff frequently recognizes that.[20]

More analytically, the existence of genuine independents and the frequent occurrence of entry and exit are directly relevant. At least the possibility of free entry is a necessary condition for competitive or contestable markets. It is not a sufficient condition for either. Entry may, in fact, constitute evidence of monopolization. Thus, whether a history of entry is evidence of market power or lack of it, is an empirical question.

As indicated above, by definition a monopolistic price is one that is greater than the cost at which incumbents can produce the market output or that of any actual or potential viable entrant into the market. Consequently, introduction (and maintenance) of rates below the conference rates, whether by a new entrant, an independent line or a conference member acting independently is, in the absence of extraneous factors, powerful evidence that the prior rate was monopolistic.[21]

The FMC Report shows that liner markets have experienced substantial entry and exit. The FMC Report concluded that that indicates that they are "highly competitive".[22] Similarly, Davies considers observed entry to be an indicator of contestability.[23] These interpretations are, at best, overstatements.

Obviously, viable entry shows only that the prior rate was at least as great as the competitive rate. What it does not show is that the pre-entry rate was not greater than the competitive rate.

If viable entry occurred at prices below long-established conference rates (taking account of any quality differences), that single fact normally would show that the prior conference rates were above the competitive level. Further, if the conference, or conference members, subsequently reduced rates to match, or under-cut, the entrant's, that not only demonstrates further that rates had been monopolistic but also provides a (minimum) measure of the monopolistic element in that rate.

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20 FMC, Chapter 8 passim, for example, 166, 168 and, "As conferences regained market share, they were able to push rates up again," 176

21 Extraneous factors that might be relevant include. entrants' lower cost operation or organizational innovation, relative decline in demand in some other market, decrease in the cost of one or more factors of production, differential subsidization of the entrant.

22 FMC, 54.

23 Davies, 134

If viable entry occurred at prices equal to the conference rates, that fact, by itself, proves nothing. It is equally consistent with an hypothesis that the prior rates were competitive or that the entrant simply matched monopolistic rates and took advantage of the conference rate umbrella.

FMC's statement, "Independents [or Entrants] provide a check to the market power held by conferences,"[24] is precisely correct. But it can mean no more than it says. The existence of independent carriers does not mean that the conferences lack monopoly power; it means only that they lack unlimited monopoly power.

It might be argued that entry indicates that barriers to entry are negligible, not substantial. However, to permit monopolization, barriers need not be absolute. What viable entry shows is not that barriers to entry are negligible, but only that any barriers were not totally prohibitive. On the other hand, complete lack of entry over an extended period in a dynamic market would be consistent with a conclusion that barriers were high, perhaps high enough to protect monopolization, but would not, in itself, be conclusive.

As the FMC, Department of Agriculture (DOA), Department of Justice (DOJ) and Federal Trade Commission (FTC) reports on the 1984 Act all make clear, data are not available for formal statistical analysis of the relationship between conference and independents' rates. However, those studies provide substantial anecdotal evidence on the issue. That evidence indicates that conference rates in the American trades have often been monopolistic. Not only have some independents been able to enter or operate at rates below the conference levels, they have been able to do so profitably. The fact that independents have added substantial amounts of capacity attests to the economic attractiveness of the conference rate umbrella.[25]

Incidents that indicate that conference rates were above the competitive level include:

- CALCOT (a California-based cotton exporter) found that breaking away from Transpacific Westbound Rate Agreement (TWRA) resulted in lower rates directly and indirectly through the conference's subsequent rate reductions. Similarly, "Typically, independent lines write service contracts or volume incentive contracts, and the conferences/rate agreements respond."[26]

- Agricultural shippers have frequently responded to increases in conference rates by switching to non-conference or charter carriers. Exporters of forest products, for example, have responded by negotiating SC's or IA's.[27]

- Shipper associations have forced rate reductions through the use of independents.[28]

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24 FMC, 333.

25 FMC, 159, 175, 182.

26 Crouch, 44 and 49. TWRA carriers reportedly made profits at the lower, more competitive rates. At least one independent offered high-quality service at less than conference rates according to FMC, 159.

27 Neenan, 22, 23.

28 Friedmann, ODU, 217-19.

Service contracts have been prime vehicles for both conference members and independents (such as Evergreen was until recently) to undercut tariff rates. Relatively few SC's have been consummated by conferences.[29] Where FMC does report conference SC rates, frequently discounts have exceeded 50%, but carrier and shipper responses to FMC questionnaires indicate that the majority of discounts lie between 11% and 25% and most of the remainder between 1% and 10%.[30] The ability and willingness of conferences, when necessary, to grant such discounts indicates that the prior tariff rates substantially exceeded competitive levels.[31]

IA's, on which substantial proportions of traffic move, have played a similar role.[32] IA's have been concentrated in the Pacific trades, and according to FMC, the large number of IA's by TWRA and ANERA may have been caused by competition from independent carriers.[33] Discounts in excess of 20% are common and, on occasion, exceed 40%. Whereas exporters of several farm products have benefitted from IA's, virtually all IA's on those commodities had been terminated by mid-1988, that on cotton exports to Japan, in 1986 and on poultry in 1987.

The fact that conferences prohibit IA on SC's further suggests that the conference rates often exceed the competitive level. Since IA and SC's are important in forcing rates to levels below conference tariff rates, it is not surprising that conference carriers oppose mandatory IA on SC's; while shippers "overwhelmingly" favor them.[34]

In short, the facts that non-conference carriers and conference members acting independently have often been able to charge and sustain rates below the established conference level and that conferences have sometimes cut rates in response constitutes strong evidence that conference rates have been above the competitive level.

B. Excess Capacity

The second virtual proof that the liner markets are monopolized is the persistence of excess capacity. The proof is straight-forward. Excess capacity is correctly defined simply as more capacity than the amount that can be employed efficiently in the market in question, at present prices.[35] Competitive market forces eliminate excess capacity either (or both) through reducing price to the point where available capacity is fully utilized or through removing capacity

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29 FMC, 609, 616, 620.

30 On roadmaking equipment, some discounts in 1988 were greater than 70%, FMC, 634-6

31 This fact also indicates that there is, as discussed more fully below, discrimination in conference pricing, even though carriage under SC is a somewhat different product from carriage at tariff rates, because of the minimum volume requirement. Associated cost savings could well justify modest discounts, such as 1% to 10%. It is, however, unlikely that discounts of 25% to 50% could be so justified

32 This in no way conflicts with FMC's contention that IA may sometimes strengthen the conference system, FMC, eg 658 FMC reviewed IA's on several dozen commodities between 1985 and 1988, FMC, 666-675

33 FMC, 654 FMC attributes the popularity of IA's primarily to excess capacity

34 FMC, 679

35 More technically, it exists whenever an increase in output would reduce unit costs.

from the market.

The limited resources and time available for the present study preclude making an independent analysis of the existence or magnitude of excess capacity. There is, however, virtual unanimity among representatives of the government, the liner industry, and shippers that excess capacity has pervaded the industry.[36] Of particular significance is FMC's contention that collusion with price control reduces risk of periodic collapse.[37] That implies that excess capacity is chronic. In this report, I accept the consensus on the persistence of excess capacity.

A number of factors tend to create excess capacity. First, construction subsidies and cargo reservation by foreign and American governments contribute to the existence of excess capacity. Their existence implies that, if the industry were otherwise competitive, rates and returns would be at less than the competitive levels.

Second, although liner industry representatives express concern about excess capacity, the liner companies, themselves, have increased their fleets' size and carrying capacity. For example, the conferences have reportedly faced overtonnaging and unconstrained expansion of members' capacity:[38] between 1983 and 1986, TEU capacity in the Pacific trades increased 77%[39], and in all trades analyzed by FMC 75% between 1984 and 1988.[40] US Lines invested heavily in round-the-world service and Lance class vessels; Evergreen and Sea-Land introduced round-the-world service. Conferences have increased capacity vastly more than have independents in the US-Far East-North Pacific trade.[41]

Third, and in the present context most important, conference prices induce excess capacity:

- o By maintaining rates above competitive levels,[42] the conferences encourage both members and independents to invest more in capacity than would be profitable in free markets.
- o Also, the cartel price umbrella supports inefficient carriers and obsolete and under-utilized ships.
- o Further, by constraining price competition, they induce service competition, which often is embodied in greater speeds and frequencies and, hence, produces lower utilization rates than would occur under competition.

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36 See for a few examples out of many: DOJ, 26; FMC, 52, 55, 57, 159; Focus, 16, 32, 40, 41; Takahashi, 31; Waage-Nielsen, 51; Shippers, 9-10.

37 FMC, 598-600.

38 Several speakers at the Norfolk Conference alluded to the "lack of discipline" on the part of conference members in adding capacity in the face of current overtonnaging.

39 Takahashi, 44.

40 Booz, 14.

41 FMC, Appendix, 9B, 271.

42 FMC, 55.

Fourth, the fact that new vessels are technologically superior to and, consequently, more productive than older ships contributes to the incentive to expand tonnage. With higher than competitive rates and the urge toward service competition, the incentive to modernize excessively is stimulated. Until the obsolete ships are scrapped they either expand the pool of idle vessels or reduce the utilization rates of active ships. For example, one shipper representative pointed out that carriers build then sell, not scrap, old capacity;[43] thus, those assets remain available for ocean transportation.

Whatever the relative impacts of these causes of excess capacity, the dominant fact is that the conferences have not reduced rates to levels that would either utilize fully or eliminate the surplus unused resources. With competitive rates, either obsolete capacity would be eliminated or over-investment in high-tech vessels would be discouraged. The only obvious explanation of persistence of excess capacity is that conferences exercise monopolistic power. From the point of view of society, existing excess capacity has been created by the expenditure of valuable resources. If conference practices prevent the utilization of that capacity, those resources have been wasted.

The experience in other modes of transportation is instructive also. Antitrust immunity contributed to excess capacity in railroads and airlines.[44]

This analysis contrasts sharply with the common belief that excess capacity is a symptom, not of monopolization, but of competition. The confusion may arise from the fact that, as stated above, cartel prices coupled with the inability to preclude entry induces service competition at prices above the competitive levels. Further, if greater-than-competitive rates induce one carrier in a market to over-invest in advanced technology, other carriers in that trade may have to match or lose custom. To the individual manager this looks like a manifestation of competition, but it derives from the existence of monopolistic rates.

The basic fact remains that under competition any excess capacity that happened to arise in the short-run would be eliminated by the elimination of the highest-cost operators, vessels and services. Hence, the persistence of excess capacity is compatible only with the conclusion that conference rates exceed the competitive level.

C. Concentration

It is widely accepted that the smaller the number of independent suppliers in a market or the larger the market shares of major sellers, the greater the prospects that the market can be monopolized. Similarly, the greater the geographic scope of a cartel or a monopolist, the less role source competition can play in any market or sub-market.[45] Hence, the larger the market share of a conference and the more trades or coastal ranges it controls or influences, the greater its opportunities for monopolization.

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[43] Nikiper, 70. With competitive rates the market for old ships would tend to deteriorate, discouraging the retention of idle vessels.

[44] FTC, 52.

[45] This is compatible with the analysis in the Department of Justice's, "Merger Guidelines," for example.

Often, geographically distinct trades naturally compete with each other. Obviously, such competition among coastal ranges would impair the ability of conferences in any one of those routes to obtain monopolistic rates. Consolidation of conferences was the obvious instrumentality for reducing such rivalry; agreements between conferences, and between conferences and non-conference lines were an extension of that.

A large proportion of the conferences that pre-dated the 1984 Act have been absorbed into Super Conferences.[46] For example, by July 1989 all conferences in the U.S. North Atlantic-North Europe in both directions were consolidated.[47] In addition a talking agreement between the conferences and major independents was created --allowing all these carriers to discuss rates and services in a manner that would be vulnerable to antitrust challenge in the absence of the exemption. Similarly, in the Far East trades, sixteen conferences were consolidated into two.[48] In December 1988, the Transpacific Stabilization Agreement encompassed 85% of capacity in the in-bound Far East trade.[49]

Shares of capacity provided by conference members to major export trade areas in Europe and the Far East ranged in 1988 from 49.6% to 66%.[50] In most of these cases, shares were greater in 1988 than in 1984. The degree of market power reflected in these data is reinforced in many instances by agreements between conferences, and between conferences and independent carriers. Joint-service, chartering, cooperative working and rationalization agreements have provided additional opportunities for "competitors" to cooperate.[51] Under existing merger doctrine, the Department of Justice would be unlikely to challenge agreements that increased efficiency unless they posed some significant threat to competition.[52]

D. The Pattern of Rates

If the net effect of the 1984 Act was to weaken the conferences, then rate decreases after its passage is evidence that the conferences had monopolistic power.[53]

The competitive effect of the Act is difficult to determine --witness the major effort devoted to that in the Section 18 studies-- and there is no reason to suppose that it has been uniform either over time or across trades. Two hypotheses are supported by general statistical analyses and data on individual trades, namely: (a) before 1984, the conferences had monopolistic powers which were seriously impaired by the Act, and (b) two or three years later, at least some of the

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46 FMC, 55-57 and 108-113

47 FMC, 55-6.

48 FMC, 111.

49 FMC, 112.

50 FMC, 276-295, passim. In the Australian trade concentration was substantially less and in the Brazilian trade conference members had virtually a 100% share. These trades are atypical.

51 FMC, 109-111.

52 U.S. Department of Justice, "1984 Merger Guidelines."

53 FTC, 22, fn 53.

conferences regained much of their previous power.

Using data from FMC, the FTC produced a sophisticated statistical analysis that indicated that, on average, rates declined after 1984.[54] Although technically superior to the FMC's analysis it is not entirely conclusive, not only because of the data problems raised by the DOJ[55] but also because the downward trend began before 1984.[56] However, it is the best available general analysis.

This statistical finding is not conclusive in itself, because costs of providing ocean carriage declined during the same period.[57] However, it is reinforced by the belief shared by shippers and carriers that the prevalence of SC's and IA have been the source of "rate erosion" or "vigorous competition"[58] and that conferences were unable to increase rates in 1985.[59] This is exactly why IA and SC were included in the pro-competitive amendments to the original Biaggi Bill.[60]

Rate patterns reported by FMC for individual trades similarly show a decline after 1984 in the Pacific, Japan and Europe trades. In contrast, rates moved up beginning about 1986 in trades with Germany, Japan, Taiwan, and between the U. S. West Coast and Australia.[61]

The reversal in the rate pattern appears to have been associated with renewed assertion of conference power. Following an explosion in SC's shortly after passage of the Act, they declined precipitously as shown in Graph 1.[62] TWRA and ANERA, where SC's had been important, prohibited members from independently entering into SC's. In TWRA, between 1986

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54 FTC, Appendix A, 75. See also Booz, 17.

55 DOJ, 12-15.

56 The analyses take no account of the concurrent decline in operating costs or of the incorporation of inland transportation costs into the rates FMC reported. These omissions have, at least partially, offsetting impacts on the trend in real rates. Also no adjustments are made for variation in exchange rates; an adjustment to reflect the increase in the value of the dollar after 1984 would tend to be reflected in a steeper decline in rates than is shown by the unadjusted rate. Further, the rate data exclude service contracts; their inclusion would tend to produce a greater decline in rates than that shown in the FTC analysis.

57 Booz, 12.

58 Ferguson, 94. See also, for example, Takahashi, 30-31; Waage-Nielsen, 48; and Booz, 17-18.

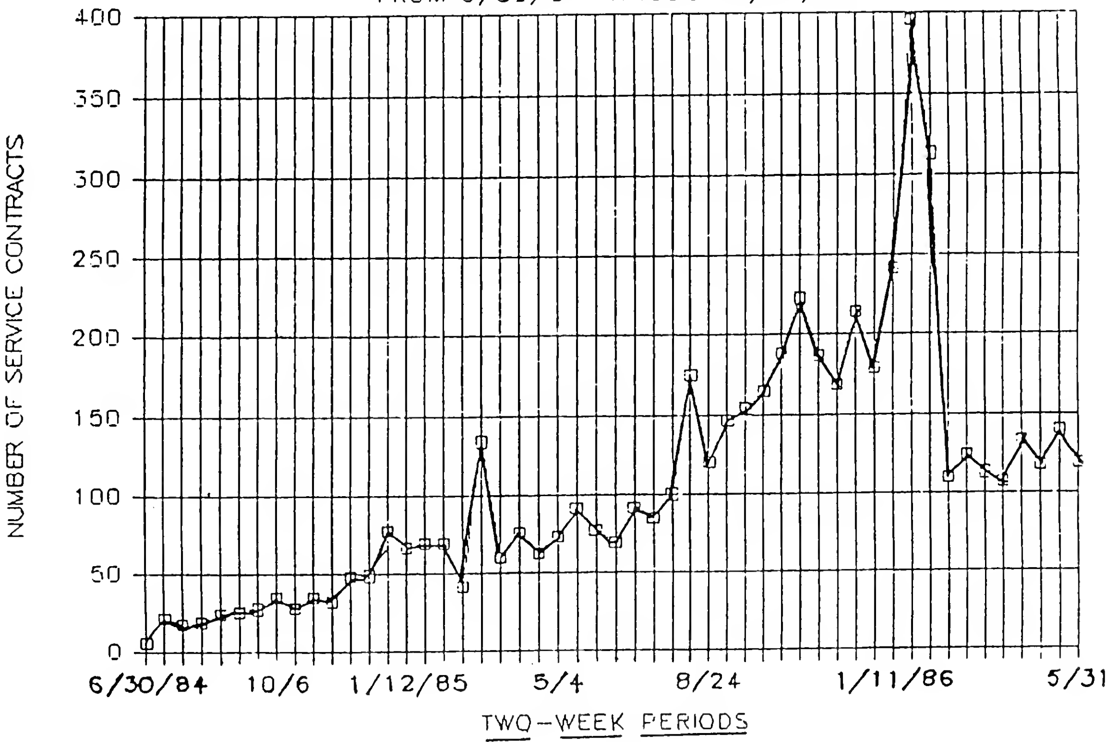
59 For example, TWRA was reported to be unable to raise rates in 1984, Friedmann, Focus, 16.

60 Ferguson, 94.

61 FMC, 215-224. The patterns, while similar, are more pronounced in the Pacific than in the Atlantic trades, FMC, 191.

62 Ferguson, 95.

GRAPH 1



and 1988, the percentage of conference tonnage moving under SC's declined from 40% to 1%.[63] At the same time, IA's increased in the Pacific trades.[64] FTC presented a brief analysis indicating that the conferences' actions "... may have contributed to the upward momentum in ... rates...."[65] Rates in other trades also increased after 1986 or 1987.[66]

FMC reported that capacity rose relative to traffic in several trades until about 1986, when off-setting changes began to emerge.[67] Thus, changes in excess capacity appear to be (negatively) correlated with changes in the power of the conferences, making it difficult to separate the impact of the two forces. Indeed, FMC often attributes changes in rates and conference power to changes in excess capacity.[68]

Profits in the liner industry are generally considered to be below normal levels.[69] Little weight can be attached to such comparisons for several reasons. In the best of circumstances, determining either depreciation and other elements of costs, or measures of capital invested so as to make relevant inter-industry comparisons is difficult. Here, with most of the corporations involved being foreign companies with diverse accounting and management practices, the problem is still more difficult. Further, the carrier managements have not acted as if they believed profits were inadequate. Profits in an industry can be said to equal or exceed the competitive market level if they are sufficient to justify additional investment in the industry. In the late 1970s and much of the 1980s capacity in the liner trades was increased rapidly,[70] indicating that actual and expected profits were at least at normal levels.

From the belief, whether justified or not, that profits in the liner industry are inadequate, an erroneous inference is frequently drawn, namely, that rates are not above competitive levels. In reality, given excess capacity, a competitive market would produce prices that were less than the costs of providing the service. Thus, rates of return similar to those in other industries would constitute proof of monopolization. On the other hand, low or negative profits tell us nothing about whether the industry is monopolized. Other evidence indicates that it is.

These considerations lead to questions about the disappearance of excess capacity. If excess capacity should continue to decline, one can expect conference strength to grow, rates to rise further above competitive levels and visible monopolistic profits to emerge.[71]

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63 FMC, 632.

64 Booz, 26.

65 FTC, 31.

66 Booz, 17-18.

67 FMC, 162-163, 166-169, 177.

68 FMC, Chapter 8, passim, eg. 177-178

69 Eg. Booz, 19.

70 See discussion of "Excess Capacity," above.

71 Davies, 136.

E. Rates: Discrimination

Economic price discrimination is a strong indicator of monopolization. In the absence of monopoly power, if the price on one service provides a greater margin over cost than does that on another, competitors would under-cut the former price eliminating the discrimination.[72]

In liner markets, rates are differentiated in exquisite detail, some tariffs providing thousands of rates. However, differentiation is not synonymous with discrimination. Where rate differences reflect differences in costs of providing the services, there is no discrimination. Indeed, rate equality in the face of cost differences is, itself, a form of discrimination. Where persistent rate differences are determined, at least in part, by factors other than cost, there is evidence of discrimination.

Four kinds of empirical evidence are available: opinion of carrier personnel and of analysts, anecdotes, experience with discounting, and statistical studies. Together, they make a reasonably strong case that the conferences practice rate discrimination.

The inclusion, as some carrier representatives state, of "competition of other carriers" and "market competition facing shippers"[73] indicates that rates are set taking account of differences in elasticities of demand. This is the essence of discriminatory rate-making. The Department of Justice found that " ... carriers have a certain amount of monopoly power; otherwise, competition would force rates for the high value commodities down to the level of [transportation] costs."[74]

A number of specific facts suggest the existence of discrimination:

- The French Shippers Council found that SC rates declined while tariff rates were subject to four increases. This "divergent behavior" apparently discriminated against small shippers.[75]
- In five of six rate histories in the US export trade with Germany and import trade with Japan, FMC found that between January, 1985 and October, 1988, tariff rates rose while SC rates rose more slowly or actually declined.[76]
- Discrimination in terminal handling charges was reported by the representative of Excel Corporation.[77]

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72 Technically, in industries such as the ocean liner industry where there are economies of scope, if the industry is a natural monopoly or natural oligopoly, the non-discriminatory price is bounded from below by the average incremental cost and from above by the stand-alone cost of providing the service in question. Data and time constraints do not permit establishing those bounds in this report, even if the industry were naturelly oligopolistic. Consequently, the existence of discrimination is considered here as only an indicator, not as proof of monopolization.

73 Ocean Carriers, Paper #9.

74 DOJ, 52.

75 FMC, 146.

76 FMC, 634-5.

77 White, 25.

In addition to such anecdotal and judgmental indicators of discrimination, two statistical analyses of the subject have been undertaken. FMC's regression analysis showed two things: most of the coefficients of factors analyzed had signs that indicate that (as stated by the carrier representatives) costs are considered in setting rates, but, in addition, the coefficient on value of the commodity showed a positive sign and was statistically significant.[78] The latter indicates that (again, as indicated by the carrier representatives) demand elasticity significantly affects rates.[79]

The FTC performed a more sophisticated analysis of the FMC data. Differences in rates on some commodities were found not correlated with distance or value. Since distance affects shipping costs, that finding suggests the presence of discrimination.[80] However, the lack of a statistically significant relationship between value and rates does not support a finding of discrimination.

The most clear-cut evidence of discrimination is the prevalence of discounting the conference rates, in the form of IA's and SC's. The fact that some, but not all, traffic can be carried at rates below the established conference rates indicates that the regular conference rates on the affected commodities provide a greater margin over cost than do other commodities, that is, shippers of those commodities were discriminated against by the conferences.

A necessary condition for discrimination to be justified on efficiency grounds is the presence of natural oligopoly (or monopoly). However, as shown elsewhere in this Report, there is no evidence that the American liner trades are natural oligopolies.

In concluding this section on monopolization, it seems fitting to recapitulate:

1. Three analytically powerful indicators of monopolization by the conference system are:

- o first, the fact that rates have been held high enough to stimulate viable entry at less than the conference rates, and offering rates below conference tariff levels by both outsiders and conference members, particularly through employing IA and SC's;
- o second, the reported persistence of excess capacity;
- o third, the evidence of economic rate discrimination.

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78 FMC, 202-4. There are serious problems with the FMC study, which was designed to examine effects of the 1984 Act rather than the question of discrimination or even monopolization. Further, the data were extremely limited. For example they cover conference rates only, 206.

79 FMC attributed the minus sign and statistical significance of total volume of traffic in a commodity group to the bargaining power of shippers; if FMC's attribution is correct, this is an indicator of discrimination. However, there might be economies in handling large volumes of particular commodities.

80 FTC, 73, fn 157. In addition to the findings mentioned above, the FTC found, contrary to the FMC, that the structure of rates did change after 1984, 73-74.

2. Other, somewhat less rigorous indicators support that finding also:

- conferences have been consolidated, reducing competition between ports and coast ranges and even between conferences and independent carriers;
- conference members control large and increasing shares of traffic in markets that are important to American exporters;
- the pattern of rates since 1984 indicates that the conferences held market power prior to 1984 and, after a brief interval, gained much of it back.

IV. CONSEQUENCES OF ELIMINATING THE ANTITRUST EXEMPTION

A. The Competitive Alternative

In the preceding section, I showed that the conferences have repeatedly monopolized American trades. The logical inference is that the conferences should be eliminated, unless the alternative would be worse.

Elimination of the antitrust exemption would be tantamount to elimination of at least the rate-setting and many capacity restrictions practiced in the conference system.[81] It would constitute largely completing the deregulation of the liner trades, by eliminating private regulation and leaving to the government the task of assuring that the market mechanism was not excessively impaired. If that were to happen, what would replace the present system?

The most obvious of the possible alternatives is that the liner markets would become contestable (effectively competitive). In that event:

- rates would tend to reflect costs;
- uneconomic price discrimination would be eliminated;
- service quality would be adjusted to provide what shippers wanted and were willing to pay for;
- excess capacity would be reduced (the motivation for commercial over-investment would be eliminated and the cost of governmental subsidization would be increased, perhaps discouraging chauvinistic subsidization);
- the opportunities for efficient companies to earn competitive profits would be enhanced;
- contracting over extended periods would be available for shippers who needed stability and;
- excessive rate rigidity would disappear.

In short, all of the adverse economic consequences of monopolization of the liner trades would be eliminated or ameliorated. However, it is sometimes argued that by its nature the liner industry does not admit of competitive outcomes. Several alternative possibilities are explored in this Section.

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[81] Not all conference functions would necessarily become illegal. Under the U.S Department of Justice's "1984 Merger Guidelines," space chartering and many other rationalization actions would not be opposed by the Antitrust Division. It is important to realize that entitrust policy has been substantially altered in the years since the debate on the 1984 Act.

B. Novel Alternative Theories

Whereas most mainstream economists would consider contestable or, possibly, restrictive oligopolistic markets the most reasonable alternative to the conference system, the FMC staff introduced a number of unconventional theories to suggest that adverse consequences would follow removal of antitrust immunity.[82]

The 'contemporary' theories it distinguishes from mainstream neo-classical theory are core theory, 'normal cost theory', and that of the Austrian school. FMC makes no reference to other and rather broadly accepted streams of contemporary thought, rent-seeking or public choice; the advocates of those theories would be likely to argue that industry lobbying has created shipping privileges and protections.

The DOJ's analysis has, in the author's view, basically disposed of the relevance of the novel theories advanced by FMC.[83] Consequently, this Report proceeds without paying further attention to them.

C. Restrictive Oligopolies

Two potentially plausible alternatives to both the conference system and perfectly competitive markets are restrictive oligopolies and contestable markets.

It is feared by some that elimination of the conferences would result in destructive competition, leading to tight, monopolizing oligopolies of very few, very large carriers. These concerns are expressed frequently in the FMC Report.[84]

For this fear to be realistic requires that the liner industry be naturally oligopolistic. That structure is neither proven nor plausible.[85] A necessary condition for natural oligopoly is great economies of scale: Specifically, only firms big enough to provide a large fraction (eg. 1/5 or 1/8) of the market could be efficient; any smaller firms would be driven out. There is no historical evidence of that on major routes in the American trades.[86] Further, FTC cites a number of econometric studies that indicate an absence of economies of scale.[87] Finally, the entry of viable small firms, discussed above, is incompatible with the natural oligopoly hypothesis.

Although the evidence indicates that the industry is not naturally oligopolistic, it is worthwhile to point out that, if it were, the conferences would introduce very great inefficiencies

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82 In its Report, FMC centers this discussion in its analysis of mass and volume rates, FMC, Chapter 14, and of TFE, Chapters 21-29.

83 DOJ, 30-37, 51-66.

84 Eg, FMC, 598. Cf also, Booz, 36-37 for an extreme statement of this view.

85 The fear of destructive competition per se and of unsustainable natural monopoly are discredited by the FTC, 14-16.

86 The FMC shows that, except in the case of Brazil, there are a multiplicity of carriers on all the major American trade routes examined Further, even when the conferences were ineffective and rates were open in the North Atlantic in the 1970s, small carriers continued to operate.

87 FTC, 17, fn 40.

indeed. By providing rate umbrellas and a collegial context which permitted small inefficient firms to survive, the conferences would be denying the shippers and the public the benefits of efficient (large-scale) operations. Further, a showing that the industry was naturally oligopolistic would constitute a strong argument for removing the antitrust exemption.

D. The Question of Contestability

The question of whether liner markets could be perfectly competitive is no more relevant than the question (Section III) of whether they are perfect monopolies. The important question is whether, freed of regulation by the cartels, the markets would be contestable. The logic of the discussion to follow is simple: There is evidence that structurally (or "naturally") liner markets are contestable; however, they do not behave as if they are contestable, hence there are institutional or external forces that forestall the realization of actual contestability.

Contestability is defined as follows: " ... where the productive techniques and market demands available to incumbents are also freely available to potential entrants, markets must be perfectly contestable if entry is costless and reversible."[88] Thus, for perfect contestability, there must be no barriers to entry or exit; also, an inability of incumbents to react promptly to entry is a sufficient condition for contestability.[89] Even in markets with few sellers, contestability assures competitive results.

Great significance attaches to the issue. If the liner markets were perfectly contestable, no regulation would be required to assure the public of economical ocean transportation, because free play of the market would produce competitive results. The threat of entry would be enough to impose competitive rates and to eliminate excess capacity. Any rate and entry regulation, public or private, could do no good and, if it had any effect, could do only harm. The only role for government would be to preserve contestability.

In robust, perfectly contestable markets, conferences could do no harm; they would be just a waste of the resources expended on them. By the same token, as FMC points out, in the real world the conference system is justified only if it enhances contestability.[90] In fact, if conferences can erect entry, exit or mobility barriers they tend to reduce contestability.[91]

Before proceeding, it is important to point out that contestability pertains to markets, not necessarily to industries.[92] Accordingly, the analyses of contestability in the liner trades typically focuses on individual trades. If capacity (not just ships but all the resources required for

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88 Baumol, et al, 7.

89 Baumol, et al, 301.

90 FMC, 595. The FMC also contends there that the question of whether the conference system does that has not been addressed empirically. Sections III and IV above comprise a limited attempt to do that.

91 In my judgement, FMC's statement (595) that the theory of contestability constitutes an academically respectable argument for retaining conferences is seriously in error. It is an argument against rate and similar regulation by anyone, public or private. It is a respectable argument against interfering with the free functioning of markets, not an argument in favor of institutions whose role is to do precisely that.

92 Cf U.S. Department of Justice, "1984 Merger Guidelines". Even if some trades are contestable, others, perhaps very thin ones or severely restricted ones such as that with Brazil, are not.

successful operation) can be moved costlessly between markets, the profit margin in one trade cannot be sustained above that in any other. However, if mobility between trades is impaired, prices above the competitive level can be sustained in some markets.[93]

The liner trades have several characteristics suggesting that they are "naturally" contestable:

- The data indicate that entry, by viable[94] carriers, into and exit from individual markets is not prohibitively difficult.[95]
- Concentration is relatively low and independents are important.[96]
- Coupled with the turn-over of carriers, the large number of small-volume carriers active in some trades is indicative of competition or contestability.[97]
- Members of different conferences have competed with each other. For example, North Atlantic competed with Mediterranean lines, and parallel movements were observed in rates on different Pacific routes.[98]
- Entry barriers in U.S. trades are low compared to non-U.S. trades, because of the requirement that conferences be open.[99]

The industry has at least one inherent characteristic that indicates less than perfect contestability: Exit is not costless. Bankruptcy is not costless. More rigorously, although ships and some other assets can move among trades, traffic and capacity utilization are highly correlated across trades. Consequently, when returns fall in one trade, the value of assets transferred to another are likely to be depressed.

Two institutional forces, in addition to the conferences, interfere with the realization of contestable results:

- First, exit is inhibited by the proclivity of governments to subsidize and protect weak carriers.

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93 This is the essence of the economic problem posed by Super Conferences. To the extent that they can prevent carriers in one market from undercutting rates in another, Super Conferences eliminate the motive for moving capacity from low-profit to high-profit trades.

94 A large percentage of capital has been contributed by new entrants, according to the FTC, 19.

95 FMC, Chapter 10, shows substantial movement in and out. The FTC, 18-19, accepts the finding of ease of entry and exit. However, the FMC data blur the distinction between line-haul and trans-shipment carriers, making it difficult to be sure that entry and exit by substantial, full-service carriers is easy, but there is no evidence to the contrary.

96 FTC, 5-7, 18.

97 FMC, 54.

98 FMC, 56, Chapter 8, passim and Tables 8-10..17, 8-19..26, 159, 163, especially 165, 169.

99 FMC, 577.

- o Second, the activities of Maritime Terminal Operators (MTOs), which are not examined in this Report, may pose barriers to entry.[100]

In conclusion, although the case is not clear-cut, it appears that the industry is potentially contestable. Whether it is contestable in actuality is a different question. FTC concluded that because of ease of entry "... long run profits... approach the competitive level."[101] Zerby concluded that "The majority of people who have examined the degree of contestability in international shipping seem to agree that in the all-water component the liner market is highly contestable."[102] However, the DOJ concluded that FMC did not prove actual contestability.[103]

Davies, like the present author, concluded that liner trades are basically contestable and policy should focus on retaining and increasing their contestability.[104] However, he went further and concluded that, currently, they are in fact contestable.[105] He found that sunk costs are small; there has been much entry, profits are low, and rates are subject to attack by outsiders. At the same time, he recognizes the MTO problem and that there may be some problems (such as loyalty contracts) with access to customers. Further, he accepts that much of the observed competitive behavior flows from excess capacity and cautions that, therefore, the appearance of contestability may eventually be eliminated.

As shown above, the conferences in fact monopolize the American trades to a significant degree. Hence, the trades do not operate in accordance with the dictates of contestability theory. Indeed, many conference actions can be interpreted as being designed to reduce the effect of "natural" contestability.

The preponderance of evidence indicates that the liner trades are potentially "naturally" contestable, but that they are often monopolized through the conference mechanism. Removing the antitrust immunity would both remove the major barrier to competition and establish a policy of realizing and retaining competitive markets.

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100 Davies, 136.

101 FTC, 23. In this statement, the FTC appears to ignore the fact, emphasized above, that so long as excess capacity persists, profits in a competitive market would be negative.

102 ODU, 193.

103 DOJ, 28.

104 Davies, 123-147, especially 134, 143.

105 Davies, 143

V. COUNTER ARGUMENTS

To this point, the burden of this Report has been that the conferences are monopolistic and that their elimination would release the forces of competition or contestability, eliminating the economically undesirable consequences of that monopolization. In this Section, I introduce and discuss arguments specifically in opposition to that position.

A. Defense of the Conference System

Economic arguments in defense of the conferences are based on several propositions:

- o Destructive competition and recurrent collapses of rates would prevail absent the conferences and would eventually lead to monopolization or tight oligopoly.[106] This line of reasoning has been refuted above, Section IV-C.

- o Demand for liner shipping is highly inelastic and, as a consequence, rate reductions would produce small increases in traffic.[107]

There are two problems here: First, if rate reductions would not expand exporters' markets significantly, they would increase shippers' revenues roughly in proportion to the decrease. By the same token, the predominant effect of a monopolistic rate is a transfer of income from shippers to the liner companies, again roughly in proportion to the rate change. Second, the fact that market price elasticities are small does not mean that the demand facing a conference or a fortiori an individual firm is inelastic. To the extent that conferences or carriers compete with each other, their own price elasticities may be very high even with inelastic market demand.

In any event, the argument is of little analytic merit. There is no basis, of which the author is aware, for determining that whether a price above the competitive level is efficient depends upon whether the demand is elastic.

- o Barriers to entry are low.[108]

The level of barriers is relevant to the theoretical question of whether monopolization could be achieved. However, it has been shown in Section III above that, in fact, it has been. As pointed out there, the fact that there has been some entry does not mean that there are no barriers only that they are not absolute.

- o Excess capacity is said to require collusion to set rates above the competitive level.

The argument is that with excess capacity, carriers have a motive for setting rates at less than the full cost of service, producing negative profit and inducing the exit of some capacity and, possibly, some carriers. That is a true statement. It is also not a justification for monopolistic rates. Rational economic policy calls for setting prices at a level that would eliminate the excess

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[106] FMC, 24-5 and 598; Ocean Carriers, Paper #1.

[107] The statement that they would produce no increases is erroneous Cf, eg Ocean Carriers, Paper #1.

[108] Ocean Carriers, Paper #1.

capacity, as pointed out in Section III-B, above.[109] Further, as stated there, conference rates have contributed to the formation of excess capacity.

o With the conference system, carriers provide better service.

Because conference rates tend to induce excess capacity they encourage competition in such service characteristics as frequencies. But there is no reason to suppose that shippers' interests are best served by the particular combination of high rates and high frequencies that conferences impose. In a competitive market, frequencies and other service characteristics would tend to match shippers' demands.

o "There is ... no evidence of conference carriers earning monopoly profits or attempting to restrict output in order to do so."[110]

This is an extraordinary statement. Given excess capacity, the small returns of the conference carriers may in fact be monopolistic profits, as discussed above. Also there is clear evidence, including some in the FMC report, of agreements that directly impose restrictions that facilitate monopolistic rates. In their space-charter agreement, Nedlloyd, Trans Freight Lines (TFL), and Sea-Land limited capacity on ships employed, and withdrew all other capacity from the Atlantic and the Mediterranean.[111] Similarly, the Transpacific Stabilization agreement, which controlled 85% of inbound Far East trade, required each party to reduce capacity committed to the trade by 10%.[112]

B. <u>The Market Works</u>

Proponents of the conferences assert that, even with the conference system intact, the market still works. They argue:

o In the American trades, the conferences are weak because of the requirement in the Act that they be open.

It is true that this tends to reduce conference power. However, the evidence presented above shows that they have not eliminated it. Although it is almost certainly true that this constraint has reduced the cartels' power, it would be extremely difficult, given the existing data limitations, to demonstrate how much impact it has had.

o The presence of independents indicates the conferences lack market power.

In 1988, independents provided substantial shares in several markets, ranging from 23%

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109 In this way society would gain some return on the investment in excess capacity to compensate for the other goods and services that could have been produced with the resources used to over-build the shipping industry

110 FMC, 600.

111 FMC, 110, cf also 56.

112 FMC, 112

to 47% by tonnage and 16% to 51% by value in the markets covered by FMC.[113] However, the conferences are not helpless in constraining competition from independents. In fact, FMC attributes many of the actions of the conferences to efforts to shut out or eliminate independents or to restrict their ability to introduce competitive rates.[114] Further, agreements have been made between conferences, and between conference members and non-conference carriers.[115]

o Conferences cannot rigidly restrict capacity, and therefore can agree on prices but not control them.[116]

This is a strange argument. It is hard to understand how an agreement on price among the major sellers in a market can fail to constitute control of prices, even if, as a worst case, the control is short-lived. It is equally difficult to understand why profit-seeking companies would devote management time and effort to attaining vacuous price agreements. The argument implies managerial irrationality.

o There has been competition between trade areas, for example, the U. S. - Mediterranean versus the U. S. -European trades.[117]

The Super Conferences are designed to preclude such competition between trading areas. Most of the conferences that operated in both the European and the Pacific trades before 1984 have been consolidated into unified cartels.

Thus, whereas there are some forces that appear to make the conference system weaker than it would otherwise be, there are a priori reasons to doubt their dominant efficacy; furthermore, whatever the logic, the evidence in Section III shows that the conferences have succeeded in extensive monopolization.

C. Arguments Supporting the Exemption

Arguments for the conferences are implicitly arguments for the antitrust exemption. Several additional arguments are more explicitly opposed to removing the exemption.

o The exemption is believed to facilitate intermodal service, enhancing geographic and product competition.[118]

As FMC points out, there was never a clear legal prohibition against intermodal rate-making, but the Act removed any doubt about its legality. Obviously, intermodal arrangements

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113 Cited in FTC, 5. Tablas, by trade, show the number and shara by weight and value of conferance and independant carriers, as wall as names of carriers, confarance entry and exit, FMC, Chapter 10 Brazil is an exception.

114 FMC, 564-6, 573, 575.

115 Thus some non-conference carriers are not actually independent

116 FMC, 584

117 FMC, 159 and Chapter 8, passim

118 FMC, 52.

could remain legal without the present blanket exemption for all economic agreements. Moreover, if intermodal rate-making were not granted statutory immunity, such agreements would not normally be considered illegal by the DOJ under present policy.[119]

o Similarly, the exemption is believed to facilitate space-chartering.[120]

Obviously some space charters may increase efficiency and, consequently, could be expected not to be opposed by the DOJ under its present policy, even if the exemption in the Act were repealed.[121] However, some of the space charter agreements cited by FMC involved concomitant restraints on capacity.[122] That is clearly a collusive act whose impact could be expected to raise or sustain rates above the competitive level and to force society to waste usable assets.

The pros and cons of TFE are not addressed in the present Report.[123] What is relevant here is that whatever the merits of TFE, the conference system is not a prerequisite for realizing them. The government could require filing and could enforce tariffs of individual liner companies. FMC does that now in the domestic trades. Also in international trade, it enforces rates filed as independent actions.

o The United States should feel constrained in its policies by concern for international comity and should not seek to "impose" its free market ideas in international commerce.[124]

The issue of international comity is extremely important and is becoming more so. It is also becoming more complex. The focus on the fact that removal of the antitrust exemption would be disruptive tends to trivialize a major contemporary problem. Sletmo[125] points out two relevant trends. Liner services, like many other industries, are becoming globalized. The structure of the industry is being drastically revamped. With its protection of less efficient carriers, the conference system may be delaying rational globalization of the world's merchant marine. This is the major aspect of international interaction with which evaluation of the conference system should be concerned.

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119 U.S. Department of Justice, Vertical Restraint Guidelines.

120 FMC, 56, 110, 111.

121 U.S. Department of Justice, "1984 Merger Guidelines."

122 FMC, 56.

123 It should be noted, however, that whereas the FMC defends TFE on the ground that it reduces rate discrimination, in fact TFE can be used as a vehicle for discrimination. See the author's "Collusion Through Fare Publication: What Can Be Learned From the Liner Trades?" forthcoming.

124 Ocean Carriers, Paper #1, first page; Booz, 40. In the early 1960s, an effort by FMC to subpoena foreign documents led to opposition and to the passing of blocking statutes. GAO, 9-10.

125 ODU, 101-120.

The divergence between American and foreign attitudes toward competition may be narrowing as other industrial nations are currently strengthening their antitrust laws.[126] Further there are many respects in which American maritime law diverges from that of major trading partners. The United States is unique among OECD countries in requiring filing and governmental enforcement of tariffs.[127] There is no obvious reason why enforcing this requirement should be less difficult than enforcing antitrust law. Similarly, under the Act, loyalty contracts are arguably illegal, yet they are clearly legal in most foreign trades. Neither of these measures is reported in the literature on the Act or widely in the press to have caused problems of international comity.

It is sometimes asserted that difficulty in obtaining documentation on foreign carriers leads to discrimination against American carriers in enforcement.[128] However, after examination of that issue, GAO found --in a study that, while objective, is not altogether conclusive-- no evidence of such discrimination.[129] Further, Section 13(B)5 of the 1984 Act provides tools for dealing with this key issue in antitrust enforcement, namely resistance by foreign carriers and governments to providing documents for enforcement of American law.

Thus, although international comity is important, it does not follow that the United States should be submissive to pressures from foreign governments, particularly when they come from their own special-interest advocates. Finally, on the basis of personal experience in international negotiation, the present author is persuaded that timidity by the United States in such matters is not warranted and that diplomatic persuasion can induce foreign governments to support changes in international cartel practice that are in the economic interest of the general public.

- One of the benefits of antitrust immunity is increased rate stability.[130]

The conferences, like other cartels, tend to dampen price fluctuations. Rate stability is economically beneficial or disadvantageous depending on the context. Stability deriving from a cartels' slow reaction to market change is typically economically inefficient. On the other hand, some shippers need stability to be able to know the level of future rates.[131]

Competitive rate-making would be flexible in response to changes in shippers' needs and in the supply situation. In addition, the disadvantage of excessive volatility could tend to be reduced through some form of forward contracting.[132]

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126 The Japanese are moving toward more rigorous control of vertical restraints than the United States, Washington Business, July 15, 1991, 19. The European Community in the Treaty of Rome and subsequent actions has increased emphasis on fostering competition, FMC, 29-30 and Hufbauer, especially 6-15 and, for the case of automobiles, 128-135

127 FMC, 486.

128 Amoss, 14.

129 GAO, 16-17. Although there are serious limitations in the GAO study, it is the only one on the subject of which the author is aware.

130 For example, Ocean Carriers, Paper #1; FMC, 131; Booz, 5.

131 This was emphasized by a number of agricultural shippers, because of their need to make forward contracts for delivery of crops yet to be harvested. Neenan, 21.

132 See for example, FTC, 20.

o Weakening the conference system would tend to reduce profits further.

In fact, FMC suggests that most carriers would not earn profits "in trades where there is considerable competition."[133] One carrier representative stated, "There will be a storm of the survival of the fittest".[134] FMC fears that this would force a decline in the American fleet or an increase in its subsidization. There are two issues here: whether that is true and, if so, the consequences for the nation and the economy of such a development. There is evidence that American liner companies are high-cost operators and, consequently, as FMC fears, would be vulnerable if they had to try to survive in a competitive market. The more difficult question is whether American business and governmental ingenuity is not up to the task of making an American fleet viable without exorbitant subsidies or the conference umbrella.[135] Addressing that is beyond the scope of this Report.

D. Defense Argument

The ultimate justification for all the subsidization and protection of the merchant marine is the defense argument. It can be disposed of quickly.

For the antitrust exemption to be a valid policy for providing an emergency reserve fleet the following would all have to be true:

The conference system sustains the U.S.-flag liner fleet.

That fleet could be called up in an emergency, when equivalent foreign capacity was not readily available;

Diverting the fleet to defense purposes would not be disruptive to essential industrial activity;

Any military benefits do not accrue predominantly to foreign nations.

Leaving aside the facts that under the conference system the U.S.-flag liner fleet has declined and that there are almost certainly more economical ways of sustaining a U.S.-flag fleet, the rest of the chain is also a series of weak links. In a prolonged major war, industrial activity expands, so, in principle, it is erroneous to expect to deprive industry of its logistics support in time of war. This proved to be true in the Gulf War, when the military refrained from calling up commercial vessels because doing so would have been economically disruptive.

Second, there are more economical means of creating and maintaining an effective reserve fleet, crews and organization.

Third, and perhaps most telling, whatever potential military benefits derive from the conference system they flow primarily to foreign merchant marines, which carry some 75% to 80% of liner traffic in the American trades.

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133 FMC, 586 Again the FMC confirms the main thrust of Sections III and IV above

134 Takahashi, 30

135 It is important to note that under present policy that fleet has shrunk.

VI. SUMMARY AND POLICY CONCLUSIONS

A. Summary

General:

The conference system does not serve the interest of the American economy in general nor of agricultural exporters in particular. American agricultural interests have traditionally opposed and do oppose monopolization by the conferences.

The conference system, under the antitrust exemption, has failed to meet the policy objectives stated in the 1984 Act, namely "... provide an efficient and economical transportation system" and "... encourage the development of an economically sound and efficient United States flag liner fleet."[136]

Conference Characteristics:

o The conference system constitutes a form of regulation, a mechanism that substitutes private, largely foreign regulation of rates for public regulation by the United States government.

o The major purpose of conferences is to suppress competition.

o They have succeeded in doing so.

o Many farmers are significantly dependent on liner exports for their incomes.

> Agricultural representatives object to the high conference rates, unpredictability of rates for forward selling, excess capacity, protection of least efficient carriers, and rate discrimination.
>
> A majority of agricultural shippers who expressed an opinion in a number of surveys favored elimination of the conferences.

o Conferences have powerful positions in many markets.

> In 1988, they handled 49% or more of the export traffic in major European and Pacific trades.
>
> They have undertaken to reduce geographic and other forms of competition by combining into Super Conferences and reaching agreements with "independent" liner operators.

Consequences of the Conferences and the Exemption:

o Conferences have frequently monopolized important American trades.
Conference rates are above competitive levels, tending to reduce the size and profitability of American export markets.

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136 Sections 2(2) and (3).

Conferences have maintained rates too high to encourage the elimination of excess capacity.

- o They have practiced rate discrimination.

- o The current rapid changes in technology and organization may overtake institutional developments, so that the conference system may be delaying rational globalization of the world's merchant marine.

Consequences of Removing the Exemption:

- o The available evidence indicates that the ocean liner trades are naturally contestable and that, therefore, elimination of the antitrust exemption and, hence, the conferences would lead to effectively competitive markets.

  Competitive rates would closely reflect costs, and would be generally lower than conference rates.

  Rates would be adjusted by market forces until much of any existing excess capacity was eliminated and, subsequently, until adequate new capacity was added, as trade flows expand or technological changes made fleets obsolete.

- o There is little, if any, justification for fearing that elimination of the conferences would lead to such adverse effects as the following:
  destructive competition and tight monopolizing oligopolies;
  antitrust challenges to efficient intermodal agreements;
  excessive international controversy.

- o The defense argument is logically weak, was shown to be at least in part impractical in the Gulf War, and, to the extent that the argument has any validity, the conference system benefits foreign countries far more than the United States. Further, there are more efficient ways of establishing and maintaining any required military reserve capability.

B. Policy Implications

- o The major policy implication of the analysis in this Report is simply that the antitrust exemption should be discontinued.

- o Although the antitrust exemption of ports and MTOs has not been addressed in this Report, it is potentially an important issue. Being free to collude in setting charges and conditions of service and in reaching any agreements with carriers or conferences, MTOs may directly impair competition and, through strengthening conferences, may do so indirectly.

CITATIONS

Citations are frequently abridged for simplification and appear in the following form: "FMC, 21," which is to be read as "page 21 of U.S. Federal Maritime Commission. Section 18 Report on the Shipping Act of 1984. (September, 1989)." Similarly, merely the author's surname is shown, with the complete reference shown in the Bibliography.

The following abbreviations or abridgements are standard in footnotes:

Booz: Booz-Allen & Hamilton, Inc., "A Review of the Section 18 Study of the 1984 Shipping Act." Booz-Allen & Hamilton, Inc., Transportation Consulting Division, Bethesda, Maryland. (May 29, 1991).

DOJ: U.S. Department of Justice, Antitrust Division. "The Department of Justice Analysis of the Impact of the Shipping Act of 1984." (March, 1990).

FMC: U.S. Federal Maritime Commission. Section 18 Report on the Shipping Act of 1984. (September, 1989).

FTC: U.S. Federal Trade Commission. "An Analysis of the Maritime Industry and the Effects of the 1984 Shipping Act." (November, 1989).

GAO: U.S. General Accounting Office. "Changes in Federal Maritime Regulation Can Increase Efficiency And Reduce Costs in the Ocean Liner Shipping Industry." Report to the Chairman, Committee on Merchant Marine and Fisheries U.S. House of Representatives, July 2, 1982.

Focus: U.S. Department of Agriculture, Office of Transportation, The Shipping Act of 1984: Focus on Agriculture. Proceedings from USDA Office of Transportation Ocean Shipping Workshops, December, 1989.

Ocean Carriers: "Ocean Common Carrier Position Papers on the Shipping Act of 1984." Submitted to the U.S. Federal Maritime Commission in Connection with its Section 18 Study by Twenty-Seven Carrier Members of FMC Agreement No. 10851. (March 20, 1989).

ODU: Old Dominion University: Proceedings: The Shipping Act of 1984, Evaluating its Impact. A Conference sponsored by the Federal Maritime Commission and Old Dominion University. Norfolk, Virginia. (June 12-13, 1986).

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8/11/93

Attachment 2

EDITORIAL/OPINION

Overhauling US

By ALLEN FERGUSON

Talk to anyone in the maritime business today and the discussion quickly turns to one subject: the announced plans by Sea-Land Service and American President Lines, the two largest U.S.-flag shipping lines, to withdraw some of their ships from U.S. registry. Yet, this immediate crisis obscures a broader U.S. maritime policy that hurts the economy and punishes consumers, producers, exporters, importers and taxpayers. Present maritime policy, in fact, is a hodgepodge of subsidies, protectionism, regulation and taxation that makes a mockery of sensible industrial policy. It supports a loser, not a winner.

To fly the American flag, a ship must be operated under archaic crewing regulations dating from 1915. According to a report of the National Research Council, they require that crews be 50% to 90% larger than those of other industrialized nations. They also directly depress the productivity of individual crew members by precluding "crossover" between departments, even though modern technology and foreign practice permit such operation.

The crews must be American citizens whose compensation — a captain receives close to $120,000 a year plus fringes, food and quarters when at sea — is typically far more than that of foreign competitors. The lower ranks of licensed shipboard personnel average $67,000.

To obtain full government support, U.S.-flag operators also must use ships that have been built and are repaired in American yards. American-built ships often cost twice as much as foreign ships.

On the tax side, operators of U.S.-owned foreign-flag ships can no longer defer taxes on foreign earnings when those earnings are reinvested in ships. Before 1986, they could. Other countries allow their national shipping lines to accumulate such profits tax-free.

To offset the many disadvantages of operating under the U.S. flag, the government has developed a number of policies. Operating differential subsidies pay some American shipping lines the difference between U.S. and foreign crew costs. The Jones Act prohibits foreign-flag carriers from operating in the U.S. domestic trades. Cargo preference laws reserve 75% of foreign aid cargoes and 100% of military cargoes for American ships. And ship lines are exempt from the antitrust laws and allowed to operate in cartels, called conferences. These conferences regulate members' capacity, sailing frequency, ports served and, most important, prices.

This policy of inefficient regulation counterbalanced by a layer of protectionism has failed. The U.S.-flag fleet's share of American trade has declined from 27.3% in 1980 to 18.6% in 1990. The number of American seafarers has fallen from 100,000 in 1960 to 27,000 today. Orders for major commercial general cargo ships at American shipyards have essentially disappeared.

Maritime policies cost Americans billions of dollars every year. The government's operating differential subsidies are budgeted for $220 million this year. Cargo preference, which increases the cost of assistance programs and military shipments, is earmarked for $501 million. The Jones Act, according to the International Trade Commission, reduces U.S economic welfare by anywhere from $4 billion to $9.8 billion.

"There must be some mistake. I n[...]
a dim[...]

THE JOURNAL OF COMMERCE, Wednesday, August 11, 1993

Maritime Policy

And the conference system produces monopoly rents for the ocean liner companies that cost American exporters and consumers some $2 billion to $4 billion a year.

As a group, current U.S. maritime policies generate annual costs for the U.S. economy of $7 billion to $17 billion, with a mid-range estimate of $10 billion.

The tail that wags this dog is a minute labor force. The jobs of 27,000 U.S. seafarers depend on current policies. Yet, these policies also reduce jobs. Most directly, stevedoring and longshore jobs suffer; maritime policies also reduce demand for providing such services to international liner operators and to domestic operators at both ends of the routes. Indirectly, maritime policies reduce employment in export industries and in businesses that use imported materials.

The defense argument in support of existing maritime policy is equally weak. If the U.S.-flag fleet is employed in peace time serving commercially important trades, it is not an entirely reliable military reserve. Most important, the Pentagon has declared that it can fight future wars without a U.S.-flag commercial fleet. Properly organized, a reserve military fleet could be ready for rapid deployment.

...ver amounted to anything worth ...e."

Here are some recommendations for reforming U.S. maritime policy:

- Repeal the requirement to use only U.S. citizen crews.
- Update regulations to allow increased crew productivity, including changes in manning requirements and flexibility in the use of crews.
- Review safety and other operating standards not worth their cost.
- Provide federal support for early retirement for older seafarers — average age is now 46 — and re-employment support for younger ones.
- Repeal the requirement that U.S.-flag companies use only ships that are built and repaired in American shipyards, thereby lowering capital costs.
- Make available for purchase on the world market capital funds now reserved for the acquisition of American-built ships.
- Reduce the cost of capital for American owners of foreign-flag ships by allowing deferral of taxes on reinvested foreign earnings.
- Reduce or eliminate restrictions on foreign investment in U.S.-flag shipping companies.
- Eliminate cargo preference.
- Allow operating subsidy contracts to lapse.
- Don't re-establish ship construction subsidies.
- Remove the antitrust exemption for ocean-liner price fixing.
- Repeal the Jones Act. Consider financial assistance for operators in the domestic trades to compensate for the decline in capital value of their U.S.-built ships.
- Establish a modern reserve fleet in accordance with Pentagon specifications, funded through the defense budget.
- Establish a merchant marine manpower reserve to assure qualified crews for reserve ships.

This set of integrated policy changes would solve most of maritime's problems, hold down budgetary and economic costs, expand trade and provide efficiently whatever commercial fleet and reserve fleet are worth the cost.

Allen R. Ferguson is an economist in Silver Spring, Md.

A ttachment 3

THE JOURNAL OF COMMERCE, Friday, July 9, 1993

Ship Groups' Immunity Said to Cost Exporters

By TIM SANSBURY
Journal of Commerce Staff

WASHINGTON — U.S. agricultural exporters are paying an estimated 18% more in ocean transport costs than they would otherwise have to because of antitrust immunity granted to rate-setting shipping conferences, according to a veteran transportation economist working under contract for the U.S. Department of Agriculture.

The estimate is the key finding of Allen Ferguson, president of AFE Inc., of Silver Spring, Md. He was commissioned to analyze the impact of the conference system on agricultural exports. Mr. Ferguson's research will be incorporated into a study the USDA's transportation and marketing analysts are preparing for later release.

The department's work represents the first attempt to measure the extra costs to shippers of carriers' jointly setting rates and services without fear of antitrust prosecution.

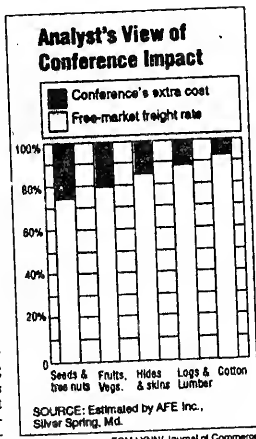
The measurement drew immediate fire from carriers, primarily from the Transpacific Westbound Rate Agreement, the San Francisco-based conference that sets rates for U.S. exports moving to the Far East.

Ronald Gottschall, TWRA managing director, said conference vs. non-conference rate differentials in the trans-Pacific now average less than 5%, and have fallen to zero in some cases.

"Where there is a differential, there may be inland transport, special handling, equipment availability and other factors involved, which are not taken to account in the study but . . . influence a shipper's decision to use conferences services," Mr. Gottschall said.

He charged that Mr. Ferguson's analysis presents "a skewed and incomplete snapshot of rate levels and trends" that shows greater rate differences than actually exist.

Agriculture exporters historically have been at odds with the shipping community over the portion of the landed price of farm exports attributable to ocean freight. Most recently, Agriculture Secretary Mike Espy sharply criticized the high rates offered by some U.S.-flag carriers on contracts to transport food aid to Russia.



SOURCE: Estimated by AFE Inc., Silver Spring, Md.
TOM LYNN/ Journal of Commerce

Ocean carrier antitrust immunity, the cornerstone of the conference system in U.S. foreign liner trades, was explored last year by a presidential panel, the Advisory Commission on Conferences in Ocean Shipping.

Ship operators testified that eliminating the immunity would result in a highly concentrated industry with few remaining carriers able to exert considerable market power, or in increased government intervention through higher subsidies or greater use of cargo reservation schemes.

Shippers generally told the commission there is no reason to treat the international ocean liner industry any differently than other industries with regard to competition and antitrust laws.

In a report for the commission, Mr. Ferguson was critical of conferences, saying they serve neither the national economy nor agriculture exporters.

More recent research for the USDA yielded the economist's 18% estimate, which he characterized as a "cartel premium" attributable to conference market power. The estimate is based on his study of exports of five key commodity groups to three major markets.

The commodities included forest products, fruits and vegetables, cotton, hides and skins, seeds and tree nuts. The markets examined were Japan, the European Community and Taiwan

The trades examined accounted for about $5.08 billion in 1991, nearly 33% of the exports of agricultural products that are categorized as liner cargos, according to Mr. Ferguson.

The economist said he used information collected by the Agriculture Ocean Transportation Coalition, a shippers' lobbying group, from individual interviews and from publicly available data to track differences in exporters' ocean freight costs when dealing with conference and non-conference carriers.

Conference premiums on the five commodity groups were 11.4% for forest products, 20% for fruits and vegetables, 8.6% for cotton, 14.6% for hides and skins and 25.5% for seeds and tree nuts. Mr. Ferguson said his 18% estimate is a weighted average of those premiums.

He said his study suggests that very large gains to U.S. exporters would flow from eliminating the power that conferences exert over rates.

The agricultural exporters supplying the five commodities to the markets covered in his research would save, at minimum, $239 million a year, or 4.6% of the revenue they receive under current ocean transport conditions, he said.

He estimated that gain could rise to $400 million a year because lower freight rates would mean lower delivered prices that would permit larger sales volumes.

Including more commodities or more markets would greatly magnify the dollar effect, Mr. Ferguson said. However, there is no way of predicting how much the gains would increase, he said

A single regulatory change — eliminating antitrust immunity — could give U.S. exporters an advantage over foreign competitors, Mr. Ferguson said. He stressed that policy view was his own, independent of the Agriculture Department.

That there is potential for saving 18% "falls directly in line with shippers' view that some limitations must be placed on the size and power of conferences," said Peter Gatti, director of policy development at the National Industrial Transportation League. He qualified his comment by noting the league has not been privy to Mr. Ferguson's study.

SEE SHIP, PAGE 3A

"Shippers are apparently after nothing more than lower rates, for which you can't fault them. But they're seeking changes based on hypothetical circumstances that don't exist in the marketplace," said a conference carrier executive

SUPPLEMENTAL STATEMENT OF
THE HONORABLE WILLIAM D. HATHAWAY
CHAIRMAN, FEDERAL MARITIME COMMISSION,
BEFORE THE COMMITTEE ON GOVERNMENT OPERATIONS
SUBCOMMITTEE ON INFORMATION, JUSTICE,
TRANSPORTATION, AND AGRICULTURE
UNITED STATES HOUSE OF REPRESENTATIVES

October 18, 1993

As much of the testimony offered at this hearing has focussed on the Federal Maritime Commission's regulation of ocean carrier agreements, it may be worthwhile to briefly review the bases of the existing regulatory system, and the role of the Federal Maritime Commission, as they apply to those agreements.

With the passage of the Shipping Act of 1984 ("1984 Act"), Congress made substantial changes to the way the Federal Maritime Commission ("Commission" or "FMC") regulates ocean common carriers serving the United States, particularly with respect to carrier agreements and practices. The Commission's powers under the Shipping Act, 1916 ("1916 Act"), to disapprove agreements on broad public interest grounds, and to disapprove individual rates detrimental to commerce, were removed. Instead, Congress established a more narrowly tailored system of regulation, including an extensive list of specific prohibited acts and practices; new mandatory terms for carrier agreements, including the right of conference carriers to set independent rates different from conference rates; and a new procedure governing harmful agreements, by which the Commission no longer approves or disapproves agreements, but may seek an injunction in federal district court against any agreement found likely to cause an unreasonable reduction in transportation service or an unreasonable

increase in cost. In the years since the 1984 Act was enacted, the Commission has carried out these new responsibilities diligently. However, it has also acted conscientiously to respect those limits which Congress has placed on its authority, especially in the areas of rate regulation and agreement review.

Under section 15 of the old 1916 Act, carriers were required to secure Commission approval for any agreement governing rates, conditions of service, or similar matters, before such an agreement could become effective. According to standards set forth in section 15, the Commission was permitted to disapprove, cancel, or modify any agreement which it found to be unjustly discriminatory or unfair, or to operate to the detriment of the commerce of the United States, or to be contrary to the public interest, or to be in violation of the Act.

Section 15 was often a formidable obstacle for carriers, who bore the burden of justifying their agreements. The Commission, with Supreme Court approval, took the position that agreements to act concertedly -- that is, to set rates, pool revenues, restrict capacity, or to engage in other activities which normally would be contrary to the antitrust laws -- were presumed to be contrary to the public interest. Such arrangements, therefore, would be approved only if the proponents could show that the agreement "was required by a serious transportation need, necessary to secure important public benefits or in furtherance of a valid regulatory purpose of the Shipping Act." FMC v. Svenska Amerika Linien, 390 U.S. 238, 243 (1968). Under the 1916 Act procedures, the

implementation of agreements was often delayed for considerable amounts of time, especially if formal protests were made. In many cases, protests were filed by other carriers, who effectively delayed or blocked the approval of their competitors' business plans.

Prior to the 1984 Act, the Commission also maintained substantially broader authority to regulate carriers' individual rates or charges. Section 18(b)(5) of the 1916 Act mandated that the Commission "disapprove any rate or charge filed by a common carrier by water in the foreign commerce of the United States or conference of such carriers which, after hearing, it finds to be so unreasonably high or low as to be detrimental to the commerce of the United States."

Congress carried forward neither the Commission's section 18(b)(5) rate review authority nor its broad discretion to disapprove agreements when it crafted the 1984 Act. Instead, under section 6(c), properly filed agreements become effective automatically after forty-five days. To balance this liberalized approach to agreement review, the 1984 Act set forth an extensive list of prohibited acts, barring many anticompetitive practices which previously had been challenged under the general standards of section 15. This shift in regulatory approach was explained in the legislative history of the 1984 Act, which indicated that Congress, rather than vesting in the Commission broad discretion to disapprove agreements, "determined to strike the overall balance between competition and cooperation in specific provisions of the

83-061 O - 94 - 11

act." H.R. Rep. No. 600, 98th Cong, 2d Sess. 34 (1984) ("Conference Report"). Examples of the 1984 Act's provisions aimed at fostering and protecting competition include section 10(c), which prohibits conferences and groups of carriers from engaging in, inter alia, boycotts, predatory practices, unreasonable refusals to deal, and allocation of shippers among specific carriers. Also, section 10(b) bars carriers from engaging in a variety of unfair practices, such as granting secret kickbacks to shippers, retaliating against a shipper who has patronized another carrier, and refusing to negotiate with a shippers' association.

Further procompetitive provisions of the 1984 Act are set forth in section 5(b), which includes a list of terms which must be incorporated in every conference agreement. For example, conferences must allow, on equal terms and conditions, open admission (and readmission) for any carrier willing to serve a particular trade, and must permit any member to withdraw without penalty. Especially noteworthy is the requirement that all conference agreements must clearly state that any member line may take "independent action" on any rate or service item required to be filed in a tariff with the Commission; that is, any member line may opt to set an individual rate below (or above) the conference rate. The conference is required to publish the independent action rate in its conference tariff upon ten days' notice. This provision introduces a strong element of internal price competition within conferences, complementing the external competition provided by independent carriers. Congress did not, however, extend the

independent action requirement to member lines' ability to enter into service contracts with shippers. As part of the overall compromise underlying the 1984 Act, section 5(b)(7) expressly authorizes conferences to regulate or prohibit members' use of service contracts.

In addition to its authority to enforce the specific prohibitions and mandatory provisions in the 1984 Act, the Commission also has the power, under section 6(g), to seek an injunction in federal district court against an agreement which is "likely, by a reduction in competition, to produce an unreasonable reduction in transportation service or an unreasonable increase in transportation cost." This is the only way the Commission can prevent the operation of an agreement. Unlike the former agreement review process under the 1916 Act, the Commission carries the burden in an injunctive suit of showing that an agreement fails to meet the section 6(g) standard.

Although the language of section 6(g) is relatively brief and non-specific, the accompanying legislative history made clear that the section was not a broad mandate for the Commission to regulate rates and disapprove agreements under a public interest standard. Instead, the Conference Report set forth in uncommon detail the "nature" of the section 6(g) standard and the appropriate analysis to be performed pursuant to it. The Report made unarguably clear that it was intended to govern the interpretation of section 6(g); thus, unlike the reference to "public interest" in section 15 of

the 1916 Act, section 6(g) came with a set of specific instructions.

According to the legislative history, section 6(g) does not authorize the Commission to seek an injunction simply because a shipper's rates have increased, or because a conference has captured a large market share. Instead, the Conference Report directed the Commission to weigh several different variables in order to appraise the relative benefits and disadvantages of the agreement. To show that an agreement runs afoul of the section 6(g) standard, according to the Report, the Commission must actually satisfy two separate tests, each with a variety of components.

First, the Commission must show that an agreement will cause a <u>substantial</u> reduction in competition. The conferees noted that "[u]nless the competitive threat is substantial, any reduction in service or increase in cost would not be unreasonable, as required by the general standard. The Commission should not, in any event, expend its limited resources to pursue insubstantial reductions." Conference Report at 34. Moreover, in a departure from traditional antitrust analysis, the Report cautioned that a "substantial reduction in competition" may not be assumed simply because a conference has a large market share:

> [P]otential reductions in competition will be at least partially offset by a member carrier's right of independent action and ability to enter and leave the conference freely. In some forms of concerted action, participation by all or virtually all of the members of a trade is necessary if the agreement is to have the desired effect on problems of overcapacity or rate instability. Thus, although a market share analysis is

> available to the Commission, in many cases, depending on the circumstances, its outcome will not be determinative or necessary for application of the general standard.

Id. at 34, 35. In light of this guidance, it is the Commission's practice to scrutinize several variables to determine whether an agreement provides its parties with excessive market power, and is thus substantially anticompetitive; the presence of shipper alternatives (including other competitive means of transport), market share, rate activity, market exit and entry data, cargo flows, and capacity utilization are all considered.

The second facet of the section 6(g) test involves a determination whether the likely net result of an agreement "will be an unreasonable increase in costs to shippers, or an unreasonable reduction in the frequency or quality of service available to shippers." This standard, Congress made clear, "does not authorize the FMC to engage in the type of ratemaking analysis undertaken by regulators of public utilities or as applied in the domestic off-shore trades." Id. at 35. Instead, a rate increase or service reduction must be "material and meaningful," and must be shown likely to "cause concrete competitive harm" to shippers before it can be judged to be unreasonable. Id. at 33, 35. Such material harm cannot be assumed from the size of a rate increase, nor does it appear that it can be demonstrated solely through theoretical economic forecasting. Instead, the Commission must establish that shippers have suffered, or will suffer, demonstrable competitive harm. The cooperation of shippers themselves is

indispensable if the Commission is to make the showing of concrete competitive harm which Congress has required.

Even if a service reduction or rate increase will likely cause material and meaningful harm, it is possible that the change will nevertheless not be "unreasonable." The Conference Report, cautioning that "the negative impact upon shippers may be offset by the benefits of an agreement," directed that the Commission balance shipper harm against an agreement's potential advantages. Id. at 35. Benefits to be weighed include a conference's ability to address overcapacity and rate instability, its effect on international comity, its benefits to U.S.-flag carriers, and its ability to create efficiencies. Such efficiencies may include rationalization of service (through coordination of sailing schedules and chartering space on other carriers' vessels), development of economies of scale, and improved access to necessary capital. Id. at 36. The Report noted, however, that the Commission may weigh the existence of reasonable and commercially proven alternatives when balancing an agreement's potential benefits against its likely competitive harm.

Bearing in mind the new responsibilities and limitations imposed by section 6(g) and the other provisions of the 1984 Act, the Commission has developed and refined its processes for the filing and monitoring of agreements. When an agreement is filed, it is immediately reviewed by attorneys in the Commission's Office of General Counsel and by transportation analysts and economists in the Bureau of Trade Monitoring and Analysis. These offices

scrutinize agreements to insure that they contain the mandatory provisions set forth in the Act, and to determine whether they run afoul of the prohibited acts sections or the general standard of section 6(g). Some types of agreements are also subject to specific informational requirements; rate-fixing, pooling, joint service, and consortium agreements are required to submit an Information Form, which provides cargo carryings and market share information for the past year and identifies competitors and the nature and extent of that competition. Agreements which contain the authority to alter service are required to provide specific information on changed port calls or reduced sailings.

The Commission's responsibility under section 6(g) does not end with the initial filing of an agreement. The Commission maintains an extensive program of ongoing information collection and trade monitoring. Depending on each agreement's anticompetitive potential, monitoring is performed on either a periodic or a continuous basis. Most effective agreements are required to file reports, including Minutes of Meetings, Shippers' Request and Complaint Reports, Consultation Reports, and, if applicable, descriptions of space chartering activity. Also, the Commission's monitoring group routinely prepares economic reports on trade-wide and agreement-wide bases, as well as individual economic profiles on ocean carriers.

When an agreement is filed, Commission staff often contact the carriers or their counsel regarding any provisions which may violate provisions of the Act or be potentially injurious to

competing carriers or shippers. Through this process of informal negotiation, the Commission has been highly successful in persuading carriers to modify potentially unlawful or harmful provisions, without having to resort to formal agency or court proceedings.

To date, the Commission has not been presented with a situation which it believed met Congress's standard for seeking an injunction under section 6(g). The chronic condition of excess capacity in many of the U.S. liner trades has placed pressure on carriers to keep rates and services at competitive levels. Moreover, the procompetitive provisions of the 1984 Act, especially the right to take independent action on tariff rates, have fostered competition among agreement parties and precluded unreasonable rate increases. In some cases, potentially problematic agreement provisions have been addressed through negotiation, or corrected after the Commission has formally requested additional information or taken other action. Also, the Commission has not received financial data from shippers and shippers' groups documenting actual competitive harm from any agreement, including controversial, highly publicized conferences such as the Trans-Atlantic Agreement. Under the standards laid down by Congress in the legislative history of section 6(g), it is clear that, without such evidence from shippers -- such as percentage increases in product costs, revenue losses, lost orders, lost market share, employment cutbacks, or reduced investments -- the Commission would

have little basis to convince a court that an agreement causes material and meaningful harm to shippers and should be enjoined.

As noted above, however, section 6(g) is not the sole basis for the Commission's regulation of ocean common carriers. The Commission is also charged with administering the extensive list of prohibited acts set forth in the 1984 Act, and the Commission's investigative and prosecutorial offices (the Bureaus of Investigations and Hearing Counsel, respectively) actively combat deceptive practices by carriers, such as misdescribing cargo or granting untariffed, under-the-table rebates to selected shippers. In 1991 alone, the Commission collected almost $22 million in civil penalties as a result of such enforcement efforts. Also, aggrieved shippers, ports, carriers, or other persons may bring private actions through the Commission's various formal and informal complaint procedures.

The Commission has also acted decisively to enforce the mandatory agreement terms set forth in the Act, especially the right of independent action. For example, in 1986, the Commission issued regulations which, among other things, forbid conferences from requiring a member to attend a meeting or otherwise explain, justify, or compromise an independent action rate. Also in 1986, the Commission compelled a number of conferences in the Pacific trades to remove restrictions which discouraged or impeded members ability to take independent action; from one of these conferences, the Transpacific Westbound Rate Agreement ("TWRA"), a $300,000 civil penalty was collected. Furthermore, in November, 1992, the

Commission issued a final rule which, among other things, protects conference carriers' ability to adopt other members' independent action rates, and prevents conferences from charging carriers for administrative costs based on the number of independent actions taken by each carrier. The Commission is currently defending these latest regulations in a suit filed in the U.S. Court of Appeals for the D.C. Circuit by TWRA and the Asia North America Eastbound Rate Agreement.

Nevertheless, Congress has not given the Commission unchecked power to intervene in carriers' pricing and service decisions. As the Conference Report noted, Congress "intended that ocean carriers be free to structure their own affairs, except when such structuring violates specific statutory provisions or the new, more narrowly drawn general standard." Conference Report at 36. Therefore, absent specific evidence showing that the relevant statutory standards are being violated, the Commission may not attack or undo carriers' rate increases, service changes, or business decisions simply because they appear harsh, steep, or sudden.

Blue Diamond Growers

October 26, 1993

Congressman Gary A. Condit
1123 Longworth House Office Bldg.
Washington DC 20515-0518

Dear Congressman Condit:

I would like to thank you sincerely for holding a hearing on the relationship of maritime policy to U.S. agriculture exports. It was an honor to give testimony and air some facts that are not often exposed when maritime issues are discussed in Washington.

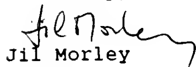
You may recall that at the hearing the ocean carriers' panel came after that of the shippers. This being so, the shippers did not get an opportunity to address some of the points raised by the carriers. I would like to clear up two issues raised by Mr. Schrier of Manalytics and Mr. Greenberg of APL.

Both Mr. Schrier and Mr. Greenberg asserted that rates on containers of almonds to Japan had decreased 45% from 1982 up to the present day. My records don't go back to 1982 but I am attaching a copy of a TWRA tariff from May, 1985, showing that a 40ft. container of almonds to Japan cost a total of $700. Today we are paying $2037.60 - an increase of 291%.

Additionally, Mr. Greenberg's testimony twice made reference to ocean carrier cartels and agricultural cooperatives having the same anti-trust immunity to fix prices; this is totally erroneous since we and our competitors operate in a free market and never discuss prices.

Again, thank you for helping your many agricultural constituents who depend on export sales of their crops.

Sincerely,



Jil Morley

JM/sp

P.O. Box 1768, Sacramento, California 95812 (916) 442-0771
The Almond People®

TABLE I

"ALL-IN" RATES PER FEU
(Major Moving Agricultural Products)
1982-1993

U.S. West Coast/Japan Conference Tariff Rates, 1982-1993

	1982	1993	Nominal Change 1982-1993	1993 (1982 Prices)	Real Change 1982-1993
Dry Products:					
Cotton	$ 2415	$ 1522	-37%	$ 1039	-57%
Kraft Bd	1998	1612	-19%	1100	-45%
Wood Pulp	1454	1124	-23%	767	-47%
Hides	1460	1996	37%	1362	-7%
Hay	2293	998	-56%	681	-70%
Almonds	2124	1701	-20%	1161	-45%
Raisins	1274	1701	34%	1161	-9%
Refrigerated Products:					
Oranges	5056	4346	-14%	2966	-41%
Beef Primal	5856	4460	-24%	3043	-48%
Simple Average	$ 2659	$ 2162	-19%	$ 1475	-45%

CPI in 1982: 96.9 (1984 = 100)
CPI in 1993 (June): 142.0
CPI ratio, 1993 vs. 1982: 146.5%

TRANSPACIFIC WESTBOUND RATE AGREEMENT

WESTBOUND LOCAL AND INTERMODAL FREIGHT TARIFF
FMC NO. 2

Orig./Rev.	Page
3rd Rev.	236
Cancels	Page
2nd Rev.	236
Effective Date	
MAY 1, 1985	
Correction No.	794

FROM: U. S. Ports and Points (See Rule 1-A)

TO: Northeast Asia Base Ports in Japan, Korea, Taiwan Hong Kong and P.R.C. (See Rule 1-B)

Except as provided rates apply per ton of 1,000 kilos (W) or per cubic meter (M) whichever produces the greater revenue.

COMMODITY DESCRIPTION AND ORIGIN	RATE BASE	JBP	KOR	TWN	HKG	PRC	ITEM NO.
FRUITS AND NUTS - Dry Stoe							
Nuts, Edible, N.O.S.							08-0200
WC	W	36	173	93	140	140 MK (2)	
(1) Min 15.5 KT/PC (2) Min 16 KT/PC20, 20 KT/PC40, To Huangpu only (3) Min 21 KT/PC To Shanghai only (4) CY/CY only	W					121 MO	
	W	(R) 26 (4)		41 (1)		99 SL (3)	
	PC20	(R) 365	790	590			
	PC40	500					
AG	W/M	202	205	205	205		
Peanuts, shelled, not blanched or otherwise prepared or preserved							08-0210
MLB	W	85					
AG	W	85					
Pecans, shelled, not blanched or otherwise prepared or preserved							08-0250
IPI (Motor)(WC) -From Tornillo, TX	PC40	1590					
AG	W	123	274	281	277		
Pistachios							08-0260
(1) To Huangpu only (2) To Shanghai only	W					294 NY (1)	
	W					294 SL (2)	

For explanation of abbreviations and reference marks, see Page 6 - 7.

TRANSPACIFIC WESTBOUND RATE AGREEMENT WESTBOUND LOCAL AND INTERMODAL RULES TARIFF FMC NO. 1	Orig./Rev.	Page
	1st Rev.	135
	Cancels	Page
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	Effective Date	
	MAY 1, 1985	
	Correction No.	31

FROM: Ports and Points in the U.S. and Canada (See Rule 1-A)

TO: Ports in the Far East (See Rule 1-B)

RULES AND REGULATIONS

RULE NO. 28 - ORIGIN RECEIVING CHARGES AT U.S. PORTS AND POINTS

A. CONTAINERIZED CARGO - ORIGIN RECEIVING CHARGES

Except as provided, all cargo moving under commodity tariffs shall be subject to the following receiving charges, including application of minimum weight or measurement requirements. Subject to a minimum of one revenue ton per bill of lading, the receiving charge shall apply in addition to tariff minimum charges.

CARGO TYPE	WC	AG, MLB, IPI
CY origin	$ 13.00/RT	$ 5.00/RT
CFS origin		
General cargo (1)	$ 19.00/RT	$ 15.00/RT
Dangerous/Hazardous	$ 38.00/RT	$ 30.00/RT
Non-containerized Cargo See Rule 28(E)	$ 19.00/RT	$ 15.00/RT
"Per Container" CY rated cargo	PC20 - $ 160.00 PC35/40/45 - $200.00	PC20 - $90.00 PC35/40 - $110.00
"Per Cubic - Feet" cargo	per above on the basis of (R)weight	per above on the basis of (R)weight
"Per Package" or Lumpsum rated cargo	per above on the basis of weight	per above on the basis of weight
"Per MBM" rated cargo		
CY	$ 20.00/MBM	$ 16.00/MBM
CFS	$ 25.00/MBM	$ 21.00/MBM

(Continued on next page)

(1) Includes Baled Hay and Hay Cubes.

For explanation of abbreviations and reference marks, see Pages 6 - 7.

TESTIMONY OF

DICK LYONS

LYONS DISTRIBUTING COMPANY

before the Committee on Government Operations,

Subcommittee on Government Information, Justice and Agriculture

September 30, 1993

Mr. Chairman, my name is Dick Lyons, and my company, Lyons Distributors of Stamford, Connecticut ___(give brief company description here)___ is a member of the United Fresh Fruit and Vegetable Association. United is an international trade association for the fresh produce industry representing fresh fruit and vegetable growers, packers, brokers, importers and exporters.

In 1990, the UFFVA surveyed its members and found that the Shipping Act of 1984 should be revised. The 1984 Act, which permits the existence of ocean shipping cartels largely owned by foreign steamship companies, impacts the export and import of commercial agricultural cargoes shipped in containers: fresh fruits and vegetables, citrus, nuts, cotton, apples, grapes, etc. Our survey, in 1990, showed that transportation costs are a very significant portion of our total product cost in the foreign markets, in the range of 30% of the total landed cost. We feel that if the conferences are eliminated, it would lower freight rates, allow shippers to negotiate contracts with individual ocean carriers they choose, and maintain these terms as confidential between the parties, and not published for all foreign competitors to see.

Since then, several studies have confirmed that the current system harms U.S. agricultural interests, U.S. agricultural employers, importers and exporters. In 1990,

the U.S. Department of Agriculture published its survey, entitled, The Shipping Act of 1984: Surveys of Agricultural Shippers. In 1991, The Center for Agricultural Business at the California State University in Fresno, published its study, The Impact of Ocean Freight Rates on Export Competitiveness: A Case Study of the California Cotton Industry. In 1992, The Report of the Advisory Commission on Conferences in Ocean Shipping was released. This year, USDA conducted yet another study of the impact of the Shipping Act of 1984, and specifically the steamship cartels on U.S. agriculture. The results indicate that the shipping cartels increase transportation costs, offer limited service, stymie competition and injure U.S. competitiveness.

The current system hurts U.S. fruit and vegetable consumers by forcing them to pay more for the products we import, and hurts U.S. exporters by increasing their costs to reach foreign markets, at a time when U.S. agriculture faces unprecedented global competition.

Agricultural products are particularly sensitive to the steamship cartel pricing practices. For example, a citrus exporter from Florida has indicated that he has to pay very different freight costs for shipping oranges and grapefruit. When the product reaches the importer, that individual is charged widely varying prices for two commodities that have similar production costs due to the difference in freight costs. In addition, ocean transportation costs are a significant portion of the foreign landed costs, averaging 30% for UFFVA members. In some cases, such as California grapefruit sold in Japan, ocean transportation alone constitutes 60% of total landed cost. With transportation constituting such a large cost, it is essential that transportation services provided to U.S. agricultural exporters be as competitive as possible. Otherwise, the Japanese can, and do, purchase citrus, for example, from

South American, Central American, European and North African sources. The same holds true for all other U.S agricultural commodities.

You have heard of the Transatlantic Agreement which came into being in 1992, which the Federal Maritime Commission says conforms with U.S. law. It controls and regulates U.S access to European markets and European access to U.S. markets. It is comprised of one U.S. company and 12 foreign companies. This cartel meets privately to set prices for ocean transportation. It determines which products it will provide volume discounts for and which U.S. exports it will not. The cartel decides how many containers it will make available to U.S. exporters, and it decides what ports will receive ocean shipping service. For example, the TAA steamship lines has eliminated direct service between the Port of Philadelphia and North Europe and has eliminated the Philadelphia bill of lading. These unilateral actions were protested, but to no avail. For those located in this area, transportation costs to both exporters and importers have increased from 30 to 90% over last year. Additionally, the vast majority (57%) of cargo to or from Northern Europe generated in the Philadelphia region now goes through New York. This is a life or death issue for forwarders, brokers, terminal operators, local trucking companies, labor and regional banks and other business tied to activity at the Philadelphia port. The Philadelphia Regional Port Authority, the Delaware River Port Authority and the Philadelphia Customs Brokers and Forwarders Association have joined with regional shippers and are attempting to form a regional shippers association to bring cargo, and hopefully service, back to the port.

Revisions to the '84 Shipping Act to reduce the excessive power of the cartels, to make service contracts available to individual carriers without interference from their competitors and to make terms of such arrangements confidential would go a long

way toward avoiding a repetition of the Philadelphia situation and making U.S. agricultural exports competitive.

In sum, study after study has shown the current system has negative consequences for U.S. agriculture. It provides a subsidy for foreign owned steamship lines, and it creates dislocation in the U.S. agriculture industry and threatens our competitiveness in world markets. We ask you to support legislation to revise the Shipping Act of 1984.

**SUPPLEMENTAL STATEMENT OF
THE HONORABLE WILLIAM D. HATHAWAY
CHAIRMAN, FEDERAL MARITIME COMMISSION,
BEFORE THE COMMITTEE ON GOVERNMENT OPERATIONS
SUBCOMMITTEE ON INFORMATION, JUSTICE,
TRANSPORTATION, AND AGRICULTURE
UNITED STATES HOUSE OF REPRESENTATIVES**

October 18, 1993

As much of the testimony offered at this hearing has focussed on the Federal Maritime Commission's regulation of ocean carrier agreements, it may be worthwhile to briefly review the bases of the existing regulatory system, and the role of the Federal Maritime Commission, as they apply to those agreements.

With the passage of the Shipping Act of 1984 ("1984 Act"), Congress made substantial changes to the way the Federal Maritime Commission ("Commission" or "FMC") regulates ocean common carriers serving the United States, particularly with respect to carrier agreements and practices. The Commission's powers under the Shipping Act, 1916 ("1916 Act"), to disapprove agreements on broad public interest grounds, and to disapprove individual rates detrimental to commerce, were removed. Instead, Congress established a more narrowly tailored system of regulation, including an extensive list of specific prohibited acts and practices; new mandatory terms for carrier agreements, including the right of conference carriers to set independent rates different from conference rates; and a new procedure governing harmful agreements, by which the Commission no longer approves or disapproves agreements, but may seek an injunction in federal district court against any agreement found likely to cause an unreasonable reduction in transportation service or an unreasonable

increase in cost. In the years since the 1984 Act was enacted, the Commission has carried out these new responsibilities diligently. However, it has also acted conscientiously to respect those limits which Congress has placed on its authority, especially in the areas of rate regulation and agreement review.

Under section 15 of the old 1916 Act, carriers were required to secure Commission approval for any agreement governing rates, conditions of service, or similar matters, before such an agreement could become effective. According to standards set forth in section 15, the Commission was permitted to disapprove, cancel, or modify any agreement which it found to be unjustly discriminatory or unfair, or to operate to the detriment of the commerce of the United States, or to be contrary to the public interest, or to be in violation of the Act.

Section 15 was often a formidable obstacle for carriers, who bore the burden of justifying their agreements. The Commission, with Supreme Court approval, took the position that agreements to act concertedly -- that is, to set rates, pool revenues, restrict capacity, or to engage in other activities which normally would be contrary to the antitrust laws -- were presumed to be contrary to the public interest. Such arrangements, therefore, would be approved only if the proponents could show that the agreement "was required by a serious transportation need, necessary to secure important public benefits or in furtherance of a valid regulatory purpose of the Shipping Act." FMC v. Svenska Amerika Linien, 390 U.S. 238, 243 (1968). Under the 1916 Act procedures, the

implementation of agreements was often delayed for considerable amounts of time, especially if formal protests were made. In many cases, protests were filed by other carriers, who effectively delayed or blocked the approval of their competitors' business plans.

Prior to the 1984 Act, the Commission also maintained substantially broader authority to regulate carriers' individual rates or charges. Section 18(b)(5) of the 1916 Act mandated that the Commission "disapprove any rate or charge filed by a common carrier by water in the foreign commerce of the United States or conference of such carriers which, after hearing, it finds to be so unreasonably high or low as to be detrimental to the commerce of the United States."

Congress carried forward neither the Commission's section 18(b)(5) rate review authority nor its broad discretion to disapprove agreements when it crafted the 1984 Act. Instead, under section 6(c), properly filed agreements become effective automatically after forty-five days. To balance this liberalized approach to agreement review, the 1984 Act set forth an extensive list of prohibited acts, barring many anticompetitive practices which previously had been challenged under the general standards of section 15. This shift in regulatory approach was explained in the legislative history of the 1984 Act, which indicated that Congress, rather than vesting in the Commission broad discretion to disapprove agreements, "determined to strike the overall balance between competition and cooperation in specific provisions of the

act." H.R. Rep. No. 600, 98th Cong, 2d Sess. 34 (1984) ("Conference Report"). Examples of the 1984 Act's provisions aimed at fostering and protecting competition include section 10(c), which prohibits conferences and groups of carriers from engaging in, inter alia, boycotts, predatory practices, unreasonable refusals to deal, and allocation of shippers among specific carriers. Also, section 10(b) bars carriers from engaging in a variety of unfair practices, such as granting secret kickbacks to shippers, retaliating against a shipper who has patronized another carrier, and refusing to negotiate with a shippers' association.

Further procompetitive provisions of the 1984 Act are set forth in section 5(b), which includes a list of terms which must be incorporated in every conference agreement. For example, conferences must allow, on equal terms and conditions, open admission (and readmission) for any carrier willing to serve a particular trade, and must permit any member to withdraw without penalty. Especially noteworthy is the requirement that all conference agreements must clearly state that any member line may take "independent action" on any rate or service item required to be filed in a tariff with the Commission; that is, any member line may opt to set an individual rate below (or above) the conference rate. The conference is required to publish the independent action rate in its conference tariff upon ten days' notice. This provision introduces a strong element of internal price competition within conferences, complementing the external competition provided by independent carriers. Congress did not, however, extend the

independent action requirement to member lines' ability to enter into service contracts with shippers. As part of the overall compromise underlying the 1984 Act, section 5(b)(7) expressly authorizes conferences to regulate or prohibit members' use of service contracts.

In addition to its authority to enforce the specific prohibitions and mandatory provisions in the 1984 Act, the Commission also has the power, under section 6(g), to seek an injunction in federal district court against an agreement which is "likely, by a reduction in competition, to produce an unreasonable reduction in transportation service or an unreasonable increase in transportation cost." This is the only way the Commission can prevent the operation of an agreement. Unlike the former agreement review process under the 1916 Act, the Commission carries the burden in an injunctive suit of showing that an agreement fails to meet the section 6(g) standard.

Although the language of section 6(g) is relatively brief and non-specific, the accompanying legislative history made clear that the section was not a broad mandate for the Commission to regulate rates and disapprove agreements under a public interest standard. Instead, the Conference Report set forth in uncommon detail the "nature" of the section 6(g) standard and the appropriate analysis to be performed pursuant to it. The Report made unarguably clear that it was intended to govern the interpretation of section 6(g); thus, unlike the reference to "public interest" in section 15 of

the 1916 Act, section 6(g) came with a set of specific instructions.

According to the legislative history, section 6(g) does not authorize the Commission to seek an injunction simply because a shipper's rates have increased, or because a conference has captured a large market share. Instead, the Conference Report directed the Commission to weigh several different variables in order to appraise the relative benefits and disadvantages of the agreement. To show that an agreement runs afoul of the section 6(g) standard, according to the Report, the Commission must actually satisfy two separate tests, each with a variety of components.

First, the Commission must show that an agreement will cause a <u>substantial</u> reduction in competition. The conferees noted that "[u]nless the competitive threat is substantial, any reduction in service or increase in cost would not be unreasonable, as required by the general standard. The Commission should not, in any event, expend its limited resources to pursue insubstantial reductions." Conference Report at 34. Moreover, in a departure from traditional antitrust analysis, the Report cautioned that a "substantial reduction in competition" may not be assumed simply because a conference has a large market share:

> [P]otential reductions in competition will be at least partially offset by a member carrier's right of independent action and ability to enter and leave the conference freely. In some forms of concerted action, participation by all or virtually all of the members of a trade is necessary if the agreement is to have the desired effect on problems of overcapacity or rate instability. Thus, although a market share analysis is

> available to the Commission, in many cases, depending on the circumstances, its outcome will not be determinative or necessary for application of the general standard.

Id. at 34, 35. In light of this guidance, it is the Commission's practice to scrutinize several variables to determine whether an agreement provides its parties with excessive market power, and is thus substantially anticompetitive; the presence of shipper alternatives (including other competitive means of transport), market share, rate activity, market exit and entry data, cargo flows, and capacity utilization are all considered.

The second facet of the section 6(g) test involves a determination whether the likely net result of an agreement "will be an unreasonable increase in costs to shippers, or an unreasonable reduction in the frequency or quality of service available to shippers." This standard, Congress made clear, "does not authorize the FMC to engage in the type of ratemaking analysis undertaken by regulators of public utilities or as applied in the domestic off-shore trades." Id. at 35. Instead, a rate increase or service reduction must be "material and meaningful," and must be shown likely to "cause concrete competitive harm" to shippers before it can be judged to be unreasonable. Id. at 33, 35. Such material harm cannot be assumed from the size of a rate increase, nor does it appear that it can be demonstrated solely through theoretical economic forecasting. Instead, the Commission must establish that shippers have suffered, or will suffer, demonstrable competitive harm. The cooperation of shippers themselves is

indispensable if the Commission is to make the showing of concrete competitive harm which Congress has required.

Even if a service reduction or rate increase will likely cause material and meaningful harm, it is possible that the change will nevertheless not be "unreasonable." The Conference Report, cautioning that "the negative impact upon shippers may be offset by the benefits of an agreement," directed that the Commission balance shipper harm against an agreement's potential advantages. Id. at 35. Benefits to be weighed include a conference's ability to address overcapacity and rate instability, its effect on international comity, its benefits to U.S.-flag carriers, and its ability to create efficiencies. Such efficiencies may include rationalization of service (through coordination of sailing schedules and chartering space on other carriers' vessels), development of economies of scale, and improved access to necessary capital. Id. at 36. The Report noted, however, that the Commission may weigh the existence of reasonable and commercially proven alternatives when balancing an agreement's potential benefits against its likely competitive harm.

Bearing in mind the new responsibilities and limitations imposed by section 6(g) and the other provisions of the 1984 Act, the Commission has developed and refined its processes for the filing and monitoring of agreements. When an agreement is filed, it is immediately reviewed by attorneys in the Commission's Office of General Counsel and by transportation analysts and economists in the Bureau of Trade Monitoring and Analysis. These offices

scrutinize agreements to insure that they contain the mandatory provisions set forth in the Act, and to determine whether they run afoul of the prohibited acts sections or the general standard of section 6(g). Some types of agreements are also subject to specific informational requirements; rate-fixing, pooling, joint service, and consortium agreements are required to submit an Information Form, which provides cargo carryings and market share information for the past year and identifies competitors and the nature and extent of that competition. Agreements which contain the authority to alter service are required to provide specific information on changed port calls or reduced sailings.

The Commission's responsibility under section 6(g) does not end with the initial filing of an agreement. The Commission maintains an extensive program of ongoing information collection and trade monitoring. Depending on each agreement's anticompetitive potential, monitoring is performed on either a periodic or a continuous basis. Most effective agreements are required to file reports, including Minutes of Meetings, Shippers' Request and Complaint Reports, Consultation Reports, and, if applicable, descriptions of space chartering activity. Also, the Commission's monitoring group routinely prepares economic reports on trade-wide and agreement-wide bases, as well as individual economic profiles on ocean carriers.

When an agreement is filed, Commission staff often contact the carriers or their counsel regarding any provisions which may violate provisions of the Act or be potentially injurious to

competing carriers or shippers. Through this process of informal negotiation, the Commission has been highly successful in persuading carriers to modify potentially unlawful or harmful provisions, without having to resort to formal agency or court proceedings.

To date, the Commission has not been presented with a situation which it believed met Congress's standard for seeking an injunction under section 6(g). The chronic condition of excess capacity in many of the U.S. liner trades has placed pressure on carriers to keep rates and services at competitive levels. Moreover, the procompetitive provisions of the 1984 Act, especially the right to take independent action on tariff rates, have fostered competition among agreement parties and precluded unreasonable rate increases. In some cases, potentially problematic agreement provisions have been addressed through negotiation, or corrected after the Commission has formally requested additional information or taken other action. Also, the Commission has not received financial data from shippers and shippers' groups documenting actual competitive harm from any agreement, including controversial, highly publicized conferences such as the Trans-Atlantic Agreement. Under the standards laid down by Congress in the legislative history of section 6(g), it is clear that, without such evidence from shippers -- such as percentage increases in product costs, revenue losses, lost orders, lost market share, employment cutbacks, or reduced investments -- the Commission would

have little basis to convince a court that an agreement causes material and meaningful harm to shippers and should be enjoined.

As noted above, however, section 6(g) is not the sole basis for the Commission's regulation of ocean common carriers. The Commission is also charged with administering the extensive list of prohibited acts set forth in the 1984 Act, and the Commission's investigative and prosecutorial offices (the Bureaus of Investigations and Hearing Counsel, respectively) actively combat deceptive practices by carriers, such as misdescribing cargo or granting untariffed, under-the-table rebates to selected shippers. In 1991 alone, the Commission collected almost $22 million in civil penalties as a result of such enforcement efforts. Also, aggrieved shippers, ports, carriers, or other persons may bring private actions through the Commission's various formal and informal complaint procedures.

The Commission has also acted decisively to enforce the mandatory agreement terms set forth in the Act, especially the right of independent action. For example, in 1986, the Commission issued regulations which, among other things, forbid conferences from requiring a member to attend a meeting or otherwise explain, justify, or compromise an independent action rate. Also in 1986, the Commission compelled a number of conferences in the Pacific trades to remove restrictions which discouraged or impeded members ability to take independent action; from one of these conferences, the Transpacific Westbound Rate Agreement ("TWRA"), a $300,000 civil penalty was collected. Furthermore, in November, 1992, the

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Commission issued a final rule which, among other things, protects conference carriers' ability to adopt other members' independent action rates, and prevents conferences from charging carriers for administrative costs based on the number of independent actions taken by each carrier. The Commission is currently defending these latest regulations in a suit filed in the U.S. Court of Appeals for the D.C. Circuit by TWRA and the Asia North America Eastbound Rate Agreement.

Nevertheless, Congress has not given the Commission unchecked power to intervene in carriers' pricing and service decisions. As the Conference Report noted, Congress "intended that ocean carriers be free to structure their own affairs, except when such structuring violates specific statutory provisions or the new, more narrowly drawn general standard." Conference Report at 36. Therefore, absent specific evidence showing that the relevant statutory standards are being violated, the Commission may not attack or undo carriers' rate increases, service changes, or business decisions simply because they appear harsh, steep, or sudden.

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