Issue VI: December 2003

Also available at:
http://www.ams.usda.gov/tmd/AgOTT/

In response to agricultural shippers, who rely on good market information and assistance, USDA created this semi-annual report as an update on the ocean container market's cost and service trends. The report is the result of input from large and small agricultural shippers, including shippers' associations, controlling over 150,000 40-foot equivalent units, split nearly evenly between dry and temperature-controlled (refrigerated and frozen). Input was also received from vessel and non-vessel operating ocean carriers, as well as freight forwarders, in key U.S. agriculture import and export trade routes. Although it is not a statistical sampling of the population of agricultural exporters, every attempt has been made to contact a broad range of shippers.

For more information, contact Ron Hagen (202) 690-1320 or
Heidi Reichert (202) 690-2325, United States Department of Agriculture.

Overview

The ocean shipping market is cyclical, often shifting back and forth between carrier- and shipper-favorable environments. This is evident in 2003. The June 2003 *Agricultural Ocean Transportation Trends* report revealed a carrier-controlled market, including increases in ocean transportation charges, capacity concerns, and minimal flexibility in contract negotiations. Additionally, there was a reduction in containers, especially refrigerated containers, due in part to the Iraq war, which caused an increase in cost. However, in the latter half of 2003, the shipping environment is benefiting the agricultural shipper.

- Carriers are willing to negotiate lower rates and surcharges and offer additional services to increase market share.

- Port congestion has nearly disappeared, and disruption to service or equipment availability is no longer a problem.

- The U.S.-Asia trade imbalance has resulted in failed general rate increases, helping rates to remain stable.

- The new security measures have had little negative effect on agricultural shipments.

Nevertheless, if projected increases for U.S. exports are significant, competition for space on outbound vessels will also increase, which could cycle the shipping environment back to the benefit of the carriers.

Current Shipping Environment Encourages Greater Use of Service Contracts

Contract environment is favorable for shippers. Since June 2003, there has been a trend toward a favorable contract negotiating environment for the shipper. The level of flexibility by ocean carriers has substantially increased since earlier this year, and it is believed that carrier flexibility will continue. Some carriers are initiating contract renegotiation with existing customers, proposing amendments to extend the duration of the contract or to increase the contract volume. Shippers report being offered lower rates or other favorable terms, some as soon as 30 days after the initial signing. Carriers are undertaking these efforts to remain competitive as the increase in overall capacity has elevated the level of competition for market share. (See section subtitled "Trade imbalance continues to influences rates.")

Agricultural shippers prefer using contract rates. The passing of the Ocean Shipping Reform Act of 1998 (ORSA) permitted shippers to negotiate service contracts that maintain confidentiality for certain contract elements; prior to OSRA, all contract elements were available for public viewing. As a result of OSRA and due to the ongoing favorable negotiating environment, a transition from using the tariff or "public rate" to negotiate rates within service contracts is essentially complete for the agriculture industry. The public tariff, however, is often referenced in contracts and frequently used as a benchmark in negotiations.

An overwhelming number of agricultural shippers who responded to structured interviews report that 100 percent of their shipments move under negotiated confidential ocean service contracts. The shippers interviewed together represent over 200,000 20-foot equivalent units per year. Those who do not ship exclusively by contract report that containers shipped under tariff rates make up no more than 2-5 percent of their total shipments. These statistics are not surprising since shipping lines are now willing to negotiate contracts for as few as 12 refrigerated containers, for example. Further, rates found in such small-volume contracts are now often competitive with contracts for much larger shipments.

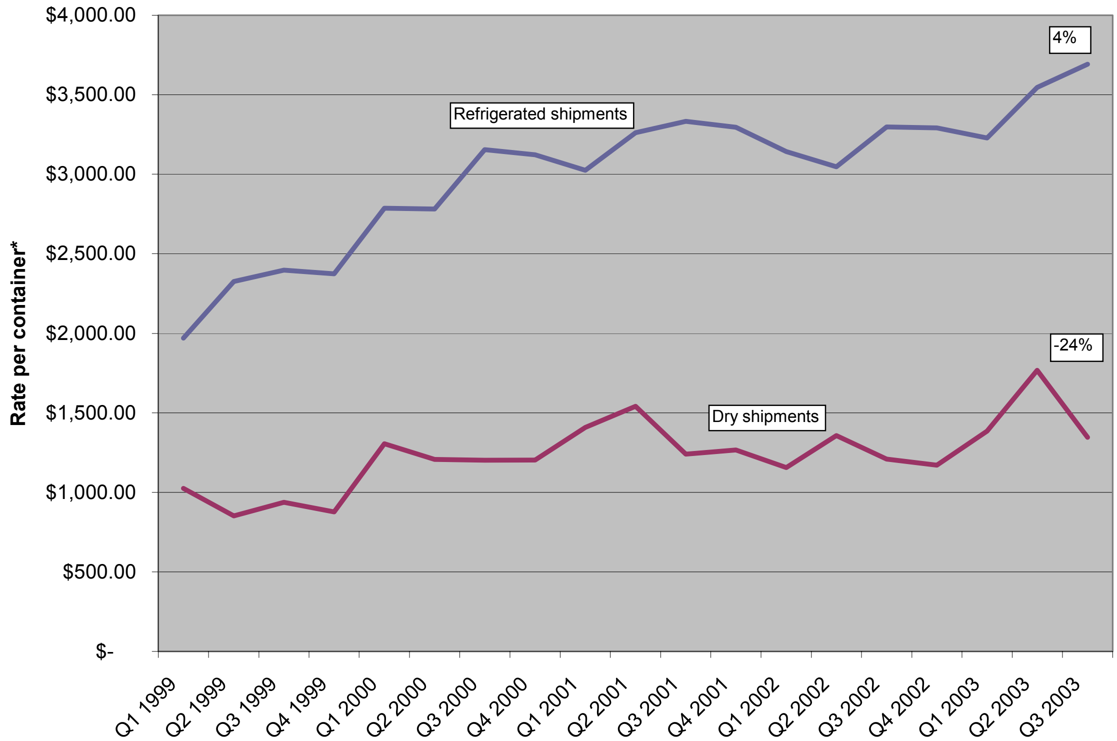
The use of contract rates is due not only to the availability of lower rates and confidentiality, but also because of the opportunity for shippers to negotiate other services. For example, recently when the supply of refrigerated containers was low and unable to meet shipper demand, the availability of refrigerated containers for loading in the Midwest was particularly challenging. In response, carriers began offering new opportunities for supplying refrigerated containers to the Midwest. During contract negotiations, carriers are reportedly also willing to reduce rates and provide special services into certain new niche overseas markets in an effort to assist the shipper and attract business to those trade lanes.

Rates Remain Steady in Response to Overcapacity

Proposed rate increases did not stick. Reports from shippers and a look at public tariffs reveal that carriers were not successful in implementing the general rate increases (GRI) announced by talking agreements during the summer of 2003. (The *Agricultural Container Indicators* report, Quarters 2 and 3, provides a list of selected GRIs recently filed: www.ams.usda.gov/tmd2/agci.) In particular, GRIs for exports from the U.S. West Coast to Asia are not sticking, according to publicly filed tariff rates. The *Ocean Rate Bulletin* (www.ams.usda.gov/tmd/ocean) provides current tariff rates for selected agricultural products.

Average rates for refrigerated containers exported to Asia increased only 4 percent from last quarter, though proposed GRIs were as much as 40 percent of the existing rate (figure 1). For dry cargo, contract rates have generally remained unchanged, trending downward. The average tariff rate for dry cargo shows a 24-percent decrease in rates, partially attributed to a decrease in surcharges (figure 1). Shippers also report that contract rates are declining in trade lanes such as Latin America to the United States and the United States to the Mediterranean region. However, it is reported that export shipments from the U.S. East Coast for transpacific destinations are, at least for some cargo, subject to contract rate increases. In October, the Trans-Atlantic Conference Agreement announced an increase in eastbound tariff rates effective January 1, 2004. The rate increases are $150 per 40- and 45-foot containers, $120 per 20-foot container, and $8 per ton of cargo.

Figure 1: Container rates for U.S. agricultural commodities to Asia



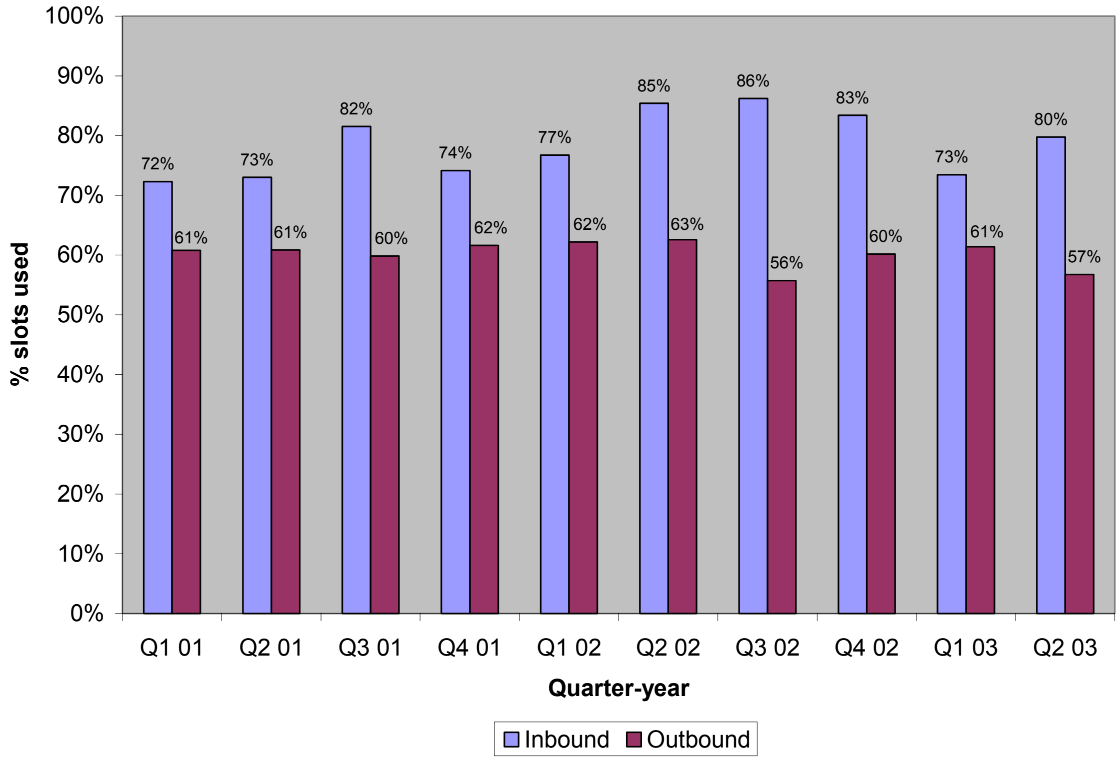
(Source*:* *Agricultural Container Indicators*, USDA/AMS, http://www.ams.usda.gov/tmd2/agci/, Quarter 3, 2003)

As previously discussed, the current negotiating environment is allowing shippers to reject rate increases proposed by carriers; however, in some instances, carriers are voluntarily proposing reductions in existing service contracts.

Trade imbalance continues to influence rates. There continues to be an imbalance of inbound and outbound cargo within the U.S. and Asia trade lanes. The percentage of container slots used for outbound shipments from the United States is typically only around 60 percent, whereas approximately 80 percent of inbound capacity is used (figure 2). This imbalance causes a dramatic difference between inbound and outbound rates and services.

The dramatic differences between rates and service levels in the inbound and outbound trade lanes are due also in part to the ability of the cargo to absorb additional transportation costs while still being competitive in the marketplace. Inbound cargo is characterized by relatively high value, manufactured consumer goods, such as computer equipment, while export cargo is characterized by relatively lower value cargos–ranging from waste paper to forest products to agricultural products. Inbound, higher valued cargo, for example, is able to sustain rate increases without requiring an increase in the market price and, as a result, is supporting rates that are often 10 times the level of rates for outbound cargo. For example, a dry container headed outbound with a low-value product may generate approximately $460 in income for the carrier; however, that same container, carrying a higher valued product, will generate $3,000 on the voyage back to the United States.

Figure 2: Container slots used, U.S.-Asia trade lanes



(Source: *On Board Review*, PIERS, New York, 2001-2003)

It appears that carriers are attempting to balance several objectives: the need for revenue, the need to reposition containers, and the desire for market share. Some carriers price the U.S. outbound journey, which is of most importance to agricultural shippers, to gain at least some revenue for repositioning containers back to Asia. Other carriers are refusing to make outbound bookings below their internally determined variable cost of operation, including port and handling charges.

Talking agreements such as the Westbound Transpacific Stabilization Agreement (WTSA) announced this summer a variety of GRIs. The GRIs have generally not been accepted by shippers. Carriers will most likely continue to press for higher rates for outbound shipments; however, the extraordinary price sensitivity of U.S. agricultural exports may cause shippers to refrain from selling overseas instead of accepting higher freight rates. Both carriers and shippers are now more carefully assessing the profitability of a sale and are rejecting sales if the transportation costs are too high.

Carriers make decisions outside talking agreements. More than ever, carriers are tending to break from guidelines recommended by the talking agreements of which they are members. This was particularly apparent during quarters 2 and 3 of this year. This tendency appears to be a result of the trend of an oversupply of container slots relative to current demand. For instance, a $200-per-container increase for forest products announced by the WTSA for October 1 has largely been abandoned by carriers. Shippers report that individual carriers are signing new contracts with increases of as little as $50 per container. For other agricultural commodities, GRIs of up to $600 per container were announced, but shippers signed contracts with the carriers for increases of significantly lower amounts.

The trend for individual carrier divergence from talking agreement guidelines is less pronounced for other contract components than for the underlying rate or GRI. For example, in areas such as surcharges, free time, extra days, and demurrage, many carriers are presently willing to adhere to talking agreement guidelines. Carriers not members of a talking agreement will also often follow recommended surcharges provided by the talking agreements, such as bunker, chassis, demurrage, terminal handling, and currency adjustment. However, recently shippers are experiencing a different trend. Carriers are diverging from talking-agreement-recommended surcharges. For example, in the third quarter of 2003, the WTSA-recommended currency adjustment factor for Japan was 42 percent of the base rate; however, individual carriers are requiring currency adjustment factors anywhere from 40 to 43 percent of the base rate (table 1).

Table 1: Currency Adjustment Factor

Trade Lane	WTSA CAF Q3	Tariff CAF Q3
U.S.-Japan	42 %	40-43 %
U.S.-Taiwan	4 %	3 %
U.S.-Singapore	8 %	8 %

Shippers Enjoy a Season with Very Little Service Disruption

Port congestion has nearly disappeared. At this time in 2002, port congestion was perhaps the number one challenge for agricultural exporters and importers as a result of the West Coast port shut downs. U.S. exporters were reporting lost sales as U.S. port congestion prevented cargo from entering terminals. Over the past 12 months, U.S. port congestion has essentially disappeared. Even the most congested ports following the West Coast port labor dispute, such as the Ports of Los Angeles, Long Beach, and Oakland, are no longer experiencing congestion.

Outbound equipment is readily available. During 2002, ocean carriers were still attempting to absorb new capacity with the delivery of new ships. This overcapacity, combined with the disruption at the West Coast ports during fall 2002, forced carriers to remove vessels and reduce the frequency of sailings. This was particularly apparent in the U.S.-Asia trade lanes. During this time of capacity reduction, the greatest impact on agricultural exporters was the decision of Maersk Sealand to withdraw from the all-water

West Coast to Europe route, choosing instead to serve that market by a Houston, TX, to Europe sailing. This forced shippers to choose land-bridge movements instead.

Many shippers found that their dependence on Maersk Sealand and its West Coast all-water routes put them into almost a "captive" situation. Many shippers were forced to absorb the approximately $800-per-container land-bridge cost to move cargo from California's central valley locations to Houston. Other shippers report that they have sought alternative carriers either from the Gulf Coast or the West Coast so as to reduce dependency on a single all-water carrier to Europe. However, other than the Maersk Sealand redeployment, during the fall of 2003, agricultural shippers report virtually no service disruption. After the tumultuous year of the West Coast labor disruption, the current service stability is a welcome respite for shippers and carriers alike.

Some carriers, which had until very recently restricted allocations of containers (particularly refrigerated containers), have reportedly increased their allocations. The restricted allocations were especially burdensome on shippers farther away from ocean ports. Therefore, the benefits of increased allocation are being felt first by inland shippers, such as those in the Midwest. Twenty-foot containers are in somewhat short supply; however, ocean carriers have substituted 40-foot containers with little difficulty. Equipment availability is no longer an issue, which is quite a dramatic change from even 6 months ago.

A source of uncertainty is the expected delivery of new and very large vessels into many U.S. trade lanes. The vessels will be delivered and placed in service during 2005. While this is too far into the future to directly impact rates and service levels over the coming 6 months, the potential for even greater overcapacity is resulting in a new trend. Carriers are already offering multiyear contracts to larger volume shippers. Presently, carriers in export trade lanes are seeking market share and long-term customers, with attractive inducements available to agricultural exporters willing to make the long-term commitments. Shippers can expect aggressive competition for cargo once the new ships come into service in 2005.

Cargo Security Measures Cause Little Disruption for Agricultural Shipments

During the first three quarters of 2003, various cargo security measures promulgated by the Bureau of Customs and Border Protection (CBP) within the Department of Homeland Security and the Food and Drug Administration (FDA) have not led to disruptions in the flow of ocean-going agricultural commerce. These new rules are, for the most part, required under the Trade Act of 2002 and the Public Health Security and Bioterrorism Preparedness and Response Act of 2002 (Bioterrorism Act).

Importers quickly adapt to 24 hour rule. While initially feared as likely to cause delays, particularly of perishable goods, the so-called "24 hour rule" for imports has not created havoc in the agricultural import trades. The new rule requires ocean carriers to submit to the CBP complete cargo manifest information at least 24 hours prior to loading the cargo on the ship in the foreign port. This in turn forces the agricultural importer to provide the necessary information to the ocean carrier even earlier.

> The Customs and Border Protection Web Site provides information regarding the 24-hour rule. http://www.customs.ustreas.gov/xp/cgov/import/carriers/24hour_rule/

Since CBP initiated its enforcement in March 2003, the 24-hour rule has gradually added more information components for which prior notice is required. CBP has done so in a manner that has allowed importers to prepare and adapt. Agricultural importers report that education of their overseas suppliers has been essential, along with revisions to the way business is done in overseas orders. Further, investment by companies in their internal information technology tools has helped agricultural importers better manage their cargo data so that it can be transmitted electronically and in a more timely fashion.

One byproduct of the 24 hour rule has been the imposition of a "Security Manifest" surcharge by ocean carriers, based upon the costs to develop cargo manifest submission systems. Those surcharges were accepted in many of the agricultural ocean transportation contracts negotiated during May, June, and July 2003. However, the Security Manifest surcharge may be dropped during the next round of contract negotiations due to the installation of more efficient manifest data collections systems and submission mechanisms and as carriers increasingly compete for cargo.

Agricultural shippers are prepared for export advanced notice requirement. The export version of the 24 hour rule will take effect in spring 2004. However, CBP has already issued proposed regulations, and the agricultural community is working to adapt to the new rules. Of primary interest to the agricultural community is CBP's incorporation of the Automated Export System (AES) "Option 4" data filing mechanism. AES Option 4 exempts qualified exporters from the 24-hour notice requirement. However, the exporter must show the ocean carrier a copy of its Option 4 certification to have the cargo loaded.

> The Customs and Border Protection Web Site provides information on the AES and Option 4 registration. http://www.cbp.gov/xp/cgov/export/aes/letter_intent/register.xml

In the new export rules, Option 4 is proving to be a tremendous relief to U.S. agricultural exporters who were fearful that requiring submission of accurate export data 24 or as much as 48 hours in advance of loading could significantly hinder U.S. exports of perishable agricultural commodities. Under AES Option 4, the export data may be filed up to 10 days after sailing, based upon the justification that only companies which have previously registered and been scrutinized by CBP and the U.S. Census Bureau can qualify for filing under Option 4. Registration requires disclosure of the U.S. exporter's identity, a description of the company and the commodities exported, and other information to allow U.S. Government authorities to determine security risks well in advance of shipping. Many agricultural exporters are already registered under Option 4, and an avalanche of agricultural exporters filed their applications for Option 4 status prior to the August 13, 2003, deadline imposed by the U.S. Census Bureau.

In the meantime, as is the case for imports, agricultural exporters have invested in training and systems development to assure compliance with export advance notice requirements and Option 4. There is a general sense in the agricultural community that as long as CBP and the U.S. Census Bureau continue to allow exporters to use Option 4 filing, agricultural exports will not be hindered.

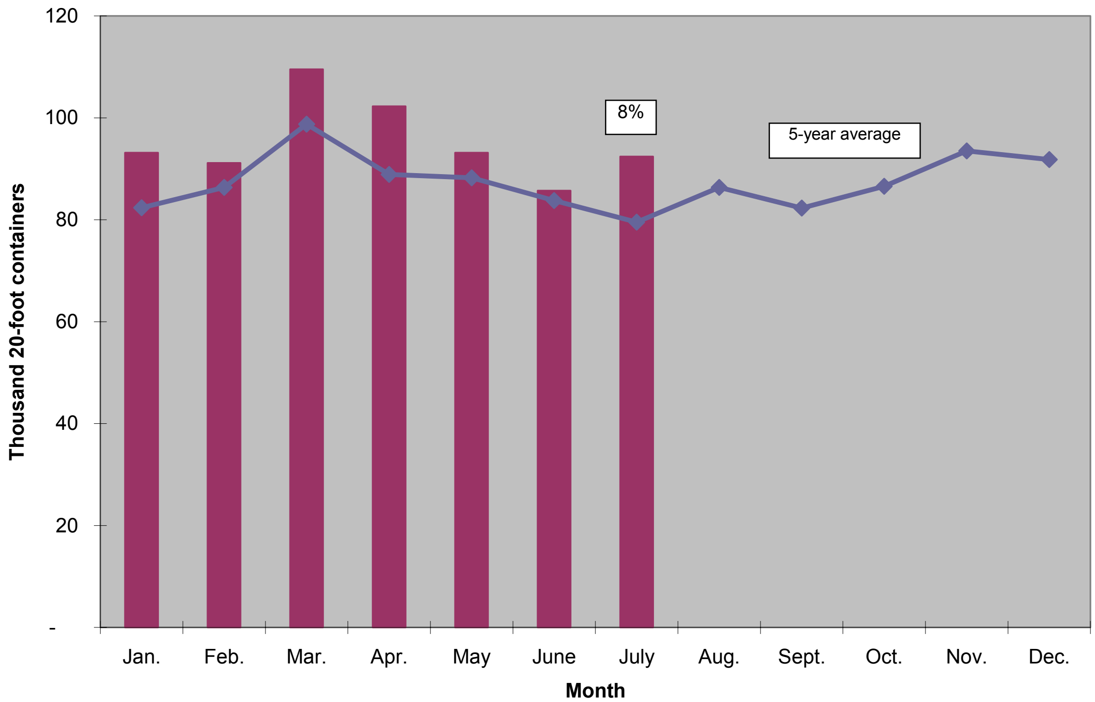
New FDA regulation impacts food importers. Major agricultural organizations such as the National Food Processors Association, United Fresh Fruit and Vegetable Association, and the Agriculture Ocean Transportation Coalition, have conveyed to FDA concerns about the interim Registration of Food Facilities regulation (68 Fed. Reg. 58.894) and the Prior Notice of Food Imports regulations (68 Fed. Reg. 58.974). Implementation of FDA's Bioterrorism Act regulations will begin December 12, although an enforcement "grace period" has been announced through March 2004. Disruptions, such as delayed or rejected agricultural shipments, may occur, depending on FDA's approach to enforcing the new regulations and helping shippers understand compliance of these regulations.

> The F DA Web Site provides detailed information regarding Bioterrorism Act Regulations Requirements for Facilities Registration and regulations for Prior Notice of Food Shipments.
> http://www.fda.gov/oc/bioterrorism/furls/

Agricultural Export Volumes Increase as the U.S. Dollar Weakens

Although containerized agricultural exports to Asia are typically at their annual low each July, this year July shipments are 16 percent higher than the 5-year average (figure 3). This could be a result of the weakening U.S. dollar, which may result in more affordable and competitive U.S. agricultural products. According to the Department of Commerce, overall exports of foods, feeds, and beverages, which are typically shipped in containers, were at their highest since November 1996 (Foreign Trade Statistics, Monthly Trade Highlights, Department of Commerce, July 2003). USDA reports that gains, particularly in soybeans, cotton, fruit, nuts, and meats, are pulling U.S. agricultural exports up, compared with last year. The Economic Research Service of USDA expects this increased competitiveness to continue into 2004 (source: USDA/Economic Research Service, *Outlook for U.S. Agricultural Trade*, August 26, 2003). The result could be a significant upturn in U.S. agricultural export volume. If a significant increase occurs, agricultural shippers could experience a strain on specialized equipment such as controlled-atmosphere and refrigerated containers. Further, if demand for all U.S. products grows, shippers may find an increase in competition for space on outbound container vessels. Such competition often results in higher freight rates, revealing once again the cyclical nature of the shipping industry.

Figure 3: Outbound volume for containerized agricultural shipments, U.S. to Asia



(Source: *Agricultural Container Indicators*, USDA/AMS, http://www.ams.usda.gov/tmd2/agci/, Quarter 3, 2003)

Summary

The ocean transportation industry in 2003 is experiencing another cyclical transportation year. The shipping market is stable for the first time in many years. As the shipping environment becomes more favorable, agricultural shippers are economically reassessing how to ship their products. With ocean freight rates relatively low and the container shortage and congestion problems disappearing, both shippers and carriers are moving away from previous shipping procedures. They are accepting that the imbalance in trade volume and transportation pricing between imports and exports can influence their market. Moreover, as larger vessels come online, carriers will look for longer contractual commitment, in return for preferential terms for the shipper. Further, the new governmental security measures will not have as much impact on agricultural shipments as previously expected.