Agricultural Ocean Transportation Trends
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Shipper & Exporter Assistance
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The bottom line: There is nervousness that "things are about to get tougher" as rates go up and equipment shortages loom. It’s a good time to assess your current contracting position.

Summary

The ocean transportation marketplace is cyclical, with demand for vessel space and supply of available containers moving up or down. This is based on many factors, including vessel supply, U.S. consumer demand for agricultural imports, foreign demand for U.S. agricultural exports, weather conditions determining U.S. harvest volumes and quality, and strength of the U.S. dollar versus foreign currencies, as well as the integral strength of foreign currencies and the strength of those economies (and their ability to buy U.S. products). Thus far this year, there has been an increased demand for vessel space and increasing transport costs for agricultural shippers. This trend is expected to continue for the next 6 months. This will present a significant challenge to companies seeking to keep their agricultural products competitive in the global marketplace or to provide U.S. consumers with attractively priced imports.

Other factors are making this agricultural shipping environment even more dynamic during 2000. The changing legal regime controlling the negotiation and provision of ocean transportation services is one such factor. Although the Ocean Shipping Reform Act was enacted in 1998, the year 2000 will be the first complete year for which the new act applies. There are already changing practices resulting in changing relationships between carriers and shippers. Contracts are no longer simply volume discounts, but increasingly contain negotiated and tailored service provisions.

Agricultural shippers are facing fundamental changes in the structure of ocean transportation--namely unprecedented consolidation of ocean carriers. The consolidation includes both the vessel operators and other service providers (including freight forwarders, non-vessel operating common carriers, etc.). While there is more container capacity on the water now than ever before, there are fewer companies controlling that capacity. Mergers have effectively eliminated the traditional U.S. flag carriers as independent competitors for the business of U.S. agricultural importers and exporters.

Finally, another structural change, the elimination of many ocean carrier conferences coinciding with the growth of "talking or stabilization agreements," is a notable challenge to agricultural shippers. The virtual disappearance of truly independent

carriers operating outside the collective rate discussion organizations (conferences and talking agreements) greatly influences the agricultural ocean shipping environment. Due to a combination of these factors, it can be said that agricultural shippers, exporters, and importers can expect to see increasing numbers of agriculture-oriented equipment, such as sophisticated new refrigerator technology.

These factors collectively lead to the following forecast for the coming 6 months:

1. Agricultural exporters and importers can expect to pay more for transportation for the remainder of 2000.
2. Agricultural shippers should increasingly be concerned with ocean carrier equipment shortages.
3. The trend toward service contracts, as opposed to tariff movements, will likely continue.
4. Carriers will be willing to maintain their relationship with customers by amending contracts to avoid shipper payment of liquidated damages due to a legitimate shortfall by the shippers. At the same time, carriers will continue to minimize their exposure to damages to the shipper should the carrier be unable or unwilling to carry tendered cargo under the contract.
5. While contract rates are intended to be kept confidential, the rates being paid by agriculture importers and exporters will continue to be known by shippers in the agricultural export and import business.

The bottom line: There is nervousness that "things are about to get tougher" as rates go up and equipment shortages loom. It is a good time to assess your current contracting position.

Service Contract Trends

There is no question that volume still translates into negotiating clout and into better shipping terms. Depending upon the cargo, the larger volume shipper gets the better deal. On the other hand, carriers are paying more attention to the small shipper who is willing to sign a commitment. Agricultural shippers are signing contracts with volume as small as 10 20-foot equivalent units (TEU) and are often able to negotiate very attractive terms relative to what their larger volume competitors are obtaining.

(See sidebar, "A Closer Look.") Agricultural shippers have been able to negotiate extra free time, better credit terms (for example, 30 days), claims resolution procedures, increased rate notification periods, guaranteed carriage, protection against general rate increases (GRI) and specific surcharges, guaranteed equipment availability, store door delivery, the release of containers without bills of

A Closer Look:
Were you able to obtain service items requested?

A total of 88.8% shippers said they were able to obtain most of the key service contract provisions they sought. The remainder of those surveyed (11.2%) were able to obtain some of the key provisions they sought.

lading, and increased carrier liability for cargo loss or damage beyond that typically included in the bill of lading's Carriage of Goods by Sea Act limits ($500 per container). Not all agricultural shippers are able to negotiate all of these terms, but a growing number of agricultural shippers have been able to include some improvements over the traditional service contracts previously offered by the shipping line rate conferences.

(See section entitled "Surcharges Trends" for information about surcharges trends in service contracts.)

Equipment Availability Trends

The traditional factors for choosing a carrier have been, first, rates and, second, dependability. But the quality and availability of specialized equipment are becoming an increasingly important means of distinguishing between the carriers with whom agricultural carriers choose to do business. Some carriers are investing heavily in humidity-controlled containers. This relatively newer technology provides new marketing opportunities for certain perishable commodities. For example, it has opened up new markets for U.S. grapes worldwide. On the other hand, demand for this new humidity-controlled equipment far exceeds its availability. The few carriers offering this equipment have been unable to meet agricultural export demand due to an insufficient number of such containers. While additional humidity-controlled containers are being built, the shortfall in available equipment will continue for at least the next 24 months.

Rate Trends

The bottom has been reached in agricultural transportation rates. (See sidebar.) Whether shipping under the tariff or under a negotiated contract, rates (both export and import) are increasing rapidly, particularly in the westbound trans-Pacific trade. Rates are firming for exports of dry cargo (cotton, forest products, etc.), while increasing dramatically for refrigerated agricultural exports. Refrigerator containers are in short supply, and, depending upon the underlying value of the commodity, rates are increasing by significant percentages, ranging from 10 to 50 percent. Coming on only 30 days notice (as required by the Shipping Act), these increases are beginning to have an impact on the marketability of U.S. agricultural products in Asian markets. At present, the westbound ships are operating at approximately 70-percent capacity, which will, for the next few months, limit the ability of the carriers to effectively impose a general rate increase on outbound dry cargo. In contrast, the demand for refrigerated container space more closely matches the supply, allowing carriers to raise rates.

More About Rate Trends

Ocean Freight Rate Trends for Raw Cotton and Fresh Apples Shipped to Selected Markets in Asia from the U.S. West Coast
(See appendix.)

From a long-term perspective, rates are still below the historical average. However, relative to the low rates that U.S. agricultural exporters have enjoyed for the past several years, the new rate increases are noticeable, particularly as they are being imposed so rapidly. In other words, the gradual decline in rates several years ago is now being followed by a rapid escalation of rates. Rates will continue to escalate for the next 12 months for two reasons:

1. Asian demand for U.S. product is increasing, thus increasing the total volume of exports moving westbound across the Pacific.
2. The imbalance between eastbound and westbound shipments, which has led to so many empty westbound containers, is now being eliminated. Eastbound (import) demand for space has plateaued (with corresponding softening of rates benefitting some agricultural importers). The end of the cargo imbalance means reduced excess capacity westbound, thus increased demand for a diminishing supply of empty containers.

How long will the export transportation rate escalation continue? Rates for refrigerated U.S. exports will continue to increase until they cause foreign buyers to shift to alternative sources with lower delivered prices. Or, said differently, rates will increase until the landed cost of the product becomes too expensive for Asian consumers. In summary, U.S. agricultural exports that require more refrigerated space will continue to face dramatic freight increases, while dry commodity exports will be subject to firming rates and more modest increases. But, the trend line for rates is upward for both dry and refrigerated cargo.

Surcharges Trends

Ocean transportation cost increases will be found in the underlying freight rates, as well as in the form of new and creative surcharges. It will be typical to find a bill of lading showing freight rates supplemented by five or six additional surcharges, which in combination greatly surpass the negotiated freight rate. This trend will likely accelerate through the end of 2000. Carriers are insisting that transportation contracts allow the imposition of additional surcharges during the course of the contract.

Many agricultural exporters and importers have been able to negotiate contracts which provide protection from increases in existing surcharges, while accepting the imposition of new surcharges which might be published in the carrier's tariff during the course of the contract. However, carriers continue to be nervous about fluctuating fuel costs and tend not to agree to a freeze on the BAF (Bunker Adjustment Factor). On the other hand, it is more likely that contracts will freeze the CAF (Currency Adjustment Factor) and THC (Terminal Handling Charges). Some shippers are able to negotiate an acceptable range of CAF and BAF, allowing some limited increase in those surcharges during the course of the contract. But, agricultural exporters and importers should recognize that it will become increasingly difficult to negotiate "all-in" contracts.

While carriers continue to embrace contracting, even for small volumes of cargo and for a short duration, they are becoming increasingly aware of the revenue impacts of a long-term commitment. Since service contracts were first authorized in 1984, a typical practice has been to sign a contract to cover a specific number of containers. Often, this number is less than that which the shipper expected to actually ship. The understanding and typical practice was that after this Minimum Quantity (of volume) Commitment (MQC) was reached, the shipper could continue to tender cargo, and the carrier would carry it at the contract negotiated rate.

Recently, reflecting the increasing demand for space, carriers have begun to refuse to carry cargo after the MQC has been met. Agricultural shippers should be aware that, while a low MQC reduces the likelihood of liquidated damages for failure to ship the required number of containers, it could reduce future shipping options. The MQC may constitute not only the minimum number of containers that the shipper would tender under the contract, but also the maximum number of containers that the carrier will accept. The carriers will continue to accept additional containers while honoring the contract rate if they cannot get more revenue elsewhere for those container spaces. In this period of rising demand and rising rates (tariff and contract), carriers are increasingly refusing to carry above the Maximum Volume Commitment (MVC).

Instead, they are insisting on a renegotiation of the contract rate. In recent months, this has come as a surprise to many agricultural importers and exporters who are forced to renegotiate the terms of the contracts once they have met the MVC, even before the termination date of the contract. The lesson in this is that agricultural exporters and importers who recognize that ocean transportation costs will continue to increase should protect themselves by committing a number of containers which is closer to the level they expect to ship. Agricultural shippers can no longer depend on carriers to handle cargo at the contract rate after the MVC is met.

We are beginning to hear of service contract provisions which proscribe a range of volumes to be carried under the contract; for example, a minimum of 100 40-foot equivalent unit (FEU) to a maximum of 500 FEU. This makes the contract more flexible and alleviates the burden on the shipper to predict the actual volume to be shipped over the course of the contract. While not common, some carriers are agreeing to such range provisions. The good news is that, even if you can't negotiate a range provision and fall short of your MVC, carriers appear to be reluctant to seek liquidated damages. They recognize that this can poison a relationship with the shipper. Thus, the carriers are willing to amend a contract if a shortfall appears eminent. Either the MVC is amended to a lower number of containers, or the term of the contract is amended. Increasingly, the contract amendment reduces the MVC and shortens the duration of the contract, thus freeing the carrier to pursue higher revenue shippers elsewhere.

Confidentiality Trends

The Ocean Shipping Reform Act eliminated the long-standing requirement that the contract rate be published. However, this has not created uncertainty as to the specific rate being offered. While agricultural exporters are not precisely aware of the rates being paid by their competitors, they seem to have an idea of the "going rate." This general knowledge of the marketplace is expected to continue. Virtually all ocean service contracts now contain confidentiality clauses, committing both parties to keep the contract terms confidential.

While shippers and carriers feel that they know the rates being charged by others, they are less certain that they know the service terms that have been negotiated by others. The amount of free time, the treatment of detention and demurrage, the container release practices, the service guarantees, and advance surcharge/rate notification are specific elements that are being negotiated by some shippers. These will increasingly provide a significant cost and service advantage to the agricultural exporter or importer who successfully negotiates such provisions.

Carrier Consolidation Trend

There is general concern and disagreement in the agricultural shipper community about the impact of carrier consolidation. It appears that consolidation has not yet caused a capacity reduction. On the other hand, the carrier's collective activities in the form of talking agreements are being increasingly felt by agricultural shippers. This will be explored further in the next *Agricultural Ocean Transportation Trends*.

Appendix

More about Rate Trends

<u>The Cost of Exporting Agricultural Products to Asia</u>: USDA has been tracking ocean container rates to Asia since 1997 using tariffs filed with the Federal Maritime Commission and, since May 1999, by the carriers electronically. Apple and cotton rates have been selected to act as indicators of refrigerated and dry container rates, respectively, due to the amount of cargoes shipped each year and the number of Asian countries which receive both commodities. Rates are weighted and averaged according to each carrier's market share, by commodity and by country. The resulting rate is meant to reflect the cost the U.S. exporter pays, on average, to ship apples or cotton to a particular country. Apple rates appear in table 1 below.

Table 1: Fresh apple rates for selected Asian ports from the U.S. West Coast
(Weighted averages based on actual market share for shipping lines)

	1997	1998	1999	April 2000	May 2000
Malaysia	$4,381	$3,267	$3,301	$3,016	$2,822
Hong Kong	$3,475	$2,634	$2,676	$2,700	$3,215
Singapore	$4,988	$3,434	$3,064	$3,015	$2,981
Taiwan	$3,743	$2,373	$2,370	$2,369	$2,376
Ho Chi Minh	$6,858	$4,935	$3,694	$3,267	$3,680
Thailand	$4,370	$3,333	$2,978	$3,099	$3,094
Average	*$4,636*	*$3,329*	*$3,014*	*$2,911*	*$3,028*

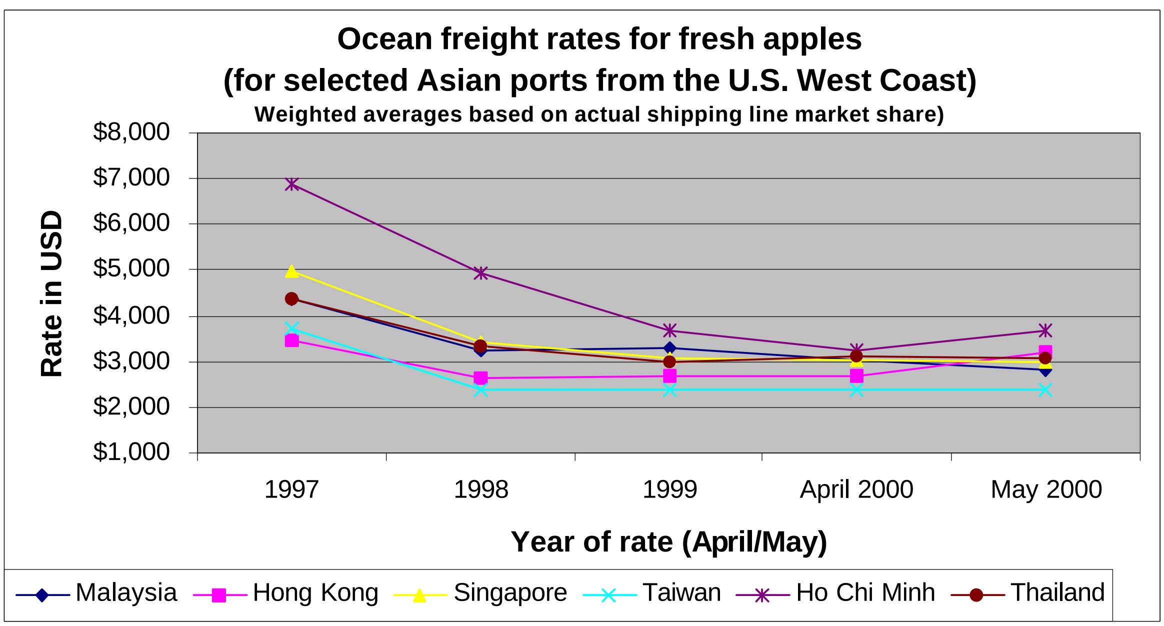

Figure 1: Ocean freight rates for fresh apples

For apples, May 2000 rates range from $2,376 per container from the Pacific Northwest to Taiwan to $3,680 per container from the same port of origin to Vietnam. Generally rates are lower to major container hubs like Singapore, Hong Kong, and Taiwan and higher to countries like Vietnam, Thailand, and Malaysia, which receive a substantial amount of their containers after they are transshipped through the major hub countries. In figure1, it is apparent that rates dropped significantly from 1997 to 1998 and continued to drop slightly each year until April 2000. Rates to all countries are averaged at the bottom of the table. From April 1997 to April 2000, rates dropped from $4,636 to $2,911, a decline of 37 percent. Over the last month, from April to May, rates to all countries have increased from $2,911 to $3,028, about a 4-percent increase. Further increases should be anticipated as the Westbound Transpacific Stabilization Agreement, a “discussion group” of 12 Pacific Ocean shipping lines, recently announced that it intends to increase refrigerated shipping rates for commodities like apples by about $1,200 this year.

For cotton, April 2000 rates range from $1,604 per container from Southern California ports to Hong Kong to $2,305 per container from the same point of origin to Vietnam. In both table 2 and figure 2, it is apparent that rates dropped more significantly in some countries than in others. From 1997 to 1999, average rates for U.S. cotton to Asia dropped from $2,119 to $1,409 per container, or 33 percent. From April 1999 to April 2000, rates rose again by $520 per container, or 38 percent over the last year. This April cotton rate does not include the recent, May 1, 2000, announced increase of $250 per container for cotton shipments from the United States to Asia.

Table 2: Raw cotton rates for selected Asian ports from the U.S. West Coast
(Weighted averages based on actual market share for shipping lines)

	1997	1998	1999	2000
Malaysia	$2,529	$1,660	$1,115	$2,214
Hong Kong	$1,639	$1,571	$1,067	$1,604
Taiwan	$1,583	$1,454	$1,097	$1,772
Vietnam	$2,945	$2,839	$2,125	$2,305
Thailand	$1,900	$1,851	$1,642	$1,733
Average	*$2,119*	*$1,875*	*$1,409*	*$1,926*

For April 2000, cotton rates are on average 33 percent below the cost of shipping apples to Asia. Cotton shipments do not require the special services required for apple shipments, that is, refrigerated containers, special slots for electrical power connections, and temperature maintenance checks during transit. Also, more carriers are able to compete for cotton

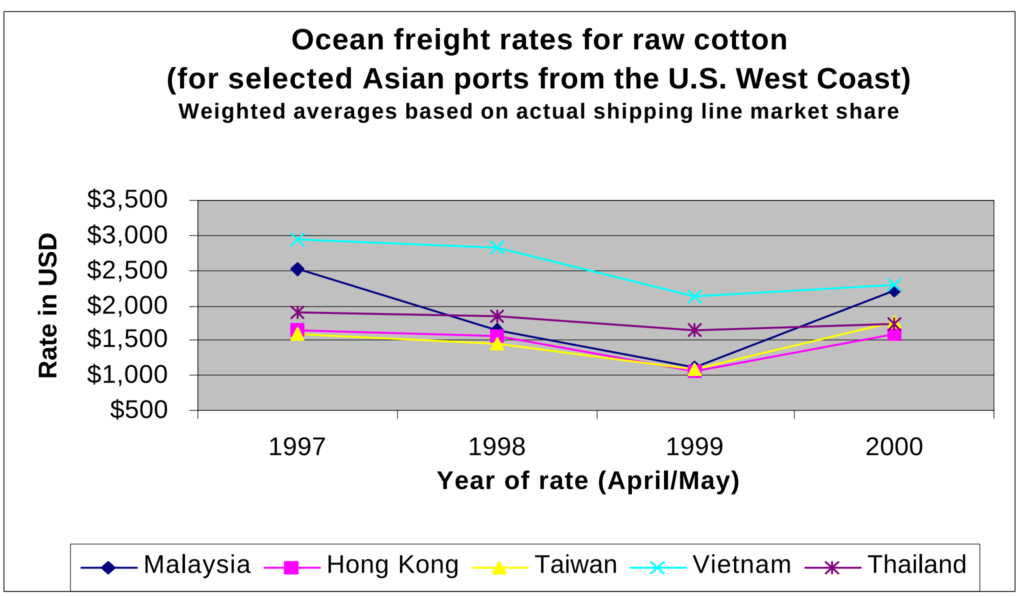

Figure 2: Ocean freight rates for raw cotton

shipments, which increases the likelihood of lower rates.

It must be remembered that the rates reported above are those posted by the ocean carriers as required by U.S. law. These rates do not reflect containers which move under confidential contracts, which are considerable.   Although carriers appear to update and adjust their public tariffs according to changes in the market or by mutual agreement, the average rate levels reported above are probably higher than the average rate levels of the confidential shipping contracts if those were known.