United States General Accounting Office

GAO

Briefing Report to Congressional Requesters

October 1994

CARGO PREFERENCE

Effects of U.S. Export-Import Cargo Preference Laws on Exporters

GAO/GGD-95-2BR

GAO

United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-257255

October 31, 1994

The Honorable Henry B. Gonzalez
Chairman, Committee on Banking,
Finance and Urban Affairs
House of Representatives

The Honorable Gerald D. Kleczka
House of Representatives

As you requested, we examined the frequency with which exemptions, or waivers, from cargo preference requirements[1] for U.S. Export-Import Bank (Eximbank) financed exports were granted between 1990 and 1992. We also attempted to determine whether Eximbank cargo preference requirements were having an adverse effect, in terms of lost sales, particularly on exporters located in the Midwest.

On September 20, 1994, we briefed your staff on the results of our analysis on the effects of cargo preference requirements of the Eximbank's efforts to assist U.S. exporters. This letter summarizes the information presented, and Appendix I contains the materials used in that briefing.

Background

Section 1241-1 of title 46, U.S. Code, requires that exports financed by an instrumentality of the U.S. government, such as the Eximbank, be carried on U.S.-flag vessels, unless a waiver, or exemption, is granted that allows the use of foreign-flag vessels.[2] Eximbank regulations require that these provisions be applied to all loans and long-term loan guarantees.[3] The Maritime Administration (MARAD) administers cargo preference requirements and grants exemptions from the requirements. MARAD grants two types of waivers—general and statutory—for Eximbank preference cargo. General waivers are granted on a country-by-country basis and allow vessels flagged under the recipient foreign nation to transport up to 50 percent of the cargo generated under an individual loan or guarantee agreement if that nation has not discriminated against U.S.-flag vessels in its trade. According to a MARAD official, general waivers are designed to assist in the growth of the merchant marine of developing nations. MARAD's statutory waivers permit goods to be shipped on foreign-flag vessels when

[1]The United States has a variety of cargo preference laws that require significant portions of U.S. government cargo be shipped on U.S.-flag vessels.

[2]Section 1241-1 is based upon a Joint Resolution of Congress, Mar. 26, 1934 (ch. 90, 48 stat. 500).

[3]The Eximbank considers an agreement to be long-term if the repayment period exceeds 7 years or if the amount of the transactions exceeds $10 million irrespective of the length of the payment period.

U.S.-flag vessels are unavailable. As long as a waiver is granted, the cost of shipping cargo on a foreign flag vessel may be eligible for Eximbank financing if the items shipped meet the Eximbank's foreign content rules.[4]

Results in Brief

We found that in 1990 and 1991 the number of general waivers that MARAD granted held steady at 7; however, in 1992 they more than doubled to 15. From 1990 to 1992, the number of statutory waivers, granted when U.S.-flag vessels were unavailable, more than tripled from 28 in 1990 to 102 in 1992.

We also did not find any situations where Eximbank cargo preference requirements were causing the five U.S. exporters that we spoke with to lose sales; however, exporters did raise other concerns that resulted from their complying with the cargo preference requirements. Moreover, we did not find any evidence suggesting that midwestern exporters were uniquely affected by the cargo preference requirements.

Scope and Methodology

We interviewed officials at the Eximbank, MARAD, the St. Lawrence Seaway Development Corporation (SLSDC), and the Federal Maritime Commission to get information and their perspectives on the effects and administration of the cargo preference requirements. We collected and analyzed data on the composition of the U.S.-flag fleet, cargo preference programs, and the number of waivers granted by MARAD. We did not independently verify the accuracy of the data we obtained from any of these agencies.

To determine if the Eximbank's cargo preference requirements had an adverse effect on Eximbank efforts to assist U.S. exporters and whether cargo diversion was extensive, we interviewed officials of five firms that we judged most likely to show lost exports because of cargo preference requirements. Most of these firms are Fortune 500 firms located in the Midwest that have received export financing assistance from the Eximbank and have had to comply with cargo preference requirements. We sought firms whose exports were heavily dependent on ocean vessels for transport to overseas markets and that could potentially lose export sales because of cargo preference requirements. These five firms were recommended to us by a midwestern banker who had assisted these companies in arranging financing for foreign sales through the Eximbank

[4]MARAD considers foreign shipping costs for an item to be a foreign component if the costs are included in the total contract price of the item.

and by Eximbank officials who had also participated in these types of deals.

To determine if midwestern exporters were harmed to a greater extent than other U.S. exporters, we examined (1) the various options to export products that are available to companies in the region, in particular intermodal networks and (2) the use of the Saint Lawrence Seaway for ocean shipping originating in the Great Lakes region.

Agency Comments

On May 20, 1994, we discussed a draft of this report with the Chief of the Civilian Agencies Division for MARAD. On May 23, 1994, we discussed a draft of this report with a vice president of Eximbank who is responsible for contract administration. On June 8, 1994, the Director of the Office of Development and Logistics at SLSDC provided written comments on the sections of our report that pertained to the St. Lawrence Seaway. Overall, these officials said that our presentation of their policies and procedures was accurate; however, in several instances they provided technical clarifications and corrections, which we have included where appropriate.

We did our review from May 1993 through January 1994 in accordance with generally accepted government auditing standards.

As agreed with the Committee, unless you publicly release its contents earlier, we plan no further distribution of this briefing report until 30 days from the date of this letter. At that time, we will send copies of this briefing report to various congressional committees and other interested parties. We will also make copies available to others upon request.

The major contributors to this briefing report are listed in appendix II. Please contact me at (202) 512-4812 if you or your staff have any questions about this briefing report.

Allan I. Mendelowitz

Allan I. Mendelowitz Managing Director
International, Trade, Finance,
and Competitiveness

Contents

Abbreviations

FAS	Free alongside ship
FMC	Federal Maritime Commission
MARAD	U.S. Maritime Administration
P.L.	Public Law
RORO	roll-on, roll-off vessels
SLSDC	St. Lawrence Seaway Development Corporation

Data on Eximbank's Administration of Cargo Preference Requirements and the U.S.-Flag Fleet

GAO Objectives

- Determine the frequency that waivers from Eximbank cargo preference requirements were granted between 1990 and 1992.

- Determine whether cargo preference requirements for Eximbank- financed exports were having an adverse effect, in terms of lost sales, particularly on midwestern exporters.

GAO

Methodology

- Collected empirical data on the U.S.-flag fleet and Eximbank cargo preference requirements from the MARAD and Eximbank.

- Interviewed officials at MARAD and Eximbank regarding the administration of cargo preference requirements

GAO

Methodology (cont.)

- Interviewed officials of several midwestern firms that we judged likely to show any lost exports due to cargo preference requirements for Eximbank-financed exports.

GAO

Background

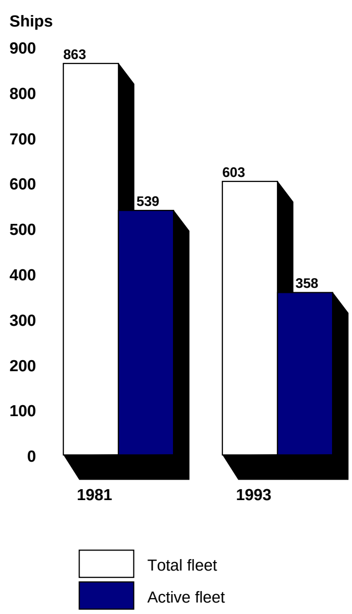
- Section 1241 of title 46, U.S. Code, requires that exports financed by an instrumentality of the U.S. government, including the Eximbank, be transported on U.S.-flag vessels.

- Eximbank regulations require that this provision apply to all loans and long-term guarantees.

GAO

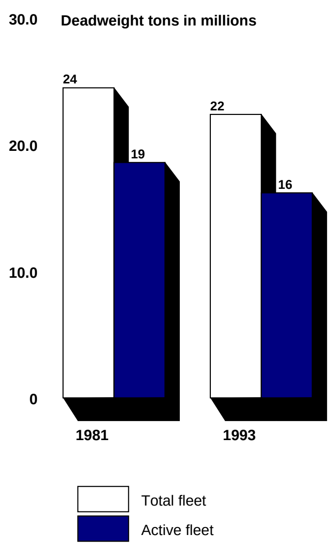
Background: U.S.-Flag Vessels in the Merchant Marine Have Declined

Number of Ships in Oceangoing U.S. Merchant Marine, 1981 and 1993



GAO Background: U.S.-Flag Fleet Cargo Capacity Has Also Declined

Cargo Capacity of the U.S. Oceangoing Merchant Marine, 1981 and 1993



GAO

Background (cont.)

Exporters have a variety of options to accommodate cargo:

- Bulk carriers
- Container ships
- Break-bulk ships
- Roll-on/roll-off (RORO) vessels

Exporters Have a Variety of Choices to Transport Cargo

Several types of oceangoing vessels transport cargo. Bulk carriers generally carry commodities such as corn and wheat; container ships are designed to accommodate 20-foot to 40-foot containers. These containers can be transported by ships, trucks, rail cars, or aircraft. Break-bulk ships usually transport commodities such as bound lumber or goods stacked on wooden pallets. These pallets, or other holders, can be separated or broken apart. Break-bulk ships also transport cargo that is so heavy or large that it cannot be accommodated in standardized containers. There are also other specialized general cargo ships, such as roll-on/roll-off (RORO) vessels. RORO vessels are designed to accommodate cargo such as tractors and trucks by allowing them to be driven on and off the vessel. According to a 1989 study, transatlantic trade has been dominated by the use of container ships and RORO vessels since 1973.[1] However, it is important to note that most Eximbank ocean freight subject to cargo preference laws is shipped to Asia; very little is shipped to Africa and almost none to Europe.

The type of vessel used to ship Eximbank cargo is determined by the type of product being financed. Eximbank assists in the export of a variety of products requiring a mix of different types of cargo ships. However, bulk vessels are not normally used for Eximbank-financed cargo because Eximbank does not ordinarily finance the types of cargo shipped in bulk vessels.

[1]Muller, Intermodal Freight Transportation.

GAO

Background (cont.)

- The existence of ocean shipping conferences may have an effect on ocean shipping rates—carriers belonging to conferences generally charge the same rates.

Some U.S.-Flag Carriers Are Members of Ocean Shipping Conferences

U.S.-flag carriers that are members of shipping "conferences" may charge rates that are the same as foreign-flag carriers. Such 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 cargo revenues."[2]

Conferences that participate in U.S. trade are required to file tariffs with the Federal Maritime Commission (FMC). These tariffs include the shipping rates, terms, and conditions of transport covering all of the commodities that their ocean going vessels carry. For liner vessels, freight rates are generally set by shipping conferences on behalf of all their members. According to a MARAD official, shippers that utilize liner services pay the same rate for the movement of a particular cargo between two points regardless of the flag of the vessel because the rates are set uniformly for members of the conference.

In the bulk shipping market, freight rates are established through open market competition. There, the combination of low cost and services offered is the driving force when choosing a carrier, unless cargo preference requirements are in effect. It is important to point out that most shipping conferences allow members to form service contracts with their customers where the shipping rates may be below tariff rates. This process allows for some element of competition in the conference system. Carriers are not required to file service contracts with FMC, but this information must be made public.

[2] Maritime Policy and Agricultural Interests: Impacts of the Conference System, U.S. Department of Agriculture (Washington, D.C.: Oct. 1993).

GAO

Types of Waivers

MARAD grants two types of waivers from Eximbank cargo preference requirements:

- General waivers are granted on a country-by-country basis and allow cargo to be shipped on vessels under the foreign recipient nation's flag.

- Statutory waivers are granted when U.S.-flag vessels are unavailable.

GAO Types of Waivers (cont.)

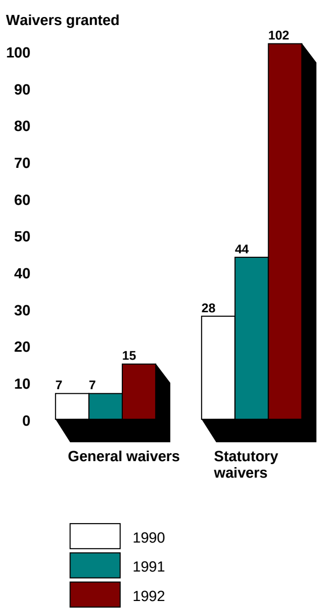
Requirements	General waiver	Statutory waiver
Nondiscriminatory treatment[a]	Yes	No
Country-by-country analysis	Yes	No
Unavailability of U.S.-flag vessels at a reasonable rate, within a reasonable time, incapable of transporting a particular cargo or sailing to a particular destination.	No	Yes

[a] General waivers may not be granted to countries that discriminate in their trade against U.S.-flag carriers.

GAO

Frequency of Waivers

The number of Eximbank general and statutory waivers has increased



GAO Frequency of Waivers (cont.)

- MARAD will not grant a waiver to a company that prefers to use a particular type of vessel that is more beneficial for its cargo if there is a U.S. carrier available to transport the cargo.

GAO

Cargo Preference Effects on Eximbank-Financed Exports

- Eximbank-financed exports account for small amount of the nation's preference cargo.
- Between 1990 and 1992 Eximbank-financed exports were less than 1 percent of U.S. preference cargo.

GAO

Cargo Preference Effects on Eximbank-Financed Exports (cont.)

Most U.S. preference cargo was generated by three government agencies:

- The Department of Defense
- The Department of Agriculture
- The Agency for International Development

Most Preference Cargo Was Generated by Three Government Agencies

Between 1990 and 1992, three U.S. government agencies generated most of the nation's preference cargo: the Department of Defense—through foreign military sales, the Military Sealift Command, and various other programs; the Department of Agriculture—through P.L. 480 title I and title III programs; and the Agency for International Development—through P.L. 480 title II and section 416 food assistance programs. During this period, Eximbank-financed preference cargo constituted less than 1 percent of the nation's total preference cargo.

GAO Cargo Preference Effects on Eximbank-Financed Exports (cont.)

- The existence of intermodal networks eliminates the need for immediate access to oceangoing U.S.-flag vessels.

- Intermodal networks also eliminate the need for exporters to divert cargo from one port to another because of unavailability of U.S.-flag vessels.

- Midwestern exporters rely on intermodal networks because of lack of U.S.-flag service in Great Lakes region.

GAO Cargo Preference Effects on Eximbank-Financed Exports (cont.)

- The last U.S. carrier ended service in the St. Lawrence Seaway in 1989 because:

- The Seaway has much competition from rail and truck companies.

- The Seaway is too shallow for larger container ships.

- The Seaway is closed for 3.5 months because of the winter weather.

GAO Cargo Preference Effects on Eximbank-Financed Exports (cont.)

- Because of the existence of shipping conferences, shipping costs may not be higher for exporters affected by cargo preference requirements.

- Freight rates for conference members are generally set by the conference on behalf of all their members.

- Conference members typically offer liner service with ships operating on scheduled itineraries.

GAO

Cargo Preference Effects on Eximbank Financed Exports (cont.)

- None of the Exporters that we spoke with were able to attribute lost sales to the cargo preference requirements. However, exporters said the requirments limited their ability to obtain speedy shipments.

One exporter said that cargo preference requirements sometimes increased the time it takes to deliver cargo, since exporters are limited to using U.S.-flag carriers. He said that exporters do not have the flexibility and additional choices that would exist if they were allowed to use foreign-flag carriers. He also said that in most cases customers want their goods as quickly as possible and are sometimes inconvenienced because they must wait longer to receive those goods. However, he said he knew of no circumstances where deals were actually lost due to these requirements.

GAO Cargo Preference Effects on Eximbank Financed Exports (cont.)

- In one case, instead of using a RORO vessel an exporter was forced to use another type of vessel to comply with the requirements.

A manufacturer of heavy machinery said that by adhering to cargo preference requirements on some occasions his company was not able to obtain the type of vessel—RORO vessels—that it preferred to transport its products and had to use other types of U.S-flag vessels.[3] When other than RORO type of vessels are used, the company must disassemble its equipment and then reassemble it when the goods reach their destination. The company official said that not only does this situation create more work, but disassembly may lead to theft of parts and can expose them to damage from environmental elements such as salt water.

[3]RORO vessels are designed to accommodate cargo such as tractors and trucks by allowing them to be driven on and off the vessel.

Major Contributors to This Briefing Report

General Government Division, Washington, D.C.

James McDermott, Assistant Director
Jean-Paul Reveyoso, Evaluator-in-Charge
Rona Mendelsohn, Communications Analyst

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000
or by using fax number (301) 258-4066, or TDD (301) 413-0006.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (301) 258-4097 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

United States
General Accounting Office
Washington, D.C. 20548-0001

Bulk Mail
Postage & Fees Paid
GAO
Permit No. G100

Official Business
Penalty for Private Use $300

Address Correction Requested