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The U.S. Merchant Marine & The Food Aid Partnership

An overview of the role of the U.S. merchant marine in food aid

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Jean, thank you for that kind introduction. It is indeed a great honor and pleasure to be here with all of you today.

The IFAC conference provides a tremendous opportunity to focus public attention on the pressing needs of the world's hungry and to continue a vibrant dialogue on how food aid can be made more effective. AID and USDA should be congratulated for the fabulous job they did in putting this conference together with such a superb program. I am humbled at the opportunity to play a small part in such an important humanitarian endeavor. So I thank you for inviting me to speak with you today.

And I am also privileged to share this opportunity to address you today with my colleague and friend, John Reinhart, who so capably heads the US division of Maersk Line, Ltd. as its President and CEO. We go back quite a long time now and have worked together for many years to support US flag shipping and the food aid program.

Liberty Maritime is proud of its role in delivering food aid around the world. Since its founding in 1988, Liberty has focused on providing the most efficient, economical ocean carriage of U.S. food-aid in large bulk shipments.

Our company has done that -- first and foremost -- through significant financial investments. Liberty has invested over $200 million in vessels supporting the food aid programs. This includes three new 52,000 DWT U.S.-flag handymax bulk carriers constructed in 2001 and 2004 at a cost of about $100 million. Because these vessels are newer, faster, have state of the art equipment and were built especially to carry food aid, they are operationally more efficient and better able to serve the food aid community reliably and at a lower and more competitive cost than many other vessels, including foreign flag vessels as well.

With these state-of-the-art ships, manned by highly skilled and trained U.S. citizen crews, Liberty has delivered almost 30 million tons of food aid on over 500 voyages to more than 40 different countries over the last twenty years. During the period from 1988 to 2008, we carried on average 250,000 tons per year on each of our ships. Our commitment to these programs, in partnership with many of you here, has helped make them the most successful humanitarian relief programs in history.

In my view, one of the most wonderful things about these programs is that they represent a triumph, not of government and bureaucracy, but of working Americans. It is the farmers, millers, truckers, merchant mariners, railway workers, longshoremen, and relief workers who make it all possible. And they do so through hard work and by providing their political support for the continuous funding of the programs. As former Administrator Andrew Natsios observed:

> *"Together they form an unbroken chain of humanity stretching from this country's fertile fields to hungry families a half a world away."*

It's that human connection that makes our food aid program different and uniquely successful. I've heard farmers say that they feel they've made a difference, knowing that their bounty goes to people in need overseas as gifts marked "from the American people." In the same vein, I know from talking to our mariners what a positive effect it has when they sail into foreign ports, where people are hungry, with holds full of grain and the American flag proudly waving off the stern.

These observations have helped me to understand why food aid has been so successful over the last half century: It's simple. It's heartfelt. It gives many Americans a direct stake in the program. And it hews to the great American tradition of neighbors helping neighbors in a tangible way. It is a noble program!

I thought this might be a good opportunity to talk about the role of the U.S.-flag merchant marine in the delivery of food aid. I'm going to focus in particular on how U.S.-flag vessels differ from foreign-flag vessels, why cargo preference is so vital, what is significant about the way cargo preference works, and how we can make ocean transportation more efficient.

The world of ocean shipping cannot be understood without some discussion about government regulation. Vessel owners are generally free to document their vessels wherever they want excepting a few countries which have citizenship and other nationality requirements like the United States. Much of the regulatory schemes applicable to vessels arise from the country of documentation or the flag state. Requirements like whether the crew must be of a certain nationality or whether the vessel owner pays taxes are decided by and large by the flag state.

Foreign-flag vessels documented in countries like Panama, Liberia and Belize impose only modest, if any, health and safety regulations, virtually no labor laws, and often lax environmental requirements upon the vessels they register. Foreign-flag vessel owners often pay their seafarers a third world wage and neither the vessel owners nor the seafarers pay taxes. Thus, the low freight rates that some foreign flag vessels have offered in the past come with a significant hidden and societal price tag.

In contrast, U.S.-flag ship owners pay their U.S. citizen crews wages, as well as private health and pension benefits that are among the highest in the world. U.S.-flag vessel owners also face a regulatory framework of health, safety, and environmental laws second to none that includes developed country labor laws and the Internal Revenue Code to name just a few. And that's not all. U.S. vessel operators face a number of additional burdens which are often unnoticed. For example, if we repair our ships overseas in most foreign countries, the Customs Service levies an additional ad valorem duty equal to 50 percent of the cost of those repairs – a penalty if you will that no foreign flag ship owner must account for.

The end result is that foreign-flag vessels, which make up the vast majority of the world's available tonnage, have significant cost advantages over U.S. flag vessels. These advantages create an uneven playing field in the foreign commercial trades. This uneven playing field has been the focus of a great deal of Congressional attention over the many years especially in the context of foreign wars and conflicts.

Since the beginning of our Republic, Congress has determined -- and indeed history has proven on many occasions -- that sea power and sealift capacity are absolutely necessary for our national defense. In every major foreign conflict the United States has fought from World War I to the present

war in Iraq, the vast majority of equipment and supplies has gotten to where they are needed in ships. Historically, 97 percent of all armed forces material has been delivered by ocean-going vessels.

The United States has also learned from sad experience that the only vessels that are entirely reliable and readily available when called upon are U.S.-flag ships. When U.S. foreign policy is internationally unpopular, as it was in the 1973 Arab-Israeli War or in Vietnam, or when the world commercial market is already at or near full capacity, as it was in World War I or at times during the first Iraq war (Operation Desert Shield and Storm) or even today, foreign-flag vessels are often either not available, not interested due to world politics and alliances, or only available at astronomical rates. Foreign flag rates during the most recent Middle East conflicts were often double the cost of U.S.-flag vessels manned by U.S. citizen officers and crews. Our American seafarers are the only true measure sure to fill the need regardless of international popularity or cost.

The problem of unreliability and unavailability by the way, is not unique to the movement of national defense cargoes. As the world's shipping resources have been stretched by the booming Asian economies in recent years, there have been many instances of foreign-flag vessels showing no interest in carrying U.S. food-aid cargoes. Indeed GAO found in its report of last year, for example, that 14 percent of food-aid commodity requests in

2005 received no foreign-flag bid. This recent trend has resulted from the fact that foreign flag vessels can receive much higher rates today in the commercial market than they can in the food aid market.

Congress has also determined that the most cost effective means of providing that sealift capacity so essential in times of war and national emergency is to support a healthy privately owned U.S. merchant marine which trades internationally and/or domestically. A government-owned fleet on permanent standby was the Soviet command economy approach to the sealift problem – and it never worked. Even standby vessels have to be crewed, and it is very expensive and hugely inefficient to have those trained crews available on a moment's notice without a private, operating fleet, to draw upon.

For these reasons, Congress has enacted programs to help counteract the regulatory burdens and mandates it has imposed on the U.S. merchant marine. Among the most crucial of these programs is cargo preference.

Cargo preference laws require, as you know, that when the U.S. Government pays for and ships a cargo, a portion of these government-impelled cargoes must move in privately owned U.S.-flag vessels. This has been the law since the early 1950s when the U.S. Government started

shipping more and more international cargoes and was first codified in the same year that PL 480 was enacted. For Department of Defense shipments, 100 percent of such cargoes must be carried under the U.S. flag. For food-aid cargoes, the requirement has been 75 percent since 1985 so long as U.S.-flag vessels are available at fair and reasonable rates.

In the past, criticism has sometimes been voiced about the higher cost of U.S.-flag transportation. However, as the foreign commercial shipping market continues to skyrocket for several years now with no end in sight - resulting in the fact that foreign flag shipping costs are now almost double US flag costs - there is really no need to discuss this particular topic – but there are two points that should not go unaddressed.

First, the U.S. Government's international food-aid budget is almost completely insulated from the extra cost, if any, of U.S.-flag transportation. Congress enacted a mechanism in 1985 that requires the U.S. Maritime Administration to reimburse food-aid shipper agencies for certain ocean freight costs. Most importantly, MARAD is required to provide reimbursement whenever the cost of ocean freight as well as any extra U.S.-flag cost exceeds 20 percent of the value of food-aid commodities and products. Given the rising cost of commodities, this mechanism now reimburses the food-aid program for a substantial portion of the cost of all ocean freight, whether it be carried by foreign-flag or U.S.-flag vessels.

For the fiscal years 2000 to 2007, for instance, this has resulted in an average annual payment by MARAD of about $162 million per year to the food aid program.

Second, what U.S.-flag bulk food aid carriers can charge is limited by law to what is referred to in the statute as “fair and reasonable rates.” MARAD establishes these rates based upon very detailed and certified cost information provided by ship owners. MARAD then calculates average costs and affords carriers a modest or “reasonable” rate of return based upon an OMB-approved formula. And I would also point out that this is a ceiling on rates, not a floor! As a result, this mechanism protects food-aid shippers from market highs at least so long as U.S.-flag bulk vessels are among the vessels offering to carry the food aid.

Finally, for the past several years, US flag transportation rates for food aid cargoes have been up ***to 50 per cent lower*** than foreign flag commercial market rates due to the soaring foreign bulk freight market. This again results from the implementation of the fair and reasonable rate system which caps US flag rates while the foreigners are not subject to such rate regulation.

As you can see, food aid is already well protected from the cost of ocean transportation. Ironically, our food-aid programs are not protected, of course, from high market prices for commodities, and this would apply wherever the commodities are purchased. Crop failures in Australia, rising meat consumption in Asia, and new domestic ethanol demands have all driven commodities prices up over 40 percent since the Bush Administration's initial supplemental food-aid funding request last fall. As the commodities' market is now a world market, there is no easy mechanism for avoiding world commodity prices.

Although the food-aid programs are well insulated from the cost of ocean transportation, there <u>is</u> <u>always</u> room for improvement. We were greatly heartened to see in last year's GAO report a reiteration of many of the reform proposals the U.S. merchant marine industry has been advocating for many years.

For example, many freight requirements utilized in the transportation of international food aid vary from those used to transport commercial grain cargoes around the world. Although these requirements may be justifiable in certain instances, they are almost always costly. Making an ocean bulk carrier responsible, for instance, for inland transportation by rail or truck – which would be very uncommon – actually unheard of in the commercial world – has a high cost associated with it. A myriad of logistical problems –

as GAO pointed out – can arise and ship owners have no choice but to take those risks into account in the rates they offer. We continue to urge the parties involved to take a hard look at booking note and charter party terms that deviate from commercial practice to be sure that they serve a purpose that outweighs the extra cost they often create.

Another example of non-commercial terms relates to payment terms. Freight payments in the food-aid business have historically been much slower than payments under comparable commercial arrangements. Under typical bulk commercial arrangements, the full freight is due within three days after the vessel has loaded. In the food-aid program, at best, full payment is usually made within 30 days – sometimes even 60 days - of vessel discharge after the voyage is over. Significant hold-backs – up to 10 percent - taking months to resolve are not uncommon. Anything that can be done to adopt more commercial-like payment terms would, I believe, help lower freight rates and should be considered.

Although there is room for improvement, I would be remiss in not pointing out that we believe that AID, USDA and the PVOs do an excellent job. We appreciate how hard it is to coordinate purchases and deliveries often in very trying circumstances and we applaud your efforts as local and inland distribution is almost always a very challenging task.

Finally, and as I stated in the beginning of my presentation: **We are your partners in the food-aid effort.** All of us at Liberty and in the maritime industry are extraordinarily proud of the food aid programs and our role in helping to make them possible. We look forward to remaining a strong link in the unbroken chain of human compassion in the years to come, proudly flying the U.S. flag, and crossing the oceans with American crews to deliver the gifts of neighbors helping neighbors, wherever they may be.

With that last thought, I would like to conclude my remarks and thank you once again for the opportunity to speak with you today.