DEVALUATION SURCHARGES IN OCEAN FREIGHT RATES

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In recent years the device of the devaluation surcharge or currency adjustment factor (i.e., a surcharge on the basic freight rate) has been widely used by Conferences or shipping lines to compensate themselves for devaluations of their tariff currencies. The general principle, that if the tariff currency is devalued a surcharge on the original freight rate is required to restore the status quo ante, seems obvious enough. Conferences themselves have stressed that this is the object of devaluation surcharges and currency adjustment factors, and that they are not intended as a way of making additional profit. However, the widespread uniformity in devaluation surcharges imposed by Conferences and shipping lines all over the world, when the considerations which should determine the appropriate quantum of surcharge are anything but uniform, suggests that shipowners are using a very rough rule of thumb and have not made detailed calculations of the level required to restore the status quo ante. At the same time, the relative lack of investigation of these surcharges by governments and shippers' organisations suggests that the justification for the quantum of devaluation surcharge imposed in any particular instance may not be receiving sufficiently close attention. This note attempts to draw attention in simple terms to the issues involved.

Shipping lines fix freight charges to cover the total costs incurred in carrying the cargo, with a reasonable profit on the operation. The costs are incurred in various countries and in various currencies. Since it would be impracticable to collect freight charges in the various currencies in which the amounts will be expended, freight rates are expressed in one currency which can be converted into the required amounts of other currencies. The currency in which freight rates are expressed is known as the tariff currency. Until the devaluation of sterling in 1967, many Conferences used sterling as the tariff currency. In 1968 most Conferences switched their tariff currency to the U.S. dollar, which they still use today.

If the rates of exchange between the tariff currency and the currencies in which expenditure is incurred (called for convenience "expenditure currencies") change, it is clear that the amounts of those currencies resulting from conversion of the tariff currency will also change. There have been three recent devaluations of tariff currencies—the devaluation of sterling in 1967, the devaluation of the U.S. dollar in 1971, and the devaluation of the U.S. dollar in 1973. All were followed by upward

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adjustments in freight rates—known as devaluation surcharges after the sterling devaluation, as currency adjustment factors after the first U.S. dollar devaluation, and as tariff currency devaluation surcharges after the second U.S. dollar devaluation.

HOW SURCHARGES WERE FIXED

We now show how one should assess the justification for such surcharges, taking the latest devaluation of the U.S. dollar as an example. When the U.S. dollar was devalued by 10 per cent in February 1973, most Conferences introduced tariff currency devaluation surcharges, usually either 10 per cent or 11·11 per cent. The latter figure was obviously arrived at on the basis that if before the devaluation a freight rate was $100, devaluation by 10 per cent reduced its value to $90, and to return to the original value of $100 it was necessary to add $10, i.e. 11·11 per cent of the $90.

The underlying assumption is that the devaluation of the U.S. dollar, the tariff currency, by 10 per cent has reduced its value by 10 per cent in relation to *every* expenditure currency. A devaluation surcharge of 10 per cent or 11·11 per cent is clearly appropriate only if this assumption is correct. The U.S. dollar was devalued by 10 per cent in relation to gold. (The price of one ounce of gold was increased from $38 to $42·22.) The relationship between the U.S. dollar and *other currencies* depends on the reactions of the countries using those other currencies. Each country can do any of the following:

(a) Maintain the existing rate of exchange with the dollar—e.g., Thailand.
(b) Set the rate of exchange so that the dollar has depreciated by 10 per cent in relation to its currency—e.g., Australia, New Zealand.
(c) Set the rate so that the dollar has depreciated by less than 10 per cent in relation to its currency—e.g., Sweden.
(d) Set the rate so that the dollar has depreciated by more than 10 per cent in relation to its currency.
(e) Set the rate so that the dollar has appreciated in relation to its currency.
(f) Float its currency and experience any of the relationships set out in (a) to (e) above.

There is therefore no automatic relationship between the devaluation of the U.S. dollar in terms of gold and the relationship between the U.S. dollar and expenditure currencies—the factor which should determine the quantum of devaluation surcharges.

THE CORRECT METHOD

How then is the appropriateness of the quantum of a particular devaluation surcharge to be assessed? The only valid method is to start from the principle already stated, that revenue is required to meet costs incurred in various currencies, but is collected in one currency—the tariff currency. Hence we must compare the amounts of expenditure currencies into which the freight rate converts before devaluation with the amounts of expenditure currencies into which it converts after devaluation. What has to be taken into account is not the devaulation of the dollar in terms of

gold but the changes in exchange rates between the dollar and the expenditure currencies. The analysis could yield varying results. One possible outcome could be that there was no change in the amounts of expenditure currencies after conversion, so that no adjustment was required to restore the status quo ante. Or there could be a shortfall or an excess: this depends on the exchange relationships and the relative importance in the total freight rate of the expenditure currencies concerned in each particular case. It is thus clear that each case will be unique. The devaluation surcharge introduced in one country cannot be used as a yardstick to judge the appropriateness of the surcharge in another country, because the probability of identical features prevailing in any two countries is infinitesimal.

To make use of this analysis we need to know both the changes in exchange rates between the dollar and the expenditure currencies, which are readily ascertainable, and also the amount spent in each expenditure currency before devaluation. Precise information on these amounts may not be available or even calculable, especially where a Conference has many different lines of different nationalities and methods of operation. But several governments and shippers' organisations which have undertaken a certain amount of route analysis will have some approximate information to work on, which would make it possible to reach firm conclusions.

GENERAL FREIGHT RATE INCREASES

It has been argued that the removal of the devaluation surcharge would lead to a general freight rate increase, because although the devaluation surcharge is not justified by monetary factors it is valuable to Conferences as a means of counteracting rising costs of operation. But there is a difference between general freight rate increases and surcharges. General rate increases are introduced to meet increases in costs of operation which are of a basic, permanent nature. A surcharge is introduced to meet a sudden increase in one particular set of costs which is not expected to be permanent. For example, a port conditions surcharge would be introduced when there is heavy congestion in a port, and removed when the congestion disappears; the Suez surcharge was introduced to meet the extra cost of voyaging round the Cape, and will presumably be removed if the Suez Canal re-opens; bunker fuel surcharges have been introduced to meet rises in fuel costs, and have been reduced as fuel costs declined; so have currency adjustment factors.

Under the combined effect of tariff rules, custom and negotiation, general freight increases are made only after advance notice, generally of at least three months. During this period Conferences can be called upon to justify the freight increase, and discussions can be held between shippers' organisations and governments on the one hand and Conferences on the other. But Conference tariffs provide for surcharges to be introduced without notice because of their sudden and emergency nature, though there has been some concession in respect of port surcharges, where some Conferences adopt arrangements which amount to one month's notice. Most devaluation surcharges have been introduced either with immediate effect or with a few days' notice.

Therefore, to allow a devaluation surcharge to continue or to be introduced on the ground that there would otherwise be a general freight increase amounts to allowing

a Conference to make a general freight increase *without notice and without the need to justify it* to governments or shippers' organisations. This is clearly to the disadvantage of shippers.

When a general freight increase is announced shippers' organisations and governments request Conferences to justify the increase. In the course of the justification it is possible to obtain information on the various cost components, such as stevedoring costs, fuel costs, wage costs, port dues, etc., which have contributed to the need for an increase. However fragmentary and incomplete such information may be, it assists in building up knowledge on freight rates. But when a devaluation surcharge of say 10 per cent is not warranted by monetary factors, but is allowed to continue to meet general cost increases, no such apportionment of the 10 per cent among various cost items is possible. The process of building up knowledge on freight rates is therefore hindered.

There is the further danger that if a devaluation surcharge is allowed to be introduced or to continue without being justified on exchange rate grounds, a Conference will in due course introduce a general freight increase anyway to cover increased costs of operation, and will then take up the (correct) position that the devaluation surcharge has nothing to do with increased costs of operation.

It is the writer's impression that devaluation surcharges are either being taken for granted or, where they are being examined at all, are being assessed superficially either in relation to the devaluation of the dollar in terms of gold or in relation to the quantum of surcharge introduced in other countries, neither of which, as demonstrated above, is a valid method of assessment. It is hoped that this note will stimulate a more critical approach.