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NEW OPPORTUNITIES FOR COAL

INTRODUCTION

After fueling the early stages of the Industrial Revolution in the United States, the U.S. coal industry entered a prolonged period of decline. Following the Second World War, competition from cheaper oil and natural gas, widespread labor strife and growing concern over the environment combined to curtail sharply demand for America's most abundant resource. With the surge in world oil prices that began in the 1970s, though, "King Coal" gained a new lease on life. As a result, coal now promises to become one of America's most important export commodities.

Estimates compiled for the House Merchant Marine and Fisheries Committee show that the United States could increase its share of the coal export market from its present 18 percent to as much as 38 percent by the end of the century. If realized, the increased foreign currency earnings from the new coal trade could add $14 billion annually to the U.S. payments balance. Thousands of new jobs would be created. Most important, perhaps, the ability of the oil producing nations to disrupt the world's economy would be substantially diminished.

To accomplish this, America must take steps to ensure that its ports, railroads and loading facilities can accommodate vastly increased volumes of coal.

The need to do so is urgent. Although the United States' 1.7 trillion tons of recoverable coal reserves accounts for 30 percent of the world total, other nations too are in a position to be major coal exporters. Australia, South Africa, and Canada already provide stiff competition for U.S. firms. Colombia, China, Poland and even the U.S.S.R. are moving aggressively to market their coal. Given such alternate sources, there is no guarantee that the world will turn to the U.S. for coal in the coming decades.

Yet, U.S. coal companies enjoy one critical advantage: they are seen as a secure source of supply. It is this view which allows these firms to charge the $4 to $6 premium that U.S. coal currently commands. Should the price of American coal rise too far above its competitors, however, it may find its market fading. This makes the question of port modernization critical to the coal trade's future. Failure to act now could result in American coal costing as much as 40 percent more than its competitors. If this occurs, it is virtually certain that customers will turn to other sources.

Ports play a critical role because transportation charges account for the lion's share of what a customer pays for a delivered ton of coal. Anything affecting these charges thus has an enormous impact on marketability. In the case of coal, which reaches foreign markets by ship, the advent of the "Super-Collier" has sparked a revolution in coal transportation.

Super-Colliers are huge vessels averaging 150,000 dead weight tons (dwt) and requiring harbor depths of up to 55 feet. While these mammoth carriers comprise only about 7 percent of the world coal fleet, they are expected to account for 25 percent by 1985 and 44 percent by 1990. The trouble is, no coal port in the United States can load a vessel of this size; only one, Hampton Roads, Virginia, can even accommodate ships of up to 100,000 dwt.

By contrast, eighteen ports worldwide have the harbor depths of 55 feet or greater to handle the Super-Colliers; there are twenty-four ports with harbor depths of between 45 and 55 feet that can handle ships of up to 100,000 dwt. There are plans, moreover, to deepen several more ports outside the U.S. to allow them to serve these huge ships. Since many of these deep ports are located in countries that compete with the United States for the coal trade, it is clear that they will gain a major cost advantage over the U.S. unless American harbor facilities are upgraded.

The responsibility for dredging U.S. ports and harbors has traditionally rested with the federal government. Federal funds have financed port construction and the Army Corps of Engineers has done the work. The lead-time for such projects, however, can be up to twenty-one years -- far too long to allow the U.S. to take advantage of the current opportunity to participate in the rapid expansion of the international coal market. Yet the private sector stands ready to step into the breach and take on the responsibility for making the port improvements. More important, the task can be accomplished without creating new, massive federal subsidies or imposing complicated regulatory regimens.

The renovation of U.S. ports and harbors can be accomplished without spending a single federal dollar. Private sources of funds, within the U.S. and abroad, have already indicated a willingness to invest in such projects. In fact, Japan is currently involved in providing funds to renovate the port of Long

Beach, California. Private capital in Germany and France has also expressed interest in financing port construction.

No new regulations are needed for such projects. Indeed, rather than new regulations, relief from old ones is needed, for regulatory impediments, such as those that create the twenty-one-year lead-times, constitute the single biggest obstacle to improving U.S. ports. What is needed most from government, therefore, is to get out of the way.

The only thing the federal government should do to encourage foreign capital to help pay for U.S. port renovations is to send a clear signal abroad that America is serious about expanding U.S. coal trade. Washington must also signal that it supports private initiatives to improve the coal transportation system. This signal is needed because, under the Carter Administration, support for coal exports was ambivalent -- at best. Although there had been much rhetoric, little was done to make such trade possible, and a great deal was done to make it more difficult. What is needed now is to indicate clearly the renewed national commitment to coal exports and the federal sanction of private efforts toward that end. With these actions, foreign doubts would be dispelled, and America's role in the world coal market assured.

A program to revitalize American coal transport would include:

* Coal Export Zones -- Areas designed to take advantage of recent initiatives to streamline the regulatory process for port dredging.

* Coal Export Investment Companies -- Joint ventures, licensed by ports, to act as magnets for foreign capital and project managers for port renovations.

* National Coal Exchange -- A private clearinghouse for coal exports that would establish specifications for blends of coal, which would be mixed at the ports, and act as a mechanism to create a commodity market for coal similar to those that exist for other commodities. Its long-term goal would be to help standardize coal grades and establish a stable mechanism for ensuring long-term sources of supply.

Each element of this program is aimed at a particular part of the larger problem of encouraging U.S. coal exports. More important, each uses the private sector or local authorities rather than the federal government. Control of the port renovations would rest primarily with the ports themselves. Financing would come exclusively from private sources. The commodities exchange would also be an exclusively private enterprise. In this way, the three elements of this program would advance the Reagan Administration's goals of fostering a New Federalism and privatizing the energy market.

A PRESSING NEED FOR THE PROGRAM

In its review of the procedures employed in authorizing the maintenance and dredging of U.S ports, Congress found that "The principal causes of regulatory delay...are the absence of any rational management approach to the conduct of system wide maintenance and the lack of interagency coordination..." (House Report 97-454). In short, there were too many fingers in the pie. To correct this, procedural reforms have been approved, including an "expedited authorization process or 'fast track' for certain deep-draft navigation improvements." The aim of these initiatives is to reduce the lead-time for port dredging from the present twenty-one years to around two and one-half years. The thrust of these reforms, the House Merchant Marine Committee said, is to "restore the traditional primacy of the state [governments]..." in port construction.

Accomplishing the necessary port renovations will take more than procedural reform; it will take a great deal of money. Outlays for a single dredging project can easily run as high as half a billion dollars. It has been estimated that as many as ten deep-draft ports may ultimately be needed to accommodate the expanded U.S. coal trade. Other necessary improvements -- such as the addition of loading facilities, storage yards and special blending areas -- could cost twice again as much. In a time of budgetary constraint, the $15 billion expenditure that upgrading U.S. ports would entail most certainly would encounter strong opposition in the Congress. Only private sector alternatives, therefore, hold real hope of addressing this problem in a timely fashion.

Financing the necessary U.S. rail system improvements presents a similar problem. Although the federally controlled portions of the rail system, such as Amtrak, receive a subsidy, they represent only a small segment of the overall network. As such, the $10 to $12 billion needed to upgrade the non-federal sections of track must come from private sources.

Given the fact that $25 to $27 billion is likely to be needed over the long run to make America competitive in the international coal trade and that public funds are unavailable (but should not be) for this purpose, it is clear that private sector alternatives are needed. Coal Export Zones represent one approach to providing such alternatives.

COAL EXPORT ZONES

Coal Export Zones are designed to provide a mechanism whereby local port authorities can take advantage of the "fast track" procedural reforms approved in congressional committee. They would provide the infrastructure to facilitate the approval process, and would be a local licensing agency for Coal Export Investment Companies and Coal Exchanges. The Coal Export Zones would not, however, have any regulatory authority, so that the procedural reforms to expedite the port renovation approval process would not be undercut by regulations promulgated at the local level.

To establish a Coal Export Zone, the local port authority would select a board of governors of three to five members and apply to the Secretary of Commerce for designation as a Coal Export Zone. Approval would be automatic and would qualify the port to use the "fast track" procedures for dredging and maintenance. It would also allow the port to license Coal Exchanges and Coal Export Investment Companies. The port would also be allowed to use existing authority to issue Industrial Development Bonds in connection with such projects.

The designation would not be limited to specific ports or to any specific number of ports. This will allow as many port renovations as the market will support, eliminating the competition for the federal dollars that currently finance such projects.

COAL EXPORT INVESTMENT COMPANIES

Coal Export Investment Companies would be joint ventures that could be licensed by any U.S. port authority or combination of port authorities. Partners in the joint venture could include: 1) mining companies, 2) railroads, 3) barge lines, and 4) coal buyers, including foreign governments or corporations. Their purpose would be to invest in projects that would improve the physical infrastructure and marketing system for coal exports. These projects could include: 1) port and waterway improvements, 2) portside facilities and 3) coal preparation facilities such as blending stations and washing terminals. The Coal Export Investment Companies also would be allowed to invest in upgrading the "up-river" elements of the coal export transportation system such as railroad track and loading facilities.

The Coal Export Investment Company is intended to act as the "magnet" for foreign capital. It would give foreign investors an opportunity to participate not only in the financing of port renovations, but in the actual projects themselves. This would serve to reinforce foreign commitment to using U.S. coal in two ways. First, overseas interests would have an opportunity to own a portion of the terminal's loading facilities and other privately held operations at the port itself and would expect a profit from their use. Second, since their investment would be repaid through assessment of user fees, it would be in their interest to ensure that coal moves through the port.

Coal Export Investment Companies also would receive a congressional "charter." Although the charter would carry no special privileges, it would provide a governmental sanction for such ventures. Since most overseas purchasers of U.S. coal operate through governmental entities, they would place considerable credence in the legitimizing effect such sanctions would have. Therefore, this sanction is an important, albeit largely symbolic, stamp of approval.

COAL EXCHANGES

A basic flaw in the present system of marketing U.S. coal is that some ten thousand different grades are being sold. This situation is an anachronism dating from the time when coal boilers were far less sophisticated than they are today and when much of the coal produced was used relatively close to where it was mined. As a result, many large industrial and utility boilers actually are designed to burn coal from a specific mine. As the market for coal expands, though, it is clear that the lack of standardization introduces a substantial and unnecessary inefficiency into the utilization of this fuel.

Coal Exchanges would permit a gradual process of standardization of coal. Instead of specifying a particular mine, a coal customer would instead specify a set of desired characteristics. Various types of coal could be analyzed to determine what combination would produce the desired effect, and they could be blended at the port before loading. Once a blend was established, it could then be listed on the exchange with a designation tying it to a particular blending station -- say New Orleans #5. If another customer at a different port wanted to purchase coal with similar characteristics, it would be necessary only to blend the coals available in that region to achieve the mix of New Orleans #5. Over the long run, as boilers became more standardized and were designed for blends rather than for the coal from a specific mine, the number of grades would be sharply reduced, bringing down the cost.

An exchange also would allow customers to seek the lowest price. If a mine were underutilized and willing to discount its product, it could be used in a blend. As such, a potential buyer could make minor adjustments in the mix to take advantage of the discounted coal and offer the ultimate user a lower price.

The standardization of coal and use of blends also could help to utilize more fully America's coal resources. For example, coal from Wyoming's Powder River Basin has a very low sulfur content but has a low heat content as well. As a result, it is unsuitable in some applications. Conversely, coal from Ohio has a high heat content, but also has a high sulfur content. Blending these two could result in a coal with relatively high heat content and lower sulfur content. Other specialized blends could help use coal more efficiently. The key, however, is that a desired set of characteristics (say high heat content and low sulfur content) could be achieved through blending without linking a buyer to a particular mine.

CONCLUSION

Expanding U.S. coal exports is an opportunity for a private sector initiative. The port and harbor renovations and improvements to the rail transport system could be accomplished more efficiently by private firms than by the federal government. Since substantial foreign capital probably would be willing to underwrite these projects, moreover, the expansion could take place without adding to the federal deficit or to the tax burden on the public.

From the viewpoint of foreign investors, the projects should be very attractive. By being full participants in the port and the harbor renovations, they could profit from the actual construction and from the financing. More important, they would be taking a crucial step toward assuring themselves a secure energy supply at a time when they are tempted to increase their dependence on the Soviet Union for energy.

For the Reagan Administration, the three-point program of Coal Export Zones, Coal Export Investment Companies and a Coal Exchange presents an opportunity to take a concrete step to implement its goals of privatizing the energy market and implementing the New Federalism. It could do this without adding new pressures on the budget.

According to the Draft Report of the Inter-Agency Coal Working Group, the U.S. could be exporting from 475 to 565 million tons of coal by the year 2000. To achieve this ambitious goal, the nation must have the port facilities and rail system these volumes will require. Should the U.S. fail to move now to put them in place, it may lose a golden opportunity.

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