BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Secretaries Of Agriculture And Transportation

Transportation Of Public Law 480 Commodities--Efforts Needed To Eliminate Unnecessary Costs

The Cargo Preference Act of 1954 requires that at least 50 percent of Public Law 480 Title I agricultural commodities be transported in privately owned U.S. flag vessels if available at fair and reasonable rates. Agriculture pays the ocean freight differential, which is based on the difference between the higher transportation rates of U.S. flag vessels and the average rate of foreign flag vessels that would have been selected without cargo preference.

GAO reviewed calendar year 1982 purchase authorizations and identified significant problems causing higher freight differential payments. Agriculture lacks sufficient involvement with and control over the bidding and negotiation process. Foreign countries or their agents have no incentive to negotiate lower U.S. flag rates, and Agriculture has inadequate procedures and controls to ensure the integrity of the process. Also, Agriculture needs to better manage its responsibilities for complying with cargo preference requirements, approving vessel selections arranged by foreign countries, and calculating differential payments.

The Maritime Administration assists Agriculture by calculating a fair and reasonable rate (based on cost and profit) which is the maximum rate that a U.S. flag vessel can receive for a voyage. Maritime's procedures do not adequately ensure that each vessel's rate is fair and reasonable.

This report contains recommendations for improving each of these areas.

GAO/NSIAD-85-74
JUNE 18, 1985

032318

Request for copies of GAO reports should be sent to:

U.S. General Accounting Office
Document Handling and Information
Services Facility
P.O. Box 6015
Gaithersburg, Md. 20877

Telephone (202) 275-6241

The first five copies of individual reports are free of charge. Additional copies of bound audit reports are $3.25 each. Additional copies of unbound report (i.e., letter reports) and most other publications are $1.00 each. There will be a 25% discount on all orders for 100 or more copies mailed to a single address. Sales orders must be prepaid on a cash, check, or money order basis. Check should be made out to the "Superintendent of Documents".

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

B-199688

The Honorable Elizabeth H. Dole
The Secretary of Transportation

The Honorable John R. Block
The Secretary of Agriculture

This report discusses opportunities to improve the cost effectiveness of ocean transportation of commodities shipped under the Public Law 480 Title I program.

This report contains recommendations addressed to you. As you know, 31 U.S.C. §720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and the Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Director, Office of Management and Budget, to the cognizant congressional appropriation and authorization committees, and to other interested parties.

Frank C. Conahan

Frank C. Conahan
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE SECRETARIES OF
AGRICULTURE AND TRANSPORTATION

TRANSPORTATION OF PUBLIC LAW 480 COMMODITIES--EFFORTS NEEDED TO ELIMINATE UNNECESSARY COSTS

D I G E S T

Title I of Public Law 480 authorizes the President to enter into agreements with friendly countries for the sale of U.S. agriculture commodities under favorable financing terms. Because the U.S. government finances the sale, the Cargo Preference Act of 1954 requires that at least 50 percent of the commodities be transported in privately owned U.S. flag vessels if available at fair and reasonable rates.

The Department of Agriculture pays the ocean freight differential (OFD) for transportation of Title I commodities. OFD is based on the difference between the higher transportation rates of U.S. flag vessels and the average rate of foreign flag vessels that would have been selected without cargo preference.

Agriculture is also responsible for complying with cargo preference requirements, approving vessel selections arranged by foreign countries, and calculating OFDs. The Maritime Administration computes a fair and reasonable rate for Agriculture (termed a guideline rate) that becomes the maximum transportation rate a U.S. flag vessel can receive for a voyage.

GAO's objective was to assess whether Agriculture and Maritime adequately managed the expenditure of U.S. funds in the ocean transportation of Public Law 480 Title I agricultural commodities. GAO reviewed 21 purchase authorizations for calendar year 1982, each exceeding $1 million in ocean freight differential. The purchase authorizations represented $72.3 million, or about 67 percent of calendar year 1982 OFD payments. GAO also reviewed guideline rate calculations prepared by Maritime for vessels transporting commodities under these purchase authorizations.

Significant problems were identified in three areas: (1) Agriculture's control over the bidding and negotiation process for ocean transportation contracts, (2) Agriculture's OFD calculation and approval of vessels, and (3) Maritime's guideline rate calculations. Because of these problems, Agriculture may be paying substantially higher ocean freight differentials than necessary.

CONTROLS OVER BIDDING AND NEGOTIATIONS

Agriculture needs more involvement with and control over the bidding and negotiation of ocean transportation contracts. Under the process, foreign countries or their agents receive transportation offers and negotiate the rates for U.S. and foreign flag vessels. They have no incentive to negotiate lower rates for U.S. flag vessels because Agriculture pays the additional costs of using U.S. flag vessels. Also, Agriculture's procedures and controls to ensure the integrity of the process are inadequate because country agents

--use a closed tender approach whereby bids are not generally opened in public, which could allow the submission of late bids or bids based on knowledge of already submitted bids.

--may negotiate with any preferred vessel owner or broker (company that represents vessels attempting to obtain cargo), which does not ensure that the lowest possible transportation rates are negotiated for U.S. flag vessels.

--may serve as vessel brokers when not serving as country agents, which could lead to favoritism in the negotiation of rates and the selection of vessels.

As a result, the process does not ensure that Agriculture's transportation costs are the lowest possible. (See ch. 2.)

RECOMMENDATION

GAO recommends that Agriculture require transportation offers to be opened publicly to eliminate or minimize the problems in the bidding and negotiation process.

AGENCY COMMENTS AND GAO EVALUATION

Agriculture agreed with much of GAO's analysis but believes there are significant drawbacks and questions relating to open tenders. Therefore, it has taken a different interim approach to correct the identified problems until it can fully evaluate GAO's recommendation for publicly opened tenders.

Agriculture said that it would strengthen its monitoring of the current system by contacting vessel brokers or owners if it has reason to believe that negotiations were selective. It will not approve vessel contracts until it is reasonably satisfied that the negotiating process has been fair and has resulted in the most advantageous U.S. flag rates. GAO believes that increased monitoring alone will not identify selective negotiations or correct the other problems in the system. GAO believes that a system of publicly opened bids would better assure a fair process and result in the most advantageous U.S. flag vessel rates.

VESSEL APPROVALS AND OFD CALCULATIONS

Agriculture is responsible for complying with cargo preference requirements, approving vessel selections arranged by foreign countries, and calculating OFDs. GAO identified examples in five areas which illustrate the need to emphasize a policy of minimizing Agriculture expenditures for transporting Public Law 480 Title I commodities.

For example, Agriculture computes the OFD after the foreign country or its agent selects the U.S. and foreign flag vessels. Each purchase authorization has a standard provision for calculating OFD. Agriculture either did not consistently follow the provision or applied it in a manner that reduced the costs to foreign countries at the expense of higher Agriculture payments.

GAO also found examples in which Agriculture could have managed cargo allocation more cost effectively. Cargo allocation refers to the extent that U.S. flag vessels and foreign flag vessels are used in transporting commodities. Agriculture accepted country agent vessel selections that reduced the foreign country's transportation costs or served some other interest of the country. This resulted in higher OFD payments.

RECOMMENDATIONS

GAO recommends that the Secretary of Agriculture establish a clear policy to minimize Agriculture's transportation expenditures consistent with cargo preference requirements and direct the Administrator, Foreign Agricultural Service, to revise and implement program regulations on the basis of this policy.

AGENCY COMMENTS AND OUR EVALUATION

Agriculture commented that it had already implemented the substance of GAO's recommendations. Based on subsequent discussions with Agriculture officials and a limited review of files, GAO believes that Agriculture is taking steps to improve the cost effectiveness of the program. A full evaluation of Agriculture's progress would require another detailed GAO review. Such a review would be appropriate after Agriculture completes planned changes in program management and regulations.

GUIDELINE RATE CALCULATIONS

Maritime has little assurance that guideline rates, as intended, represent cost plus a reasonable profit. Differences in vessel speed, fuel consumption in port and at sea, load and discharge rates, and per diem amounts can materially affect the calculation. However, Maritime does not verify data used in developing the calculations, and the accuracy of important data is questionable. (See ch. 4.)

Maritime calculates a guideline rate assuming a vessel will return to the United States without cargo. However, evidence suggests that vessels may be carrying cargo on the return voyage (backhauling) and that other vessels have been scrapped overseas. Neither Agriculture nor Maritime routinely monitors shipments to identify these situations. Because guideline rates are established based on a round trip voyage, the potential exists for a vessel to earn excessive profits.

Guideline rates are not computed on liners even though they transport a substantial amount of Public Law 480 commodities--about 34 percent of U.S. flag tonnage under Title I for the 3 calendar years ended in 1982. Liners carry goods or commodities to several destinations on one voyage and generally travel on regularly scheduled trade routes. Maritime has not prepared guideline rates on liners because of the difficulty in separating revenues and costs for the portion of the voyage covering only the Public Law 480 commodity. Yet, without such guideline rates, the U.S. government does not know whether the transportation rates for liners represent cost plus a reasonable profit.

As a result of these problems with guideline rate calculations, Agriculture may be paying substantially higher OFD than necessary.

RECOMMENDATIONS

GAO recommends that the Secretary of Transportation direct the Maritime Administrator to devise and institute a method for assessing whether transportation rates for liners represent cost plus a reasonable profit. Also, vessel owners should be required to have their independent accountants semiannually certify that vessel costs and operating data are accurate.

GAO recommends further that the Secretary of Agriculture issue regulations requiring certification that non-liner U.S. flag vessels did not carry cargo on a return voyage and were not scrapped. The regulations also should provide that the guideline rate will be recalculated (and the transportation rate adjusted) if a vessel obtains cargo on the return voyage or is scrapped or sold overseas.

AGENCY COMMENTS AND GAO EVALUATION

The Department of Transportation commented that the Maritime Administration is devising a methodology for determining the reasonableness of rates on preference cargoes moving on U.S. flag liner vessels.

Transportation said that costs used for determining fair and reasonable rates should be verifiable, but it favors certification of data by vessel operators. GAO, however, believes that the certification by an independent accountant provides better assurance of accurate data.

Neither Transportation nor Agriculture accepted GAO's recommendation concerning backhauling and scrapping. Transportation commented that, although the GAO recommendation is conceptually sound, it would be practical to implement this recommendation only for known one way voyages or for backhauls involving preference cargo. Agriculture commented that the costs of monitoring and enforcing such a provision might exceed the revenues obtained and it may be unwise to create an implicit disincentive for U.S. flag vessels to seek backhaul cargo. Despite these comments, GAO reaffirms its recommendations. As the report points out, substantial U.S. funds are involved and neither Agriculture nor Maritime routinely monitor shipments to identify when U.S. flag vessels backhaul or scrap. GAO believes that the best approach to identify these situations is through certification by vessel owners and that a method for recalculating the guideline rate and adjusting the transportation rate can be devised which will not destroy the incentive to backhaul.

Contents

APPENDIX

ABBREVIATIONS

GAO	General Accounting Office
OFD	ocean freight differential

CHAPTER 1

INTRODUCTION

Title I of the Agricultural Trade Development and Assistance Act of 1954, Public Law 83-480, as amended (7 U.S.C. 1701 et seq.), authorizes the President to sell U.S. agricultural commodities to friendly countries under favorable financial terms. The Secretary of Agriculture is responsible for administering the program, and the Commodity Credit Corporation within the Department of Agriculture finances the sale. Agriculture issues purchase authorizations under which the foreign country purchases commodities directly from U.S. suppliers. The foreign country or its agent is responsible for arranging the ocean transportation, but Agriculture must approve vessel selections to ensure compliance with the Cargo Preference Act of 1954.

CARGO PREFERENCE REQUIRES U.S. FLAG VESSELS' PARTICIPATION IN TRANSPORTING COMMODITIES

Because U.S. government financing is involved in Public Law 480, cargo preference law applies. The Cargo Preference Act of 1954 (46 U.S.C. 1241(b)), which amended section 901 of the Merchant Marine Act, 1936, requires that at least 50 percent of the gross tonnage of cargo generated by certain U.S. government programs must be transported in privately owned U.S. flag vessels. The requirement applies only to the extent that U.S. flag vessels are available at fair and reasonable transportation rates. Through passage of cargo preference legislation, the Congress has attempted to develop and maintain the U.S. merchant marine.

The Maritime Administration within the Department of Transportation reviews cargo preference and reports annually to the Congress. The Division of National Cargo within Maritime's Office of Market Development is responsible for the general administration of cargo preference for various federal agencies. Also, the Division assists Agriculture by calculating rates (termed guideline rates) intended to guarantee that U.S. flag vessels do not receive transportation rates exceeding fair and reasonable rates.

COUNTRY AGENTS AND AGRICULTURE COORDINATE IN ACQUIRING OCEAN TRANSPORTATION

The foreign country is responsible for purchasing the commodity and acquiring ocean transportation. It generally employs a company as a transportation agent (country agent)[1] to issue tenders (requests for offers) for transportation, receive and evaluate offers, negotiate rates and contract terms, help select the vessels, and coordinate the selection with Agriculture. Among other things, commodity offers submitted by commodity suppliers and transportation offers submitted by vessel owners (or vessel brokers) specify various tonnage and coastal ranges. In evaluating offers, the country agent compares commodity prices with transportation offers to determine which combination of commodity and transportation offers will result in the lowest cost to the foreign country. The United States finances the sale of the commodities; the country repays the United States over extended periods at low interest rates.

Agriculture has a limited but very important role in the system for acquiring ocean transportation. Its Vessel Approval Branch in the Ocean Transportation Division of the Foreign Agricultural Service approves public transportation tenders issued by country agents. It also provides general guidance in the allocation of cargo between U.S. and foreign flag vessels. Agriculture obtains copies of the transportation offers from the country agents and approves the selection of both U.S. and foreign flag vessels and contract terms after country agents have negotiated and tentatively selected vessels. As part of the approval process, Agriculture relies on the Maritime Administration to ensure that U.S. flag vessels offer fair and reasonable rates.

Agriculture computes and pays the ocean freight differential (OFD), which is based on the difference between the higher transportation rates of U.S. flag vessels[2] and the average rate of foreign flag vessels that would have been selected without cargo preference. The foreign country pays the average rate of foreign flag vessels (weighted by tonnage) for shipments on U.S. flag vessels and the entire transportation costs for shipments on foreign flag vessels. Transportation charges are paid upon provision of the services and foreign country payments for transportation are not financed by the U.S. government. Agriculture pays the OFD from appropriations for the Title I program.

---

[1]The term country agent refers to a country or its agent, whichever arranges the ocean transportation.

[2]U.S. flag vessels' transportation rates are consistently higher than those of foreign flag vessels because of higher capital and operating costs.

As shown below, Agriculture paid about $240 million in OFD for transporting about 4.9 million metric tons of Title I commodities between 1980 and 1982.[3]

	U.S. flag tonnage[a]		Ocean freight differential[a]	
Year	Metric tons (millions)	Percent of total[b]	Payments (millions)	Rates (per ton)
1980	1.33	38.7	$ 43.9	$32.95
1981	1.54	42.4	88.0	57.14
1982	2.06	50.1	107.5	52.18

[a]U.S. flag tonnage and OFD are approximates based on approved tonnage and rates.
[b]U.S. flag vessels did not obtain 50 percent of the total commodities in 1980 and 1981 because they were not available at fair and reasonable rates.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objective was to assess whether the Department of Agriculture and the Maritime Administration adequately managed the expenditure of U.S. funds for the ocean transportation of Public Law 480 Title I agricultural commodities. To do so, we examined three major areas: (1) Agriculture's control over the system for bidding and negotiating ocean transportation contracts, (2) Agriculture's OFD calculation and approval of vessels, and (3) Maritime's guideline rate calculations. To assess these areas, we reviewed cargo preference and Public Law 480 legislation and regulations, examined Agriculture and Maritime files and other records, discussed issues with Agriculture and Maritime representatives, and analyzed statistical data on Title I shipments for 1980, 1981, and 1982. We also interviewed foreign embassy officials, country agents, vessel owners, vessel brokers, and commodity suppliers to discuss the program and specific purchase authorizations. Vessel brokers represent vessels in attempts to obtain the cargoes.

We reviewed 21 purchase authorizations for 1982, each exceeding $1 million in OFD. These authorizations represented $72.3 million, or about 67 percent of all 1982 OFD payments. We selected 1982 purchase authorizations because it was the latest year for which complete information was available when we began our review.

---

[3]Calendar years are used throughout this report.

We reviewed 13 guideline rate calculations prepared by Maritime for vessels transporting commodities under the 21 purchase authorizations. Our purpose was to evaluate the calculation of the rates for various types of vessels and voyages as well as to determine Maritime's consistency in preparing the calculations.

We often found it difficult to assess whether U.S. financial interests were adequately protected in individual purchase authorizations that we reviewed. Often, Agriculture files and records lacked documentation for decisions and approvals, so we relied on Agriculture representatives to explain why certain decisions were made. Also, Agriculture file memoranda about OFD calculations often contained insufficient detail.

Our review was performed in accordance with generally accepted government audit standards.

CHAPTER 2

AGRICULTURE NEEDS MORE INVOLVEMENT WITH AND CONTROL OVER BIDDING AND NEGOTIATIONS

In the bidding and negotiation for transportation contracts, a country agent receives offers and negotiates the rates for U.S. and foreign flag vessels but has no incentive to negotiate lower rates for U.S. flag vessels. Moreover, the Department of Agriculture's procedures and controls to assure the integrity of the process are inadequate because country agents (1) use a closed tender approach whereby bids are not generally opened in public, (2) may negotiate with any preferred vessel owner or broker, and (3) may serve as vessel brokers when not serving as country agents. Accordingly, the process does not ensure that Agriculture's transportation costs are the lowest possible.

COUNTRY AGENTS HAVE THE MAJOR ROLE IN BIDDING AND NEGOTIATIONS

The country agent requests transportation offers from the industry through public notices called tenders, which include essential information a vessel owner needs to calculate a transportation offer. Among other things, the tender specifies the type and amount of the commodity, dates and locations for loading and discharging, and vessel limits for depth and length at the discharge port. The country agent must receive the bids by the time and date specified in the tender. Country agents normally do not open offers in public because, according to them, this enables them to negotiate the best rates and performing vessels for the foreign country.

A tender normally allows the foreign country to accept, reject, or negotiate any or all offers. At bid opening and evaluation, the country agent has the offers specifying varying rates and terms, and, over several days, will usually negotiate rates and other terms with vessel owners. The agent, with or without representatives of the foreign country, will coordinate commodity offers with transportation offers to select the most cost effective alternative for the country. In contrast to transportation offers, commodity offers are read in public (with an Agriculture representative in attendance) and selected without negotiations. After vessels are tentatively selected, the country agent submits the vessel data to Agriculture for approval.

During 1982, country agents were employed by 26 of the 29 foreign countries participating in the Public Law 480 Title I program. Country agents may represent more than one country;

for example, one agent represented 13 countries. Three countries not employing agents held tenders in which transportation offers were opened in public; one of the three subsequently negotiated offers.

Agriculture's role in the bidding and negotiation process is minimal. It does not receive the original transportation offers; instead, the country agent submits copies of U.S. and foreign flag offers to Agriculture after bid closing. Agriculture is not usually involved in the negotiations nor does it receive any record of the negotiations. Agriculture approves the country agent's selections of U.S. and foreign flag vessels.

COUNTRY AGENTS LACK INCENTIVE TO NEGOTIATE U.S. FLAG RATES

Country agents have no incentive to negotiate lower U.S. flag rates; their responsibility is to the foreign countries, not to the United States. A reduction in U.S. flag rates does not benefit the foreign country because, for U.S. flag vessel shipments, the foreign country pays only an amount equivalent to the weighted average of foreign flag rates, and this amount does not change with a lowering of U.S. flag rates.

Country agents have great incentive to negotiate the lowest possible foreign flag rates so that the foreign country pays less in transportation costs. Also, negotiating lower foreign flag rates decreases the country's payments for shipments on U.S. flag vessels because rates for those foreign flag vessels transporting commodities are an integral part of the average computation. Lowering this average results in higher U.S. OFD payments.

Disincentives exist for country agents to attempt to significantly lower U.S. flag rates through negotiations. Country agents receive commissions for transportation services from vessel owners. Under Agriculture's regulations, commissions exceeding 2-1/2 percent of the U.S. flag vessel's contract, which is generally the transportation rate multiplied by transported tonnage, cannot be financed. Lowering rates through negotiations would decrease the contract amount, thus lowering the agent's commission. For example, a bulk grain shipment ranging between 30,000 to 40,000 tons[1] at a transportation rate of $90 to $100 a ton could yield a vessel contract of $2.7 million to $4 million. On a $4-million contract, the agent's commission would be $100,000. Assuming a 10-percent reduction in rates, the agent's commission would be $10,000 less.

---

[1]The term ton in this report is a metric ton, which equals 2,204.6 pounds.

More importantly, a country agent has a disincentive to negotiate and select a U.S. flag vessel offered through a broker because the commission is often shared equally between the agent and the broker. So, on the $100,000 commission on a $4-million cargo contract, the agent would receive only $50,000 rather than the entire $100,000. Therefore, the agent may selectively negotiate for vessels without brokers rather than negotiate with all vessel owners.

We compared the original offers by U.S. flag vessel owners with the final transportation rates for 1980, 1981, and 1982. U.S. flag vessels usually lowered their offered rates. However, several country agents and vessel owners explained that U.S. flag vessels know that the country agent is expected to negotiate to a lower rate and vessel owners will marginally lower the original offers routinely. Even though rates may be lowered, Agriculture does not know how aggressively rates are negotiated and whether negotiations were adequate to obtain the lowest possible rates for U.S. flag vessels. We believe the United States should not rely on a third party--the country agent--for negotiations when substantial Agriculture funds are involved in each shipment.

INTEGRITY OF BIDDING AND NEGOTIATION PROCESS NEEDS MORE PROTECTION

Our specific concerns with the bidding and negotiation process are that country agents (1) use a closed tender approach whereby bids are not generally opened in public, (2) may negotiate with any preferred vessel owner or broker, and (3) may represent vessels as the vessel brokers when not serving as country agents. The integrity of the process is important financially to the United States because U.S. and foreign flag transportation rates as well as foreign flag offers are significant factors in calculating OFD payments. The process does not ensure that Agriculture's transportation costs are based on the lowest possible rates.

Closed tenders do not provide adequate controls

Under the present closed tender process, Agriculture does not receive the original transportation offers; instead the country agent generally receives the bid in private and later sends copies to Agriculture. Accordingly, Agriculture lacks controls ensuring the integrity of the bidding process. The closed tender process could allow the submission of late bids or bids based on knowledge of already submitted bids.

The offers are very important financially to the United States because of the method by which Agriculture computes the

OFD. As part of the OFD calculation, Agriculture computes an average transportation rate representing the foreign flag vessels that could transport the total quantity of commodity purchases. The average rate is a weighted average of the foreign flag vessels actually selected to carry the commodity and other foreign flag vessels that would have carried the commodity if cargo preference did not exist. The specific rates and tonnages of offers for certain unselected vessels are used to formulate the portion of the weighted average covering vessels that would have carried the commodity without cargo preference. The weighted average determines the foreign country's payments for U.S. flag vessels. An incentive exists for the country agent to have lower foreign flag bids; the lower the weighted average calculation, the less the foreign country pays and the more the United States pays for respective shares of the U.S. flag vessel payment.

An example illustrating the importance of foreign flag bids concerns a U.S. flag vessel contracted to carry a 10,500-ton bulk soybean oil shipment. The country agent received three responsive foreign flag offers for $75.00, $74.90 and $54.60 a ton, respectively. According to Agriculture's procedures, the OFD was based on the weighted average of foreign flag vessels selected to carry the commodity (none in this case) and foreign flag vessels that would have transported the cargo in the absence of cargo preference (the vessel with the $54.60 offer). The spread of $20.30 between the lowest foreign flag offer and the next lowest offer is important because it represented $213,150 of the OFD paid by the United States and lowered the country's payment by an equal amount.

In addition to problems concerning the receipt of offers, Agriculture does not receive copies of transportation contracts, company invoices, or payment data for foreign flag vessels even though OFD payments are based in part on the foreign flag rates. Thus, it is unable to verify the actual foreign flag rates paid, yet these rates are significant in calculating OFD.

Country agents may negotiate preferred vessels

Neither Agriculture nor the transportation industry has rules for the negotiation process. A country agent is free to selectively negotiate with owners or brokers of whichever vessels are desired, which may include all, any, or none of the bidders. For example, the country agent could choose not to negotiate at all, thereby protecting an original low bidder, or could negotiate only with a favored bidder to obtain a rate marginally below the lowest original bid. The process does not ensure that the lowest possible transportation rates are negotiated for U.S. flag vessels.

We met with representatives of many of the major U.S. flag vessel owners involved in the program. These representatives expressed concern over the process allowing country agents to negotiate ocean transportation rates. The process allows a vessel owner to be the original low bidder on a specific tender yet not be selected or have a fair opportunity to compete in the negotiation process. Offers from a vessel owner closely associated with the country agent may be negotiated and selected. These representatives dislike the negotiation process and prefer an open tender system in which each vessel owner submits a non-negotiable bid and bids are opened in public.

One case we reviewed clearly shows that country agents can negotiate with whomever they wish. A U.S. flag bulk carrier offered to transport the commodity at $74.39 a ton. The country agent received the bid from the vessel's broker before the deadline for receipt of offers. Five days later, but before the selection of vessels, the broker notified the agent that the vessel owner was willing to accept $63.97 a ton and invited a counter offer because the owner was willing to compete vigorously for the cargo. The agent responded that it was not in conformity with tender customs to consider such an amendment after the closing time and date of the tender; yet the owner was an original bidder and his later offer indicated a willingness to negotiate. Subsequently, the agent requested Agriculture's approval for another vessel at $68.40 a ton, which represented a reduction of about 50 cents from its original offer. The U.S. flag bulk carrier's later offer was $4.43 lower than the rate of the approved vessel for a total difference between offers of at least $370,000 based on the tonnage involved. Negotiations with the bulk carrier would have reduced the OFD.

In another case, a U.S. liner company originally bid $162.18 a ton while a second U.S. company offered $126.66. Both companies were bidding to carry multiple shipments at these rates. The second company was the only competitor for the liner company because of the second company's low rate. The country agent negotiated with the liner company to accept a rate of $124.75--a drop in its rate of $37.43 a ton and $1.91 a ton less than the second company's original bid. The agent did not negotiate with the owners of the second company, stating that the liner offer was more favorable because factors other than price, including better service and vessel reliability, were considered. An Agriculture representative said that this agent had a history of selecting the liner company. The agent at that time also served as a broker representing the liner company in attempts to obtain shipments under Title II (donation program) of Public Law 480. Since no negotiations were held with the original low bidder, no assurance exists that Agriculture paid the lowest possible cost.

As discussed previously, a country agent has a disincentive to negotiate a U.S. flag vessel offered through a broker rather than one offered without a broker because the commission is shared with a vessel broker. The country agent may select and negotiate a vessel without a broker rather than negotiate with all vessel owners to attain the lowest possible U.S. flag vessel rate. Agriculture representatives cited two country agents that were very reluctant to select vessels that had submitted offers using brokers.

Country agents also serve as vessel brokers

Although Agriculture regulations prohibit a country agent from serving as broker and agent on the same purchase authorization, country agents do serve as brokers on purchase authorizations for which they do not serve as country agents. A company can serve as country agent and negotiate a vessel on one tender and also represent the same vessel as a broker on another tender within a short time, as the following examples indicate.

1. A company served as a country agent when a U.S. flag vessel owner was selected to carry a June shipment. In October, the vessel owner employed the same company to act as its broker in its attempts to obtain the vessel's next cargo for another country, but the attempt was unsuccessful. A representative of the vessel owner explained that, at the time of the selection for the initial June cargo, the vessel owner informally agreed to employ the company in subsequent business, believing the agreement improved the chances of the vessel being selected for the initial cargo.

2. A company represented a U.S. flag vessel owner as a broker on numerous shipments to four countries during 1980 and 1981. During 1982, the company (a) served as country agent when this owner was selected for two March shipments, (b) represented the owner as broker in April, May, July, and August shipments for which it was not the country agent, and (c) served as country agent when this owner was selected for two September shipments. The owner did not employ a broker during the March and September shipments. During 1982, the country agent negotiated vessels from this owner on four shipments totaling 79,000 tons of cargo and represented the owner as a broker for vessels selected on seven shipments totaling 94,000 tons.

3. A company served as a country agent when vessels from a foreign flag vessel owner were selected on 12 shipments during a 3-month period ending in May 1982. The same company acted as a broker for the same vessel owner on 10 shipments to various countries between May and August 1982.

Although it is difficult or impossible to assess the overall impact on the program or individual situations, these relationships, in our opinion, could lead to favoritism in the negotiation of rates and the selection of vessels under the present closed tender process.

PUBLICLY OPENED BIDS WOULD IMPROVE THE TENDERING PROCESS

With a system of open tenders, bids would be opened and read in public and the lowest bidder meeting the tender terms would generally be selected without negotiations. Vessel owners, knowing there is no negotiation of rates, would submit their lowest offers on the initial bids. Owners would prefer open tenders for a fairer opportunity to compete for contracts. In our opinion, the open tenders may also promote lower costs through greater participation in the bidding process.

The government of Sri Lanka holds open tenders and does not employ a country agent. A Sri Lanka embassy representative told us that a country delegation visits Washington to conduct the bidding process, and the country believes that the delegation, with its experience and expertise, can better handle the process than a country agent. The representative believes that open tenders lead to more competition and lower transportation costs for the commodities. Sri Lanka has always had many transportation offers, and intense competition exists solely because it holds open tenders. Although the country pays travel costs for the delegation, it pays less overall because the vessel owner pays no commission to the country agent and such savings are factored into a vessel's rate. Sri Lanka, as a matter of principle, will not negotiate offers, because when it starts to negotiate it is subject to questions and criticisms and would have to negotiate all offers to be fair with everyone.

In our opinion, publicly opened bids would eliminate or minimize the problems we identified in the bidding and negotiation process. Because no rate negotiation would take place, the United States would not need to rely on country agents to negotiate offers in its behalf. Because offers would be opened and read in public at the same time, the process would be more reliable and provide more assurance that Agriculture pays the lowest possible costs.

Accurate guideline rate calculations are important in a system with open public tenders, just as it is for closed tenders. The Maritime Administration assists Agriculture by preparing a guideline rate that is intended to ensure that Agriculture pays a transportation rate that is fair and reasonable for the shipment. With open tenders, low bidders would generally be selected with no rate negotiations. In situations in which there is little or no competition among U.S. flag vessels, an accurate guideline rate is needed to ensure that rates are not excessive.

CONCLUSIONS

Agriculture needs more involvement with and control over the bidding and negotiation of transportation contracts. A country agent has no incentive to negotiate lower rates for U.S. flag vessels. Agriculture also lacks adequate procedures and controls to ensure the integrity of the bidding and negotiation process. The process does not ensure that Agriculture pays the lowest possible costs. Publicly opened bids would improve the tendering process. Negotiations with vessel owners would not occur except under unusual circumstances such as where the low bidder exceeds its guideline rate.

RECOMMENDATION

We recommend that the Secretary of Agriculture require publicly opened transportation offers. The offered transportation rates must be firm and non-negotiable and awards should be consistent with open, competitive, and responsive bid procedures. Agriculture should provide an observer for transportation bid openings, as it does for commodity bids.

AGENCY COMMENTS AND OUR EVALUATION

Agriculture agreed with much of our analysis, although it has taken a different interim approach to correct the identified problems until it can fully evaluate the major change in the vessel tendering procedure that we recommend.

Agriculture commented that, as we pointed out, the closed tender approach leads to negotiation of vessel offers by the countries or their agents, neither of whom "would be expected to have as their highest priority minimizing the freight cost of U.S. flag vessels." Agriculture did not specifically comment on the integrity of the bidding process, but recognized that it cannot rule out the possibility of attempts being made to manipulate foreign flag offers to increase OFD payments.

Agriculture said that there are significant drawbacks and questions relating to open tenders. A summary of its comments and our evaluation follow.

Agriculture commented that, consistent with Public Law 480's policy of developing and expanding export markets for U.S. agricultural commodities, the countries are responsible for purchasing commodities and contracting for ocean freight. The countries are required to follow commercial practices insofar as possible to orient them toward the U.S. market for commercial business; most countries have chosen closed freight tenders which, according to Agriculture, reflects widespread commercial practice. In a discussion subsequent to our receipt of Agriculture's comments, Agriculture representatives were unable to provide any specifics concerning the degree that closed freight tenders are used in commercial practice. We believe significant differences exist between commercial and Public Law 480 transactions. For example, U.S. flag vessels would not be used in commercial transactions, except under rare circumstances, and OFD would not be involved. More importantly, we believe there is not inherent contradiction between a system of publicly opened bids and the overall policy framework. In this respect, we note that Congress in 1977 added section 115 to Title I requiring publicly opened bids for agricultural commodities largely because of irregularities in the bidding and award of commodity contracts.

Agriculture also commented that for many Title I shipments there is extremely limited competition among U.S. flag vessels and there is strong concern that open tenders without negotiations would often result in higher rates and, in some cases, tend toward the maximum guideline rates. Additionally, Agriculture stated that Maritime's view is that published tariff rates for liners represent fair and reasonable rates so open tenders could result in bookings at the published rates when experience indicates rates can be negotiated downward. Our position, as stated in this chapter, is that accurate guideline rates are needed in situations with little or no competition among U.S. flag vessels. In contrast to Agriculture's comments on published liner rates, the Maritime Administration in its comments recognized the desirability of an appropriate procedure for considering the reasonableness of liner rates and is proceeding to develop a methodology. In our opinion, with accurate guideline rates prepared on liner and non-liner U.S. flag vessels, the lack of competition would not present an obstacle to open tenders.

Agriculture commented that open tenders would not entirely eliminate the need to negotiate freight rates because the process frequently results in mismatches and residuals. We concur that residuals and mismatches will occur but do not believe they represent a major deterrent to open tenders. This would be an unusual circumstance where negotiations may be necessary.

Agriculture said that it has chosen, as an interim measure, to strengthen its monitoring of the current system by contacting specific vessel brokers or owners any time it has reason to believe that selective negotiations may have taken place. According to Agriculture, the sole purpose is to inquire whether competitive parties have been countered on their original offers and whether there are any unusual circumstances that should be brought to Agriculture's attention. Agriculture said that it will not approve vessel contracts until it is reasonably satisfied that the negotiating process has been fair and has resulted in the most advantageous U.S. flag vessel rates. Based on the seriousness and significance of the issues addressed in this chapter, we believe that more positive action is needed. Agriculture's description of the increased monitoring would indicate a continued low level of involvement in the process. Agriculture would become involved only on an exception basis--when it has reason to believe selective negotiations may have taken place. The system, in our opinion, is inadequate to identify when selective negotiations have occurred. We believe that a system of publicly opened bids would better assure a fair process and result in the most advantageous U.S. flag vessel rates.

CHAPTER 3

D PAYMENTS COULD BE REDUCED THROUGH IMPROVED PROGRAM MANAGEMENT

Agriculture is responsible for complying with cargo preference requirements, approving vessel selections arranged by foreign countries, and calculating ocean freight differentials. We identified examples which illustrate the need to emphasize a policy of minimizing Agriculture expenditures for transporting Public Law 480 commodities. Such a policy could save Agriculture millions of dollars each year in unnecessary OFD payments while still maintaining cargo preference requirements. The savings could be used to reduce the program's cost or to increase commodity purchases.

PREPARING OFD CALCULATIONS

Agriculture computes the OFD after approving U.S. and foreign flag vessels. Each purchase authorization has a standard method for calculating OFD. Agriculture did not consistently follow the method or else applied it in a manner that reduced the costs of foreign countries at the expense of higher Agriculture payments.

Public Law 480, the Cargo Preference Act of 1954 and regulations for both do not explain how the OFD will be computed. Further, Agriculture has no handbooks, guidelines, or written policy covering the OFD calculation. Each purchase authorization has a standard provision which states that the OFD will be computed on the basis of the difference between (1) the weighted average freight rate(s) of foreign flag vessels offered that, in Agriculture's opinion, could carry the total quantity of the commodity purchases and (2) the lowest U.S. flag rates offered, regardless of U.S. flag vessels selected that, in Agriculture's opinion, could carry the required U.S. flag tonnage. Agriculture computes an OFD for each U.S. flag vessel, representing the difference between the U.S. flag vessel's rate and the weighted average rate of the foreign flag vessels.

Agriculture paid substantially higher OFD than necessary as shown by the following two examples.

Example 1 On a purchase authorization for about 100,000 tons of bulk wheat to be transported to Egypt, the country agent selected (and Agriculture approved) a large U.S. vessel, the Point Vail, to transport about 83,000 tons. To avoid using a foreign flag vessel, Egypt decided to delay the purchase of the remaining tonnage to a later tender.

The Agriculture memorandum explaining the OFD calculation stated that, without cargo preference, Egypt would have selected the foreign flag vessel Argosy Pacific, which offered to transport 60,000 tons at $17 a ton. Egypt would have transported the balance (the difference between the 83,000 tons on the Point Vail and 60,000 tons that would have been transported on the Argosy Pacific) on smaller vessels but, according to the memorandum, the rate of a smaller offered vessel was not factored into the OFD computation. Agriculture representatives explained that their unwritten policy is to compute OFD using similar terms and conditions; they said it would be unfair in this case to compare the rate bid by a small foreign flag vessel which would have been unloaded at a slower discharging facility with the rate of larger vessels like the Point Vail and Argosy Pacific which would have been unloaded at a larger and faster discharging facility. However, a vessel's discharge rate is not a factor for consideration stated in the purchase authorization.

The purchase authorization specifically requires that the OFD computation be based on the weighted average freight rate(s) of foreign flag vessels offered that could carry the total quantity of the commodity purchases. The Argosy Pacific could have carried only about 75 percent of the 83,000 tons transported by the Point Vail. The language in the purchase authorization suggests that Agriculture should have calculated a weighted average using the Argosy Pacific and a second foreign flag offer for about 20,000 tons. Moreover, the Argosy Pacific offer was late, and therefore an offer from a different foreign flag vessel should have been used in the calculation. The country agent received the Argosy Pacific offer about 1-1/2 hours after the bid deadline and submitted the bid to Agriculture with other bids, annotating on the bid that the offer was not valid because it was received very late.

As a result of using the late bid in the OFD calculation and not adjusting the weighted average freight rate, Agriculture paid an additional amount of about $550,000, which benefited Egypt by an equal amount. Based on our recommendation,[1] Agriculture requested in November 1984 that Egypt reimburse the United States for $140,115, representing the funds associated with the erroneous use of the late offer.

Example 2 Egypt selected the U.S. flag vessel Cove Explorer to transport 20,000 tons of wheat from Albany, New York. The vessel's rate of $75 a ton was the lowest U.S. flag vessel rate and was $30 a ton less than the same vessel's rate from the West Coast. No foreign flag offers existed for Albany, and the price of wheat was $7.14 more a ton in Albany than on the West Coast.

---

[1] Overpayment of Transportation Costs for Public Law 480 Commodities (GAO/NSIAD-85-21) Oct. 24, 1984.

Agriculture's file memorandum on the OFD computation stated that Agriculture constructed a $26.11 rate to prevent Egypt from transferring the purchase of wheat from Albany to the West Coast. The memorandum stated that Egypt contacted Agriculture and requested permission to cancel the Albany purchase and load the Cove Explorer on the West Coast instead. According to the memorandum, Egypt was concerned that it would be paying a higher price for the wheat and that the OFD would be based on a $32.90 a ton rate for a foreign flag offer for St. Lawrence loading (closest offer to Albany). Instead of using the St. Lawrence offer for the OFD calculation, Agriculture agreed to construct a foreign flag rate of $26.11 a ton, representing an estimated foreign flag rate for a vessel to transport the wheat from the West Coast ($34.25), less the higher cost for purchasing from Albany ($7.14) and an unspecified deduction ($1 a ton). The purchase authorization provided that Agriculture could determine or construct a foreign flag rate if the foreign country employed its own vessels or other vessels under its control; no provision existed for constructing a foreign flag rate under other circumstances. Concerning the potential cancellation of the sale, commodity supplier representatives explained that sales are very rarely canceled and the commodity supplier for this sale said it was not contacted concerning a potential cancellation. Because Agriculture constructed the rate rather than using the St. Lawrence offer at $32.90 a ton, Agriculture paid an additional $135,800 in OFD payments and Egypt saved an equivalent amount.

ALLOCATING CARGO BETWEEN U.S. AND FOREIGN FLAG VESSELS

Cargo preference requires that at least 50 percent of commodities be transported on privately owned U.S. flag vessels if available at fair and reasonable rates. Agriculture has no regulations or guidelines on the method for balancing U.S. and foreign flag vessel selections to meet the 50 percent requirement. The Maritime Administration, responsible for general administration of cargo preference, is concerned about attaining the 50 percent requirement for U.S. flag vessels overall and employing various types of U.S. flag vessels (bulk carriers, liners, tankers).

Agriculture is responsible for approving the allocation of cargo for each tender of each purchase authorization. An Agriculture representative said that an attempt is made to balance cargo on a yearly basis for each country. If a commodity involved purchases in both bulk form as well as bagged or drummed packaging, then Agriculture would attempt to balance the cargo for each.

During 1982, cargo allocation varied significantly for individual foreign countries and commodities (see app. I).

Although the use of U.S. flag vessels for many foreign countries was just above 50 percent for each commodity, participation for many countries varied from none in one country to 100 percent in three countries. Yet, Agriculture did maintain 50.1 percent of U.S. flag vessels overall for all foreign countries in 1982. Agriculture files for the purchase authorizations that we reviewed contained little or no explanation for the cargo allocations.

We found examples in which Agriculture could have managed cargo allocation more cost effectively. Agriculture accepted country agents' vessel selections that reduced the foreign country's transportation costs or served some other interests of the country. In our opinion, Agriculture should place more emphasis on minimizing expenditures consistent with the requirements of cargo preference. The following two examples illustrate our concern over the cargo allocation process.

Example 3 On the first three tenders under this purchase authorization for soybean oil, Pakistan selected 49,000 tons for U.S. flag vessels and 21,300 tons for foreign flag vessels. The invitation for bid on the fourth (and last) tender was for 30,000 tons which, if transported on foreign flag vessels, would have essentially met the 50 percent cargo preference requirement. However, because of low commodity prices at bid opening, Pakistan purchased 38,850 tons--not 30,000 tons. Pakistan selected the foreign flag vessel with the lowest rate to transport 21,500 tons at $31.35 a ton and the U.S. flag vessel Wilmington Getty to transport 17,350 tons at $93.50 a ton. The Wilmington Getty originally bid to carry about 23,000 tons at a rate of $68.49. Because the vessel carried only 17,350 tons, the vessel owner substantially increased the transportation rate to $93.50 a ton. The Wilmington Getty also transported on the voyage 4,000 tons of soybean oil to Bangladesh at a rate of $105 a ton.

Pakistan rejected the next lowest foreign flag vessel at $36 a ton for 17,000 tons because it considered the vessel, built in 1958, too old. Another foreign flag vessel also bid at $36 a ton for 20,000 tons but was unwilling to carry less tonnage. Other foreign flag vessels were not considered because their offered rates were much costlier. A Pakistan embassy official said that "going with a U.S. flag vessel was an easy way out." Based on our analysis, however, the selection of the Wilmington Getty saved Pakistan about $45,000 in transportation costs.

If Agriculture had approved the use of foreign flag vessels only on this tender, the imbalance for the purchase authorization (and yearly totals for the country) would have been about 11,000 tons, and 55 percent would have been transported on foreign flag vessels. Agriculture showed flexibility in similar situations in other countries where the imbalance was offset.

Also, tonnage approved by Agriculture is approximated subject to a 5-percent tolerance so the exact amounts vary from approved amounts. Had Agriculture approved only foreign flag vessels, then it would not have paid OFD of about $1.04 million.

Example 4 At the country agent's request, Agriculture approved a geographical balance of cargo in which Liberia's cargo was transported solely on U.S. flag vessels and Zaire's cargo was transported solely on foreign flag vessels. On two tenders, Liberia purchased about 43,300 tons of bagged rice, which was transported on U.S. flag liners owned by one company. Zaire purchased about 60,900 tons of bulk wheat, which was transported on foreign flag vessels. The same country agent served both countries.

The approval came after a major disagreement between an Agriculture representative and the country agent on whether to geographically balance Liberia and Zaire. Since 24,400 tons were approved for U.S. flag vessels on the first tender, the representative wanted Liberia's second tender for 18,900 tons to be transported on foreign flag vessels. According to an Agriculture memorandum, the country agent protested and insisted that the Acting Director of the Ocean Transportation Division had agreed, if possible, to use U.S. flag vessels for Liberia to offset an earlier approval of all foreign flag vessels for Zaire shipments. Yet, there was no written agreement and the Acting Director was unavailable when the decision was made. The Acting Director told us that he had only discussed the possibility of geographical balancing of the two countries; geographical balancing was contrary to Agriculture's policy of balancing cargo on a yearly basis for each country. In our opinion, the geographical balancing seemed unusual since the shipments to the two countries were dissimilar--Liberia was approved for transporting 43,300 tons of bagged rice on liner vessels whereas Zaire was approved for transporting 58,570 tons of bulk wheat on bulk carriers.

According to the Acting Director, Zaire normally purchases commodities out of the U.S. Gulf, but the wheat in this case was purchased from the Great Lakes. There were no U.S. flag vessel offers from the Great Lakes and, under Agriculture's existing policy, there was no requirement to use U.S. flag vessels. If Liberia had transported the second tender rice cargo on foreign flag vessels instead of transporting 100 percent on U.S. flag vessels (no geographical balancing), Agriculture would have paid about $1.1 million less in OFD.

APPROVING PROCUREMENTS ON THE BASIS OF LOWEST LANDED COST

Agriculture's regulations covering commodity purchases allow the foreign country to purchase on the basis of the lowest commodity price or on the basis of lowest landed cost. Lowest landed cost combines a higher priced commodity with lower ocean transportation costs, resulting in the lowest overall cost for both the commodity and transportation. In our opinion, Agriculture needs to revise the regulations to ensure that, when U.S. flag vessels are involved, the United States pays for commodities and transportation on the basis of lowest landed cost, which will lower costs overall and eliminate confusion over the purchase of commodities and ocean transportation.

The following two examples show how substantial savings could have resulted had lowest landed cost (defined as the total commodity and transportation cost) been a clearly understood requirement for U.S. flag vessels.

Example 5 Bangladesh purchased bulk wheat in March 1982 and transported about 84,000 tons on vessels under the control of Bangladesh (foreign flag) and about 85,000 tons on the following U.S. flag vessels.

Vessel	Tonnage approved	Rate per ton	Loading location
Point Vail	55,000	$105.00	Baltimore
President Adams	15,750	99.00	Sacramento
President Taylor	14,750	99.00	Northwest

The Point Vail was approved to transport 55,000 tons even though its capacity is about 89,000 tons. The vessel's offer provided Bangladesh with five options to carry differing quantities from various locations. One option called for the vessel to load 87,500 tons at $86 a ton; the option specified loading a portion of the cargo on the U.S. East Coast and completing the loading in the St. Lawrence area. Under lowest landed cost, Bangladesh could have purchased the wheat to match the vessel owner's option by loading a portion of the cargo in Baltimore and completing loading in the St. Lawrence. While Bangladesh would have paid slightly higher commodity prices, Agriculture would have paid about $1.48 million less in OFD. This amount represents the difference between (1) the actual payments for the tonnage transported on the Point Vail (at a rate of $105 a ton) as well as the President Taylor and President Adams (at $99 a ton), and (2) potential payment to the Point Vail for transporting an entire cargo at $86 a ton.

Example 6 In a November 1982 bulk wheat purchase for Bangladesh, Agriculture approved about 71,300 tons on a foreign flag vessel under Bangladesh control and about 68,250 tons on the U.S. flag vessel Ultramar. Two U.S. flag vessels had each offered to transport 70,000 tons--the Ultramar (bulk carrier) at $87.49 a ton and the Point Vail (tanker) at $83.77 a ton. The

Ultramar increased its rate to $91.11 a ton because of the tonnage reduction from 70,000 to 68,250, whereas the Point Vail offered to transport the reduced tonnage at its original offered rate--$83.77 a ton.

A Bangladesh representative contended that according to conversations with Agriculture and Public Law 480 requirements, the Bangladesh embassy must purchase the wheat at the lowest available commodity price. The lowest commodity price was available at U.S. Gulf ports for loading onto a dry bulk carrier. There was an additional surcharge on the commodity price for loading a tanker. Bangladesh thus contracted for ocean transportation by the bulk carrier Ultramar even though a lower ocean transportation rate was offered by a different type of vessel, the tanker Point Vail. Agriculture maintains that the foreign country must purchase commodities for the type of U.S. flag vessel that will satisfy the cargo preference at the lowest cost in transportation. Agriculture contends that Bangladesh was informed of this before the selection of the Ultramar and that the OFD was calculated on the basis of the Point Vail's offer.

Bangladesh requested Agriculture to recalculate the OFD on the basis of the Ultramar's offer. The additional costs to Bangladesh because it selected the Ultramar totaled about $500,000--the difference between the Ultramar's rate of $91.11 a ton and the Point Vail's rate of $83.77 multiplied by the 68,250 tons actually transported on the Ultramar. In July 1983, Agriculture's Deputy Assistant Administrator for Export Credits denied Bangladesh's request, stating that Agriculture is bound by the regulations to base the OFD on the lowest rated U.S. flag vessel responsive to the tender.

Agriculture did not consistently apply its regulations in the two examples. In the March, 1982 purchase (example 5), an Agriculture representative agreed that higher costs resulted but said the regulations require Bangladesh to purchase on the basis of lowest commodity cost; the regulations state that when vessels owned or controlled by the foreign country purchasing the commodity are to be used, the foreign country must purchase the commodities on the basis of the lowest commodity prices. Yet, in the November 1982 purchase (example 6), Agriculture required Bangladesh to procure commodities for the type of U.S. flag vessel that would satisfy cargo preference at the lowest cost in transportation.

During our review, Agriculture recognized problems with the criteria for purchasing commodities and transportation and worked to alleviate them. In May 1984, Agriculture revised the purchase authorization language concerning the criteria for approval of commodity contracts and OFD computations. An important provision in the revised language states that if commodity purchases are not made on the basis of lowest landed cost when using U.S. flag vessels, OFD payments will be calculated on the rates of U.S. flag vessels that would represent the lowest landed cost. Agriculture's notice to the commodity and transportation industry said the changes were being made immediately to minimize government expenditures and to ensure that available funding will transport the maximum volume of commodities at a time of urgent food needs in many countries.

Subsequent to Agriculture's comments of March 11, 1985, we learned that those provisions of the May 1984 notice which detailed how OFD would be calculated had been superceded by a change, dated February 28, 1985. In general, this latter change increased the amount of discretion Agriculture may use in calculating OFD. According to Agriculture representatives, the change was made because one country had been unfairly penalized in an OFD calculation based on the May 1984 provisions. However, the February 1985 change goes beyond the circumstances of that particular case and has broader implications for future OFD calculations. The implications of the increased flexibility will depend on how it is implemented and are difficult to evaluate at this time.

Agriculture's purchase authorization changes may resolve the problems, but Agriculture should update the regulations to ensure that the United States pays on the basis of lowest landed cost and that OFD is calculated in a manner consistent with minimizing U.S. costs.

REQUIRING DEMURRAGE AND DESPATCH PROVISIONS IN VESSEL CONTRACTS

Although not stated in the regulations, Agriculture's policy is to require demurrage and despatch provisions in U.S. flag vessel contracts. These provisions provide a financial incentive to the vessel owner and the foreign country to load and discharge the commodity in a timely manner. Because some foreign countries do not want to risk paying demurrage, vessels are selected without these provisions. Despite its own policy, Agriculture approves vessels without the provisions, resulting in higher OFD payments.

Purchase authorizations require that transportation tenders and vessel contracts for U.S. flag vessels specify guaranteed loading and discharging rates and include demurrage and despatch provisions. The guaranteed loading and discharging rates establish the contractual period for the vessel and foreign country to load and discharge the cargo. If the vessel completes loading and discharging in less time than contractually agreed, the vessel owner pays despatch to the foreign country; if the vessel is not loaded and discharged within the specified period, the country pays demurrage to the owner. According to trade custom, demurrage is always twice the amount of despatch (e.g., $10,000 per day of demurrage would mean $5,000 per day of despatch), and the amounts vary depending on negotiations between the country agent and vessel owner. Under normal commercial practices, when demurrage and despatch provisions exist, a vessel pays the loading costs and the foreign country pays the discharging costs (termed vessel load/free out). In contrast, when the provisions do not exist, a vessel owner pays both loading and discharging costs (termed full berth terms).

Agriculture representatives and vessel owners explained that U.S. flag vessel owners increase their rates to protect against unanticipated discharging delays when bidding on a full berth terms basis. Vessels can wait for lengthy periods of time, without compensation, for berths in foreign ports with inefficient loading facilities. We were told that, because of intense competition, foreign flag vessels do not increase their rates as much for anticipated port delays. Even if foreign flag vessels increase rates proportionately, the OFD will be higher because of the overall higher rates and costs of U.S. flag vessels. This results in higher OFD payments.

Agriculture approved 108 shipments, or about 23 percent, of U.S. flag vessel shipments between 1980 and 1982 on full berth terms. Although information is not available to quantify the amount of increased OFD resulting from the lack of demurrage and despatch provisions, the purchase authorization discussed below indicates the amount could be substantial.

Example 7 Four U.S. flag liners from one company were selected to carry the U.S. flag portion of the cargo to Somalia and two foreign flag vessels were selected to carry the foreign flag portion. The U.S. company submitted offers on the basis of full berth terms as well as vessel load/free out with demurrage and dispatch provisions. The vessel load/free out rates were $37 a ton lower. Agriculture's files on Somalia have several State Department messages stating that port congestion was a significant problem in Somalia. A company representative explained that the company increased its full berth term rate to offset potential delays in berthing at the discharge port.

The country agent recognized that the $37 a ton premium was primarily to protect the company against delays in discharging cargo in Somalia and that only about $10 a ton represented the actual discharging costs. Also, according to the agent, Somalia was not set up to arrange the discharge of the cargo and preferred that the vessel assume the discharging responsibility; furthermore, the agent said that the country lacked dependable staff to prepare records of the loading and discharging periods.

The additional costs to the United States of full berth terms could be substantial but are difficult to precisely determine. The amount of additional costs would be determined by the extent to which foreign flag vessels also charge premiums for full berth terms. If the foreign flag rates did not include any amount for anticipated delays in Somalia for port congestion, the amount of higher OFD in this example could approximate $637,000.

MANAGING TENDER TERMS

Agriculture approves ocean transportation tenders prepared by the foreign country agent before distribution to the transportation industry. The tender cites shipment specifications (such as commodity tonnage, load and discharge locations, and vessel length and depth limits required by port conditions), which enable vessel owners to prepare offers.

The tender specifications, or tender terms, can be restrictive or rigid, yet Agriculture has limited information concerning conditions in foreign countries when approving tenders. Restrictive tender terms can affect the extent of competition or the rates offered by competing vessels. Vessel owners explained that countries can exclude vessels through placing length and depth restrictions in the tender even though existing conditions within the country would not require the restrictions. Further, guaranteed rates of cargo discharge in tenders become important when vessels calculate their offers; vessel owners said that foreign countries can set lower guaranteed discharge rates than facilities can actually discharge to decrease the country's potential for paying demurrage and increase the vessel owner's potential for paying despatch to the foreign country. Also, we noted that tenders can specify many shipments over several weeks or months, even though port or warehouse conditions may not require the multiple shipments, yet small tonnages may command high rates and limit competing vessels. An Agriculture representative said that Agriculture attempts to pursue with country agents proposed changes in tender terms from prior years, but it is difficult to determine whether tender terms are unnecessarily restrictive.

In addition, Agriculture representatives, vessel owners and country agents had varied opinions on whether vessel owners must submit offers that comply with all tender terms or whether foreign country officials or their agents can negotiate various terms before vessel selection. Agriculture has no written directives or policies covering this situation. The lack of clear rules could result in situations in which importing countries reduce their costs at the expense of increased OFD, as discussed below.

Example 8 Pakistan's tender for soybean oil stipulated that vessels should not exceed 600 feet in length. The U.S. vessel Golden Phoenix, a 931 foot converted liquefied natural gas tanker, was offered with the intent of unloading the cargo (at the ship's expense) outside the port into smaller vessels (not exceeding 600 feet) that would then discharge at the berth. Yet, Pakistan selected another U.S. vessel, the Perryville, at $12.97 more a ton. A Pakistan embassy official explained that the country needed the soybean oil and did not want to risk incurring problems with discharging. Because the tender excluded vessels over 600 feet and included no provisions for discharging into smaller vessels, Pakistan ruled the Golden Phoenix as a nonresponsive bid. Agriculture paid about $311,000 in additional OFD.

Conversely, an Egyptian tender specified that vessels submit bids on the basis of vessel load/free out terms which means the vessel pays the loading costs and the foreign country pays the discharging costs. Six foreign flag vessels were offered on the basis of free in/out trimmed terms (foreign country pays both loading and discharging costs). The country agent notified the vessel owners to change the offers to comply with tender terms. The country agent selected two of the vessels to transport a portion of the commodity, and Agriculture included another of these vessels in the weighted average for the OFD calculation. If the country agent had rejected offers for these vessels as nonresponsive, Agriculture would have used other foreign flag offers in the weighted average and paid about $96,000 less in OFD.

CONCLUSIONS

Agriculture is responsible for complying with cargo preference requirements, approving vessel selections arranged by foreign countries, and calculating ocean freight differentials. We identified examples which illustrate the need to emphasize a policy of minimizing Agricultural expenditures for transporting Public Law 480 Title I commodities. Such a policy could save millions of dollars each year in unnecessary OFD payments while still maintaining cargo preference requirements. The savings could be used to reduce the program's cost or to increase commodity purchases.

RECOMMENDATIONS

GAO recommends that the Secretary of Agriculture establish a clear policy to minimize Agriculture's transportation expenditures consistent with cargo preference requirements. GAO also recommends that the Secretary direct the Administrator, Foreign Agricultural Service, to revise and implement program regulations on the basis of this policy. The Service should emphasize cost reductions in the problem areas we have identified: computation of OFD, allocation of cargo, shipment on the basis of lowest landed cost, requirement for demurrage and despatch, and elimination of unnecessarily restrictive tender terms.

AGENCY COMMENTS AND OUR EVALUATION

Agriculture commented that it had already implemented the substance of our recommendations. Based on subsequent discussions with Agriculture officials and a limited review of files, we believe that Agriculture is taking steps to improve the cost effectiveness of the program. A full evaluation of Agriculture's progress toward minimizing its transportation expenditures consistent with cargo preference requirements would require another detailed GAO review. Such a review would be appropriate after Agriculture completes action on planned changes in program management and regulations. In this regard, although there have been changes to the ocean transportation provisions of purchase authorizations, the basic Public Law 480 Title I regulations on ocean transportation have not been updated since 1968. We believe that Agriculture needs to give priority attention to updating the regulations. With regard to this updating, we have identified specific areas where cost reductions should be emphasized in the areas discussed in this chapter. In response to agency concerns that some flexibility is desirable in the regulations, we have modified proposals that were presented in our draft report which detailed specific changes in the regulations.

Agriculture's specific comments on sections of this chapter and our evaluations are contained in appendix II.

CHAPTER 4

FAIR AND REASONABLE TRANSPORTATION RATES ARE NOT ASSURED

Cargo preference requires that at least 50 percent of government sponsored cargo be transported on U.S. flag vessels if available at fair and reasonable rates. The Maritime Administration assists Agriculture by calculating a "fair and reasonable" rate, termed a guideline rate, which is the maximum transportation rate that the vessel may receive for the voyage. Maritime does not verify data used in developing guideline rate calculations and the accuracy of important data is questionable. Moreover, the guideline rate is not adjusted when vessels return to the United States with cargo or when vessels are scrapped overseas. Most importantly, Maritime does not calculate guideline rates on U.S. flag liners, which carry a substantial portion of Public Law 480 commodities. As a result, Agriculture may be paying substantially higher OFD than necessary.

ACCURATE GUIDELINE RATES ARE IMPORTANT

Maritime calculates fair and reasonable rates (guideline rates) for voyages of U.S. flag vessels on the basis of cost plus a reasonable profit. The guideline rates are important because they are the primary method available to Agriculture to control the transportation rates of U.S. flag vessels and the resulting OFD payments. Vessel owners obviously seek rates as high as possible. The foreign countries and country agents have no incentive to lower the transportation rates of U.S. flag vessels because Agriculture pays the OFD on these vessels. Vessel owners and brokers are aware of competition because they know the location of potential competing vessels and may bid and attain high rates if they perceive little or no competition. Thus, a vessel owner could offer a rate for a particular shipment based on the absence of competitors, which may be inconsistent with the vessel's cost plus a reasonable profit.

HOW MARITIME CALCULATES RATES

Maritime's Division of National Cargo, Office of Market Development, prepares guideline rate calculations by estimating vessel costs and profit on the basis of the vessel's voyage from the United States to the foreign destination and return to a U.S. port without cargo. Guideline rates are prepared for U.S. flag vessels likely to be selected for the cargo. Guideline rates are not calculated on liners except under unusual circumstances when liners carry a full shipload of cargo.

Data from various sources is compiled to develop a guideline rate calculation. The country's invitations for bid and the vessel's bid contain the anticipated tonnage, loading and discharging locations, and estimated tonnages guaranteed by the country for daily loading and discharging of the vessel. A vessel's speed, fuel consumption at sea and in port, and daily costs are generally supplied by the vessel owner at Maritime's request. With this data, Maritime estimates the number of days that the vessel will be in port, the number of days at sea, and the barrels of fuel the vessel will consume on the voyage. Maritime then estimates the main elements in the calculation--fuel and per diem costs. Fuel costs represent the barrels multiplied by current prices. Per diem costs represent the number of days at sea and in port multiplied by the vessel's daily cost. Maritime also includes in the calculation estimates for other items, such as port costs and fees, canal fees, stevedoring, and cleaning. It then applies a profit rate to the total estimated costs. The guideline rate equals the total estimated costs plus profit divided by tonnage.

Maritime varies the guideline rate calculation for vessels built before 1955 by categorizing vessels similar in design, cargo capacity, fuel consumption, and speed. For vessels within a category, Maritime uses averages for tonnage, fuel consumption, vessel speed, and per diem costs rather than amounts for the particular vessel. Maritime originally established five categories of vessels, but during 1982 vessels within categories IV and V only participated in transporting Public Law 480 Title I commodities.

After Maritime calculates the guideline rate, it will inform Agriculture that the bid is acceptable if the vessel's offer is below the guideline rate. If the offer is above the guideline rate, Maritime will provide the rate to Agriculture and the country agent will then negotiate with the vessel owner to lower the rate to or below the guideline rate. If the owner will not accept a rate at or below the guideline rate, the agent approaches another U.S. flag vessel. When a proposed rate is at or below the guideline rate, Agriculture will approve the vessel and finance the OFD portion of the rate.

QUESTIONABLE DATA USED IN CALCULATIONS

Differences in vessel speed, fuel consumption in port and at sea, load and discharge rates, and per diem amounts can materially affect the calculation. However, Maritime does not verify data used in developing the calculations and the accuracy of this important data is questionable. As a result, Maritime has little assurance that guideline rates represent cost plus a reasonable profit.

Vessel owners generally provide data to Maritime on vessel speed, fuel consumption, and per diem amounts. Although the owners are not apprised of the details of the calculation, they obviously know why the data are needed and have an incentive to inflate per diem, understate vessel speed, and overstate fuel consumption, especially since the information is not verified. According to a Maritime representative, Maritime does not verify data submitted by vessel owners because its right of access to vessel owner records is unclear and it would require additional personnel to audit the records.

An example from Maritime's records illustrates the need to verify data. Maritime prepared a guideline rate in October 1982 for a U.S. flag vessel for which the per diem amount in the calculation was $23,143. Maritime files showed no source for this amount but contained an undated note that the vessel owner informed Maritime of the various elements in the per diem amount, totaling $21,420 per day. A vessel operating statement for the 6 months ending June 30, 1982, filed within another office of Maritime, showed an average daily cost of $18,771. These discrepancies show that conflicting data exist and that current and accurate cost data for a vessel are needed. The difference between the low and high amounts would affect the guideline rate by about $8 a ton, or about $520,000 in the estimated costs of the voyage involved.

For category vessels, Maritime calculates guideline rates using averages for tonnage, fuel consumption in port and at sea, vessel speed, and per diem. Significant variations can exist between the category vessel averages and specific vessel data. For example, the averages in a category IV vessel calculation varied considerably from (1) the approved tonnage and actual transported tonnage and (2) unverified data supplied by the vessel owner. In March 1982, Maritime prepared a single guideline rate for several category IV vessels. The differences between the guideline rate data and data supplied by one vessel owner in November 1981 are shown below.

--Tonnage - the category IV average was 21,775 tons, yet the vessel was approved for 25,000 tons (the vessel actually carried about 26,000 tons). The total estimated costs would be divided by the larger tonnage, which would yield a significantly lower guideline rate.

--Vessel speed - the category IV average was 12 knots (vessel will travel 288 miles per day), yet the owner reported vessel speed at 14 knots (or 336 miles per day). The faster speed would require about 8 less days at sea, and lower per diem and fuel cost.

--Per diem - the category IV average was $11,264, yet the owner reported per diem expenses of $16,069. The significantly higher per diem would yield higher costs.

--Fuel consumption - the category IV daily average was 91 barrels in port and 365 barrels at sea, yet the owner reported 130 barrels in port and 390 barrels at sea. The higher fuel consumption would yield higher costs.

Because few category vessels remain in service, we believe Maritime should use current and verified data rather than compute a category average.

Two shipments aboard a U.S. tanker demonstrate the problems with using the category averages for tonnages. Maritime calculates guideline rates by dividing the total estimated costs plus profit by the category tonnage. If the category tonnage is much lower than the actual or approved tonnages, the guideline rate is significantly overstated. On the first shipment, Maritime prepared the guideline rate using a category V average of 25,208 tons, while the tanker was approved for 30,000 tons and actually carried about 31,500 tons. The difference between the approved and guideline rate tonnage of 4,792 tons means the guideline rate should have been about $9.40 a ton lower. On the second shipment, the tanker replaced an originally scheduled category V vessel. Maritime informed Agriculture that the guideline rate prepared for the original vessel also applied to the tanker because both were category V vessels. Maritime prepared the calculation using a category V average of 24,118 tons. The original vessel was approved for 32,500 tons and the tanker actually carried 31,604 tons. The difference between the approved and guideline rate tonnage of 8,312 means the guideline rate should have been about $18.60 a ton lower--about 18 percent below the approved rate.

Questionable load and discharge rates may be contributing to inaccurate guideline rates. Maritime determines the necessary time for loading and discharging a vessel on the basis of load and discharge guaranteed rates shown in the country's tender. In preparing guideline rates, the tonnage is divided by the guaranteed rate to represent the number of days to load and discharge the vessel. In several guideline rates we reviewed, the actual load and discharge days were considerably lower than the estimated days that were based on the tender guarantees. Maritime accepts the load and discharge rates stated on the tender and does not review historical data on completed shipments to assess whether the guarantee load and discharge rates approximate actual figures.

Guideline rates often contain high costs for unloading cargoes which are unsupported within Maritime records. In certain countries, a vessel that is too large to berth and discharge in the country's facilities will lighten, or discharge, part or all of its cargo outside the port into smaller ships that will berth at the country's facilities. In the calculations we reviewed, Maritime used rates for lightening which were higher in some cases than the rates charged by foreign flag vessels to transport the commodity from the United States to the particular country. Moreover, when using vacuvators (i.e., mechanical equipment for unloading grain from tankers), Maritime allowed the same per ton rate in all the calculations we reviewed. A Maritime representative said Maritime derived the lightening and vacuvator rates from industry sources but could not provide us with documentation. Further, Maritime does not determine (after shipment completion) whether costs are accurate. We believe that accumulating historical data would allow Maritime to consider possible changes in future calculations. Because of the magnitude of the costs, Maritime should assure that the estimates approximate actual payments.

VESSEL BACKHAULING AND SCRAPPING--POTENTIAL FOR EXCESSIVE PROFITS

Maritime calculates a guideline rate assuming a vessel will return to the United States without cargo. Although costs for the return voyage are factored into the guideline rate, evidence suggests that vessels may be carrying cargo on the return voyage (backhauling) and that other vessels have been scrapped. Neither Agriculture nor Maritime routinely monitor shipments to identify these situations. Because guideline rates are established based on a round trip voyage, the potential exists for vessels to earn excessive profits.

Neither Agriculture nor Maritime have regulations addressing guideline rate calculations when vessels backhaul or are scrapped. Agriculture prepared a proposal to be published in the Federal Register that was forwarded to Maritime for comment in April 1982. The proposal would have made the round trip transportation rate subject to reduction when the vessel is scrapped, ownership is transferred, or the vessel backhauls cargo. Agriculture and Maritime disagreed whether the guideline rate should be calculated to the discharge location or to the scrapping location, and the proposal was not published. In February 1984, Agriculture was considering a new proposed regulation requiring that vessel contracts contain an alternative rate for a one-way voyage that would apply if the U.S. flag vessel was scrapped or ownership was transferred prior to the vessel's return to the United States. Agriculture believes that U.S. flag vessels seldom backhaul, no method exists to readily determine whether U.S. flag vessels do backhaul, and the administrative costs of monitoring a backhaul provision would likely exceed any benefits to the United States.

Evidence suggests that backhauling may be occurring. Maritime's Division of Statistics, Office of Trade Studies and Subsidy Contracts, gave us data on the locations for 23 U.S. flag vessels during 1982. These vessels do not include liners that are expected to make numerous stops within a trade route. These vessels transported commodities under 21 purchase authorizations that we reviewed. The Division receives vessel location data from Lloyds of London Press, Ltd. Several vessels, primarily tankers, did not return directly to the United States but stopped at one or more locations. The Lloyd's data is consistent with reports from vessel owners that vessels are backhauling. One vessel owner explained that a vessel backhauled oil for the U.S. government's Strategic Petroleum Reserve after discharging Public Law 480 cargo but was unable to obtain backhaul cargo after other shipments. At the time of our discussion, another company vessel had been idled for 1-1/2 months in the Persian Gulf awaiting backhaul cargo. The company seeks backhaul cargo, yet its availability is rarely known in advance.

We compared a list of U.S. flag vessels transporting commodities under 21 purchase authorizations with a Maritime list of vessels that intended to scrap in 1982. Neither Agriculture nor Maritime's Division of National Cargo knew that two of the vessels, the Little Apex and the Coastal California, had been scrapped overseas after transporting Public Law 480 commodities. Vessel owner representatives confirmed that the two vessels had been scrapped and did not return to the United States. Agriculture and Maritime knew in advance that a third vessel, the Perryville, planned to be scrapped overseas, but Agriculture paid a round trip rate because of contract language.

Coastal California scrapped overseas

In April 1982, the Coastal California was approved to transport about 25,000 tons of bulk wheat from the U.S. Northwest Pacific to Egypt. The guideline rate calculation was based on costs and profit for a round trip voyage. After discharging the grain in Egypt, the vessel transported diesel oil to Singapore before being scrapped in Taiwan. A vessel owner representative confirmed that the vessel carried a cargo of diesel oil and that the purpose of the interim voyage was to pay for the voyage costs to the scrap yard.

We requested Maritime to calculate a one-way guideline rate for the Coastal California. Maritime's policy is to include vessel costs to the scrap yard, one-day vessel shutdown allowance, and transportation costs to return the vessel's crew to their home ports. Because the distance from Egypt to Taiwan was almost the same as the distance for the vessel to return to the U.S. Gulf, the original guideline rate applied.

We estimated the one-way guideline rate for the Coastal California after cargo discharge in Egypt. Total per diem, fuel costs, and profit would be substantially less than the round trip costs. We do not believe the U.S. government should have to pay the additional costs to transport the vessel to the scrap yard because in this situation the vessel made an interim voyage to pay these costs. If the owner accepted a lower transportation rate based on one-way voyage, the United States would have saved about $450,000 in OFD.

<u>Perryville scrapped overseas, but United States paid round trip rate</u>

Pakistan chartered the Perryville to carry approximately 24,000 tons of soybean oil. The vessel's contract provided for:

> "Freight rate: US $71.87 metric ton ...However, if voyage terminates at Karachi for scrapping, owners will refund difference between US $71.87 per metric ton and US $61.58 per metric ton to Trading Corporation of Pakistan."

After discharging the soybean oil at Karachi, the vessel proceeded to Bangladesh, where it was scrapped. The owner declined to make any refund because the provision required a rate reduction only if the vessel was scrapped at Karachi.

Maritime approved the $71.87 rate as fair and reasonable for the round trip to Karachi and, at Agriculture's request, also calculated a rate of $61.58 as fair and reasonable if the vessel was scrapped at Karachi. According to an Agriculture representative, the obvious intent was to ensure that Agriculture did not pay for a round-trip voyage if only a one-way voyage occurred; Agriculture did not anticipate that the vessel would be scrapped at any port other than Karachi. The origin of the language in the provision is unknown. A Pakistan embassy representative said that the provision was suggested by Maritime and Agriculture; however, their representatives do not recall making such a suggestion. The vessel received about $242,000 in additional compensation based on Agriculture's position that costs should terminate at the discharge location. The amount represents the difference between round trip and one-way rates ($10.29 a ton) multiplied by the approximate 23,500 tons actually transported on the voyage.

GUIDELINE RATES ARE NEEDED FOR LINERS

Maritime does not compute a guideline rate on liners even though they carry a significant amount of Public Law 480 commodities. Liners transport cargo to several destinations on one voyage and generally travel on regularly scheduled trade routes. On occasion, however, Maritime will compute a guideline rate for a vessel owned by a liner company carrying a shipload to one destination. Maritime has not prepared guidelines rates on liners because of the difficulty in separating revenues and costs for the portion of the voyage covering only the Public Law 480 commodity. Yet, without such guideline rates, the U.S. government does not know whether the transportation rates for liners represent cost plus a reasonable profit.

During 1980, 1981, and 1982, U.S. liners transported about 34 percent of Public Law 480 Title I tonnage, as shown below.

	Shipments		Tonnage		Average
	Number	Percent	Amount (millions)	Percent	rate
Liners	265	55.8	$1.69	34.3	$105.73
Non-liners[a]	210	44.2	3.23	65.7	84.47
Total	475	100.0	$4.92	100.0	$ 91.78

[a]Non-liners are bulk carriers, tankers, and barges.

The rates for Public Law 480 Title I liner shipments during the years ending in 1982 vary from a low of $56.50 a ton to a high of $226 a ton. Because of differences in time frames, countries of destination, tonnage, and type of commodity, few liner shipments were comparable. No definite trend in the data exists, except that low tonnages generally demand much higher rates, and the rates to South and Central American countries were lower. On shipments that were marginally comparable, rates differed considerably. These situations included similarly sized shipments on the same vessel to the same country or on the same vessel to neighboring countries, as shown in the five examples below.

same vessel to neighboring countries, as shown in the five examples below.

	Liner and year	Destination	Tonnage	Commodity	Rate per ton
1.	Genevieve Lykes				
	1981	Egypt	5,986	bagged flour	$135.57
	1982	Egypt	1,057	bagged flour	106.05
2.	President Adams				
	1982	Bangladesh	15,750	bulk wheat	$ 99.00
	1982	Indonesia	15,250	bulk wheat	81.11
3.	Marjorie Lykes				
	1980	Egypt	6,993	bagged flour	$ 85.87
	1981	Egypt	7,942	bagged flour	130.90
	1981	Egypt	5,714	bagged flour	139.38
4.	Del Oro				
	1980	Ghana	8,610	bagged rice	$ 99.90
	1981	Senegal	8,332	bagged rice	158.92
5.	Aimee Lykes				
	1981	Tanzania	6,000	bulk corn	$140.00
	1982	Kenya	6,000	bulk wheat	102.50

The rates vary significantly, particularly since liners carry other cargoes to the country of destination and other destinations. In our opinion, because of the high rates and the variances, Maritime should devise a method for calculating guideline rates on liners.

At our request, Maritime's Office of Ship Operating Costs informally computed guideline rates on three liner shipments. The Office has data on U.S. flag vessels, including liners, and in 1982 was involved with proposals for new administrative procedures for calculating fair and reasonable rates. On the three shipments, the Office found the actual transportation rates greatly exceeded the guideline rates. On one 6,000-ton shipment, the Office calculated a guideline rate of about $69 when the actual transportation rate was $102.50, a difference of about $33.50 a ton. The Office based the calculation on a formula that considered the relationship of outbound cargo revenue to total cargo revenue on the trade route as well as the need to provide a profit incentive to the vessel operator. Regarding the formula, a representative of the Office advised us that Maritime needed input from the liner industry as well as more analysis to perfect the formula. In our opinion, perfecting and applying the calculation of guidelines rates on liners is important because of the potential for limited competition.

CONCLUSIONS

Substantially higher OFD payments may result because Maritime does not verify important data used in the calculations and because the accuracy of data is questionable. Given the amount of Federal funds involved in OFD payments, vessel owners should supply Maritime with independently audited vessel cost and operating data. Additionally, the guideline rates are not adjusted when vessels backhaul cargo or are scrapped overseas, and guideline rates are not calculated on U.S. liners.

RECOMMENDATIONS

GAO recommends that the Secretary of Transportation direct the Maritime Administrator to devise and institute a method for assessing whether transportation rates for liners represent cost plus a reasonable profit. Also, vessel owners should be required to have their independent accountants semiannually certify that vessel costs and operating data are accurate.

GAO recommends that the Secretary of Agriculture issue regulations requiring certification that non-liner U.S. flag vessels did not scrap or carry cargo on a return voyage. The regulations also should provide that the guideline rate will be recalculated and the transportation rate adjusted if a vessel obtains backhaul cargo or is scrapped or sold overseas.

AGENCY COMMENTS AND OUR EVALUATION

The Department of Transportation commented that the Maritime Administration has recognized the desirability of an appropriate procedure for considering the reasonableness of rates on preference cargoes moving on U.S. flag liner vessels and has undertaken to devise and institute an appropriate methodology. Moreover, the Office of Management and Budget has raised this issue and has requested preparation of a notice of proposed rulemaking to establish fair and reasonable rate guidelines for liner vessels. Accordingly, Maritime is proceeding with an evaluation of the impact of implementing procedures and the development of an effective methodology.

Transportation agreed that costs used for determining fair and reasonable rates should be verifiable; however, it favors an alternative approach whereby vessel operators would submit data and certify its accuracy. It said many companies already certify the accuracy of data submitted to Maritime under various programs and in those instances the government would have the right to verify the submitted information as it deems necessary. We believe that the semiannual certification of cost and operating data by the vessel owner's independent accountant provides better assurance of accurate data.

Both the Departments of Transportation and Agriculture commented on GAO's recommendation that the Secretary of Agriculture issue regulations requiring certification that vessels did not carry cargo on the return voyage and providing for recalculating the guideline rate if the vessel obtains cargo on the return voyage or is scrapped or sold overseas.

Concerning backhauling, Transportation commented that, although the recommendation is conceptually sound, it would be practical to implement this recommendation only with respect to known one-way voyages or for backhauls involving preference cargo. Transportation said the instances of U.S. flag bulk carriers securing return cargo after outbound voyages carrying preference cargo are extremely rare. When they do occur, they are likely to involve a lengthy interval of layup that could logically be considered as equivalent to the homebound voyage. Agriculture has doubts about the wisdom of seeking refunds from U.S. vessels which return with backhaul. Presumably, refunds would be obtained only when vessels had obtained the full guideline rate--an event that has occurred rarely during the past 2 years. Agriculture also said that the costs of monitoring and enforcing such a provision might exceed the revenues obtained and it may be unwise to create an implicit disincentive for U.S. vessels to seek backhaul cargo.

Regarding scrapping, Agriculture commented that its policy is to request importing countries to obtain scrap rates from U.S. flag non-liner vessels whenever there is reason to believe that such vessels might be scrapped following a Title I shipment. Also, proposed regulations have been drafted requiring U.S. flag vessels beyond a certain age to include scrap rates in their charter parties. Maritime said that it is already current policy to determine fair and reasonable rates on a one-way basis for preference cargo voyages of vessels which are to be scrapped or sold overseas after cargo discharge; over the past 2 years Maritime has consistently made available on request to Agriculture and the Agency for International Development an alternative guideline rate for any voyage on which a vessel older than 20 years may be sold overseas for scrap purposes.

Despite the Agriculture and Maritime comments, we reaffirm our recommendation that the Secretary of Agriculture issue regulations requiring certification that non-liner U.S. flag vessels did not scrap or carry cargo on a return voyage. As our report points out, substantial amounts of U.S. funds are involved and neither Agriculture nor Maritime routinely monitor shipments to identify when U.S. flag vessels backhaul or scrap. Accordingly, we question whether they can identify situations involving backhauling and scrapping. Agriculture will not know whether the cost of monitoring and enforcing the provision will exceed the revenues unless it attempts to do so. We believe that the best approach to identify these situations is through certification by vessel owners, which should involve minimal cost to the government.

Maritime limited its comments on backhauling to bulk carriers. As stated in the report, evidence suggests that tankers may be backhauling and our recommendation included all non-liner vessels. During our limited review of Agriculture's files in March 1985, we found another example in which a U.S. flag vessel backhauled cargo. The vessel transported about 110,000 tons of Title I bulk wheat to Egypt in Spring of 1983 and backhauled about 110,000 tons of oil from the North Sea for the Strategic Petroleum Reserve. While we did not fully develop the cost implications to the United States, we believe that this and other examples are worthy of Agriculture's and Maritime's attention because of the possibility of excessive transportation payments.

We concur that disincentives for backhauling should not exist, but we believe that a method for recalculating the guideline rate and adjusting the transportation rate can be devised which will not destroy the incentive to backhaul.

Allocation of Cargo on U.S. Flag Vessels During 1982

Country and commodity	Total tonnage	Total per commodity Tonnage	Total per commodity Percent	Total per country Tonnage	Total per country Percent	OFD rate (per ton)	Approx. OFD (millions)
Bangladesh:	398,114			200,533	50.4	$56.88	$11.4
Bulk wheat	309,060	153,756	49.7				
Bagged rice	54,554	27,277	50.0				
Bulk oil[a]	34,500	19,500	56.5				
Bolivia:	64,936			32,470	50.0	38.40	1.2
Bulk wheat	64,936	32,470	50.0				
Congo:	6,333			3,167	50.0	80.00	.3
Bagged rice	6,333	3,167	50.0				
Costa Rica:	113,369			56,253	49.6	27.08	1.5
Bulk corn	51,809	51,809	100.0				
Bulk oil[a]	2,116	0	0				
Bulk wheat	59,444	4,444	7.5				
Dominican Republic:	75,000			36,000	48.0	11.00	.4
Bulk corn	69,000	36,000	52.2				
Bulk oil[a]	6,000	0	0				
Egypt:	1,864,388			944,358	50.7	60.15	56.8
Bagged flour	462,437	234,758	50.8				
Bulk wheat	1,401,951	709,600	50.6				
El Salvador:	112,168			54,540	48.6	32.12	1.8
Bulk wheat	86,555	54,540	63.0				
Bulk oil[a]	7,612	0	0				
Bulk Corn	18,001	0	0				
Ghana:	17,069			7,888	46.2	64.00	.5
Bagged rice	17,069	7,888	46.2				
Guinea:	15,483			7,750	50.1	82.80	.6
Bagged rice	15,483	7,750	50.1				
Haiti:	66,503			30,114	45.3	10.55	.3
Bulk Wheat	59,552	26,063	43.8				
Bulk oil[a]	6,951	4,051	58.3				
Honduras:	47,045			24,285	51.6	17.30	.4
Bulk wheat	47,045	24,285	51.6				

Allocation of Cargo on U.S. Flag Vessels During 1982

Country and commodity	Total tonnage	Total per commodity Tonnage	Total per commodity Percent	Total per country Tonnage	Total per country Percent	OFD rate (per ton)	Approx. OFD (millions)
Indonesia:	95,572			47,822	50.0	$49.02	$2.3
Bulk wheat	95,572	47,822	50.0				
Jamaica:	95,501			43,135	45.2	27.85	1.2
Bulk corn	51,900	6,000	11.6				
Bagged rice	14,433	9,000	62.4				
Bulk wheat	20,947	20,947	100.0				
Bulk oil[a]	1,033	0	0				
Bagged blended foods	3,074	3,074	100.0				
Bagged wheat flour	4,114	4,114	100.0				
Kenya:	82,977			51,491	62.1	65.14	3.4
Bulk wheat	68,991	44,491	64.5				
Bagged rice	13,986	7,000	50.1				
Liberia:	43,301			43,301	100.0	54.36	2.4
Bagged rice	43,301	43,301	100.0				
Madagascar:	17,282			8,641	50.0	72.00	.6
Bagged rice	17,282	8,641	50.0				
Mauritius:	12,744			12,744	100.0	65.10	.8
Bagged rice	6,975	6,975	100.0				
Bagged flour	5,769	5,769	100.0				
Morocco:	258,675			129,675	50.1	40.65	5.3
Bulk wheat	258,675	129,675	50.1				
Pakistan:	109,150			66,350	60.8	33.91	2.2
Bulk oil[a]	109,150	66,350	60.8				
Peru:	51,603			9,500	18.4	30.82	.3
Bagged rice	51,603	9,500	18.4				
Senegal:	23.909			11,875	49.7	55.27	.7
Bagged rice	23,909	11,875	49.7				
Sierra Leone:	10,251			10,251	100.0	54.80	.6
Bagged rice	10,251	10,251	100.0				

Allocation of Cargo on U.S. Flag Vessels During 1982

Country and commodity	Total tonnage	Total per commodity Tonnage	Total per commodity Percent	Total per country Tonnage	Total per country Percent	OFD rate (per ton)	Approx. OFD (millions)
Somalia:	47,112			23,599	50.1	$105.27	$2.5
Bagged wheat	4,957	0	0				
Bagged flour	13,774	5,899	42.8				
Bagged rice	22,141	14,550	65.7				
Drummed oil[a]	6,240	3,150	50.5				
Sri Lanka:	119,593			60,000	50.2	46.48	2.8
Bulk wheat	119,593	60,000	50.2				
Sudan:	174,001			82,133	47.2	45.37	3.7
Bulk wheat	152,885	71,575	46.8				
Bagged flour	21,116	10,558	50.0				
Tanzania:	25,944			12,144	46.8	71.42	.9
Bulk corn	13,800	0	0				
Bagged rice	12,144	12,144	100.0				
Tunisia:	76,648			37,500	48.9	50.34	1.9
Bulk wheat	76,648	37,500	48.9				
Zaire:	58,570						0
Bulk wheat	58,570	0	0				
Zambia:	30,309			12,722	42.0	72.29	.9
Bagged wheat	19,779	9,479	47.9				
Bagged rice	6,451	3,293	51.1				
Bulk oil[a]	4,079	0	0				
TOTAL				2,060,291		$107.4	

[a]Cottonseed or soybean oil.

United States Department of Agriculture
Foreign Agricultural Service
Washington, D.C. 20250

MAR 11 1985

Mr. J. Dexter Peach
Director
Resources, Community, and Economic
Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

Thank you for the opportunity to review your draft report, "Transportation of Public Law 480 Commodities--Efforts Needed to Eliminate Unnecessary Costs." We are pleased that you have undertaken this study since during the past 2 years we have undertaken a series of internal reviews with the same objective in mind--to reduce program costs consistent with meeting the major goals of the Public Law 480 (P.L. 480) program. It is gratifying that your studies and ours have yielded similar conclusions in several key areas. For example, we have already implemented the substance of all of the recommendations in your Chapter 3, and one of the two recommendations of your Chapter 4. Further, we agree with much of your analysis in Chapter 2, although we have taken a different approach to correct the problems identified on an interim basis until we can fully evaluate the major change in the vessel tendering procedure that you recommend.

In the following comments, we will focus on areas where we believe either factual or interpretative content could be improved, or where a wider perspective of program objectives is needed.

Chapter 2

You correctly point out that the closed tender approach used by most Title I recipient countries leads to negotiation of vessel offers by the countries themselves, or their agents, neither of which would be expected to have as their highest priority minimizing the freight cost of U.S. flag vessels. You also note the possibility of conflicts of interest on the part of agents. Since the Department of Agriculture (USDA) does not directly control the negotiating process, you recommend that regulations be changed to require all recipient countries to conduct open freight tenders, awarding to lowest bidders with no negotiations.

This is a complex subject and several aspects need to be discussed. First, the overall policy framework of the P.L. 480 Title I program needs to be underlined. Consistent with the policy stated in Section 2 of P.L. 480 of developing and expanding export markets for U.S. agricultural commodities, the Title I program is administered with recipient countries themselves responsible for purchasing commodities and contracting for ocean freight. They are required to follow commercial practices insofar as possible so that they become familiar with dealing in letters of credit, U.S. agricultural commodity specifications and other areas which we hope will orient them to the U.S. market for commercial business. In this light, we have permitted countries to decide for themselves whether to conduct open or closed freight tenders according to their individual needs. Most have chosen closed freight tenders and we believe that this reflects widespread commercial practice.

Second, but equally important, there are many Title I movements for which there is extremely limited competition among U.S. flag vessels. We have Title I shipments each year where there is only one U.S. owner offering a vessel suited to the quantity available for U.S. flag shipment, and many shipments where there are only two or three such U.S. vessels. There is thus a strong concern that open tenders for U.S. flag vessels without negotiations would often result in higher, rather than lower freight rates. This is especially true in the relatively depressed freight market that has existed over the past 2 years where rates contracted in the Title I program have often been negotiated substantially below the Maritime Administration (MARAD) guideline rates. We would expect open tenders to result in some freight rate increases toward the maximum guideline rates. It must be remembered that MARAD's guideline rates provide for the owner to recapture all costs, including capital costs, plus a profit--an achievement that is not possible at all stages in the business cycle.

Third, MARAD does not provide guideline rates on liners which represent a significant number of Title I shipments. MARAD's view is that published tariff rates represent fair and reasonable rates. Open tenders, therefore, could result in bookings at the published rate when, in fact, experience indicates that such rates can be negotiated downward in many cases.

Finally, even if open tenders were adopted in the Title I program, it would not be possible to entirely eliminate the need to negotiate freight rates since the process of allocating quantities purchased to vessels frequently results in mismatches or residuals that require negotiated adjustments.

In summary, there are significant drawbacks and questions related to open tenders that your report does not deal with. Recognizing these, USDA has chosen as an interim measure to strengthen its monitoring of the current system to try to ensure that the lowest possible U.S. flag freight rates are obtained in the Title I program. Primarily, this consists of contacting specific vessel brokers or owners at any time we have reason to believe that selective negotiations may have taken place. Our sole purpose is to inquire whether competitive parties have been countered on their original offers and whether there are any unusual circumstances that should be brought to our attention. We will not approve vessel contracts until we are reasonably satisfied that the negotiating process has been fair and has resulted in the most advantageous U.S. flag rates.

In addition, we have prepared a draft regulation setting out the responsibility of importing countries and their agents to give first priority to fixing U.S. flag vessels so as to minimize their cost. Importing countries obviously prefer to arrange shipments to reduce foreign flag costs--for example, by limiting the number of loading ports. The quantity of commodities remaining for U.S. flag vessels may then have to be loaded at a number of ports at a higher freight rate. This draft regulation is part of a revision and updating of Title I regulations which we hope to publish for public comment this year.

Chapter 3

Your report sets out five areas where ocean freight differential (OFD) payments might be reduced. USDA has taken initiatives in all of these areas during the past 2 years. However, in one area, Allocating Cargo Between U.S. and Foreign Flag Vessels, MARAD has informed us that we are already utilizing all of the flexibility permitted under cargo preference regulations to rationalize shipping costs. We will, therefore, address the remaining four areas.

GAO evaluation

In explanation of the statement about cargo allocation, an Agriculture official provided correspondence with Maritime concerning an Agriculture proposal to reduce transportation costs by balancing shipments between U.S. and foreign flag vessels on a regional basis rather than by country and purchase authorization. Although sympathetic to Agriculture's efforts to reduce costs, Maritime rejected the proposal on the grounds that regional balancing could result in U.S. flag vessels serving only a limited number of recipient countries. Maritime also thought that the proposal could change the cargo mix on some routes and impair the ability of U.S. vessel operators to provide the adequate regular service needed to attract commercial cargo. Agriculture's proposal to balance preference cargo shipments on a regional basis, in our opinion, would have been a major change from the current system and, as discussed in example 4, it is not clear that regional balancing would achieve the cost savings intended.

We found that opportunities exist within the current system (balancing by country and purchase authorization) to allocate cargo more cost effectively, and such opportunities should not be lost. In some instances, a precise division of cargo between U.S. and foreign flag vessels is not always possible for each country and purchase authorization. The system inherently requires compensating adjustments in the allocation of cargo for other countries and purchase authorizations. Maritime recognizes that these circumstances will occur. In other instances, a precise division of cargo might be possible but would involve significantly increased transportation costs, such as the extra costs incurred when a full shipload of cargo is divided between U.S. and foreign flag vessels. In these instances, opportunities exist to save transportation costs and Agriculture and Maritime should work together to allocate cargo cost effectively.

Preparing OFD Calculations. While USDA agrees that OFD computations should be done so as to minimize expenditures, this must be done consistent with the overall objectives of the Title I program, including the policy of compensating recipient countries fairly for the added costs of using required U.S. flag vessels. Accordingly, the long-standing policy in OFD computations has been to determine which vessels the importing country could reasonably have been expected to use to carry the total quantity of commodities purchased, absent the requirement to use U.S. flag vessels. To determine the average non-U.S. flag freight rate, we usually select a combination of vessels--some of which actually received contracts, and some of which made offers but were not fixed because the tonnage was placed on U.S. flag vessels. When it is the practice of the importing country to handle vessels of a larger size at certain faster discharging facilities, it is reasonable to utilize for OFD computations the freight rates offered by such vessels specifically for discharging at such facilities (so long as the capacity of such facilities is not implicitly exceeded). We believe that your Example 1 in Chapter 3 fails to appreciate the above policy and recommends a course of action that would at times significantly undercompensate Title I countries for the added freight costs resulting from redistributing tonnage to accommodate U.S. flag vessels. We suggest that your report be revised to recognize the policy of fair compensation to recipient countries.

We would further note that our May 17, 1984 notice to suppliers incorporated into purchase authorizations a provision permitting the Director, PL 480 Operations Division to construct foreign flag rates under certain circumstances, including those mentioned in your Example 2.

GAO evaluation

We agree that recipient countries should not bear the additional, identifiable costs of U.S. flag shipping and understand this to be the principle which underlies Agriculture's payment of ocean freight differential. At the same time, we do not believe that recipient countries should be overcompensated and, in our opinion, the manner in which the OFD was calculated in examples 1 and 2 (pp. 15-17) overcompensated Egypt for the costs involved in using U.S. flag vessels. In example 1, Agriculture did not calculate OFD as required by the purchase authorization which stipulated a basis of the weighted average freight rate(s) of foreign flag vessels that could have carried all of the commodities purchased. Instead, Agriculture based OFD on an ineligible late bid of a single foreign flag vessel which physically could have carried only about three-fourths of the cargo transported on the U.S. flag vessel. In example 2, Agriculture passed over an actual foreign flag offer for St. Lawrence loading and "constructed" a foreign flag rate for Albany, even though the purchase authorization did not provide for constructing a rate in such circumstances.

Approving Procurements on the Basis of Lowest Landed Cost. As your report notes, on May 17, 1984 we issued a notice to suppliers providing that lowest landed cost can be determined on the basis of either U.S. or non-U.S. flag vessels, and stating that OFD computations can be based on U.S. flag vessels representing lowest landed cost options, even if the importing country chooses to use other U.S. flag vessels. These provisions were incorporated into all purchase authorizations (PA's) issued after May 15, 1984. We intend to incorporate this PA change into formal P.L. 480 regulations in the context of the planned updating of regulations previously mentioned.

We suggest that you reconsider, however, your recommendation that the option of purchasing on the basis of lowest commodity price be deleted for purchases which are to be shipped on U.S. flag vessels. This recommendation would not result in OFD savings since we can and do base OFD on vessels representing the lowest landed cost option. Your recommendation would, however, deprive importing countries of the ability to choose the types of vessels they believe are suited to their port capabilities and delivery requirements, recognizing that they will bear any additional freight costs associated with such choices.

GAO evaluation

When discussing these comments with Agriculture officials, we learned that those provisions of the May 17, 1984, notice detailing how OFD would be calculated had been superceded by a change dated February 28, 1985. In general, this latter change increased the amount of discretion Agriculture may use in the OFD calculations. We were told that the change was made because one country had been unfairly penalized in an OFD calculation based on the May 1984 provisions. On the other hand, the February 1985 change goes beyond the circumstances of this particular case and has broader implications for future calculations of OFD. At this time, it is unclear how Agriculture will implement this recent change.

Requiring Demurrage and Despatch Provisions in Vessel Contracts. Title I purchase authorizations call for demurrage and despatch provisions in U.S. flag vessel contracts, except when the Director, PL 480 Operations Division, determines otherwise, and except in the case of bulk oils which may be shipped according to trade custom. We agree with the report's conclusion that waiving this requirement can result in higher OFD payments, and in 1983, we essentially ceased granting such waivers for vessel discharge in foreign ports. We have continued to occasionally permit berth terms at load ports (no demurrage/despatch on loading) while retaining demurrage/despatch at discharge ports after having determined that for certain commodities, vessels were more likely to pay despatch than earn demurrage when loading in the United States. Thus, the effect of this partial waiver has probably been to lower rather than increase U.S. flag rates since the possibility of paying despatch at load ports is eliminated.

This latter point indicates the value of permitting discretion on the question of demurrage/despatch provisions. There could arise circumstances in the future where it would be in the interests of the program to permit exceptions, even on discharge--for example, during a temporary period of extreme congestion in the ports of a country experiencing a food emergency. We urge that your report acknowledge these points.

GAO evaluation

GAO examined summary data for 1984 shipments under the Public Law 480 program. Based on these data, Agriculture has made progress in adhering to the policy of requiring demurrage and despatch provisions in vessel contracts. Although Agriculture stated that it essentially ceased granting waivers, we identified six countries that arranged shipments without such provisions at discharge ports. At our request, Agriculture provided explanations for the lack of demurrage and despatch provisions for these shipments. Most involved the use of lash barges and Agriculture said that the application of demurrage and despatch provisions on lash barges is not as clear cut as with conventional vessels; lash barges are dropped from another vessel, which may continue on to other ports and pick up the empty barges at a later date. Thus there may not be a pressing need for the rapid discharge of cargo from the vessel owner's point of view. Yet, upon further discussion, an Agriculture representative told us that Agriculture had not discussed the matter with lash vessel owners and Agriculture is unsure of how much the lack of the demurrage and despatch provisions affects the rates of lash barges. He said the matter is something that Agriculture should investigate.

We concur that exceptions to the policy of requiring demurrage and despatch may be needed in certain situations. However, we believe the exceptions should be justified and documented.

Managing Tender Terms. Your report notes that freight tender terms, which must be reviewed by USDA, sometimes contain restrictions which may prevent the lowest cost U.S. flag vessels from receiving contracts. It also notes that guaranteed discharge rates may be set lower than actual rates being achieved in the countries involved, and that delivery schedules may specify multiple shipments even though warehouse capacity in the countries seems adequate to permit fewer, larger shipments with lower freight rates.

Dealing with some 33 countries in the Title I/III program, and given current and expected staffing constraints, it is difficult to ascertain current foreign port, warehouse and other conditions on an up-to-the-minute basis. Our principal independent sources of information are the U.S. diplomatic missions in recipient countries. It is our firm policy not to permit any Title I/III shipment to move until we have received an operational reporting cable (ORC) from the responsible U.S. mission. These ORC's must include recommended delivery schedules, taking into account urgency of need, and port and storage capabilities. If we have questions concerning the accuracy of discharge capabilities, we request specific information from our diplomatic missions, and also look at actual discharge rates achieved in the past as evidenced in laytime statements on file in USDA.

The Department of Agriculture is also alert to opportunities to reduce U.S. flag costs by negotiating with Title I/III countries to permit larger vessels to be used--even if it means that cargo must be partially or fully lightened because of inadequate port capabilities. In Egypt, for example, U.S. flag bulk freight rates have decreased from over $100 per ton a few years ago, to $45-55 per ton last year, largely due to the use of various larger U.S. vessels carrying cargoes ranging up to 110,000 tons. We have similarly negotiated with three other major recipient countries during the past 2 years with the result that we expect to be saving millions of dollars of OFD costs this year compared to what would have been paid under previous freight tender terms.

In short, we believe that we are already achieving what your report recommends within the limits of our current staff constraints.

GAO evaluation

These comments are not fully responsive to the issues discussed in this section. Agriculture did not comment on the matter of whether vessel owners must submit vessel offers that comply with all tender terms or whether tender terms are negotiable as well as the potential cost implications to the United States.

Since Agriculture stressed the importance of operational reporting cables, we examined these cables for numerous Public Law 480 countries. For the most part, these cables pertained to overall country program and commodity matters but some did deal with transportation. Of more relevance, however, Agriculture maintains files which contain information on each country's ports, including physical specifications and storage and discharge capabilities. Data on foreign ports, in our opinion, were good in some cases and spotty or non-existent in others.

We view the managing of tender terms as more than having data on port and discharge facilities. As illustrated in example 8 (p. 25), we emphasize the importance of how the tenders are written and how Agriculture uses the information to calculate the OFD. Restrictive tender terms can affect the extent of competition and the rates that are offered by vessels competing for the cargo.

In an example not contained in the report, a country agent tendered for about 65,000 tons of bulk wheat in a manner which complicated meeting cargo preference requirements and may have restricted offers. For loading,

> "Any ten days Sept. 10/25, 1982, but Charterers prefer to ship in three shipments of about 22,000 tons each evenly spread within these dates."

The charterer's preference for dividing the cargo into three similar-sized shipments complicated meeting cargo preference requirements. Agriculture approved one U.S. flag vessel to carry 28,000 tons (the largest tonnage offered by a U.S. flag vessel), another U.S. flag vessel at 4,470 tons, and a foreign flag vessel at 32,466 tons. Did the charterer's preference for three shipments at 22,000 tons influence U.S. flag vessels not to offer? Would a lower U.S. flag vessel rate have been obtained if the preference was not included in the tender? While it is impossible to make such judgements after the fact, we believe Agriculture needs to do more to identify such restrictive tender terms because of the potential cost implications to the United States.

Chapter 4

Accurate Guideline Rates are Important. We leave commentary on this section to the Maritime Administration which has responsibility for guideline rates.

Vessel Backhauling and Scrapping--Potential for Excessive Profits. We have drafted proposed regulations requiring U.S. flag vessels beyond a certain age to include scrap rates in their charter parties. We hope to publish these proposed rules for comment this year. Meanwhile, it is our policy to request importing countries to obtain scrap rates from U.S. flag non-liner vessels whenever we have reason to believe that such vessels might be scrapped following a Title I/III delivery. The Maritime Administration has been providing guideline scrap rates to us on such vessels, although we have been concerned about the method used for computing such rates. We have taken the position that the scrap rate should only apply to the final port of discharge. MARAD, however, has computed the scrap rate including travel to the actual scrap port.

An example of the difference in the one-way scrap rate to the port of discharge versus port of scrap is as follows: We approved a U.S. flag vessel from the U.S. Gulf to Karachi at $71.87 per metric ton (round trip basis) and $61.58 per metric ton (one-way basis). Thereafter, the owner decided to scrap the vessel at Chittagong, Bangladesh (about 2,600 miles more distant). In response to our request for a one-way rate to Chittagong, MARAD stated that the rate of $71.87 per metric ton was fair and reasonable.

We have doubts about the wisdom of seeking refunds from U.S. vessels which return with backhaul. Presumably, refunds would be obtained only when vessels had obtained the full guideline rate--an event that has occurred rarely during the past 2 years. The costs of monitoring and enforcing such a provision might exceed the revenues obtained. It might also be worthwhile considering whether it would be wise to create an implicit disincentive to U.S. vessels to seek backhaul cargo.

APPENDIX II

Conclusion

We ask that you consider the above views of USDA in developing your final report. In addition, we ask that you consider carefully the comments in the enclosure on some of the specific examples you cite in your draft report.

Sincerely,

Robert J Cammer for

Richard A. Smith
Administrator

Enclosure

Comments on Specific Issues

Closed tenders do not provide adequate controls (Page 11).

In an example illustrating the importance of foreign flag freight bids in relation to the amount of ocean freight differential to be paid by CCC, reference was made to a U.S. flag vessel contracted to carry a 10,500 ton shipment of bulk soybean oil. The freight rates for the three responsive foreign flag offers were $75.00, $74.90 and $54.60 per ton--a spread of $20.30 between the lowest foreign flag offer and the next lowest offer. The OFD was based on the rate of the offer of a vessel that would have transported the cargo in the absence of cargo preference--i.e., the offer of $54.60 per ton. GAO has stated, "Accordingly, the United States paid $213,150 on additional OFD resulting from the low offer, lowering the country's payment by an equal amount."

As we read the above statement, the implication is that USDA should not have used the lowest offered rate in computing the OFD. No explanation whatsoever has been provided in the GAO draft report to support this implication. By contrast, in a memorandum to the file, USDA compared in detail the $54.60 rate with the rates of other vessels under similar terms and conditions and found the rate used in the OFD computation to be in line with the market. Therefore, we request that the GAO delete any implication in its report that USDA's use of this rate was improper.

USDA recognizes that we cannot rule out the possibility of attempts being made to manipulate foreign flag offers to increase OFD payments. As suggested by GAO, we could send a representative to the office of the country agent to observe the receipt of offers, but this will not make offers any more legitimate. We would appreciate any additional suggestions GAO may be able to make regarding cost effective means of addressing this issue.

GAO evaluation

The sole purpose of our example was to illustrate the importance of foreign flag bids in the OFD computation. We did not intend to imply that Agriculture erred in its calculation of OFD or that the lowest bid used in the calculation was nonresponsive. To avoid any such implication, we have modified the language in this example. With respect to the possibility that foreign flag offers might be manipulated to increased OFD payments, we believe that the publicly open bidding system we recommend would reduce this possibility.

Allocating Cargo Between U.S. and Foreign Flag Vessels

Example 5 (Page 28)

We do not agree with GAO's statement, "While Agriculture did follow established procedures, we believe the approximate $2.1 million in savings should have dictated the use of the GOLDEN DOLPHIN." If USDA had approved the use of the GOLDEN DOLPHIN, a subsidized vessel, at the rate offered, this movement would not have counted as an eligible U.S. flag movement, since the rate was higher than MARAD permitted as a condition to the GOLDEN DOLPHIN's eligibility to carry preference cargo. USDA would, therefore, have been vulnerable to the charge of wasting money on U.S. flag vessels which do not qualify for cargo preference. We suggest that GAO either delete Example 5 from the proposed draft report or retract the statement that USDA could have saved $2.1 by approving the GOLDEN DOLPHIN.

GAO evaluation

In our draft report, we used an example involving a U.S. bulk carrier, the Golden Dolphin, which receives an operating differential subsidy from Maritime. The Golden Dolphin was the low U.S. flag bidder for a cargo of bulk wheat, but Agriculture disqualified the vessel because its owner would not accept a lower rate at or below the Maritime guideline rate which was calculated to compensate for the vessel's subsidy. As a result, Agriculture paid an additional $2.1 million OFD for shipment of the cargo on three other U.S. flag vessels. We believed that, although Agriculture followed established procedures, it should have attempted to minimize its costs in this instance.

Maritime officials confirmed Agriculture's statement that had it selected the Golden Dolphin, the cargo transported would not have counted toward meeting the cargo preference requirement because the vessel's bid would not have been accepted as fair and reasonable.

In its written comments, Maritime said that our discussion did not reflect the true complexity of certain litigation (which involved the entry of subsidized bulk carriers in preference cargo trade) and Maritime's efforts to balance the benefits of subsidies with the cargo preference law. Maritime concluded that "in the total context and in the context of the government's total subsidy costs, we do not agree that Agriculture acted improvidently."

We agree that the decision not to select the Golden Dolphin was complicated by the litigation and competitive considerations and have deleted the example. It is understood that the application of cargo preference will result in higher costs by using U.S. flag vessels instead of foreign flag vessels. In this example, however, at issue is the higher cost of selecting a certain U.S. flag vessel over others. A less expensive vessel designed to carry bulk commodities was replaced by two liners and a tanker at substantially higher rates.

APPENDIX III

U.S. Department of Transportation

Assistant Secretary for Administration

400 Seventh St., S.W.
Washington, D.C. 20590

MAR 25 1985

Mr. J. Dexter Peach
Director, Resources, Community
and Economic Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

We have enclosed two copies of the Department of Transportation's (DOT) reply to the General Accounting Office (GAO) draft report, "Transportation of Public Law 480 Commodities - Efforts Needed to Eliminate Unnecessary Costs," dated January 30, 1985.

GAO recommends improvements in the bidding and negotiation process that the U.S. Department of Agriculture (USDA) follows for transportation of P.L. 480 commodities. The report also recommends improvement in the DOT/Maritime Administration (MARAD) policies and procedures for providing fair and reasonable rate guidelines to shipper agencies. DOT's comments are directed only at those recommendations which involve MARAD's guideline rate activity, as set forth in Chapter 4 of the draft report.

GAO recommends that the Secretary of Transportation direct the Maritime Administrator to devise and institute a method for assessing whether liner rates represent cost plus a reasonable profit. MARAD is proceeding with an evaluation of the impact of implementing procedures and the development of an effective fair and reasonable rate methodology, and is planning to issue a Notice of Proposed Rulemaking to establish guidelines.

GAO also recommends that vessel owners should be required to have their independent accountant semi-annually certify that vessel cost and operating data are accurate. It is unclear whether this recommendation was directed only toward bulk vessels or toward liners as well. In either case, DOT agrees that costs used for determining fair and reasonable rates should be verifiable. However, we favor an alternative approach whereby vessel operators would submit operating data and certify its accuracy.

GAO further recommends that the Secretary of Agriculture issue regulations requiring certification that bulk vessels did not carry cargo on the return leg of a preference cargo voyage. DOT believes it would be practical to implement this recommendation only with respect to known one-way voyages or for backhauls involving preference cargo.

If we can be of further assistance, please let us know.

Sincerely,

Jon H. Seymour

Jon H. Seymour
Acting

Enclosure

DEPARTMENT OF TRANSPORTATION
MARITIME ADMINISTRATION

Response to Draft GAO Report - Transportation of Public Law 480 Commodities - Efforts Needed to Eliminate Unnecessary Costs

The draft report recommends improvements in the bidding and negotiation process USDA follows for transportation of P.L. 480 commodities and in MARAD's policies and procedures for providing fair and reasonable rate guidelines to shipper agencies. MARAD's comments are directed only at those recommendations which involve MARAD's guideline rate activity, as set forth in Chapter 4 of the draft report.

GAO RECOMMENDATION

That the Secretary of Transportation direct the Maritime Administrator to devise and institute a method for assessing whether liner rates represent cost plus a reasonable profit.

MARAD RESPONSE

MARAD has recognized the desirability of an appropriate procedure for considering the reasonableness of rates on preference cargoes moving on U.S.-flag liner vessels, and has undertaken to devise and institute an appropriate methodology. Moreover, OMB has raised this issue in its FY 1986 ODS budget passback and has requested preparation of an NPRM to establish fair and reasonable rate guidelines for liner vessels. Accordingly, MARAD is proceeding with an evaluation of the impact of implementing procedures and the development of an effective fair and reasonable rate methodology.

It should be noted, however, that allocation of costs on liner service against particular and occasional large parcels of preference cargo is an extremely complex matter. The factors on which the liner operator bases its rate may take into account a variety of current conditions affecting the particular country trade, as well as the liner operator's own immediate operational status. These may be factors which cannot readily be perceived when determining the reasonableness of individual rates. Nonetheless, MARAD is attempting to resolve these concerns in developing a guideline method, described above.

GAO RECOMMENDATION

That vessel owners should be required to have their independent accountant semi-annually certify that vessel cost and operating data are accurate.

MARAD RESPONSE

It is unclear whether this recommendation was directed only toward bulk vessels or toward liners as well. In either case, we agree that costs used for determining fair and reasonable rates should be verifiable. However, we favor an alternative approach whereby vessel operators would submit operating data and certify its accuracy. Many companies already certify the accuracy of data submitted to MARAD under various programs. As in those instances, the government would retain the right to verify the submitted information as it deems necessary. These requirements are already included in our draft NPRM which establishes a fair and reasonable rate methodology for liquid and dry bulk carriage of preference cargoes. We would incorporate similar requirements for liner vessel carriage of preference cargoes in the NPRM on liner vessels described in our response to the previous recommendation.

GAO RECOMMENDATION

That the Secretary of Agriculture issue regulations requiring certification that bulk vessels did not carry cargo on the return leg of a preference cargo voyage. The regulations would also provide for recalculation of the guideline rate if the vessel obtains cargo on the return voyage or if it is scrapped or sold overseas.

MARAD COMMENT

Conceptually, the idea is sound. However, the instances of U.S.-flag bulk carriers securing return cargo after outbound voyages carrying preference cargo are extremely rare. When they do occur they are likely to involve a lengthy interval of lay up for the vessel before it can make a homebound cargo and the possibility of a substantial ballast voyage to position the vessel for a return cargo. Should a vessel lay up at a foreign port for an extended period of time before securing a return cargo, the lay up time could logically be considered as equivalent to the homebound ballast voyage provided for in the original guideline rate. Accordingly, we believe it would be practical to implement this recommendation only with respect to known one-way voyages or for backhauls involving preference cargo.

With respect to overseas scrapping or sale, it is already current policy to determine fair and reasonable rates on a one-way basis for preference cargo voyages of vessels which are to be scrapped or sold overseas after cargo discharge. For example, over the past 2 years MARAD has consistently made available on request to USDA and AID, before a vessel offer is approved by the agency, an alternative guideline rate for any voyage on which a vessel aged in excess of 20 years, may be sold overseas for scrap purposes and accordingly may not be returned to the United States. (Rates for vessels of less than 20 years old are provided if desired by the shipper agency.) There have been repeated instances of such sales for scrapping. It is our understanding that the agencies have been responsive in making provisions with the vessel operators to recapture the difference between the roundtrip rate and the rate based on scrapping overseas.

One final comment not directly associated with a specific recommendation is in order. The example involving the Golden Dolphin (pp. 28-29) concludes that the Department of Agriculture should have fixed that vessel and would have saved in transportation costs. While reference is made to certain litigation, the discussion does not reflect the true complexity of the litigation and Maritime's program efforts to balance the benefits of subsidies with the cargo preference law, while avoiding conferral of undue advantage over other U.S.-flag vessels. In the total context and in the context of the Government's total subsidy costs, we do not agree that Agriculture acted improvidently.

#

(483370)

31467