United States General Accounting Office 139939

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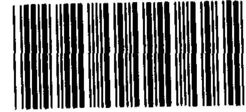
Testimony



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For Release on

Delivery Expected at 2:30 p.m. EST Tuesday November 7, 1989

PL 480 Title I Transporation Issues

Statement of
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Before the
Committee on Agriculture, Nutrition, and Forestry
U. S. Senate

047005/139939

GAO/T-NSIAD-90-08

GAO Form 160 (12/87)

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss with you our observations on P.L. 480 Title I transportation issues. Our work was conducted at your request and updates issues addressed in prior GAO reports[1] which identified various problems in the way the Department of Agriculture (USDA) managed ocean transportation of P.L. 480 commodities.

In essence, we have been concerned for several years that existing practices have not ensured that USDA's transportation costs are the lowest possible and that USDA's procedures and controls have not ensured that the integrity of the process is adequate.

Although USDA has taken some corrective actions in response to our prior reports, such as instituting open bidding, our recent work indicates that several transportation issues still warrant additional consideration. These include

-- delays in payment of vessel owners by recipient countries, which increase shipping costs;

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[1]Transportation of Public Law 480 Commodities--Efforts Needed to Eliminate Unnecessary Costs (GAO/NSIAD-85-74) June 18, 1985; Opportunities for Greater Cost Effectiveness in Public Law 480, Title I Food Purchases (GAO/NSIAD-84-69) April 19, 1984; Cargo Preference Requirements Add To Costs Of Title II Food For Peace Programs (GAO/OCE-84-3) August 2, 1982; Economic Effects Of Cargo Preference Laws (GAO/OCE-84-3) January 31, 1984.

-- the clustering of tenders, which creates peak demand and increases shipping costs;

-- the role of country agents, which increases the risk of irregularities in the program; and

-- the lack of sufficient government control of the program.

BACKGROUND

Under Title I, concessional credits are provided by the U.S. government to developing countries to purchase and import U.S. agricultural commodities. Recipient countries are responsible for paying shipping costs for the commodities that are in effect equal to the free market cost for ocean transportation. However, because of U.S. cargo preference law, 75 percent of the P.L. 480 commodities have to be shipped on U.S. flag vessels which are more costly than foreign flag vessels. For commodities shipped on U.S. flag vessels, USDA pays the difference between the average rate of foreign flag vessels that would have been selected without cargo preference and the higher cost of shipping on U.S. flag vessels. This difference is called the ocean freight differential (OFD). Since P.L. 480's inception in 1954, the United States has paid approximately $1.8 billion in OFD to U.S. shippers.

Shipping Title I commodities involves several participants: the recipient country, the country agent, the ship owner, the ship broker, the commodity supplier, and USDA. Once USDA issues a purchase authorization for commodities, it is the responsibility of the foreign country, subject to USDA approval, to procure the commodities and arrange the ocean transportation, directly or through its agent. In fiscal year 1989, all but two recipient countries had country agents. 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. USDA approves the public transportation tenders issued by the country agents. Country agents receive a commission of 2-1/2 percent of the freight costs if they use U.S. flag ships. This commission is shared with ship brokers if they are used.

The ship owners of U.S. and foreign flag vessels bid for shipments of P.L. 480 commodities, often with the assistance of brokers. The broker's function is to make the ship owner aware of potential business, ascertain and explain the tender terms, and assist the ship owner in winning the tender at the highest possible freight rate. Once the commodity and freight tenders are announced, the freight bids and the commodity bids are submitted. USDA then matches the two types of bids to come up with the "lowest landed cost", i.e. the lowest combination of commodity and transportation costs. As part of the transportation process, USDA

relies on the Maritime Administration (MARAD) to ensure that the rates offered by the U.S. flag vessels are fair and reasonable.

IMPLEMENTATION OF OPEN BIDDING

In 1985 we recommended that USDA require transportation offers to be opened publicly to eliminate or minimize the problems in the bidding and negotiation process. That recommendation was finally implemented, nearly 4 years later, on May 25, 1989.

Open bidding appears to have improved the integrity of the bidding process and introduced openness and transparency into the heretofore closed negotiating process for shipping rates. Bids are now opened and read in public and the lowest bidder meeting the tender terms is selected without negotiations. Vessel owners, knowing there is no negotiation of rates, have a strong incentive to submit their lowest offers on the initial bid. Ship owners we interviewed said that open bidding is better than closed bidding because it is more equitable in that everyone has a chance to qualify. Thus, open tenders may promote lower costs through greater participation in the bidding process.

LATE PAYMENT

U.S. ship owners experience substantial delays in recovering payment from recipient countries. Several ship owners we met with

complained that they have significant problems with collecting freight payments. Such delays eventually result in higher transportation costs, including higher OFD payments by the U.S. government.

Recipient countries usually pay 90 percent of the transportation charges upon discharge, and the 10 percent balance is withheld as cargo shortage claims. This procedure is contrary to the standard bulk shipping practice which mandates 100% freight payment on completion of the cargo loading. A sample taken by MARAD of the 10 percent withholding from U.S. flag carriers showed that they had arrearages during a one year period (April 1, 1988 to March 31, 1989) in excess of $11 million. One MARAD official told us they had received complaints on this issue and referred them to USDA.

According to ship owners, such payment delays cost them money and increase their operating costs. The cost to the U.S. government is higher because higher costs result in higher freight rates and larger OFD payments. According to one ship owner, the delays in paying the 10 percent of freight charges can take many months, with one unresolved case still pending after 16 months. This same ship owner had 21 P.L. 480 shipments between July 1986 and November 1988 and estimated that compared with commercial credit terms, the opportunity cost of late payments, which was approximately $514,000, increased the company's cost by one percent.

According to ship owners, USDA does not take action against countries which are delinquent in paying shipping costs. USDA maintains that it is limited in what it can do because it is not a party to the shipping contract which is between the recipient country and the shipper. However, it reports that it does initiate contact with countries with delinquent payments asking them to correct the problem.

In light of the problems encountered by U.S. shippers, USDA may wish to reassess its position on this issue. For example, MARAD considered the issue important enough to recommend to USDA that the payment terms be changed to 95/5 percent. The delay in receiving payment raises the cost to the shipping companies who, in turn, raise the rates they charge. These higher rates increase the U.S. government's OFD payments. Addressing the issue could lower program costs.

CLUSTERING OF TENDERS

The clustering of tenders during the third and fourth quarters of the fiscal year also increases freight rate costs. This has been a perennial problem with the P.L. 480 program. Our analysis of the 1988 shipments showed that tenders were heavily skewed during the last two quarters. Such clustering causes heavy demand for the limited number of U.S. flag ships toward the end of the fiscal year in order to satisfy the cargo preference requirement.

Concentrating demand in this way usually results in higher prices, and likely leads to higher freight costs. Spreading the shipment of P.L. 480 commodities more evenly over the year could eliminate peaks in demand and lower shipping costs. This, in turn, could lower the program's cost to the U.S. government.

According to a USDA official, clustering takes place because of prolonged negotiations between the U.S. government and recipient countries to draw up the basic annual country agreements that specify the terms and conditions binding the recipient countries.

In our 1984 report on improving the cost effectiveness of P.L. 480 we concluded that Title I tenders should be spread out over the year. A USDA official told us that there have been improvements in signing country agreements early in fiscal year 1989. However, clustering continues to occur.

TENDER STRUCTURING

Over a dozen representatives of the U.S. government, shipping industry, and some agents and brokers have expressed concerns about improprieties relating to country agent operations. These concerns include the possibility of questionable payments and the potential for country agents to structure transportation tenders to favor particular ship owners. Even under open bidding, country agents still write the tender specifications, subject to USDA

approval, and these specifications can affect competition. For example, unnecessarily restrictive vessel length and depth limits in the tender can affect the extent of competition or the rates offered by competing vessels.

CARGO PREFERENCE

Cargo preference as legislated is designed to help maintain the U.S. merchant marine industry and thereby assure that in time of war the United States would have a merchant marine fleet of its own to transport material and troops. To help accomplish this goal, at least 50 percent of U.S. government-financed shipments was required to be carried on U.S. flag vessels. The Food Security Act of 1985 increased this requirement for P.L. 480 shipments to 75 percent. MARAD pays to USDA the additional 25 percent incremental cost above the original 50 percent ceiling.

In 1988, Title I commodity costs were budgeted at $788 million. The OFD cost of the cargo preference requirement was approximately $79.2 million in calendar year 1988.

We have issued two reports on cargo preference and are currently undertaking a congressionally requested review of the agricultural trade implications of cargo preference, including its cost to the U.S. government.

EXTENT OF GOVERNMENT INVOLVEMENT

Because of continuing perceptions of the vulnerability of the program to abuse, several proposals involving greater U.S. government involvement in the P.L. 480 Title I transportation process have been suggested. Several ship owners, country agents, and government officials we met with stated that if USDA better controlled the process, the potential for program abuse would be reduced.

One program participant formally proposed that USDA appoint its own agents to handle all matters relating to U.S. flag and any other ocean freight financed by USDA. Such a move would give USDA more direct control over freight expenditures and would lessen concerns relating to fraud and abuse.

Similarly, a USDA official told us that having the government fulfill the role of the country agent may enhance the program's image and provide greater control over shipping operations. He added that 10 and 15 additional employees would be needed for USDA to carry out this function. Because of these additional budget expenditures he did not consider it possible at this time.

We believe the proposal that calls for USDA to assume the country agent role deserves further attention by USDA. While it would necessitate an increase in USDA staffing it should also result in

a reduction in program costs through the elimination of country agent fees. USDA should determine whether it is cost-effective for the U.S. government to undertake this responsibility. If the proposal can reduce program costs and at the same time reduce the perceived vulnerability of the program to irregularities it should be implemented.

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Mr. Chairman and Members of the Subcommittee, this concludes my statement. I will be happy to answer any questions you may have.