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Report to Congressional Requesters

September 1994

CARGO PREFERENCE REQUIREMENTS

Objectives Not Significantly Advanced When Used in U.S. Food Aid Programs

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The Honorable John B. Breaux
Chairman, Subcommittee on Merchant Marine
Committee on Commerce, Science and
Transportation
United States Senate

The Honorable Timothy J. Penny
Chairman, Subcommittee on Foreign
Agriculture and Hunger
Committee on Agriculture
House of Representatives

As you requested, we reviewed how cargo preference requirements apply to U.S. food aid programs. In our report we have provided matters for congressional consideration regarding the continued application of cargo preference requirements to food aid programs and made recommendations to the Secretaries of the Departments of Agriculture and Transportation and to the Administrator of the Agency for International Development that are intended to improve the management of this application, should it continue.

Copies of this report have been sent to the Secretaries of the Departments of Agriculture, Defense, State, and Transportation; the Administrators of the Agency for International Development, the Foreign Agricultural Service, and the Maritime Administration; the Director of the Office of Management and Budget; and other interested parties. Copies will also be made available to others on request.

Please contact me at (202) 512-4812 if you or your staff have any questions concerning this report. The major contributors to this report are listed in appendix X.

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Executive Summary

Purpose

Over the past 3 years, an average of about $200 million per year in government funds has been used to pay the added cost of shipping U.S. food aid to foreign countries on U.S.-flag ships rather than on lower-cost foreign-flag ships. Since 1954 Congress has required that a certain percentage of U.S. food aid be transported on U.S.-flag ships. This requirement is known as "cargo preference." The current requirement is that 75 percent of food aid tonnage be shipped on U.S.-flag ships. Although this rule results in higher transportation costs for U.S. food aid programs, the objective of this requirement is to help ensure that an adequate and viable merchant marine is maintained (1) to serve as a naval auxiliary in times of war or national emergency and (2) to carry a substantial portion of U.S. domestic and foreign waterborne commerce.

Due to the additional costs associated with transporting food aid on U.S.-flag ships, the Chairman of the Subcommittee on Merchant Marine, Senate Committee on Commerce, Science, and Transportation, and the Chairman of the Subcommittee on Foreign Agriculture and Hunger, House Committee on Agriculture, asked GAO to examine how cargo preference requirements apply to U.S. food aid programs. Specifically, GAO agreed to determine

- whether the application of cargo preference requirements to food aid programs is meeting the intended objectives of helping to maintain U.S.-flag ships (1) to serve as a naval and military auxiliary in time of war or national emergency and (2) to carry a substantial portion of U.S. waterborne domestic and foreign commerce,
- how cargo preference requirements affect U.S. food aid programs, and
- how practices currently used by the U.S. Department of Agriculture (USDA) and the Agency for International Development (AID) in managing food aid transportation affect its costs.

Background

Currently available data show that in 1991 U.S.-flag ships transported about 4 percent of all waterborne commerce imported into or exported from the United States (foreign commerce). Food aid preference cargos accounted for less than one-fourth of that percentage.

For the period 1990-93, 84 percent of the food aid tonnage transported on U.S.-flag ships was bulk commodities, such as wheat or corn, shipped on bulk carriers, tug/barge combinations, and tankers. These ships were typically chartered for specific voyages. Processed products such as cans of vegetable oil, or bags of flour or rice, accounted for the remaining

16 percent of the food aid tonnage and were typically transported on ships that provided a regularly scheduled service between specific ports known as "liner" service.

In addition to cargo preference, the Merchant Marine Act of 1936, as amended, established subsidy programs to help support the U.S. merchant marine. These subsidies help (1) offset the high costs of constructing ships in U.S. shipyards and (2) U.S. shipowners compete with their foreign competitors by offsetting higher U.S. operating costs.[1] Congress developed these programs in response to general downturns in the U.S. maritime industry, to support a U.S. merchant marine sufficient to meet the objectives of the Merchant Marine Act of 1936.

In doing its work, GAO obtained cargo preference data and related information from AID, USDA, the Department of Defense (DOD), the Maritime Administration,[2] the World Food Program, two private voluntary organizations that assisted AID in distributing U.S. food aid, and several international shipbrokers. GAO also obtained ship data, as well as U.S. shipowners' views on the cargo preference program, through a structured interview conducted with representatives of 18 U.S. shipping companies. Together, these companies transported over 80 percent of U.S. food aid tonnage during the previous 3 years.

Results in Brief

The application of cargo preference to food aid programs does not significantly contribute to meeting the intended objectives of helping to maintain U.S.-flag ships as a naval and military auxiliary in time of war or national emergency or for purposes of domestic or foreign commerce. While applying cargo preference requirements to food aid programs does help support some U.S.-flag ships and their crews, in the case of serving as a naval and military auxiliary, DOD does not view the U.S.-flag ships employed to transport bulk commodities for food aid programs as militarily useful. As for the crews that support those ships, DOD believes that they could be a potential source of manpower for the Ready Reserve

[1]Since 1982 no funding has been provided for ship construction subsidies, and the Clinton administration has entered into an agreement with the Organization for Economic Cooperation and Development to eliminate government subsidies for shipbuilding by January 1, 1996. In addition, current subsidies for offsetting operating costs will expire by December 1998, although the Clinton administration has submitted proposed legislation to Congress that would continue operating support by establishing a similar subsidy program.

[2]The Maritime Administration is an agency of the U.S. Department of Transportation.

Force (RRF)[3] but does not believe that applying cargo preference to food aid programs is a cost-effective means of providing for crews.

In the case of domestic commerce, cargo preference is not an issue because all U.S. waterborne domestic cargo is already reserved for U.S.-flag ships by requirements included in the Merchant Marine Act of 1920, commonly referred to as the "Jones Act." And in the case of foreign commerce, GAO determined that the U.S.-flag ships that transported the majority of food aid preference cargos were unable to compete successfully for other foreign commercial cargos because their operating costs were too high compared to the operating costs of their foreign-flag competitors. The U.S.-flag ships that DOD find militarily useful are liners. However, for over 75 percent of these ships, transporting food aid cargo is not the reason that they maintain their U.S.-flag status. Moreover, liners are generally able to compete for foreign commercial cargos largely due to subsidies they receive to place their operating costs at a parity with those of their foreign competitors.

A principal factor contributing to the high cost of operating U.S.-flag ships is the U.S. laws and regulations with which a shipowner must comply to operate a U.S.-flag ship. For example, U.S. laws require that a U.S.-flag ship be crewed by U.S. citizens. Due to higher wages and benefits, these crews cost several times the amount of foreign crews. Also, shipowners whose ships primarily carry bulk food aid preference cargos have reduced incentives to invest in newer and more efficient ships to lower their operating costs. This is because of the cost to construct ships in U.S. shipyards; the 3-year exclusion of foreign constructed ships from preference cargos; and the guideline shipping rates, which are based on the actual costs of each individual ship, irrespective of its efficiency. Thus, cargo preference laws make it possible for U.S. shipowners to maintain inefficient and commercially noncompetitive U.S.-flag ships that do not significantly contribute to the ability of the U.S. merchant marine to carry foreign commerce other than food aid.

Additionally, cargo preference adversely affects the operation of U.S. food aid programs. The most significant impact of applying cargo preference to food aid programs is the additional costs associated with using U.S.-flag ships to transport food aid. As the funds not spent on transportation may, in some instances, be used to purchase food, using U.S.-flag ships may reduce the funds available to purchase commodities. Thus, the amount of

[3]The Ready Reserve Force is a specific component of the National Defense Reserve Fleet. Ships in the Ready Reserve Force are kept at a state of readiness that enables them to be activated in 4, 5, 10, or 20 days to meet military sealift surge requirements in event of war or emergencies.

commodities delivered to recipient countries may be decreased. Other adverse impacts include not purchasing commodities at the lowest available price, or purchasing a different variety of commodity than originally planned. These adverse impacts occur because commodity purchasing decisions can be driven by the geographic availability of U.S.-flag ships, rather than the geographic availability of the lowest priced or most desired commodity.

Finally, several of the practices USDA and AID used to manage food aid transportation affect transportation costs. One of these practices is to require shipowners to accept contract terms that require them to arrange and pay for services that are typically the responsibility of the commodity supplier or buyer in commercial sales. Another is the concentration of food aid shipments into the last half of the year, which creates a high demand for limited U.S.-flag transportation services, thus driving up shipping rates.

Principal Findings

Objectives of Merchant Marine Act of 1936 Not Significantly Furthered by Food Aid Preference Cargos

The Merchant Marine Act of 1936, as amended, established that a U.S. merchant marine shall be maintained that would be capable of serving as a naval auxiliary in times of war or national emergency and of carrying a substantial portion of U.S. domestic and foreign waterborne commerce. The application of cargo preference to food aid cargos helps maintain U.S.-flag ships and their crews. However, DOD does not currently view the U.S.-flag ships that transported 84 percent of food aid cargo preference tonnage—bulk carriers, tankers, and tug/barge combinations—as militarily useful. DOD believes that the U.S.-flag ships that participate in the food aid programs that are militarily useful are those engaged in providing liner service. DOD said these ships are an efficient way to transport ammunition and supplies. However, for the last 3 years, they transported only 16 percent of food aid tonnage carried on U.S.-flag ships. Furthermore, for over 75 percent of these ships, food aid cargo is not the reason they maintain their U.S.-flag status. Many of these ships are able to secure foreign commercial cargos because they receive annual operating subsidies from the Maritime Administration. These subsidies enable them to offer competitive rates and service.

As for crews, there are currently about 21,000 mariners in the U.S. merchant marine labor pool. DOD said that the mariners used on bulk carriers, tankers, and tug/barge combinations that transport food aid could be used as a potential source of manpower for the RRF. According to the Maritime Administration (MARAD), an agency of the Department of Transportation, the mariners used on the bulk carriers—which carry the majority of food aid cargos—number about 800. This represents less than 4 percent of the total labor pool. According to DOD, the RRF currently requires approximately 3,700 mariners. GAO believes that, given the size of the merchant marine pool, there should not be a labor supply problem for the RRF in the near future, even if the crew supported by the ships that carry the majority of food aid tonnage are not counted. Nevertheless, the size of the labor pool has been steadily declining over the years as the number of U.S.-flagged ships has decreased. DOD recognizes that as the U.S. merchant marine continues to decline, other alternatives for crewing the RRF may need to be considered in the future.

U.S.-flag bulk carriers and tug/barge combinations, which do not receive or use operating subsidies, are virtually dependent on food aid preference cargos to operate as U.S.-flag ships because they are unable to successfully compete for commercial cargos in foreign commerce. Therefore, these U.S.-flag ships contribute little to the ability of the United States to carry its foreign commerce other than food aid. Almost all U.S.-flag tankers that carry bulk food aid preference cargos receive annual operating subsidies to help them compete for foreign commercial cargos. However, because these subsidies are expiring, tankers have been and will become more dependent on food aid preference cargos. Without operating subsidies, U.S.-flag ships cannot successfully compete for foreign commercial cargos, in part due to the additional costs associated with complying with the U.S. laws and regulations required for all U.S.-flag ships. U.S. laws and regulations require that U.S.-flag ships be constructed to U.S. Coast Guard safety standards. These standards are more stringent than international standards and add to the construction cost of U.S.-flag ships. U.S. law also requires that owners of U.S.-flag ships either maintain or repair them in a U.S. shipyard, whose services are more expensive than those available at a foreign shipyard, or pay a 50-percent U.S. Customs duty on the value of work done in a foreign shipyard. Even with the added cost of the 50-percent duty, U.S. shipowners told GAO that they still find it advantageous, in most circumstances, to have maintenance work on their ships done in foreign shipyards. In addition, U.S.-flag ships are required to employ U.S. citizen crews. This requirement greatly increases shipowners' operating costs because wages and benefits paid to U.S. crews are several times those of a foreign crew.

Moreover, U.S. shipowners whose ships carry food aid preference cargos have reduced incentives to lower their costs. For example, one of the primary ways that U.S. shipowners can lower their operating costs is to invest in newer, more efficient ships. U.S. shipowners are discouraged from doing this because of the high cost of constructing ships in U.S. shipyards. Also, current legislation requires that ships constructed in less expensive foreign shipyards be operated as U.S.-flag ships for 3 years (which, because of the higher operating costs, makes it almost impossible to compete without some form of assistance) before they are eligible to carry food aid preference cargos. Furthermore, since there is a limited number of U.S.-flag ships available to carry these cargos, and the Maritime Administration's "fair and reasonable" guideline rates—which establish the maximum rates that the government should pay—are constructed for each individual ship based on its actual costs, shipowners are able to secure food aid preference cargos despite the high cost of operating their older, inefficient U.S.-flag ships. As a result, the U.S.-flag ships and crews supported by this program increase the cost to transport U.S. food aid preference cargos.

Cargo Preference Laws Adversely Affect U.S. Food Aid Programs

Over the last 3 years the food aid programs have paid U.S. shipowners almost $600 million in ocean freight differential, according to USDA data, which GAO understands to be the best available. Ocean freight differential is the difference between the rates per ton charged by owners of U.S.-flag ships used to carry food aid cargos and the rates that would be charged by owners of less expensive foreign-flag ships. Generally, USDA pays two-thirds of this cost differential and the Maritime Administration pays one-third. For several of the food aid programs, the amount spent on this differential reduces the amount available to purchase commodities. For example, for one of these programs, the funds available for each country must be used to purchase both the commodity and its transportation. Therefore, the amount spent on U.S.-flag transportation directly affects the amount of commodity that can be purchased.

Additionally, for several of the food aid programs, countries are sometimes unable to purchase the lowest cost commodity, or the desired variety of commodity. This situation occurs when no U.S.-flag ships are available at the ports where these commodities are located, or when those U.S.-flag ships available are not appropriate to carry the commodity. For example, for a recent wheat purchase for Tunisia, Tunisia was unable to take advantage of the four lowest offers because no U.S.-flag ships were available to pick up the wheat at the times when and locations where it was available. To comply with cargo preference requirements, Tunisia was forced to obtain more expensive wheat that was available where U.S.-flag ships were also available. In addition, several countries have been interested in obtaining western white wheat that is obtainable from the West Coast of the United States. However, the availability of U.S.-flag ships on the West Coast is limited because food aid cargos are not often shipped from the West Coast. This situation has forced the recipient countries to obtain different varieties of wheat available in the Gulf of Mexico, where U.S.-flag ships are also more readily available.

Certain USDA and AID Management Practices Affect Food Aid Transportation Costs

USDA and AID require shipowners to provide additional services to food aid recipient countries through the use of contract terms in transporting food aid cargos that are not typically required of shipowners whose ships carry similar commercial cargos. For example, for most landlocked countries, USDA and AID require shipowners to arrange and pay for transporting the commodity from the discharge port to its final destination. USDA and AID may also require shipowners to arrange and pay for any fumigation services required at the discharge port. USDA and AID choose to provide these services through the shipowners to give additional financial assistance to these needy countries. These additional services may increase transportation costs because they place additional costs and risks on the shipowners. Since shipowners must estimate the cost of providing these services before they are delivered and are paid based on their estimates, it is uncertain whether USDA and AID are paying more or less than the actual costs of providing these services.

Food aid transportation costs have also been increased because food aid shipments have not been spaced evenly throughout the year but are concentrated in the last half of the year. For example, in 1992, 94 percent of the food aid tonnage under one food aid program was shipped between July and December. And for 1993, 73 percent of the food aid tonnage was shipped between July and December. This concentration of food aid shipments caused increased demand for the limited number of U.S.-flag ships available and, on average, resulted in higher U.S.-flag shipping rates. The higher shipping rates were due to the entry of higher-cost U.S.-flag ships to meet the increased demand—which raised the cost of transporting food aid preference cargos.

Matters for Congressional Consideration

If Congress continues to support the objectives for which cargo preference is applied to food aid programs and is willing to continue to devote resources to that end, Congress may wish to consider a more efficient alternative for achieving those objectives. For example, a program like the current subsidy program that offsets ship operating costs, which will have expired by 1998, could be used to support those ships, and their crews, that DOD finds militarily useful and that could also successfully compete for U.S. foreign commercial cargos.

If Congress decides to continue to apply cargo preference to food aid programs, it may wish to consider giving U.S. shipowners incentives to invest in more efficient ships in order to reduce food aid transportation costs.

Recommendations

GAO makes recommendations to AID, USDA, and the Maritime Administration focused on reducing food aid transportation costs (pp. 44 and 66). While these recommendations should help reduce food aid transportation costs, they will not help achieve the intended objectives for which cargo preference requirements are applied to food aid programs.

Agency Comments

GAO obtained written comments on a draft of this report from AID, DOD, USDA, and the Department of Transportation (DOT). These comments are presented and evaluated in chapters 2 and 4, and in appendixes VI through IX. DOT's Maritime Administration said that it was "...troubled by conclusions and implications which are either not supported by verifiable data, or which mischaracterize the issues and factors affecting the conduct of the cargo preference programs." However, the Maritime Administration agreed with GAO's recommendation that it revise the way it calculates allowable freight rates for shipping food aid cargos. AID, DOD, and USDA generally agreed with GAO's conclusions and recommendations and suggested clarifications which were made where appropriate.

In their written comments, the agencies elaborated on their views of the use of certain ocean transportation contract terms when shipping food aid cargos, which may differ from contract terms used in the commercial sale and shipping of similar cargos and add cost to the transportation of food aid cargos. AID and USDA were particularly concerned about GAO's position on the Maritime Administration's efforts to implement a uniform charter party. A uniform charter party would establish the ocean transportation contract terms to be used by AID and USDA in shipping food aid commodities. AID and USDA said that the uniform charter party would greatly affect their flexibility in negotiating shipping terms with ocean freight transportation companies. GAO clarified that it has not evaluated and is not endorsing the Maritime Administration's proposed uniform charter party. Rather, GAO is recommending that, if the cargo preference program is continued for food aid programs, then AID and USDA should experiment with the use of shipping terms that are more consistent with terms used in similar private sector commercial transportation contracts, to determine whether they would reduce the costs incurred in transporting U.S. food aid cargos, while meeting program objectives.

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Chapter 4 USDA and AID Management Practices Affect Food Aid Transportation Costs

Appendixes

Related GAO Products

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Abbreviations

AID	Agency for International Development
CARE	Cooperative for American Relief Everywhere
CDS	construction differential subsidy
CRS	Catholic Relief Services
DOD	Department of Defense
DOT	Department of Transportation
FAS	Foreign Agricultural Service
MARAD	Maritime Administration
mt	metric ton
NORGRAIN	North American Grain
ODS	operating differential subsidy
OFD	ocean freight differential
OMB	Office of Management and Budget
P.L.	public law
PVO	private voluntary organization
RORO	roll on/roll off
RRF	Ready Reserve Force
USDA	U.S. Department of Agriculture
WFP	World Food Program

Background

Requirements to carry U.S. government cargos on U.S.-flag ships, or cargo preference laws, have a long history in the United States. Cargo preference was originally established as part of the Tariff Act of 1789, the second law enacted by the U.S. Congress. This law provided for an additional duty of 10 percent on imports carried on non-U.S. ships. Since then, Congress has repeatedly reaffirmed its intent, in response to general downturns in the U.S. maritime industry, to assist in the development, strengthening, and support of the U.S. merchant marine by enacting many cargo preference laws.[1]

Cargo preference laws set aside certain U.S. government cargos to be exclusively carried by U.S.-flag vessels. Cargo preference laws currently require that at least 75 percent of the food provided to needy countries through U.S. food aid programs be transported on U.S.-flag ships. This requirement has been controversial since its inception in 1954. In the view of the U.S. Department of Agriculture (USDA), and the U.S. Agency for International Development (AID), which administer the U.S. food aid programs, cargo preference requirements limit their ability to deliver food aid because of the additional funds needed to ship such aid on U.S.-flag vessels.

On the other hand, maritime interests and MARAD, an agency of the U.S. Department of Transportation (DOT), view the application of cargo preference law to food aid programs as an integral part of U.S. maritime policy. They believe cargo preference is vital to ensuring that adequate U.S.-flag ships and merchant marine personnel are available to respond to national security emergencies and to carry the domestic and foreign waterborne commerce of the United States.

The increased costs associated with using U.S.-flag ships to deliver U.S. food aid received attention in April 1993. At that time, President Clinton announced that $700 million in agricultural commodity assistance would be provided to Russia to assist its efforts to implement market reforms in the private sector. It was also reported that up to $200 million of this assistance would be required to pay for the commodities' transportation, up to $100 million of which would be spent to cover the additional cost of using U.S.-flag ships. Appendix II contains more information on the outcome of this special food aid assistance to Russia.

[1]The cargo preference laws of the United States are described in appendix I.

Cargo Preference Is One of Several Programs Established to Promote a Viable U.S. Merchant Marine

Section 101 of the Merchant Marine Act of 1936[2] required that the U.S. merchant marine be sufficient to carry a substantial portion of the waterborne domestic and foreign commerce of the United States and be capable of serving as a naval and military auxiliary in time of war or national emergency.

To satisfy these two objectives, the act established several programs to support the continued operation of U.S.-flag ships. They include construction subsidies (title V), operating subsidies (title VI), and preference cargos (section 901, as amended). Although no funding has been provided for title V since 1982, the purpose of the title V construction differential subsidy (CDS) program is to enable U.S. shipyards to construct ships at a cost equivalent to that of their foreign competitors and thus enable purchasers to obtain U.S.-constructed ships for foreign trade at competitive world prices. This program is not likely to be funded in the future, as the Clinton administration recently entered into an agreement with the Organization for Economic Cooperation and Development to eliminate government subsidies for shipbuilding by January 1, 1996.

In addition, while title VI operating differential subsidies (ODS) are intended to allow U.S.-flag ships to carry foreign commerce by granting U.S. shipowners a subsidy to place their operating costs on a parity with those of their foreign competitors—based on the difference between the fair and reasonable cost of insurance, maintenance, repair, and wages of officers and crews and the estimated costs of the same items if the ships were operated under a foreign registry—no new ODS contracts have been granted, and all current ODS contracts will have expired by December 1998. The Clinton administration has submitted proposed legislation to Congress that would establish a program similar to ODS to help support U.S.-flag ships providing liner service.

Section 901 of the Merchant Marine Act of 1936, as amended, provides guaranteed cargos (preference cargos) for U.S.-flag ships by requiring that certain government-owned or financed cargos be shipped on U.S.-flag ships. Cargo preference requirements are applied to 100 percent of military cargos, 75 percent of food aid cargos, and 50 percent of all other U.S. government-owned or financed cargos.

Cargo preference does not play a role in maintaining U.S.-flag ships to carry domestic cargos. All domestic waterborne commerce is reserved for

[2]Ch. 858, 49 Stat. 1985, June 29, 1936 (46 U.S.C. Appx. 1101).

U.S.-flag, U.S.-constructed ships by the Merchant Marine Act of 1920[3] commonly referred to as the "Jones Act," which prohibits foreign-flag ships and foreign-constructed U.S.-flag ships from trading between U.S. domestic ports. In addition, the most current data available from MARAD show that in 1991, U.S.-flag ships only carried about 4 percent of all waterborne commerce imported into or exported out of the United States (foreign commerce). Food aid preference cargos accounted for less than one-fourth of that percentage.

Cargo Preference Laws Apply to Food Aid Programs

The Cargo Preference Act of 1954,[4] as amended by the Food Security Act of 1985,[5] amended section 901(b) of the Merchant Marine Act of 1936 to require that at least 75 percent of U.S. food aid tonnage be shipped on privately owned U.S.-flag commercial ships, to the extent that such ships are available at fair and reasonable rates. The applicable food aid programs include those carried out under the Agricultural Trade Development and Assistance Act of 1954,[6] as amended, widely known as "Public Law 480," and under section 416(b) of the Agricultural Act of 1949,[7] as amended. Cargo preference also applies to assistance provided under the Food for Progress program, which was enacted as part of the Food Security Act of 1985.[8]

U.S. Food Aid Programs

USDA currently provides food aid through three channels: the Public Law (P.L.) 480 program; the section 416(b) program; and the Food for Progress program. The P.L. 480 program is comprised of three titles that provide agricultural assistance to countries at different levels of economic development. The three primary objectives of these programs are to expand U.S. agricultural exports (title I), to provide humanitarian relief (title II), and to aid the economic development of participating countries (title III). Figure 1.1 shows the percentage of metric tons (mt) of food aid provided under each U.S. food aid program for fiscal years 1991 through 1993.

[3]Ch. 250, 41 Stat. 988, June 5, 1920.

[4]Ch. 936, 68 Stat. 832, August 26, 1954.

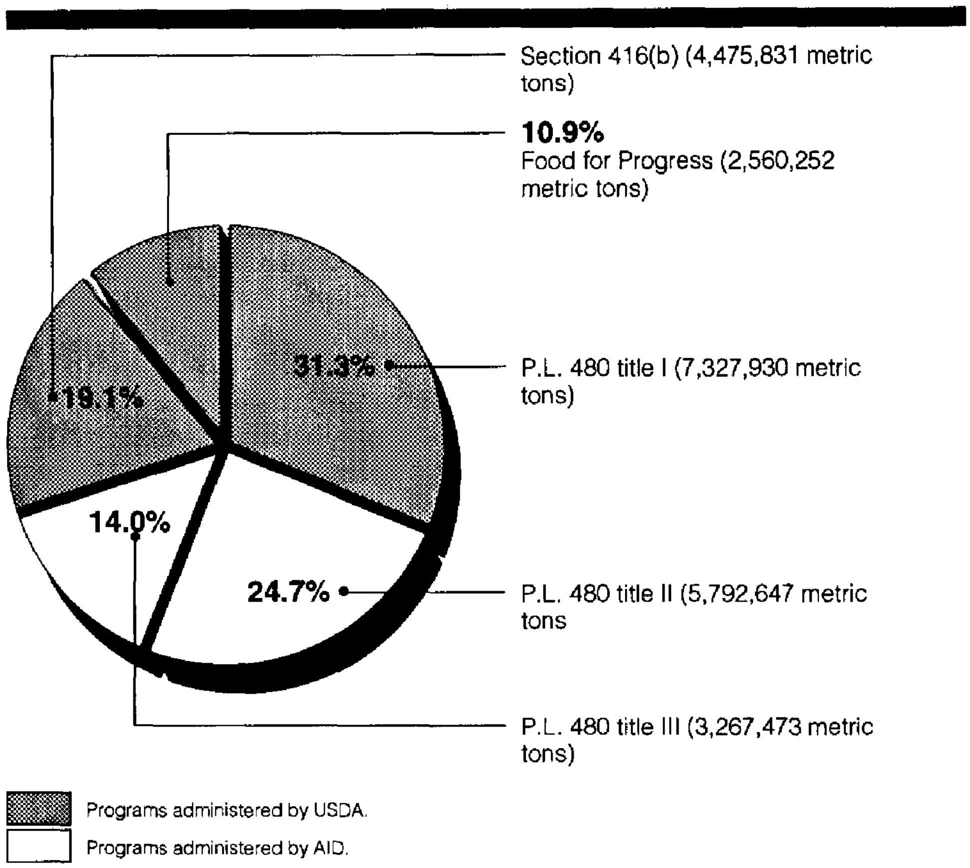
[5]Public Law 99-198, December 23 1985.

[6]Ch. 469, 68 Stat. 454, July 10, 1954.

[7]Ch. 792, 63 Stat. 1051, 1058, October 31, 1949.

[8]Public Law 99-198, December 23, 1985.

Figure 1.1: Percentage of Metric Tons of Food Aid Provided Under Each U.S. Food Aid Program, Fiscal Years 1991-93



Source: USDA.

P.L. 480 Title I

P.L. 480's title I, which is administered by the Foreign Agricultural Service (FAS) of USDA and is known as the "Trade and Development Assistance Program," provides U.S. government financing for sales of agricultural commodities to developing countries on "concessional" credit terms. The sales are made at competitive U.S. market prices, with extended credit periods of up to 30 years, low interest rates, and grace periods of up to 7 years on principal repayments. This program is targeted to countries that are having difficulties meeting their food needs through commercial means, yet have demonstrated the potential to become commercial markets for U.S. agricultural commodities. From fiscal year 1991 through fiscal year 1993, USDA extended about $1.1 billion in credit for the purchase of commodities for title I programs. The types of commodities typically financed under title I include wheat and corn for human consumption, and soybean meal and grains for animal feed.

P.L. 480 Title II

AID administers title II of the P.L. 480 program. It is known as the "Emergency and Private Assistance Program," and it provides for the donation of agricultural commodities to meet the pressing food needs of the people of developing countries. About 75 percent of the commodities used to meet nonemergency needs are made to and distributed by nonprofit private voluntary organizations (PVO) such as the Cooperative for American Relief Everywhere (CARE) and the Catholic Relief Services, or international organizations such as the World Food Program (WFP), the humanitarian feeding organization of the United Nations. From fiscal year 1991 through fiscal year 1993, over $2.1 billion in U.S. government funds were used to provide food and its transportation for title II programs. The type of food aid provided under title II includes some bulk commodities, but generally consists of processed commodities and products such as cooking oil and bagged rice and flour.

P.L. 480 Title III

Title III[9] of P.L. 480 is administered by AID and is known as the "Food for Development Program." It provides government-to-government donations of agricultural commodities to least developed countries. The revenue that the developing country generates by the sale of these donated commodities is to be used to support economic development programs in the country. Priority is to be given to countries that demonstrate the greatest need for food, the capacity to use food assistance effectively, and a commitment to policies to promote food security. From fiscal year 1991 through fiscal year 1993, over $670 million in U.S. government funds were used to provide food and its transportation for title III programs. The type of food aid provided under title III includes mainly bulk commodities such as corn, wheat, and rice.

Section 416(b)

Section 416(b) of the Agricultural Act of 1949, which is administered by USDA's FAS, provides for donations to foreign countries of food and feed commodities owned by USDA's Commodity Credit Corporation. These

[9]Before the Food, Agriculture, Conservation, and Trade Act of 1990 (P.L. 101-624, frequently referred to as the 1990 Farm Act) titles I and III were managed together by USDA. The 1990 Farm Act separated the agricultural market development (now title I) and economic development (now title III) objectives of the P.L. 480 program. Both titles are aimed at food aid needs of developing countries, but title I financing is targeted to countries that offer a good chance of becoming commercial markets, while title III is aimed at assisting the least developed countries.

donations are not permitted to reduce the amounts of commodities that are traditionally donated to U.S. domestic feeding programs, prevent the fulfillment of any agreement entered into under a payment-in-kind program, or disrupt normal U.S. commercial sales of agricultural commodities. From fiscal year 1991 through fiscal year 1993, over $1.2 billion in U.S. government funds were used to provide food and its transportation for section 416(b) programs. The type of food aid provided under section 416(b) includes bulk commodities such as corn, wheat, and rice, and processed products such as cooking oil and nonfat dry milk.

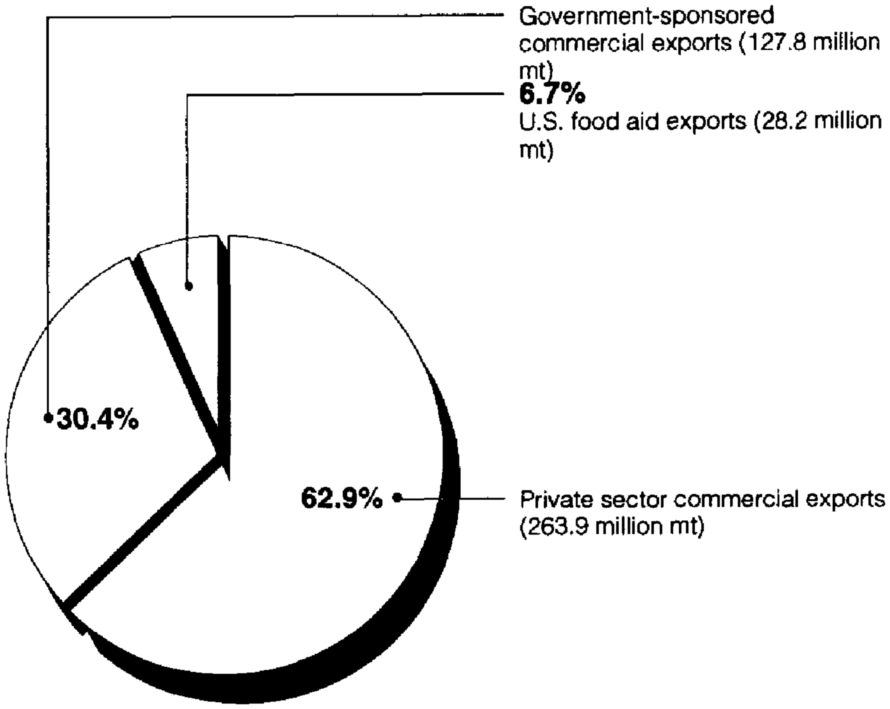
Food for Progress

The Food for Progress program, which is administered by USDA's FAS, provides commodities to support countries that have made commitments to expand free enterprise in their agricultural economies. Commodities may be provided under the authority of P.L. 480 or section 416(b). Commodities furnished using title I funds may be made available on a grant or a concessional sales basis. From fiscal year 1991 through fiscal year 1993, over $1.3 billion in U.S. government funds were used to provide food and its transportation for the Food for Progress program. The type of food aid provided under this program includes bulk commodities such as corn, wheat, and rice; and processed products such as cooking oil, flour, and nonfat dry milk.

Food Aid Tonnage Is a Small Portion of All U.S. Agricultural Exports

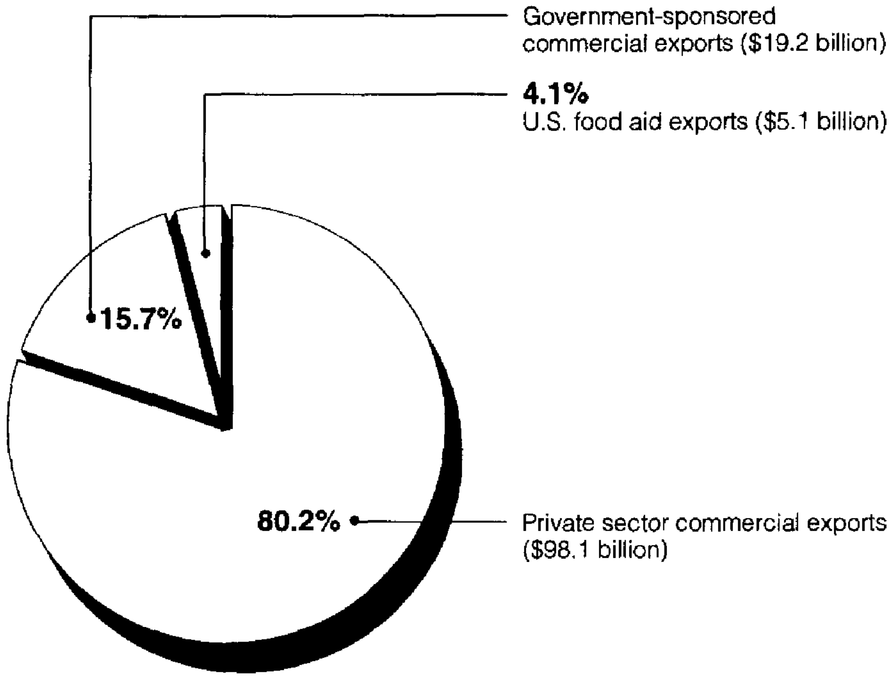
For fiscal years 1991-93, U.S. food aid tonnage represented 6.7 percent of all U.S. agricultural export tonnage. U.S. food aid also represented 18.1 percent of all U.S. agricultural tonnage exported with assistance from the U.S. government. The value of all agricultural commodities exported from the United States for fiscal years 1991 through 1993 totaled $122.4 billion, with $98.1 billion, or 80.2 percent, in private sector commercial sales; $19.2 billion, or 15.7 percent, in government-sponsored credit sales in which financing was provided at "near commercial" rates and terms; and $5.1 billion, or 4.1 percent, in U.S. food aid programs. Figures 1.2 and 1.3 illustrate the percentage of export tonnage and value that U.S. food aid programs contributed to all U.S. agricultural exports for fiscal years 1991 through 1993.

Figure 1.2: U.S. Agricultural Export Tonnage, Fiscal Years 1991-93



Source: USDA.

Figure 1.3: U.S. Agricultural Export Value, Fiscal Years 1991-93



Source: USDA.

MARAD Has Oversight Responsibility for Cargo Preference Compliance and Determining Fair and Reasonable Rates

MARAD is responsible for monitoring federal agencies' implementation of cargo preference laws and reporting annually to Congress on agency compliance. For food aid programs, MARAD reports compliance for each program and by each ship type—bulk carriers, tankers, and those ships that provide liner service. For calendar years 1990 through 1992, MARAD reported that while USDA and AID did not always achieve 75-percent compliance for each program and each type of ship, where they did not comply, it was typically due to the nonavailability of U.S.-flag ships.

In addition to monitoring compliance, MARAD establishes guideline rates that are used in judging whether U.S.-flag shipping rates are fair and reasonable. Setting guideline rates is done because federal agencies are required to use U.S.-flag ships only if they are available at fair and reasonable rates. These guideline rates are developed at the request of the federal agency that is shipping preference cargos. They reflect specific voyage information and individual ship operating and capital costs;

estimated port and cargo-handling costs; and an allowance for brokerage expenses, overhead expenses, and profit. In determining guideline rates, MARAD includes the cost of the round-trip voyage, as U.S.-flag ships carrying preference cargos typically return carrying ballast,[10] not cargo. If a U.S.-flag ship is scrapped or sold after it discharges a preference cargo, or obtains a return cargo, the guideline rate is adjusted accordingly.

The Status of the U.S. Merchant Marine Has Declined

The two principal components of the U.S. merchant marine are (1) a fleet of oceangoing ships and (2) their supporting workforce. The U.S. merchant marine is generally comprised of bulk carriers, tankers, general cargo ships, container ships, and passenger ships. These ships are engaged in providing either charter or liner service. The workforce that supports U.S.-flag ships includes seafaring officers and other seafaring workers, shipyard workers, and longshore workers.

U.S.-Flag Ships

According to MARAD's 1992 annual report to Congress, as of September 30, 1992, the U.S. merchant marine consisted of a total of 600 ships as shown in table 1.1. The 386 privately owned ships are those that may carry preference cargos.

Table 1.1: U.S. Oceangoing Merchant Marine Fleet as of September 30, 1992

U.S.-flag ships	Privately owned	Government owned	Total
Active fleet	348	11	**359**
Inactive fleet	38	203	**241**
Total	**386**	**214**	**600**

Note: The fleet includes ships of 1,000 or more gross tons, but excludes privately owned tugs and barges.

Source: MARAD.

MARAD also reported that from January 1, 1982, to January 1, 1992, the number of U.S. privately owned ships decreased by 31.4 percent, from 574 ships to 394 ships. And the deadweight tonnage[11] capacity of these ships decreased by 8.4 percent, from 21.5 million tons to 19.7 million tons. As of January 1, 1992, the U.S. privately owned merchant marine ranked 17th in

[10]Ballast is a heavy substance used to maintain a ship at its proper draft and improve its stability when it is not carrying cargo.

[11]Deadweight tonnage is the total carrying capacity of a ship expressed in tons of 2,240 pounds. Carrying capacity is the difference between the displacement of the empty ship and the displacement of the ship fully loaded.

number of ships and 11th in deadweight tons when compared with the world's merchant marine fleets. The five largest merchant marine fleets are registered in Panama (3,040 ships), Liberia (1,550 ships), China (1,359 ships), Cyprus (1,210 ships), and Japan (944 ships).

The U.S.-flag privately owned merchant marine fleet is engaged in providing either charter or liner service to transport goods. When providing charter service, a ship is contracted by the exporter or importer to transport goods from one point to another. The ships that typically provide charter service are bulk carriers, tankers, and tug/barge combinations capable of carrying bulk goods. U.S. food aid programs generally use charter service to transport bulk commodities such as wheat or corn from the United States to needy foreign countries. Ships engaged in providing liner service offer exporters or importers a set schedule of arrivals and departures at specified ports in regions of the world. The type of ships typically used to provide liner service are container ships, which carry 20- or 40-foot containers, or LASH ships[12] that carry watertight barges. Ships engaged in providing liner service, no matter what the ship type is, are commonly referred to as "liners." U.S. food aid programs generally use liners to transport processed or packaged commodities such as bagged rice or flour.

U.S. Merchant Marine Workforce

In fiscal year 1992, the average monthly U.S. seafaring employment decreased 11.3 percent, from 16,308 in fiscal year 1991 to 14,466. In addition, the average monthly workforce in U.S. commercial shipyards and longshore employment also decreased during that time. Table 1.2 summarizes the average monthly maritime workforce for fiscal years 1991 and 1992.

Table 1.2: U.S. Merchant Marine Average Monthly Workforce, Fiscal Years 1991 and 1992

	Average monthly employment	
Type of work	**FY 1991**	**FY 1992**
Seafaring shipboard jobs	16,308	14,446
Commercial shipyard jobs	93,982	90,890
Longshore jobs	26,698	25,220
Total	**136,988**	**130,556**

Source: MARAD.

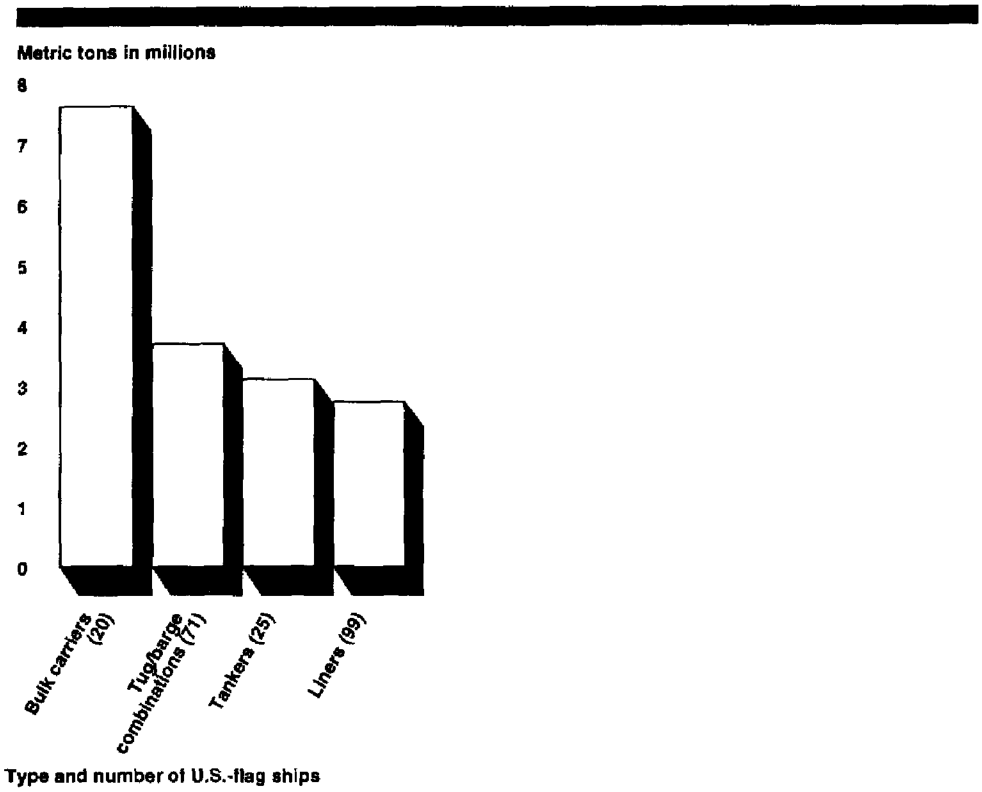
[12]LASH is an acronym for lighter-aboard-ship vessels.

U.S. Merchant Marine Participation in Food Aid Programs

From cargo preference years[13] 1991 through 1993, 144 privately owned U.S.-flag ships carried food aid preference cargos. These 144 ships included 99 liners, 25 tankers, and 20 bulk carriers. In addition, 71 tug/barge combinations, which MARAD does not include in its count of U.S.-flag ships, also carried food aid preference cargos during this time. These privately owned U.S.-flag ships and tug/barge combinations carried about 17.1 million tons of food aid from cargo preference years 1991 through 1993. As illustrated by figure 1.4, the majority (84 percent) of food aid tonnage transported by U.S.-flag ships was carried by those capable of carrying bulk commodities—bulk carriers, tug/barge combinations, and tankers.

[13]The cargo preference year spans from April 1 of one year to March 31 of the next year and was created to measure compliance of food aid cargos with the cargo preference requirements spelled out in the Food Security Act of 1985. The act required that the amount of food aid tonnage transported on U.S.-flag ships be gradually increased from 50 percent of all food aid tonnage shipped in 1985 to 75 percent by April 1988. The act also required MARAD to fund the additional cost of using U.S.-flag ships—the ocean freight differential (OFD)—for the additional 25 percent of food aid shipped on U.S.-flag ships.

Figure 1.4: Food Aid Tonnage Carried by Type of U.S.-Flag Ship, Cargo Preference Years 1991-93



Note: Total metric tons carried during this 3-year period were 17.1 million.

Source: USDA food aid shipment database.

Objectives, Scope, and Methodology

At the request of the Chairman of the Subcommittee on Merchant Marine, Senate Committee on Commerce, Science, and Transportation, and the Chairman of the Subcommittee on Foreign Agriculture and Hunger, House Committee on Agriculture, we reviewed the application of cargo preference laws to U.S. food aid programs. In discussions with their offices, we agreed to determine

- whether the application of cargo preference requirements to food aid programs is meeting its intended objectives of helping to maintain U.S.-flag ships (1) to serve as a naval and military auxiliary in time of war or national emergency and (2) to carry a substantial portion of U.S. waterborne domestic and foreign commerce,
- how cargo preference requirements affect U.S. food aid programs, and

- how practices currently used by USDA and AID in managing food aid transportation affect its costs.

In addition, we were asked to develop information on the status of food aid being provided to Russia under the Food for Progress program and on why U.S.-flag ship transportation costs for agricultural commodities to Israel under the "side letter agreement" are lower than similar voyages made under U.S. food aid programs to the former Soviet Union. This information is provided in appendixes II and III, respectively.

Our review considered information and agency data for fiscal years 1991 through 1993.

We did our work at the Washington, D.C., offices of AID, the Department of Defense (DOD), MARAD, and USDA as well as the New York offices of several international shipping brokers, the World Food Program, CARE, and the Catholic Relief Services. At these agencies we obtained and reviewed pertinent documents including correspondence, regulations, procurement files, and reports. In addition, we developed and used a structured interview instrument to collect standardized information from 18 U.S. shipping companies. All these companies either owned or operated U.S.-flag ships that carried food aid preference cargos sometime during cargo preference years 1991 through 1993. These 18 companies were judgmentally selected to cover a majority of food aid tonnage carried during this time and to represent a cross-section of the companies engaged in carrying these cargos. These 18 companies include the 10 companies that carried the most bulk food aid tonnage from cargo preference years 1991 through 1993, and 5 liner companies and 3 smaller bulk companies suggested by MARAD. Together these 18 companies carried over 81 percent of the U.S. food aid tonnage shipped during this time. A copy of our U.S. shipowner structured interview instrument is reproduced in appendix IV.

To determine whether the application of cargo preference requirements to food aid programs helped maintain a viable U.S. merchant marine for times of war or national emergency, we obtained the views of cognizant DOD officials, including representatives of the Military Sealift Command. In response to our questions, the Assistant Deputy Under Secretary of Defense for Transportation Policy expressed DOD's official view on this matter in a March 17, 1994, memorandum. Because this is the first such definitive statement made by DOD on this matter, a copy of this memorandum is reproduced in appendix V of this report.

To determine whether the application of cargo preference to food aid programs helps maintain a viable U.S. merchant marine that can carry a significant portion of the U.S.' domestic and foreign commerce, we used responses from our structured interview to establish how dependent each participating U.S.-flag ship was on food aid preference cargos and how the ships would be affected by a modification in or the elimination of the application of cargo preference requirements to food aid programs. We also used the structured interview to determine whether U.S.-flag ships could compete for foreign commercial cargos and what items affect their costs. In addition, we interviewed MARAD officials and international ship brokers to understand the differences between the U.S. shipping market and the international shipping market.

To determine how cargo preference requirements affect food aid programs, we obtained the views of USDA, AID, PVO, and World Food Program officials, examined food aid commodity and freight procurement files and other agency records, and observed USDA and AID officials procure food aid commodities and their transportation. To develop examples of how cargo preference requirements affect food aid purchasing decisions, we examined a sample of commodity and freight procurement files judgmentally selected by USDA and AID officials. These files were selected to illustrate each of the significant ways food aid programs were affected by cargo preference requirements that we identified.

To determine whether USDA and AID's management practices affect food aid transportation costs, we examined (1) the use of shipping contract terms that are not considered commercial by the shipping industry and (2) the timing of food aid purchases and shipments. Through the structured shipowner interview and interviews with USDA, AID, PVOS, and MARAD officials, and international ship brokers, and our review of commercial and food aid shipping contracts, we identified the differences between typical international commercial contracts and food aid contracts for shipping bulk agricultural commodities. We discussed these differences with USDA, AID, MARAD, and international ship brokers to understand why these differences exist and their impact on transportation costs.

We also analyzed USDA's food aid shipment database to determine how shipping rates are affected by the timing of food aid shipments. We discussed our analysis with USDA and AID officials to obtain their views on why a majority of food aid is shipped at the end of the calendar year. We did not assess the reliability of the information contained in the database but did corroborate some of its information with information from other sources to determine whether its accuracy was reasonable. USDA officials said that the information included in USDA's food aid shipment database is the best and most complete available on food aid shipments and is used by USDA for external reporting purposes.

We did our work between August 1993 and July 1994 in accordance with generally accepted government auditing standards. We obtained written comments on a draft of this report from AID, DOD, USDA, and DOT (MARAD). These comments are presented and evaluated in chapters 2 and 4, and in appendixes VI through IX.

Applying Cargo Preference Requirements to Food Aid Programs Does Not Significantly Further Objectives of 1936 Merchant Marine Act

Cargo preference requirements are applied to food aid programs to help meet the objectives of the Merchant Marine Act of 1936, as amended. While these requirements produce several benefits, as explained in chapter 1, the objectives of the act are to maintain a U.S.-flag merchant marine to serve as a military or naval auxiliary in times of war or national emergency and to carry a substantial portion of the waterborne domestic and foreign commerce of the United States. The types of U.S.-flag ships that carry a majority of food aid tonnage and are most dependent on food aid preference cargos to maintain their U.S. flag status are those bulk carriers, tankers, and tug/barge combinations that transport bulk commodities. DOD currently does not consider these types of ships militarily useful. In addition, most of these same U.S.-flag ships are virtually dependent on food aid preference cargos, are unable to successfully compete for foreign commercial cargos, and do not contribute to the ability of the United States to carry its own foreign commerce other than food aid. This situation is due to the limited options available to operate U.S.-flag ships and to U.S.-flag shipping rates that are significantly higher than their foreign competitors'. These higher rates reflect the additional construction, maintenance, and operating costs caused by the U.S. laws and regulations that shipowners must comply with to be U.S. flagged, and the reduced incentives for shipowners who primarily carry food aid preference cargos to lower their costs by investing in newer and more efficient ships.

Applying Cargo Preference Requirements to Food Aid Programs Does Little to Help Maintain a U.S. Merchant Marine as Military and Naval Auxiliary

According to DOD, while the types of U.S.-flag ships that carry a majority of food aid preference cargos may have been militarily useful at one time, it does not view them as militarily useful now. DOD officials explained that this view has changed because of their changing national security needs, the shift in the shipping industry to the use of containers, and the increase in the size and weight of their equipment. The ships that carry a majority of food aid preference cargos include the bulk carriers, tankers, and tug/barge combinations that transport bulk commodities and that carried 84 percent of all food aid tonnage shipped on U.S.-flag ships for cargo preference years 1991 through 1993. According to DOD, if the U.S.-flag ships that carry bulk commodities were no longer available, which would likely happen if cargo preference requirements were no longer applied to food aid programs, DOD believes there would be no significant impact on military readiness. However, DOD does consider liners to be militarily useful, since the containers used on liners are an efficient way to transport ammunition, equipment, and supplies. For cargo preference years 1991 through 1993, liners carried approximately 16 percent of all food aid tonnage transported by U.S.-flag ships.

DOD's view on the military usefulness of the ships that carry cargo preference food aid was confirmed by the military sealift activities of U.S.-flag ships associated with Operations Desert Shield/Desert Storm. According to DOD, none of the bulk carriers, tankers, or tug/barge combinations that have carried food aid preference cargos participated in Operations Desert Shield/Desert Storm because they were not the most appropriate type of ships to transport required equipment and supplies. The U.S.-flag ships that participated in Operations Desert Shield/Desert Storm were those that are typically engaged in liner service, and roll-on/roll-off (RORO) ships.[1] DOD officials explained at a GAO workshop[2] on Ready Reserve Force (RRF)[3] crewing requirements that DOD is increasing its reliance on the types of ships that provide liner service as it increases its use of containerization.

As for crews, DOD said that the crews used to support the bulk-carrying ships that transported the majority of food aid tonnage could be a potential source of manpower for the RRF but DOD does not believe that applying cargo preference to food aid programs is a cost-effective means of providing for crews. According to DOD, current RRF crew requirements are approximately 3,700 mariners but should increase to about 4,800 mariners as the number of ships in the RRF increase. DOD's currently policy is to fill this need from the pool of U.S. merchant mariners. There are currently about 21,000 merchant mariners in the labor pool available for approximately 9,300 shipboard jobs (each shipboard job supports about 2.2 merchant mariners). According to information provided by the Maritime Administration, the dry bulk ships in the U.S. merchant marine provide employment for about 800 mariners, or less than 4 percent of the 21,000 mariners that are currently in the merchant marine labor pool. Given the size of the merchant marine pool and the estimated need for the RRF, it does not appear there should be a labor supply problem for the RRF in the near future, even if the crew supported by the ships that carry the majority of food aid tonnage are not counted. Nevertheless, the size of the

[1]RORO ships are used to transport motorized vehicles and wheeled containers and trailers and are designed so that no gear is required for loading and unloading cargo.

[2]Strategic Sealift: Summary of Workshop on Crewing the Ready Reserve Force (GAO/NSIAD-94-177, June 6, 1994).

[3]The Ready Reserve Force is a specific component of the National Defense Reserve Fleet. Ships in the Ready Reserve Force are kept at a state of readiness that enables them to be activated in 4, 5, 10, or 20 days to meet military sealift surge requirements in event of war or emergencies. MARAD maintains these ships for DOD use.

labor pool has been steadily declining over the years as the number of U.S.-flag ships has decreased.

DOD also recognizes that as the number of U.S.-flag commercial ships, and their crew, continue to decrease and the number of ships in the RRF increase, it may need to consider options such as a merchant marine reserve program to ensure that adequate crew are available for the RRF in the future.

MARAD officials disagree with DOD's assessment of its need for the types of ships that carry bulk commodities and the crews supported by food aid preference cargos. MARAD believes that food aid preference cargos are very important to the support of a significant number of U.S.-flag ships and crews that they view as militarily useful because they were built to DOD specifications in order to fulfill some military purpose. DOD officials agreed that the ships in question could be used for military purposes. However, they also said that given their current needs, these ships would only be used as a last resort to transport military equipment because (1) the ships would require a substantial investment to modify them to carry military supplies and heavy equipment and (2) the ships are not self-sustaining in that additional gear would be required for loading and unloading the military cargos, and loading and unloading could only be done in modern ports where such gear is available. In addition, while DOD recognizes it may have a need for additional crews for the RRF in the future, it does not believe that supporting U.S.-flag ships through a food aid cargo preference program is the most efficient way to provide for this need.

Applying Cargo Preference Requirements to Food Aid Programs Does Not Significantly Contribute to the Ability of U.S. -Flag Ships to Carry Foreign Commerce

The Dependence of U.S.-Flag Ships on Food Aid Preference Cargos Varies

The Jones Act restricts domestic waterborne commerce to U.S.-constructed, U.S.-flag ships and ensures that U.S.-flag ships carry all the domestic waterborne commerce of the United States. Operating differential subsidies help U.S.-flag ships carry foreign commerce by placing their operating costs on a parity with those of their foreign competitors. Preference cargos also help U.S.-flag ships carry foreign commerce by guaranteeing them a certain percentage of government cargos. However, even with the support provided through these programs, in 1991 U.S.-flag ships carried only about 4 percent of all waterborne commerce imported into or exported from the United States, i.e., foreign commerce. Food aid preference cargos accounted for less than one-fourth of that percentage. Nevertheless, some types of U.S.-flag ships are heavily dependent on food aid preference cargos.

The types of U.S.-flag ships that carry the majority of food aid preference tonnage on average spend more than half of their time transporting food aid preference cargos. The 18 bulk carriers, 25 tankers, and 21 tug/barge combinations that were either owned or operated by the 18 shipping companies we interviewed, and that carried food aid preference cargos, carried 66 percent of all food aid tonnage transported by U.S.-flag ships for cargo preference years 1991 through 1993. During this time, these ships spent an average of 187 days each year carrying food aid preference cargos. The average number of days spent carrying food aid preference cargos varied by ship type—272 days for bulk carriers, 183 days for tug/barges, and 131 days for tankers.

Besides carrying food aid preference cargos, these ships carried amounts of commercial cargos that also varied by ship type. These commercial cargos were either domestic cargos transported by Jones Act ships or foreign cargos transported by U.S.-flag ships under ODS contracts. The ODS contracts helped the U.S.-flag ships to be more price competitive by subsidizing their higher insurance, maintenance, repair, and wage expenses. The 18 bulk carriers owned or operated by the shipping companies we interviewed, on average carried commercial cargos about 4 percent of the time. The 21 tug/barge combinations owned or operated by the shipping companies we interviewed transported commercial cargos on average about 30 percent of the time. These were primarily domestic commercial cargos carried within the Gulf of Mexico or transported to Puerto Rico. The 25 tankers owned or operated by the shipping companies we interviewed that carried food aid preference cargos also carried commercial cargos on average 62 percent of the time. All but 1 of these 25 tankers either carried foreign commercial cargos with an ODS contract or was a Jones Act tanker and carried domestic commercial cargos.

The shipping companies we interviewed that operate tankers with ODS contracts said they generally use food aid preference cargos to fill in when they are unable to get foreign commercial cargos. For example, they often carry food aid preference cargos from the United States and return with a traditional tanker cargo, such as oil or other petroleum products, with the help of their ODS contract. Additionally, they explained that as ODS contracts for U.S.-flag tankers are expiring, tankers have become and will become more dependent on food aid preference cargos to continue operating as U.S.-flag ships. When U.S.-flag ships under ODS contracts, except liners,[4] are contracted to carry food aid preference cargos, they may not collect ODS subsidies.

Jones Act tankers, which are ineligible for ODS contracts, also use food aid cargos to fill in when they are unable to get domestic cargos. Since U.S.-flag ships that carry domestic cargos under the Jones Act are too costly to operate to successfully compete for foreign commercial cargos, they do not contribute to the ability of the United States to carry its foreign commerce.

U.S.-flag ships that provide liner service also carry some food aid tonnage but are able to successfully compete for foreign commercial cargos because they either operate with ODS contracts, operate as part of an

[4]U.S.-flag liners with ODS contracts may carry food aid preference cargos and still receive their ODS subsidy because food aid cargos typically represent such a small portion of the total cargo.

ocean liner conference,[5] or do both. Ninety-nine U.S. liners transported only 16 percent of all food aid tonnage carried by U.S.-flag ships for cargo preference years 1991 through 1993. Ninety-five of these liners were either owned or operated by shipping companies we interviewed, and 88 of these 95 liners, which carried food aid preference cargos, transported 15 percent of all food aid tonnage carried by U.S.-flag ships during this period. In addition, for a majority (about 75 percent) of these 88 liners, food aid preference cargos made up no more than 4 percent of their cargos. For the others, food aid preference cargos made up between 5 percent and 40 percent of their cargos. In addition to food aid preference cargos, these 88 liners carried other U.S. government preference cargos, or domestic or foreign commercial cargos.

To determine the importance of food aid preference cargos to U.S.-flag ships, we asked the 18 shipping companies we interviewed what might happen to their U.S.-flag ships that carry these cargos if cargo preference were no longer applied to food aid programs. They responded as follows:

- None of the 18 U.S.-flag bulk carriers would remain U.S. flagged due to their heavy dependency on food aid preference cargos.
- Fourteen of the 25 U.S.-flag tankers would remain U.S. flagged because they can either carry Jones Act cargos or foreign commercial cargos with an existing ODS contract.
- Nine of the 21 U.S.-flag barges would remain U.S. flagged because they can carry Jones Act cargos.

In addition, the owners we met with who controlled the majority of 88 U.S.-flag ships that provided liner service explained that because food aid preference cargos represent such a small portion of their total cargos, the deletion of food aid preference cargos alone would have little impact on the status of their U.S.-flag ships. They said, however, that given that (1) their current ODS contracts are expiring and (2) the availability of future operating subsidies is uncertain, they are now considering reflagging as many as 54 of their 88 ships. They said the remaining 34 ships that would continue to fly the U.S. flag could be supported by carrying either Jones Act cargos or foreign commercial cargos under existing ODS contracts.

[5] Liner companies that serve the United States may be members of cartels, called "ocean freight-rate conferences." Members of such conferences often have agreements on (1) the freight rates they charge (as a way to restrict competition), (2) their sailing schedules and ports of call, and (3) the pooling of cargos or revenues. Conferences that serve the United States must file tariffs with the Federal Maritime Commission that state their rates, terms, and conditions of transport covering all commodities they propose to carry for the general public.

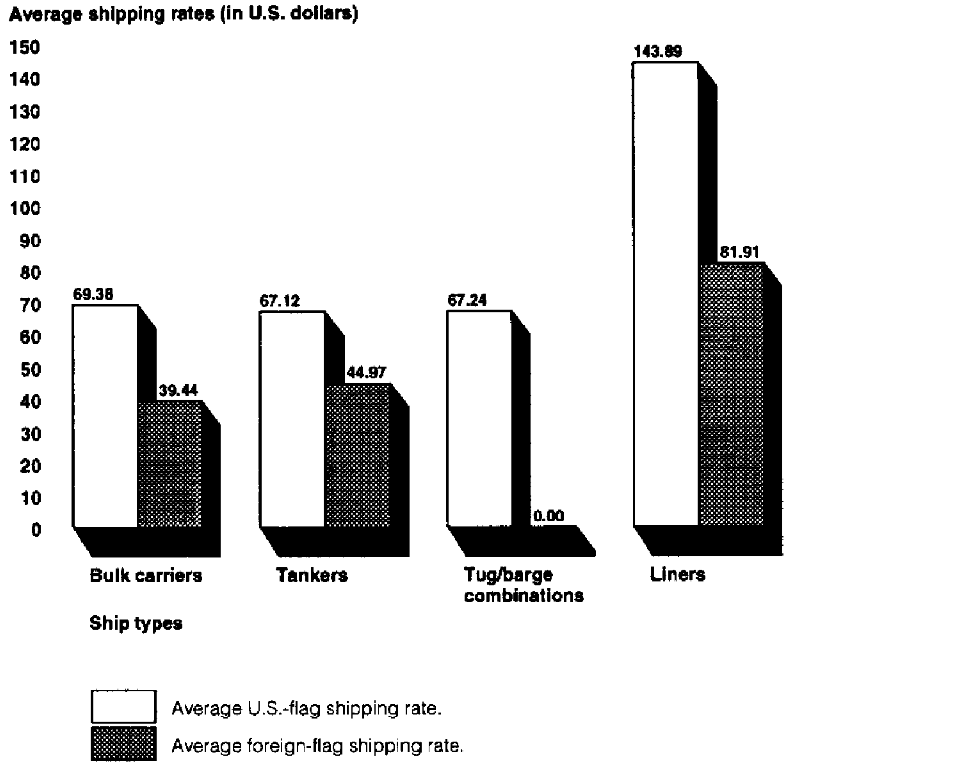
U.S.-Flag Rates Are Substantially Higher Than Foreign-Flag Rates for Food Aid Preference Cargos

U.S.-flag ships have difficulty competing for international commercial cargos because their rates are substantially higher than those of their foreign-flag competitors. For food aid preference cargos, U.S.-flag rates can be as much as twice foreign-flag rates. When food aid cargos are shipped on U.S.-flag ships, the difference between U.S.-flag and foreign-flag rates is paid by USDA, AID, and MARAD. Chapter 3 provides more information on the difference between U.S.-flag and foreign-flag shipping rates for food aid cargos. This difference is called the ocean freight differential.

Recognizing that U.S.-flag shipping rates would be higher than foreign-flag shipping rates, the law only requires federal agencies to use U.S.-flag ships if they are available at "fair and reasonable" rates. U.S.-flag shipping rates for food aid preference cargos are considered fair and reasonable if they are within MARAD's guideline rates. As described in chapter 1, MARAD establishes these guideline rates for ships carrying bulk commodities based on individual ship cost information and specific voyage information. Ships that provide liner service and carry processed goods for food aid programs are paid their tariff rates, which are filed with, and approved by, the U.S. Federal Maritime Commission. According to MARAD officials, these approved rates are inherently fair and reasonable. Yet, in many cases, these approved rates for U.S.-flag liners are still higher than rates obtainable from foreign-flag ships providing liner service.

Figure 2.1 illustrates the differences between U.S.-flag and foreign-flag shipping rates by ship type for food aid preference cargos shipped for cargo preference years 1991 through 1993.

Figure 2.1: Average U.S.-Flag and Foreign-Flag Shipping Rates Per Metric Ton for U.S. Food Aid Cargos by Ship Type, Cargo Preference Years 1991-93



Notes: No foreign-flag tug/barge combinations were used for U.S. food aid cargos during this time.

Average shipping rates reflect per ton weighted averages.

Source: USDA food aid shipment database.

U.S. Laws and Regulations Result in Higher Costs for U.S.-Flag Ships

The primary reason why U.S.-flag shipping rates are so much higher than those of their foreign competitors is the added costs U.S.-flag ships incur in complying with U.S. laws and regulations. While the benefits that accrue from these U.S. laws and regulations—U.S. citizen employment, protection of the environment, and support of U.S. shipyards—can be significant, their cost impedes the competitiveness of U.S.-flag ships. This fact was cited in the responses we received from the 18 shipping companies we interviewed, as well as in discussions we held with MARAD officials and international ship brokers. In fact, 16 of the 18 shipping companies we interviewed told us that having to comply with U.S. laws and regulations is so costly that they cannot compete with foreign-flag ships. According to these shipping companies, the requirements in U.S. laws and regulations that have the greatest impact on their shipping rates are ship construction, ship maintenance and repair, and crewing requirements.

Ship Construction Requirements

To support the U.S. shipbuilding industry, U.S.-flag ships must be constructed in a U.S. shipyard in order to carry domestic cargos under the Jones Act. A further incentive to construct U.S.-flag ships in U.S. shipyards is the exclusion of foreign constructed U.S.-flag ships from carrying preference cargos for 3 years. Several of the shipping companies we interviewed stated that due to the cost of U.S. wages and the physical condition of U.S. shipyards, building a ship in a U.S. shipyard is about twice as expensive as building it in a foreign shipyard. In addition, to be registered as a U.S.-flag ship, whether built in a U.S. or foreign shipyard, ships must be constructed to U.S. Coast Guard standards. These standards are more stringent than international standards and thus add to ship construction costs. Foreign-flag ships, which carry 96 percent of U.S. waterborne foreign commerce into and out of U.S. ports and territorial waters, are generally built to international standards in foreign shipyards at a much lower cost. Twelve of the 18 shipping companies we interviewed stated that ship construction costs greatly increased their total costs. Since the early 1980s, no newly constructed U.S.-flag ships have entered the food aid cargo preference trade.

U.S.-Flag Ship Maintenance and Repair Requirements

To increase the use of U.S. shipyards, U.S.-flag shipowners are encouraged to use U.S. shipyards for maintenance and repair. If they use a foreign shipyard for any maintenance or nonemergency repair work, they must pay a 50-percent U.S. Customs duty on the cost of the work performed. Eleven of the 18 shipping companies we interviewed stated that these requirements greatly affect their operating costs. According to the shipping company officials we interviewed, despite the added costs these requirements are not helping U.S. shipyards. In many instances, shipping companies find it less expensive to use foreign shipyards to maintain and repair their U.S.-flag ships and pay the 50-percent duty than to have the same work performed in U.S. shipyards. However, the duty is a cost that owners of foreign-flag ships do not incur.

U.S. Citizen Crews

U.S.-flag ships are required to employ crews composed of U.S. citizens. Sixteen of the 18 shipping companies we interviewed stated that the requirement to use U.S. citizen crews is one of the most costly components in operating a U.S.-flag ship. These crews have wages and benefits that generally far exceed those provided to crews of foreign-flag ships. For example, according to a November 1993 article in the Journal of

Commerce, monthly crew costs for a U.S.-flag liner can top $310,000, with the captain receiving $44,000 a month in wages and benefits. A similar foreign-flag ship spends about $100,000 a month for its crew, with the captain receiving about $10,000. In addition, the shipping companies we interviewed who have foreign-flag ships similar to the U.S.-flag ships they use to carry food aid preference cargos stated that the daily crew costs for their U.S.-flag ships are at least three times that of their foreign-flag ships. Moreover, many of these 16 shipping companies said that health insurance, retirement, and other benefits required for U.S. citizen crews cost almost as much as the wages paid to these crews.

Incentives for U.S. Shipowners Who Carry Food Aid Preference Cargos to Reduce Costs Are Limited

In addition to the high compliance costs imposed on U.S.-flag ships by U.S. laws and regulations, little incentive exists to encourage the shipowners who carry food aid preference cargos to reduce their costs, and therefore their shipping rates, by investing in new U.S.-flag ships. In fact, U.S. shipowners are faced with two large disincentives to invest in new U.S.-flag ships. These are (1) the requirement for foreign-built ships to be documented as U.S.-flag ships for 3 years before they are eligible to carry preference cargos and (2) MARAD's method of using individual ship costs to calculate fair and reasonable guideline rates.

Foreign Built U.S.-Flag Ships Must Wait 3 Years

The Merchant Marine Act of 1936, as amended, states that all privately owned U.S.-flag commercial ships are eligible to carry preference cargos unless they are built or rebuilt outside of the United States or documented under any foreign registry. If either of these conditions applies, the ship must be documented under the laws of the United States for 3 years before it is eligible to carry preference cargos. This requirement discourages U.S. shipowners from investing in new ships. If a U.S. shipowner were to purchase a foreign-built or rebuilt bulk carrier, it would be almost impossible to operate that ship as a U.S.-flag ship for 3 years without food aid preference cargos because their costs would be too high to be price competitive against foreign-flag competition. In addition, while this requirement should have the effect of helping to maintain U.S. shipyards, that has not been accomplished. U.S. shipowners reported that they are discouraged from constructing new bulk carriers in U.S. shipyards because, as several of the shipowners we interviewed explained, their cost is at least twice that of a similar ship constructed in a foreign shipyard. Therefore, U.S. shipowners said they have not been investing in either U.S. or foreign-built new bulk carriers to carry food aid cargos.

In 1981, however, the Merchant Marine Act of 1936 was amended to allow an exception until September 30, 1983, to this 3-year requirement. Under this exception, ships constructed in foreign shipyards were permitted to be considered built in U.S. shipyards for the purpose of carrying preference cargos. This exception was granted due to a lack of funding for the construction differential subsidy program, which provided funds to help offset the additional costs associated with constructing ships in U.S. shipyards. Under this limited exception, seven U.S.-flag foreign-built bulk carriers began carrying food aid preference cargos in the early 1980s. As a result of the entry of these new ships, in 1990 we reported that the average OFD cost per metric ton had decreased by 50 percent.[6]

Since the early 1980s, no newly constructed ships have entered the food aid preference cargo trade. As a result of the limited number of U.S.-flag bulk ships available, combined with the requirement that at least 75 percent of food aid tonnage be shipped on U.S.-flag ships, more old U.S.-flag tankers and U.S.-flag tug/barge combinations have entered the food aid cargo preference trade. This is especially true for tankers whose ODS contracts have expired. These new entrants are typically not the most cost-efficient and have resulted in increased shipping costs for U.S. food aid programs. For example, according to a MARAD official, if a shipowner has a 25-year-old tanker that can no longer compete for foreign commercial cargos because it no longer has an ODS contract, cargo preference requirements enable the shipowner to continue to operate this inefficient ship because it is U.S. flagged.

MARAD's Guideline Rates Are Based on Actual Ship Costs

To ensure that U.S.-flag rates are fair and reasonable, MARAD calculates a guideline rate for each U.S.-flag ship food aid preference voyage. To calculate a guideline rate, MARAD uses actual cost data for the U.S.-flag ship planning the voyage, estimates port and cargo-handling costs based on the past experiences of U.S.-flag ships, and provides an allowance for brokerage expenses and overhead. In addition, MARAD builds in a profit factor based on a 5-year average of the profitability of Fortune's top 50 U.S. transportation companies. For 1993, this profit factor was about 13 percent. Guideline rates are only calculated for ships chartered to carry bulk commodities. Ships that provide liner service are paid their tariff rates, which, according to MARAD officials, are inherently fair and reasonable.

[6]Cargo Preference Requirements: Their Impact on U.S. Food Aid Programs and the U.S. Merchant Marine (GAO/NSIAD-90-174, June 19, 1990).

MARAD's guideline rates represent the ceiling for what is considered fair and reasonable. For the majority of food aid preference cargo voyages, the actual shipping rate paid to the U.S. shipowner is below MARAD's calculated guideline rates. In fact, for 1993 the actual shipping rates paid to U.S. shipowners whose ships carried bulk commodities averaged 85 percent of their MARAD-calculated guideline rates. For tug/barge combinations and tankers, this average was 80 percent, and for bulk carriers it was 94 percent.

Since guideline rates are based on actual costs for each individual ship, they reduce the incentives for ships to become more efficient. According to MARAD officials, the percentage of profit allowed under guideline rates is the same for all U.S.-flag ships regardless of their efficiency. While we were told that the more efficient ships will always get food aid preference cargos before less efficient ships, the limited number of U.S.-flag ships available means that when the demand is high, cargos are available for the less efficient U.S.-flag ships. This situation results in the food aid programs paying higher shipping rates since less efficient ships are more costly.

To reward efficient U.S.-flag ship operators and eventually force inefficient U.S.-flag operations out of the food aid cargo preference trade, MARAD officials and many of the U.S. shipping companies we interviewed advocated modifying how MARAD calculates its guideline rates. They suggested averaging operating costs for ships of similar sizes and using that average cost to calculate guideline rates, rather than using actual costs for each individual ship. They explained that over time, averaging guideline rates will lower U.S. shipping rates for food aid preference cargos. MARAD officials also said that rate averaging should only be implemented if foreign-built ships are allowed to enter the trade to take the place of the inefficient operators that are forced out of the program.

Conclusions

The U.S.-flag ships that are most dependent on food aid preference cargos are not currently viewed as militarily useful by DOD. While the crews that support those ships could be used to help crew the RRF, DOD does not believe that providing for such crews through the food aid cargo preference program is the most cost-effective means. In addition, food aid preference cargos do not contribute to ensuring U.S.-flag ships carry a substantial portion of either U.S. domestic or foreign waterborne commerce. All domestic waterborne commerce is already reserved for U.S.-flag ships by the Jones Act, and food aid preference cargos account for a very small portion (less than 1 percent) of all waterborne foreign commerce. Therefore, the application of cargo preference requirements to food aid programs contributes little to helping achieve the objectives of the Merchant Marine Act of 1936, as amended.

Furthermore, the U.S.-flag ships that DOD currently views as militarily useful—those that provide liner service—are either supported by Jones Act trade or are largely dependent upon ODS contracts, which are expiring, to successfully compete for foreign commercial cargos because their costs are substantially greater than their foreign competitors. The higher costs of U.S.-flag ships are primarily due to U.S. laws and regulations that increase U.S.-flag ships' construction, maintenance and repair, and operating costs. In addition, U.S. shipowners are discouraged from taking the necessary steps to reduce their costs by investing in new ships because it is possible to successfully operate inefficient ships in the food aid cargo preference trade.

One way to give U.S. shipowners incentives to invest in more efficient ships would be to waive the 3-year waiting period currently imposed on cargo preference eligibility for foreign-built U.S.-flag ships. Congress, in effect, waived this requirement for a short period in the early 1980s. A result was new ships entering the market and a decrease in operating costs.

Matters for Congressional Consideration

If Congress continues to support the objectives for which cargo preference is applied to food aid programs and is willing to continue to devote resources to that end, Congress may wish to consider a more efficient alternative for achieving those objectives. For example, a program like the current ODS program, which will be expiring by 1998, could be used to support those ships, and their crews, that DOD finds militarily useful and that could also successfully compete for U.S. foreign commercial cargos.

If Congress decides to continue to apply cargo preference to food aid programs, it may wish to consider giving U.S. shipowners incentives to invest in more efficient ships in order to reduce food aid transportation costs. One possible incentive would be to allow new, foreign-built, U.S.-flag ships to immediately participate in the food aid cargo preference trade.

Recommendation

If Congress chooses to continue the application of cargo preference laws to food aid programs and acts to permit U.S.-flag foreign-built ships to immediately carry food aid preference cargos, we recommend that the Secretary of Transportation instruct the Administrator of the Maritime Administration to promote the efficiency of the ships that carry food aid preference cargos. One way this can be done is by changing the method of calculating guideline rates so that "average" operating costs for all similar-sized ships, instead of "actual" operating costs for each individual ship, are considered. While implementing this change will not help the application of cargo preference laws to food aid programs achieve its intended objectives, it should reduce food aid transportation costs.

Agency Comments and Our Evaluation

MARAD said that it was "...troubled by conclusions and implications which are either not supported by verifiable data, or which mischaracterize the issues and factors affecting the conduct of the cargo preference programs." Regarding our conclusions in this chapter, MARAD disagreed that U.S.-flag shipowners that participate in the food aid cargo preference programs are discouraged from improving the efficiency of their shipping operations. MARAD's views are that "U.S.-flag shipowners do not lack incentives to lower costs, regardless of whether they carry commercial or preference cargo. Any owner operating in a high capital cost, competitive and highly critical market has substantial incentives to lower costs." As a general statement applicable to the shipping industry at large, we agree with MARAD's views. However, we continue to believe that in the specific case of U.S.-flag shipowners who transport food aid preference cargos, those U.S.-flag shipowners have little incentive for reducing their costs because they are guaranteed by law to obtain 75 percent of the cargo tonnage. The main cost-controlling factor under this circumstance is the upper-limit rates that the shipowners can charge (guideline rates) that are calculated by MARAD based on the actual operating expenses of the individual U.S.-flag ships.

Despite MARAD's comments on incentives, MARAD agreed with our recommendation to promote the efficiency of the ships that carry food aid cargos. MARAD said that averaging costs for similar-sized ships or developing some other efficiency standard could reduce guideline rates and has testified to Congress that it would consider a change in the method of calculating guideline rates.

AID, DOD, and USDA generally agreed with our conclusions and recommendation in this chapter and offered clarifications which we made where appropriate.

Cargo Preference Requirements Adversely Affect U.S. Food Aid Programs

Applying cargo preference laws to food aid programs requires that at least 75 percent of food aid commodity tonnage be shipped on U.S.-flag ships, to the extent that such ships are available at fair and reasonable rates. Each food aid program experiences some adverse impacts from complying with these laws. The most significant impact is the additional cost associated with shipping food aid on U.S.-flag ships. This additional cost reduces the amount of funds that might otherwise be available to purchase food. The requirement to ship food aid on U.S.-flag ships can also cause the purchase of a commodity at a higher price, or the purchase of a different variety of commodities than originally planned. This occurs because decisions to purchase commodities can be driven by the availability of U.S.-flag ships, rather than the availability of the commodities.

How Cargo Preference Compliance Is Measured Varies by Program

Table 3.1 shows how commodity and transportation costs are funded and how cargo preference compliance is generally measured for each food aid program.

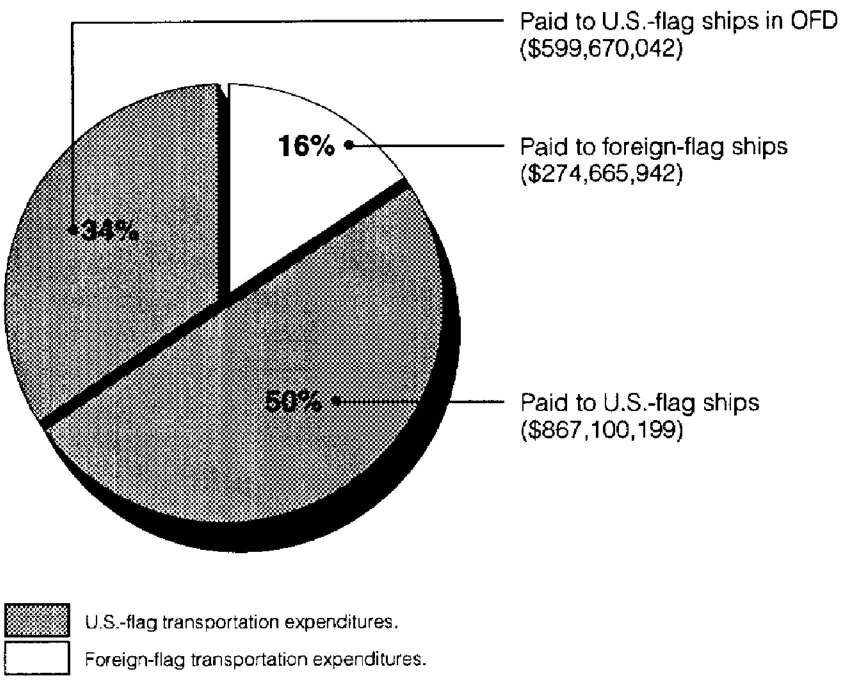
Table 3.1: Food Aid Program Funding and Cargo Preference Compliance

Food aid program	Commodity and transportation funding	Measurement of cargo preference compliance
P.L. 480 title I	USDA signs agreements with countries to purchase commodities with concessional loans. USDA and MARAD pay OFD, country pays equivalent of foreign-flag transportation costs.	Seventy-five percent of tonnage purchased under each purchase authorization— which specifies commodity, approximate tonnage, and maximum dollar amount—is shipped on U.S.-flag ships, to the extent practical.
P.L. 480 title II emergency aid PVO agreements	AID signs agreements with PVOs or recipient countries to provide set tonnages of specified commodities. USDA and MARAD pay all transportation expenses.	Seventy-five percent of total food aid tonnage provided under any part of title II is shipped on U.S.-flag ships, to the extent practical.
World Food Program	Biennial pledge from United States covers both commodity and transportation expenses.	
P.L. 480 title III	AID signs agreements with recipient countries to provide a set dollar amount of aid, which typically covers all commodity and transportation expenses.	Seventy-five percent of food aid tonnage provided to each country is shipped on U.S.-flag ships, to the extent practical.
Section 416(b)	U.S. government donates commodities. USDA and MARAD cover all transportation expenses.	Seventy-five percent of food aid tonnage provided to each country must be shipped on U.S.-flag ships.
Food for Progress	Concessional loans under title I or donated commodities under section 416(b) can be used, depending on the agreement. Transportation and OFD expenses may be covered by importing country or USDA and MARAD.	Seventy-five percent of food aid tonnage provided to each country must be shipped on U.S.-flag ships.

OFD Is a Significant Portion of U.S. Food Aid Program and Transportation Costs

According to data obtained from USDA, from fiscal years 1991 through 1993 U.S. food aid programs have paid almost $600 million in OFD to U.S. shipowners.[1] OFD is calculated for each food aid cargo preference shipment and is based on the difference between U.S.-flag rates and foreign-flag rates bid for that particular food aid shipment. As illustrated in figure 3.1, the almost $600 million in OFD costs represented 34 percent of all program funds spent on transportation from fiscal years 1991 through 1993. For this same period, the almost $600 million in OFD represented 41 percent of the program funds spent on transporting food on U.S.-flag ships.

Figure 3.1: Food Aid Transportation Expenditures, Fiscal Years 1991-93

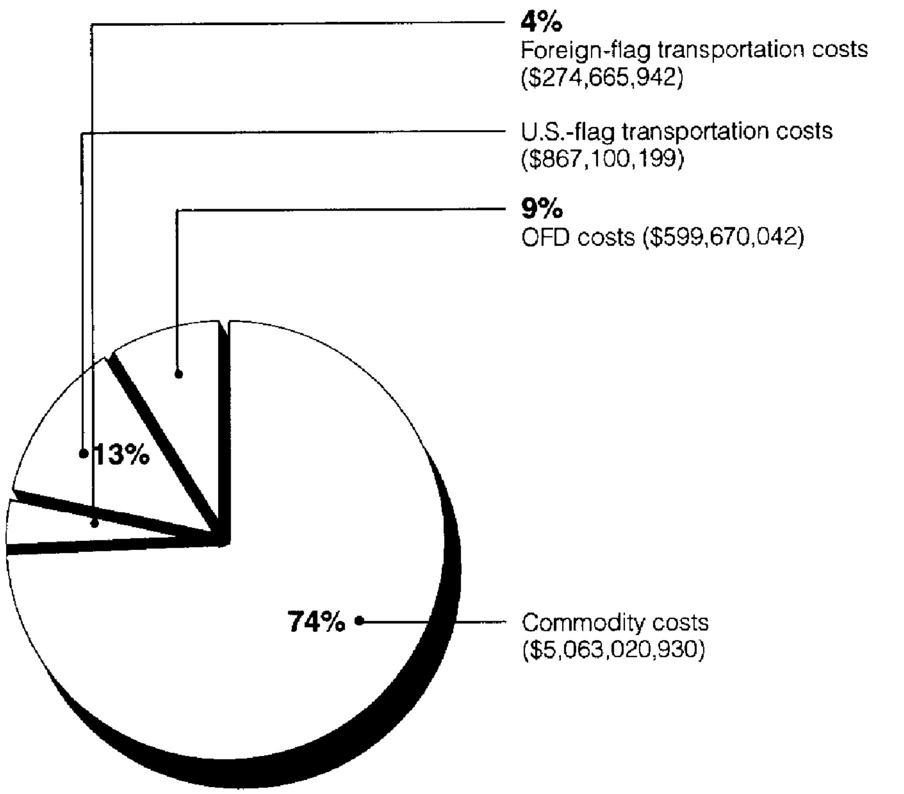


Source: USDA.

The amount spent on OFD also represented 9 percent of all funds spent on food aid programs for fiscal years 1991 to 1993, as shown in figure 3.2.

[1]USDA or AID pays OFD for the first 50 percent of food aid tonnage shipped on U.S.-flag ships; MARAD pays OFD for the next 25 percent of tonnage shipped on U.S.-flag ships.

Figure 3.2: Food Aid Commodity and Transportation Expenditures, Fiscal Years 1991-93



Note: Total U.S.-flag transportation costs are equal to U.S.-flag transportation costs and OFD costs.

Source: USDA.

OFD Expenditures Can Reduce the Amount of Commodity Purchased

For some food aid programs, the amount spent on OFD directly reduces the funds available to purchase commodities. This fact applies to title III and to U.S. contributions to the World Food Program. Both of these programs provide food aid to the least developed countries for humanitarian and economic development purposes, and both have a set dollar amount from which both the commodities and their transportation must be purchased. For other food aid programs, the amount spent on OFD affects the budgeted amount available for the program and may reduce the amount of funds available to purchase food.

Title III

The purpose of the title III program is to provide resources to least developed countries to promote broad-based, equitable, and sustainable economic development. The commodities provided through this program, or the revenue generated from their sale, are used to support economic development projects to enhance food security[2] and the privatization of food and agricultural distribution systems, among other activities. AID negotiates multiyear commitments with title III recipient countries. Agreements that specify how the resources provided will be used to support these projects, and a funding level to purchase both the desired commodity and its transportation, are signed each year during the multiyear commitment.

Under title III's funding arrangement, amounts spent on OFD directly reduce the funds available to purchase commodities. For example, Sri Lanka received $58.9 million to purchase wheat and its transportation under title III for the cargo preference year ending March 31, 1994. With these funds, Sri Lanka purchased and shipped seven lots of wheat, ranging from 42,000 mt to 52,500 mt, from July to December of 1993. Thirty-five percent, or $20.6 million, of the program was spent on transportation and therefore was not available to purchase wheat. About $10.8 million, or 52 percent of the transportation costs, was spent on OFD resulting from the higher rates charged by U.S.-flag ships.

Sri Lanka's experience is significant, according to AID officials, because the money spent on OFD was much more than expected and reduced the amount of wheat Sri Lanka had hoped to purchase. AID officials said that they believe the reason that OFD expenditures were so high for Sri Lanka was because Sri Lanka's shipments were competing for the U.S.-flag ships capable of carrying 50,000 metric tons with those shipments sent to Russia under USDA's Food for Progress program in the last quarter of the fiscal year. This competition required Sri Lanka to split its wheat shipments between smaller U.S.-flag ships at higher and increasing rates. In fact, for the two U.S.-flag ships that Sri Lanka used to carry about 22,000 mt, the rates increased from $66.81 per metric ton in August to $122.82 per metric ton in October, while the rate for a similar-sized foreign-flag ship used by Sri Lanka in October was $35.67 per metric ton. AID officials added that there is a limited number of U.S.-flag ships available, and individual shipping companies own or operate the majority of U.S.-flag ships of the same size. They said that this limits the amount of competition among shipowners for similar-sized cargos and provides little incentive to keep

[2]Food security includes assuring (1) a safe and nutritionally adequate food supply both at the national and household levels, (2) a reasonable degree of stability of food supply between and within years, and (3) access of each household to enough food to meet its needs.

rates low. They suggested that if there were more competition, the amount of funds spent on OFD would not be as dramatic, and more funds would be available to purchase commodities.

AID's goal when arranging for the purchase of commodities and transportation for title III programs is to minimize the amount of funds spent on transportation, in order to maximize the amount of commodity AID is able to purchase. AID attempts to do this by placing no more than the required 75 percent of tonnage on U.S.-flag ships. AID officials said that the size of U.S.-flag ships that are available also affects the amount of funds spent on transportation. Thus, the more ships AID has to use to get to 75-percent U.S.-flag participation, the greater the transportation costs because smaller ships generally charge higher rates.

For example, during the cargo preference year ending March 31, 1994, Mozambique received $15 million under the title III program to purchase corn and its transportation. At AID's Transportation Division, we observed AID officials determine what corn and commodity transportation would be procured for Mozambique and noted that the amount of corn that was purchased for Mozambique was determined by the U.S.-flag ships available. To comply with cargo preference requirements and maximize the funds available to purchase corn, AID placed exactly 75 percent of the 70,217 metric tons of corn purchased on U.S.-flag ships by using four ships—three U.S.-flag and one foreign flag—with the U.S.-flag rates almost twice the rate of the foreign-flag ship. If AID could have reduced the number of ships it used to three—two U.S.-flag and one foreign-flag—instead of four, only 70 percent of the tonnage would have fit on the two U.S.-flag ships. However, the savings in OFD from using one less U.S.-flag ship would have allowed the purchase of an additional 3,083 metric tons of corn. AID officials explained that without any cargo preference requirements, they would have used the two ships with the lowest rates regardless of flag. We estimated that if they would have done so, they would have been able to purchase about 14,000 more metric tons of corn.

The World Food Program—Title II

The World Food Program is the primary multilateral provider and transporter of food aid for development and disaster relief. It is also the largest source of food grant assistance for developing countries in the United Nations' system. WFP's purpose is to assist poor and food-insecure people throughout the developing world to help them become self-reliant and to provide relief food in times of natural or manmade disasters. The

U.S. government's 1991-92 biennial contribution to WFP equaled about one-third of all contributions to the program during that 2-year period. U.S. contributions to WFP are given through the P.L. 480 title II program. Therefore, the U.S. government requires WFP to comply with its cargo preference requirements for all commodities that WFP purchases with the U.S. contribution. As a result, WFP was affected by cargo preference requirements in a manner similar to countries receiving food aid through title III. Beginning with the 1991-92 U.S. contribution, the contributed amount was to cover both the commodity value and the associated transportation costs, including OFD. Previously, the U.S. government had refunded to WFP the OFD costs of complying with U.S. cargo preference laws.

While the U.S. contribution was increased in consideration of this new arrangement, at the same time over the last several years WFP officials have observed a steep rise in U.S.-flag rates with no similar increase in foreign-flag rates. For example, the difference between the cost of transporting commodities on chartered U.S.-flag ships instead of less expensive foreign-flag ships available for charter was almost 100 percent in 1991 and more than 150 percent in 1992. This resulted in WFP spending $19.7 million to cover the additional cost of using U.S.-flag ships out of the $200-million 1991-92 regular pledge portion of the U.S. contribution. WFP estimates this differential will require up to $44 million of the $225-million 1993-94 U.S. regular pledge portion of the U.S. contribution. World Food Program officials stated that this ever-widening differential will continue to substantially reduce the commodity component of U.S. contributions to the program.

Commodity Purchasing Decisions Can Be Driven by the Availability of U.S.-Flag Ships

USDA views title I as a means to develop future markets for the commercial purchase of U.S. agricultural commodities and believes that cargo preference requirements interfere with its ability to develop such markets for U.S. agricultural products. It is difficult to develop a market for a particular product when recipient countries are unable to purchase it because U.S.-flag ships are not available to transport that product. USDA officials also say that they believe that recipient countries that have had an unfavorable experience with the title I program because of the consequences of using U.S.-flag ships may choose to not purchase agricultural products from the United States commercially in the future.

The Lowest-Cost Commodity Cannot Always Be Purchased

When food aid recipients are unable to purchase the lowest-cost commodity, it is typically because no U.S.-flag ships are available to pick it up at the loading port. This situation forces the recipient countries to either purchase the commodity at a more expensive price in order to comply with cargo preference requirements, or to not purchase any commodities. For title I, USDA's policy is to purchase commodities and their transportation in a way that minimizes the total cost (lowest landed cost) to meet cargo preference requirements. Depending on the availability of U.S.-flag ships and their rates, commodities cannot always be purchased at their lowest price. For example, for a 1992 title I wheat purchase for Tunisia, the four lowest offers specified loading facilities in ports on the Columbia River and in Stockton, California. Since no U.S.-flag ships offered to transport wheat from these ports, Tunisia was unable to take advantage of these low wheat prices.

Tunisia offered to purchase the next lowest wheat offer, which restricted loading to only one ship, and place all the tonnage—approximately 54,000 metric tons—on one U.S.-flag ship. USDA would not approve this alternative because over 80 percent of the tonnage previously purchased under this purchase authorization had been shipped on U.S.-flag ships. Therefore, sending 100 percent of this purchase on a U.S.-flag ship would have cost USDA close to $730,000 in additional OFD. Eventually, Tunisia was forced to purchase wheat offered in the Gulf of Mexico at the seventh and eighth lowest price and use one U.S.-flag and one foreign-flag ship. While not necessarily resulting in a higher landed cost, these prices were over $4 higher per MT for the almost 55,000 MT Tunisia finally purchased than the lowest priced wheat obtainable regardless of the availability of U.S.-flag ships.

Food aid recipients are sometimes not able to purchase the commodities at their lowest price even if a U.S.-flag ship is available because it may not be the appropriate type or size to transport the commodity. For example, in a 1992 title I purchase Estonia wanted to place both its corn and wheat purchases on one U.S.-flag ship. The only U.S.-flag ship that offered to carry these cargos was too large to be accommodated at the loading facilities that offered the lowest wheat prices. In order to use this U.S.-flag ship, Estonia purchased higher-priced wheat (19 cents more per metric ton) from a supplier with loading facilities that could accommodate this ship.

A Different Variety of Commodity Than Desired May Be Purchased

Cargo preference requirements have also forced some countries to purchase varieties of commodities that differ from those desired due to the unavailability of U.S.-flag ships on the West Coast of the United States. According to MARAD officials, U.S.-flag ships are typically unavailable on the West Coast because of the limited number of U.S.-flag ships, the infrequent availability of cargos on the West Coast, and the port charges on the West Coast that are much higher than those in the Gulf of Mexico. This situation can preclude countries from purchasing commodities available on the West Coast. For example, during the cargo preference year ending March 31, 1994, for title I both El Salvador and Guatemala were not able to purchase the western white wheat they wanted because no U.S.-flag ships, or no U.S.-flag ships at a reasonable shipping rate, were available on the West Coast.

According to Guatemala's agent, the purchasers were a private group of Guatemala millers that sell their products in Guatemala's domestic market. To minimize their commodity costs, they wanted to purchase less-expensive western white wheat. However, Guatemala's agent explained that because of cargo preference laws, when Guatemala puts together a purchasing plan to present to USDA it must first consider the availability of U.S.-flag ships, not what type of wheat it wants to buy.

The first time Guatemala tried to purchase wheat, no U.S.-flag ships were available on the West Coast. Therefore, the Guatemalans proposed purchasing only a total of 18,000 metric tons of wheat—12,000 metric tons of western white wheat using a foreign-flag ship and 6,000 metric tons of a different type of wheat available in the Gulf of Mexico, using a U.S.-flag ship. As only 33 percent of the purchase would have gone on a U.S.-flag ship, USDA would not approve the purchase. Instead, Guatemala chose to purchase only the 6,000 metric tons from the Gulf of Mexico and purchase the balance later in the year.

We were able to observe Guatemala's next attempt to purchase wheat. For this purchase, Guatemala was still interested in purchasing western white wheat. It had many offers for this variety of wheat that were lower than the price for wheat available out of the Gulf of Mexico. In addition, one U.S.-flag ship did offer to transport wheat from the West Coast, but at a prohibitive rate. Therefore, in order to comply with cargo preference requirements, Guatemala was not able to purchase the less expensive western white wheat, but was forced to purchase more expensive wheat from the Gulf of Mexico because that was where U.S.-flag ships were available.

El Salvador's wheat purchases were similarly affected by cargo preference requirements. The first two times El Salvador attempted to purchase wheat, it received offers for and was interested in purchasing western white wheat. But because no U.S.-flag ships were available on the West Coast and USDA would not allow it to use foreign-flag ships, El Salvador chose not to purchase any wheat. On El Salvador's third attempt to purchase wheat, western white was again available, but there were still no viable U.S.-flag offers from the West Coast. In order to break this impasse, USDA allowed El Salvador to purchase western white wheat and ship all of it on a foreign-flag ship.

However, El Salvador had to agree that future purchases under this purchase authorization would maximize the use of U.S.-flag ships. Subsequent wheat purchases by El Salvador were shipped out of the Gulf of Mexico because that is where U.S.-flag ships were available. For some of these purchases, El Salvador had to forgo purchasing less expensive western white wheat because no U.S.-flag ships were available on the West Coast.

USDA officials added that both Guatemala and El Salvador were further disadvantaged by the requirement to comply with cargo preference for title I wheat purchases because of the cost of shipping the small amount of wheat available for shipment on foreign-flag ships. USDA officials explained that when U.S.-flag ships are used to carry the majority of a purchase and the remaining balance is shipped on a foreign-flag ship, the remaining balance is such a small amount that the foreign-flag rate can be more than twice what it would have been if the entire amount had been shipped on one foreign-flag ship. This is significant for title I recipient countries because they usually incur this expense.

USDA and AID Management Practices Affect Food Aid Transportation Costs

Several practices USDA and AID use to manage the transportation of food aid affect transportation costs. First, USDA and AID require shipowners to use contract terms in transporting food aid cargos that are not typically required of shipowners for commercial cargos. These terms, which are applied to food aid cargos shipped on either U.S.-flag or foreign-flag ships, may increase transportation costs because they place additional costs and risks on shipowners that are then passed back to the food aid programs through higher shipping rates. Second, food aid shipments are concentrated into the last half of the year. This concentration creates a high demand for the limited number of U.S.-flag ships available during that period, which increases U.S.-flag shipping rates and the cost to transport food aid. Finally, the administration of cargo preference for food aid programs is shared by three separate agencies—USDA, AID, and MARAD—which adds to the overall cost of its administration.

USDA and AID Contract Terms May Raise Transportation Costs

In arranging for the transportation of food aid cargos, USDA and AID have chosen to provide and pay for additional services through the shipowners to give additional financial assistance to these needy countries. Both USDA and AID require both U.S.-flag and foreign-flag ships to provide and pay for these additional services. For those U.S.-flag ships that carry bulk commodities, these additional services are reflected in increased shipping rates, which may increase the total cost to transport U.S. food aid. Due to the uncertainty U.S. shipowners encounter in estimating the cost of providing these services when developing shipping rates for food aid preference cargos, they would like USDA and AID to adopt contract terms for these cargos that are more consistent with those used for similar commercial cargos. The U.S. shipowners we interviewed believe that adopting these terms would reduce this uncertainty and result in lower U.S.-flag shipping rates. In response to complaints from U.S. shipowners, MARAD is pursuing a rule-making to require that food aid cargos be transported under a uniform charter party based on commercial terms that would provide a set of consistent commercial contract terms for food aid cargos.

Food Aid Transportation Contract Terms Differ From Commercial Terms

According to MARAD officials and the U.S. shipowners we talked to, the most widely used contract for bulk commodity cargos is the North American Grain (NORGRAIN) charter party. NORGRAIN contains typical commercial contract terms that are used as a start for the final terms agreed to between the parties for the shipment of commercial cargos. These terms differ from those used by USDA and AID for carrying food aid cargos. From our discussions with MARAD and the responses of the U.S. shipping companies that participated in our structured interview, we determined that some of the most contentious differences are the use of "full berth" terms, the timing of freight payments to shipowners, and the requirements for inland transportation and fumigation. In its provisions related to these terms, the NORGRAIN charter party places most of the financial risk on the importer of the cargos, while USDA and AID's terms place most of the financial risk on the shipowners.

Full Berth Terms

Full berth terms require a shipowner to pay the full cost of loading and unloading the cargo. They also require the shipowner to absorb the full costs associated with any delays in loading and unloading the cargo. Financial incentives for the timely loading and unloading of cargo, known as "demurrage" and "despatch,"[1] are not part of full berth terms, but are included in commercial charter parties like NORGRAIN. Without these incentives, shipowners must factor into their shipping rates any expected delays. MARAD estimates that this use of full berth terms can add up to $15 per metric ton to the cost of a 50,000-metric ton food aid preference cargo.

Although they are moving toward contract terms that are more consistent with those used for similar commercial cargos when possible, both USDA and AID use full berth terms to some extent. For title I cargos, a USDA official explained that USDA requires the shipowner to pay for cargo loading and the importing country to pay for its discharge and that there is despatch and demurrage at both the loading and discharging port. But full berth terms are still used for donated commodities provided under section 416(b) and Food for Progress because the recipient countries typically do not have the resources to pay demurrage. AID officials explained that for titles II and III bulk cargos, AID has moved from full berth terms to terms that are more consistent with those used for similar commercial cargo for some shipments. AID recognizes that this practice lowers shipping rates. But because the countries that receive food aid under these programs are the neediest, the extent to which these terms can be used depends on the country. AID's current arrangement for all bulk cargos is to have the commodity supplier pay to load the ship, have demurrage and despatch terms apply to the loading, and have any demurrage or despatch payments that may be required settled between the commodity supplier and the shipowner. For the recipient countries that have the resources, the country pays to unload the ship, and demurrage and despatch terms apply to the unloading; any demurrage and despatch payments required are

[1]Demurrage is paid to the shipowner by the charterer to compensate for any delay in loading or unloading the cargo. Despatch, typically set at one-half the demurrage rate, is paid by the shipowner to the charterer for a faster-than-expected cargo loading or unloading.

settled between the recipient country and the shipowner. For those recipient countries that do not have the resources, cargos are unloaded under full berth terms.

Timing of Freight Payments to Shipowners

Standard practice for commercial shipments is to pay the shipowner 100 percent of the freight charges due when cargo loading is complete. However, for food aid preference cargos, shipowners are not paid until the ship has arrived at its destination; then they receive 95 percent of the amount due. The remaining 5 percent is paid once the ship is on its return voyage, but only if there do not appear to be any claims against the shipowner, and no despatch is owed. Delaying payment until the cargos arrive at their destination requires the shipowner to finance the cost of the most expensive part of the voyage. These costs are reflected in the shipping rates quoted by the shipowners. MARAD estimates that this delay in payment can add as much as $50,000 in interest expense to the cost of a voyage for a U.S. shipowner. USDA officials explained that this practice may increase shipping rates, but they feel it must be done to ensure that the cargo gets to its specified destination. They are concerned that if shipowners receive payment before their ships arrive at the discharge port and then encounter some type of problem enroute, the shipowners may unload the cargo somewhere other than the specified destination. In that case, the U.S. government would have no way to get the cargo to its intended destination. USDA believes that such a situation could greatly harm its relations with the recipient countries.

Inland Transportation

For a commercial bulk cargo, any required inland transportation is arranged and paid for by the charterer. For food aid cargos, the charterer would be either the importing country itself or one of the responsible agencies. Over the last few years, however, shipowners have been required to arrange and pay for inland transportation of food aid cargos to their final destination and to incorporate this cost into their shipping rates. As shipowners must estimate the cost of providing inland transportation before it is delivered and are paid based on their estimate, it is uncertain whether USDA and AID are paying more or less than the actual cost of this service. This situation could be avoided if USDA and AID did not require shipowners to provide this service and reimbursed the recipient countries for providing this service based on actual cost (assuming the recipient countries have the necessary experience and could make the initial outlay of funds.) It seems reasonable to expect that some landlocked countries should be familiar with transporting goods inland, and should be able to make these arrangements at lower cost than shipowners who are less familiar with making these arrangements.

Although AID and USDA could reimburse the recipient country for any costs associated with transporting food aid to an inland destination, an AID official explained that for landlocked countries receiving food aid under title III, they believe requiring the shipowner to arrange and pay for this service is the best option available. This is because with the recent closing of many AID missions, AID has no one on site to make these arrangements, and AID believes it is not practical to make these arrangements from Washington, D.C. Therefore, AID's preferred means to provide these services is through the shipowners, who factor the cost of providing these services into their shipping rates. AID has not tried reimbursing the recipient countries for providing these services to determine whether this may be a more cost-effective way to provide these services. A USDA official explained that USDA also requires the shipowner to arrange and pay to transport food aid to landlocked countries receiving food aid under section 416(b) or Food for Progress when the U.S. government pays for the transportation of these cargos. USDA would consider reimbursing the recipient country for providing this service, but has found few countries interested in this option. For title I cargos, any required inland transportation is almost always arranged and paid for by the importing country.

Fumigation

Both USDA and AID also consistently require shipowners to arrange and pay for needed fumigation services because the agencies' goal is to provide a pest-free product, and some recipient countries do not have the funds to pay for this service. Bulk agricultural commodity cargos are typically fumigated when they are loaded on board ship. If a commercial cargo is infested when it arrives at its destination, fumigation would typically be paid for by the supplier or the receiver of that cargo. For food aid cargos, however, these costs are paid for by the shipowner. As shipowners do not know whether or not the cargo will be infested when it arrives at its destination, they must build the possibility of an infestation into their shipping rates for every food aid preference cargo. As fumigation at the discharge port is not often required, USDA and AID's requirement for shipowners to build this possibility into their shipping rates results in USDA and AID paying for a service that is not always provided. MARAD estimates that the cost and time required to fumigate a food aid cargo can add up to $200,000 to the cost of a voyage.

Maritime Interests Believe Adopting Commercial Terms Will Reduce Food Aid Transportation Costs

MARAD and the U.S. shipowners who participated in our structured interview and who carry bulk food aid preference cargos said that adopting contract terms that are more consistent with those used for similar commercial cargos would reduce transportation costs. Using these terms would eliminate items like those previously discussed for which the actual costs are difficult to project and that increase shipping rates for U.S. food aid preference cargos. MARAD and the U.S. shipowners we interviewed also believe that the adoption of contract terms for food aid preference cargos that are more consistent with those used for similar commercial cargos would reduce shipping rates and U.S.-flag transportation costs for these cargos.

For example, when a shipowner is carrying a cargo under full berth terms, the amount of time it would take to unload the cargo is uncertain because there is no demurrage to encourage timely unloading. For full berth term voyages, MARAD's guideline rate calculation estimates the number of days required to unload the cargo based on cargo discharge rates stated in the contract terms. MARAD does not factor in any additional days for potential delays at the destination port before unloading. Therefore, shipowners increase their rates (meaning they are closer to MARAD's guideline rate than they would be for voyages with despatch and demurrage) for full berth voyages to compensate for the uncertainty of, and lack of compensation for, delays.

This same uncertainty arises when shipowner responsibility for inland transportation is part of the contract terms. USDA and AID require shipowners to include the cost of inland transportation in their shipping rates. To estimate this cost, shipowners explained that they get bids from rail or truck companies in the recipient country for this service and include that amount in their shipping rates. In determining the total guideline rate for these cargos, MARAD includes an allowance for inland transportation based on the shipowner's estimate of these costs. But if actual costs end up being higher, shipowners are not compensated for the difference. Due to the uncertainty associated with estimating the cost of providing inland transportation services, some U.S. shipowners have chosen to no longer bid on those food aid preference cargos that require inland transportation because they view the risk of losing money as too great.

While MARAD and all the U.S. shipowners we interviewed who carry bulk food aid preference cargos agreed that adopting contract terms for food aid preference cargos that are more consistent with those used for similar commercial cargos would result in some reduction in U.S.-flag shipping rates, their estimates of the size of this reduction differed. MARAD estimated that adopting these terms could, on average, reduce U.S.-flag shipping rates by at least $5 per metric ton. Given that about 6.1 million tons of food aid was moved on U.S.-flag ships in the cargo preference year ending March 31, 1993, using the $5 estimate, the savings from using these terms could have been almost $31 million. The U.S. shipowners we talked to agreed that there would be some reduction in U.S.-flag shipping rates, with most estimating a potential savings of up to 10 percent. Given that USDA and AID spent $592 million to transport food aid on U.S.-flag ships in the cargo preference year ending March 31, 1993, using this estimate this change could have meant a savings of up to $59.2 million in U.S.-flag transportation costs.

While USDA and AID agree that their contract terms add to food aid transportation costs, they do not agree that adopting terms more consistent with terms used for similar commercial cargos would significantly reduce U.S.-flag shipping rates. This belief is based on their observations that little reduction in U.S.-flag shipping rates has occurred in response to the few changes they have already made to move to more typical commercial terms. They also point out that services such as fumigation and inland transportation would still have to be paid for from food aid budgets even if they were not paid for through U.S. shipowners.

Given that the estimated cost of these additional items is built into food aid shipping rates, we believe that a potential may exist for some savings in food aid transportation costs, and potentially food aid program costs, by removing these terms and the uncertainty associated with estimating their actual cost, and adopting more consistent commercial terms. We believe that USDA and AID should experiment with more consistent commercial terms that would cover only the actual costs for such items as fumigation and inland transportation. This would allow a determination to be made with greater certainty about which is the best approach.

MARAD's Proposed Rule-Making Would Require Use of Commercial Terms

In response to U.S. shipowner complaints that contract terms for food aid cargos are "discriminatory and noncommercial, increase shipowner costs and risks, and result in higher U.S.-flag shipping rates and unnecessary expenditures of U.S. government funds," MARAD is working toward promulgating a rule to require (1) the preapproval by MARAD of all freight tenders (i.e., bid solicitations) for preference cargos and (2) the utilization of a uniform charter party by all agencies in arranging for preference cargo shipments. The uniform charter party proposed by MARAD is based on the NORGRAIN charter party that MARAD officials said is used for a majority of commercial bulk agricultural commodity cargos. The purpose of MARAD's proposed rule is to reduce the gap between U.S.-flag and foreign-flag shipping rates by lowering shipowner costs and risks caused by inconsistent charter party terms.

MARAD transmitted a draft notice of proposed rule-making to the Office of Management and Budget (OMB) for prepromulgation clearance on December 29, 1992. Due to the objections by USDA and AID over MARAD's authority to issue the rule-making, OMB did not clear the draft notice. Both USDA and AID argued that MARAD's authority does not extend beyond ensuring that 75 percent of food aid tonnage is shipped on U.S.-flag ships. As both USDA and AID have consistently complied with this requirement, these agencies believe that MARAD's proposed rule is not justified.

In response to these objections, DOT asked the Department of Justice to determine whether MARAD had the authority to promulgate rules establishing mandatory uniform charter terms. The Department of Justice concluded that MARAD's statutory authority is broad enough for it to establish and require the use of charter term regulations. Two significant points made by the Department of Justice in its ruling were that (1) regulating charter parties to eliminate terms that adversely affect U.S.-flag carriers would further the competitive interest of the U.S. merchant marine fleet and (2) having erratic charter party terms increases costs and risks for U.S.-flag carriers that interfere with their ability to calculate and offer rates that are fair and reasonable.

As of June 1994, MARAD was completing a new notice of proposed rule-making to be submitted to OMB for consideration. A MARAD official explained that MARAD is unsure whether OMB will allow it to be published, even with the Department of Justice ruling, because this situation involves one agency making a rule that must be followed by another agency. Moreover, AID disagrees with the Department of Justice's conclusion and has formally requested Justice to reconsider its conslusion.

Timing of Food Aid Shipping Increases U.S.-Flag Shipping Rates

Beginning with fiscal year 1991, title I and title III regulations required that food aid purchases be made by September 30 of each year and that all food aid cargos be loaded by December 31. Previously, food aid had to be purchased and loaded by September 30 which, as we reported in 1989,[2] heavily skewed title I shipments to the last 2 quarters of the fiscal year to satisfy cargo preference requirements. This practice resulted in higher freight costs because of the increased demand for the limited number of U.S.-flag ships available.

As shown in table 4.1, from our review of USDA's food aid shipment database for cargo preference years 1992 through 1993, we found that for titles I and III, between 55 percent and 94 percent of annual food aid tonnage was shipped between July and December; only 8 percent or less was shipped between January and March. We also found that the average U.S.-flag shipping rates for January through March were consistently lower than the average U.S.-flag shipping rates for July through December.

Table 4.1: Average U.S.-Flag Shipping Rates and Food Aid Tonnage Shipped by Time of Year

	Title I		Title III	
Cargo Preference Year	Average U.S. rate per mt	Percent of tons lifted	Average U.S. rate per mt	Percent of tons lifted
1992				
Apr.-June	$52.13	41.87	$39.85	2.16
July-Dec.	54.94	54.30	74.36	93.57
Jan.-Mar.	48.00	3.83	68.43	4.27
1993				
Apr.-June	72.09	10.69	65.05	25.28
July-Dec.	63.64	81.22	62.65	72.71
Jan.-Mar.	63.33	8.09	47.55	2.01

Source: GAO analysis of USDA food aid shipment database.

As USDA and AID officials explained to us, there is no one reason why the majority of food aid tonnage is shipped in the last half of the calendar year. An often-cited reason is that recipient countries delay signing their annual agreements. Both USDA and AID officials said that while signing agreements earlier may result in some countries shipping their food aid purchases sooner, there are other factors unrelated to the signing of agreements that also affect the timing of shipments, e.g., the amount of commodity storage available in the country. Therefore, USDA officials explained they are reluctant to place a lot of pressure on the countries to sign agreements

[2] P.L. 480 Title I Transportation Issues (GAO/T-NSIAD-90-08, Nov. 7, 1989).

earlier because they feel such pressure may discourage the countries from participating in the title I program.

Since food aid purchasing cannot occur until it is requested by the recipient country, USDA and AID have limited influence over when food aid purchasing and shipping take place. AID officials explained that title III recipient countries consider such things as commodity prices and the condition of their food stocks and harvests in determining when to request food aid. The tendency of these countries is to wait until their alternative food sources are running low to request that food aid be purchased. For title I, USDA officials explained that they believe one of the main reasons why countries wait until the end of the fiscal year to purchase food is because of the difficulties the countries encounter in getting agreements signed and purchases approved by their governments. In addition, both USDA and AID officials said that they are reluctant to place a lot of pressure on the countries to request food aid purchases earlier because they believe it may discourage them from participating in their programs.

Because the majority of food aid tonnage is being purchased and shipped during the last half of the calendar year instead of more evenly throughout the year, on average U.S.-flag shipping rates are increased. This is due to the increased demand placed on U.S.-flag ships and the entry of higher-cost ships to meet this increased demand. On average, U.S.-flag shipping rates would be lower if these cargos were spread more evenly throughout the calendar year.

The Cost to Administer the Application of Cargo Preference to Food Aid Programs

Both USDA and AID have specific offices set up to procure food aid cargos and their transportation. These offices spend a significant amount of time dealing with cargo preference requirements. MARAD's Office of National Cargo and Compliance monitors the shipping activities of USDA and AID and assures that they comply with cargo preference laws. Based on estimates prepared by agency officials, we provide the annual cost and full-time equivalent positions required to administer the application of cargo preference to food aid cargos for each of these agencies in table 4.2.

Table 4.2: Annual Operating Costs and Personnel Required to Administer the Application of Cargo Preference Laws to Food Aid Programs

Agency	Annual operating costs	Number of full-time equivalent personnel
USDA	$365,625	8.55
AID	738,450	8.25
MARAD	598,000	8.16
Total	**$1,702,075**	**24.96**

Sources: USDA, AID, and MARAD.

One way to reduce the costs of administering cargo preference would be to consolidate the administration of cargo preference within one agency. However, responsible officials from both USDA and AID believe that there would be little reduction in personnel and program costs if the activities associated with contracting for transportation of food aid preference cargos were consolidated. Although USDA and AID officials said that some benefits would occur through the use of consistent charter terms and consolidation of cargos, they also believe that it is important to retain the transportation arrangements for food aid cargos within their respective agencies. They believe each agency understands the specific goals of the programs it administers and therefore the constraints faced in dealing with developing countries.

MARAD officials said there is a lack of centralization of government contracting for food aid programs that has resulted in higher than normal U.S.-flag shipping rates. MARAD said that consolidating the transportation arrangements for preference cargos within MARAD would yield personnel and cost savings to the U.S. government and eliminate the inconsistent practices of USDA and AID in contracting with the U.S. merchant marine fleet for transportation of food aid cargos. MARAD said this consolidation would also produce savings, as MARAD would no longer have to monitor the compliance of other agencies with cargo preference requirements.

Conclusions

The contract terms used by USDA and AID for the transportation of food aid cargos on both U.S.-flag and foreign-flag ships places additional costs and risks on shipowners. This practice results in higher shipping rates and may or may not increase food aid transportation costs. USDA and AID have developed these contract terms as a means to provide additional services to recipient countries. The terms USDA and AID use have the most impact on those shipowners whose ships carry bulk food aid cargos and who reflect the estimated costs of these additional services in their shipping rates. We believe that some potential may exist for savings in food aid transportation costs through removing the uncertainty associated with estimating the actual costs of these services by adopting contract terms that are more consistent with those used for similar commercial cargos. However, we recognize that the savings may be offset by other increases in food aid program costs and understand that USDA and AID have other concerns about the adoption of commercial terms. To determine whether any potential exists to reduce food aid transportation costs, and food aid program costs, through the use of more consistent commercial terms, which would cover only the actual costs for such items as fumigation and inland transportation, we believe that USDA and AID should experiment with them to determine which is the best approach.

Food aid transportation costs are also increased because a majority of food aid shipments occur in the last half of the calendar year instead of being more evenly spaced throughout the year. This situation increases demand for the limited number of U.S.-flag ships available and, on average, raises shipping rates due to the entry of more costly U.S.-flag ships. While we found no conclusive reason why food aid shipments are clustered into the last half of the calendar year, it is clear that food aid transportation costs could be reduced if food aid shipments were more evenly spaced throughout the year.

Recommendations

If Congress chooses to continue the application of cargo preference laws to food aid cargos, we recommend that the Secretary of Agriculture and the Administrator of the Agency for International Development take the following steps because of their potential to reduce food aid transportation costs:

- Experiment with the use of contract terms for the transportation of food aid cargos that are more consistent with contract terms used for similar commercial cargos to determine whether their use will reduce food aid transportation costs.
- Encourage recipient countries to more evenly space their food aid shipments throughout the year.

Agency Comments and Our Evaluation

AID said it agrees with our recommendation to experiment with the use of contract terms for the transportation of food aid cargos that are more consistent with contract terms used for similar commercial cargos to determine whether their use will reduce food aid transportation costs.

However, AID's preference is for a collaborative interagency effort in this regard to experiment with different terms under controlled conditions in selected shipments. We believe that this approach could meet the objectives of our recommendation.

USDA agrees that the use of contract terms more consistent with terms used for similar commercial cargos might reduce food aid transportation costs. However, they believe a primary factor that influences shipping rates is not the terms, but the degree of competition. USDA also believes that forcing commercial terms, such as NORGRAIN, on foreign countries that are not commercial buyers can defeat the purpose of the food aid provided. We agree that the degree of competition should be a major factor that affects shipping rates. However, the degree of competition among U.S.-flag ships seeking to carry food aid cargos is often limited. U.S.-flag shipowners are generally guaranteed at least 75 percent of food tonnage by law, and we would expect that the most cost-efficient U.S.-flag ships would obtain those food aid cargos before less cost-efficient U.S.-flag ships. However, when demand for U.S.-flag ships is high, competition among the limited number of U.S.-flag ships is greatly reduced, and the less cost-efficient ships are able to obtain food aid cargos despite their high rates. Regarding foreign countries' reactions to the use of shipping terms more closely aligned with NORGRAIN, we believe that the best approach for USDA is to simply experiment with the terms and evaluate the overall effects, including the effects on foreign countries as well as on transportation and program costs.

MARAD supports the use of transportation contract terms that are more closely aligned with those used in transporting similar cargos made under commercial sales transactions. In fact, MARAD believes that the adoption of their proposed uniform charter party for food aid preference cargos—which will principally impose such shipping terms on AID and USDA—will reduce transportation costs by removing what MARAD considers unnecessary risks and cost from the shipowners. AID and USDA told us that they do not support a uniform charter party because they believe the shipping terms that would be included in such an arrangement would reduce the flexibility they currently have to set shipping terms. We have not fully evaluated MARAD's proposed uniform charter party nor the potential implications it could have on the food aid programs and therefore do not have a position on the matter. We continue to believe that the appropriate course of action now is to experiment with shipping terms.

USDA agreed with our recommendation directed at reducing food aid transportation costs by more evenly spacing food aid shipments throughout the year. USDA identified several reasons why this occurs, and said it will continue its efforts to more evenly space food aid shipments by obtaining early signing of agreements and prompt purchasing of food aid.

AID did not comment on this recommendation.

U.S. Cargo Preference Laws

The U.S. Congress has enacted several cargo preference laws. The current primary laws are the Cargo Preference Act of 1904, the Merchant Marine Act of 1936, and the Cargo Preference Act of 1954. In addition, the Food Security Act of 1985 contains significant cargo preference requirements that apply specifically to U.S. food aid programs.

The Cargo Preference Act of 1904

The Cargo Preference Act of 1904 (10 U.S.C. 2631, ch. 1766, 33 Stat. 518, Apr. 28, 1904), as amended, states that only vessels of the United States may be used in the transportation by sea of supplies bought for the Army, Navy, Air Force, or Marine Corps. However, if the President finds that the freight rate charged by those vessels is excessive or otherwise unreasonable, contracts for transportation may be made as otherwise provided by law. In effect, this law requires that 100 percent of Department of Defense (DOD) cargo be shipped on U.S.-flag vessels.

The Merchant Marine Act of 1936

The Merchant Marine Act of 1936 (46 U.S.C. 1101 et seq., ch. 858, 49 Stat. 1985, June 29, 1936) was enacted to recognize the need to develop a U.S. merchant marine for national defense and to carry a substantial portion of our domestic and foreign commerce. Section 901 of the act requires government employees traveling on official business overseas to use ships registered under U.S. laws when available. Section 901 of the act was later amended by the Cargo Preference Act of 1954 and the Food Security Act of 1985 to specify the percentage of cargo tonnage that is required to be transported on U.S.-flag vessels.

The Cargo Preference Act of 1954

The Cargo Preference Act of 1954 (46 U.S.C. 1241(b), ch. 936, 68 Stat. 832, Aug. 26, 1954) amended section 901 of the Merchant Marine Act of 1936 to require that at least 50 percent of all U.S. government cargo tonnage be transported on privately owned, U.S.-flag commercial vessels, to the extent that such vessels are available at fair and reasonable rates.

The Food Security Act of 1985

The Food Security Act of 1985 (P.L. 99-198, December 23, 1985) further amended section 901 of the Merchant Marine Act of 1936 by requiring that by April 1988, and for each year thereafter, an additional 25 percent of food aid tonnage exported under Public Law (P.L.) 480, section 416, of the Agricultural Act of 1949 (Ch. 792, 63 Stat. 1051, 1058, Oct. 31, 1949), as amended, and the Food Security Wheat Reserve Act of 1980 (title III of P.L. 96-494, Dec. 3, 1980), be transported on privately owned, U.S.-flag commercial vessels. The Department of Transportation (DOT), through the Maritime Administration (MARAD), is required to fund the ocean freight differential (OFD) for the additional 25 percent of food aid tonnage shipped on U.S.-flag vessels.

Russia Food for Progress Program

Perhaps the most publicized food aid package in recent years was the U.S. pledge of $700 million in commodities to Russia announced in April 1993. As with all food aid shipments, cargo preference requirements applied to these sales. However, because much of this food aid was shipped at the time of year when most other U.S. food aid was being transported, the unavailability of U.S.-flag ships prevented the U.S. Department of Agriculture (USDA) from shipping 75 percent of this tonnage on U.S.-flag ships.

The U.S.-Russia Agreement

President Clinton pledged $700 million in agricultural aid to Russia at a summit conference with Russian President Yeltsin in Vancouver, Canada, in April 1993. The aid was to be extended primarily under USDA's Food for Progress program, which provides commodities to countries making commitments to expand free enterprise in their agricultural economies. Of the $700 million available, $500 million was pledged for commodities and $200 million was set aside for transportation.

Approximately $430 million of the aid was credit extended to Russia under Food for Progress to purchase various U.S. agricultural commodities. An additional $70 million provided was in the form of U.S. commodity donations provided under Food for Progress and section 416 of the Agricultural Act of 1949. Cargo preference laws required that at least 75 percent of the commodities sent to Russia be shipped on U.S.-flag vessels. As a result of this requirement, total transportation costs for these commodities were estimated at $200 million. Russia agreed to pay the estimated $100-million cost of transporting the Food for Progress-financed commodities at foreign-flag rates, while the remaining $100 million in transportation costs—the additional cost of using U.S.-flag ships for Food for Progress shipments and all transportation costs for section 416 shipments—was to be paid by the United States.

Problems Encountered in Food for Progress Shipments to Russia

U.S. shipowners faced problems in delivering commodities to Russia under this agreement both because of specific contractual terms as well as the nature of port infrastructure in Russia. According to USDA officials, the agreement between the United States and Russia allowed for Food for Progress cargos to be unloaded at Russian discharge ports according to the "custom of the port." Under these terms, Russian ports do not pay demurrage to shipowners for delays in unloading commodities.

In addition, for some cargos USDA required shipowners to arrange and pay for inland transportation of the commodities to their final destination and to reflect this cost in their shipping rates.

"Custom of the Port"

Under "custom of the port" terms, there are no despatch payments to the Russian discharge port if the cargo unloading is completed earlier than agreed to, and the port pays the shipowner no demurrage if the cargo unloading is completed later than agreed. According to MARAD officials and U.S. shipowners, "custom of the port" terms place them at a disadvantage compared to foreign-flag ships since many have had limited experience in delivering to Russian ports. While U.S. shipowners face greater uncertainty as to how to adjust their rates to account for possible delays in unloading cargo, an international shipbroker we spoke to stated that foreign-flag ships have had more consistent business in these ports and are in a better position to make arrangements at the ports for cargo discharge. In addition, U.S. shipowners are limited in providing for these uncertainties in the rates they set because no detention days are allowed for these cargos and are therefore not considered in MARAD guideline rate calculations. Nevertheless, as pointed out by USDA, Russia's terms did not prohibit the payment of detention at discharge.

The absence of despatch and demurrage payments at the discharge port has special significance in Russian ports, given the extensive delays in cargo unloading experienced there in the past. A U.S. interagency review of overall port infrastructure in Russia undertaken in the summer of 1993 confirmed the existence of congestion for almost all types of cargos. As a result, delays of between 20 and 40 days were experienced. The report attributed the congestion to institutional, managerial, and financial limitations, rather than to an insufficiency of port facilities. However, specific features of Russia's ports limit their capacity and efficiency, such as the reliance on an insufficient railroad system, and the absence of port bulk storage. Nevertheless, according to MARAD, for the shipments made under the Russia Food for Progress program, no discharge of a U.S.-flag vessel took longer than 27 days.

Without meaningful port storage, railcar availability becomes a primary determinant of port capacity. Limitations in railcar supply have traditionally been a problem in Russian ports. In fact, a June 1993 joint MARAD and Agency for International Development (AID) study found that limits on the number of railcars available were the major impediment to grain-handling at Russian ports. However, this was not a significant problem for shipments made under the Russia Food for Progress program. Furthermore, Russian ports have not been able to enforce agreements with railroads regarding railcar supply. Given that this key variable in their ability to unload cargo is beyond their control, the ports are reluctant to accept terms that include demurrage.

Inland Transportation

USDA generally requires shipowners to arrange and pay for transportation of food aid to inland destinations of recipient countries. While this is not a typical practice for commercial bulk commodity cargos shipped internationally, USDA requires shipowners to arrange and pay for inland transportation to relieve foreign countries from paying this cost. Shipowners are required to incorporate the costs of providing this service into their shipping rates.

In Russia, U.S.-flag shipowners are heavily reliant on the performance of the railroads in arranging for transportation of food to inland destinations. This dependency on railroads arises because other modes of inland transportation in Russia are generally scarce. According to recent U.S. studies of Russian transportation modes, the railroads are the only mode of transportation exempt from the drive toward privatization in Russia. Competition is limited, with ports usually having no choice in the selection of the railroad handling its cargos.

As previously noted, recent U.S. studies of the railroad system in Russia have pointed to problems with the adequacy and reliability of railcar supply in handling cargos discharged at ports. While the availability of railcars is traditionally a problem for Russian ports, according to USDA, only two Russian Food for Progress cargos required inland transportation, and no problems were experienced.

The complexity of Russian railroad tariffs adds to the uncertainty U.S. shipowners face when charged with inland transport responsibilities. Rate increases can be implemented at any time without advance notice. Furthermore, there is a wide range of added charges that can be imposed for special services such as storage and handling. As a result, USDA is not able to assure that these railroad rates are based on actual market costs and do not instead provide an indirect subsidy to Russia.

The Status of the Agreement

As of June 14, 1994, most of the commodities included in the Russia Food for Progress agreement had been purchased at amounts equal to or greater than in the original agreement. USDA officials explained that the commodity mix in the original agreement was amended several times at Russia's request and that unused funds slated for ocean freight differential were used to increase commodity funding. The amounts purchased as of June 14, 1994 are shown in table II.1.

Table II.1: Status of Russia Food for Progress Agreement

Commodity	Amount per agreement (in millions of dollars)	Amount purchased (in millions of dollars)
Corn	$227.5	$257.5
Soybean meal	105.0	134.2
Butter	66.5	54.4
Wheat	56.0	56.0
Rice	7.0	None
Refined soybean oil	18.0	None
Peanuts	8.0	7.4
Poultry	7.0	None
Sugar	5.0	4.7
Total	**$500.0**	**$514.2**

Source: USDA.

According to USDA officials, most of the actual shipping of the Food for Progress commodities to Russia occurred during the last quarter of fiscal year 1993 and the first quarter of 1994, a time when most other U.S. food aid shipments took place. These food aid shipments are also subject to cargo preference requirements. The demand for transportation for all food aid commodities led to increased competition during these months for the U.S.-flag ships available to carry food aid. As a result, the 75-percent cargo preference requirement for commodities shipped to Russia was not met, although (except in three instances) all U.S.-flag ships that bid were awarded cargos.

While 100 percent of the wheat purchased was shipped on U.S.-flag ships, for corn and soybean meal, for which the most tonnage was shipped, only 28 percent and 18 percent, respectively, were transported on U.S.-flag ships. Several other offers by U.S. shipowners to transport these commodities were rejected because the difference between the rates they quoted and foreign-flag rates was excessive. Still, if these offers had all been accepted, they would have added only another 3 percent to the corn tonnage and 4 percent to the soybean meal tonnage shipped on U.S.-flag vessels.

Shipping Rates for Grain Under the Israeli Side Letter Agreement Are Significantly Lower Than Food Aid Shipments to Russia

Under the Israeli cash transfer program, an agreement with AID was in effect from fiscal years 1980 through 1988, and again for fiscal years 1991 through 1994. The agreement, commonly referred to as the "side letter agreement," stated that for the portion of the U.S. cash transfer assistance that Israel used to purchase U.S. agricultural commodities, 50 percent of the tonnage purchased would be shipped on U.S.-flag ships. Each fiscal year, Israel purchases about 1.6 million metric tons of grain, of which 800,000 metric tons are shipped on U.S.-flag ships.

A Comparison of Agricultural Commodity Shipments to Israel and Russia

According to MARAD and a U.S. shipowner who has carried grain to Israel under this program, U.S.-flag shipping rates to Israel were in the low $30 per metric ton range, which is just a few dollars more than foreign-flag rates, while U.S.-flag shipping rates for food aid shipments to Russia were in the mid-$40s to mid-$60s per metric ton range. They also explained that grain shipments to Israel are made with no Israeli or U.S. government involvement. Therefore, privatized Israeli entities and the U.S.-flag shipowners have negotiated commercial arrangements that include consecutive voyage charters with terms and conditions that provide incentives to move the cargos quickly and efficiently. U.S.-flag shipowners are able to offer a low rate because they know they will immediately discharge their cargos in Israel with no unexpected port charges. In addition, the use of consecutive voyage charters, which guarantee employment for a U.S.-flag ship for a specified period of time, also significantly lowers shipping rates. Israel is interested in keeping U.S.-flag shipping rates as low as possible, because it pays the cost of using more expensive U.S.-flag ships.

According to this same U.S.-flag shipowner who has also carried food aid shipments to Russia, there are no incentives for the Russian government to minimize its costs for using U.S.-flag ships to transport Food for Progress cargos. This is primarily due to the fact that under the Food for Progress program, USDA pays the additional cost of using U.S.-flag ships, not Russia. USDA also has approved shipping charters that include terms like "custom of the port" discharges. These terms allow U.S.-flag ships to be delayed in Russian ports with no compensation to the shipowner. Russia's charters require the U.S.-flag shipowners to be responsible for all port costs. In addition, no consecutive voyage charters were used for the food aid tonnage shipped to Russia. The uncertainty about how much these items would cost led shipowners of U.S.-flag ships to quote higher shipping rates for food aid cargos to Russia. Appendix II provides additional information on food aid shipments to Russia.

The Applicability of the Israeli Experience to Russia Is Uncertain

According to MARAD officials, the extent to which the terms similar to those used for Israeli grain shipments could be used to lower rates for food aid shipments to Russia is uncertain. They explained that Israel and Russia have two very different types of business environments. Israel is an established and stable country with modern port facilities that has been arranging these shipments for the past 15 years; Russia is unstable, is just beginning to privatize its operations, and is not experienced in this type of a program. In addition, U.S.-flag ships are not experienced in how Russian ports operate and do not know what to expect in terms of delays and port and handling charges. MARAD predicts that the use of commercial terms would lower U.S.-flag shipping rates. But due to the economic condition of Russia, MARAD also predicts it will be some time before many of the terms and conditions used in Israeli shipments, which allow lower U.S.-flag shipping rates, can be successfully applied to food aid shipments to Russia.

Shipowner Structured Interview

U.S. General Accounting Office

Structured Interview - Impact of Cargo Preference

INTRODUCTION

"The U.S. General Accounting Office (GAO) is reviewing how cargo preference requirements affect U.S. food aid programs -- including the costs of using U.S. flagged vessels in providing food aid to foreign countries, and the role food-aid cargos play in supporting the U.S. merchant marine. This review was requested by Representative Tim Penny, Chairman of the subcommittee on Foreign Agriculture and Hunger, House Committee on Agriculture, and by Senator John Breaux, Chairman on the Subcommittee on Merchant Marine, Senate Committee on Commerce, Science, and Transportation.

As part of our review, we are conducting this structured interview to obtain vessel information, to identify issues associated with improving the management and reducing the costs of the program, and to provide shipowners the opportunity to comment on their experiences with the program.

The information provided to GAO during this interview, if included in our final report, will be aggregated with the information provided by other respondents and will not be identifiable by specific company. It is also our policy not to identify names of individual employees of private sector organizations in our reports.

The information you provide to us during this interview is also subject to statutory and regulatory protections. Specifically, 18 U.S.C. sec. 1905 (1988) prohibits GAO officials from disclosing confidential information except as authorized by law. In addition, GAO is not subject to the Freedom of Information Act (see 4 C.F.R. sec 81.1).

Thank you for agreeing to take part in this interview."

NOTES: A cargo preference year spans from April 1st to March 31st of the following year.

Food aid cargo preference includes preference cargo associated with Titles I, II, and III of the Agricultural Trade Development and Assistance Act of 1954 (P.L. 480), and section 416 of the Agricultural Act of 1949.

A vessel operating day is any day on which a ship is in seaworthy condition, fully manned, and either in operation or standing ready to begin operations. Assume 300 operating days in a food aid cargo preference year.

When counting operating days in which food aid preference cargos were carried, include the days associated with the return trip, if carrying ballast.

Part I - Size and Type of Fleet

"The first section of our interview asks questions about your current fleet of ships. The first series deals with U.S. flagged vessels and the second set deals with foreign flagged vessels."

a. U.S. Flagged Vessels

1. How many of the following types of U.S. flagged vessels does your company currently use for shipping cargo? *(Enter numbers.)*

   ________ Bulk Carriers ________ Tankers ________ Liners ________ Tugs

   ________ Integrated Tug/Barges (ITBs) ________ Barges

   ________ Other - Specify types: ____

2

2. For <u>each</u> of the **<u>U.S. flagged vessels</u>** identified in the previous question, please provide the following information:

Name of vessel:	Year Built: ________
Type of vessel: ☐ Bulk carrier ☐ Tanker ☐ Liner ☐ Tug ☐ Barge ☐ Integrated Tug/Barge (ITBs) ☐ Other - Specify type: ________	
Is this vessel a Jones Act vessel? .... ☐ Yes ☐ No	
Average number of crew: ________	
Vessel used for food aid cargo preference? .... ☐ Yes ☐ No	
If yes, type of commodities frequently shipped for food aid:	
Type of non-food aid cargos frequently shipped:	
Number of operating days engaged in food aid cargo preference trade for each of the last three calendar years: 1/1/91 - 12/31/91 . . . ______ Days 1/1/92 - 12/31/92 . . . ______ Days 1/1/93 - 12/31/93 . . . ______ Days	
Percent of time used for carrying food aid preference cargo: 1/1/91 - 12/31/91 . . . ______ % 1/1/92 - 12/31/92 . . . ______ % 1/1/93 - 12/31/93 . . . ______ %	
Percent of time carrying other U.S. Government cargo: 1/1/91 - 12/31/91 . . . ______ % 1/1/92 - 12/31/92 . . . ______ % 1/1/93 - 12/31/93 . . . ______ %	
Percent of time carrying commercial cargo (including Jones Act trade): 1/1/91 - 12/31/91 . . . ______ % 1/1/92 - 12/31/92 . . . ______ % 1/1/93 - 12/31/93 . . . ______ %	
Percent of non-compensatory time in cargo preference year: 1/1/91 - 12/31/91 . . . ______ % 1/1/92 - 12/31/92 . . . ______ % 1/1/93 - 12/31/93 . . . ______ %	

3

2. <u>U.S. flagged vessels</u> *(Continued)*

Name of vessel:	Year Built: ______
Type of vessel: ☐ Bulk carrier ☐ Tanker ☐ Liner ☐ Tug ☐ Barge ☐ Integrated Tug/Barge (ITBs) ☐ Other - Specify type: ______	
Is this vessel a Jones Act vessel? . . . . ☐ Yes ☐ No	
Average number of crew: ______	
Vessel used for food aid cargo preference? . . . . ☐ Yes ☐ No	
If yes, type of commodities frequently shipped for food aid:	
Type of non-food aid cargos frequently shipped:	
Number of operating days engaged in food aid cargo preference trade for each of the last three calendar years: 1/1/91 - 12/31/91 . . . ______ Days 1/1/92 - 12/31/92 . . . ______ Days 1/1/93 - 12/31/93 . . . ______ Days	
Percent of time used for carrying food aid preference cargo: 1/1/91 - 12/31/91 . . . ______ % 1/1/92 - 12/31/92 . . . ______ % 1/1/93 - 12/31/93 . . . ______ %	
Percent of time carrying other U.S. Government cargo: 1/1/91 - 12/31/91 . . . ______ % 1/1/92 - 12/31/92 . . . ______ % 1/1/93 - 12/31/93 . . . ______ %	
Percent of time carrying commercial cargo (including Jones Act trade): 1/1/91 - 12/31/91 . . . ______ % 1/1/92 - 12/31/92 . . . ______ % 1/1/93 - 12/31/93 . . . ______ %	
Percent of non-compensatory time in cargo preference year: 1/1/91 - 12/31/91 . . . ______ % 1/1/92 - 12/31/92 . . . ______ % 1/1/93 - 12/31/93 . . . ______ %	

4

b. Foreign Flagged Vessels

3. How many of the following types of foreign flagged vessels does your company currently use for shipping cargo? *(Enter numbers.)*

_______ Bulk Carriers _______ Tankers _______ Liners _______ Tugs

_______ Integrated Tug/Barges (ITBs) _______ Barges

_______ Other - Specify types: ____

4. For foreign flag vessels, how many operating days are there in your operation year?

_______ Operating days

Does this vary by vessel type?

1. ☐ No

2. ☐ Yes ----> Please describe by vessel type:

5

5. Please complete the following for <u>each type of foreign flag vessel</u> your company currently uses for shipping cargo. Each set of questions asks for <u>averages</u> for each type of vessel.

Foreign Flag Bulk Carriers

Please enter the number of foreign flag bulk carriers of less than 100,000 DWT that your company operates: *(If none, enter "none" and go to next type of vessel.)*   ______ Foreign flag bulk carriers
What is the average age of these bulk carriers: ________ Years
What is the average number of crew per bulk carrier: ________
Were any of these bulk carriers used for U.S. food aid cargo preference during the past 3 years? . . . ☐ Yes ☐ No
If yes, what were the average number of operating days these bulk carriers were engaged in the food aid cargo preference trade for each of the last three calendar years?   1/1/91 - 12/31/91 . . . ______ Days 1/1/92 - 12/31/92 . . . ______ Days 1/1/93 - 12/31/93 . . . ______ Days
What was the average percent of time these bulk carriers were idle in each of the last three calendar years: 1/1/91 - 12/31/91 . . . ______ % 1/1/92 - 12/31/92 . . . ______ % 1/1/93 - 12/31/93 . . . ______ %
What type of cargo is most frequently shipped using bulk carriers:

6

Foreign Flag Tankers (Crude & Product Tankers)

Please enter the number of foreign flag tankers of less than 100,000 DWT that your company operates:
(If none, enter "none" and go to next type of vessel.)

_______ Foreign flag crude tankers _______ Foreign flag product tankers

What is the average age of these tankers: __________ Years

What is the average number of crew per tanker: ___________

Were any of these tankers used for U.S. food aid cargo preference during the past 3 years? . . . . ☐ Yes ☐ No

If yes, which type(s) of tanker (crude or product) were used for food aid cargo? ☐ Crude ☐ Product ☐ Both types

If yes, what were the average number of operating days these tankers were engaged in the food aid cargo preference trade for each of the last three calendar years?

1/1/91 - 12/31/91 . . . _______ Days 1/1/92 - 12/31/92 . . . _______ Days 1/1/93 - 12/31/93 . . . _______ Days

What was the average percent of time these tankers were idle in each of the last three calendar years:

1/1/91 - 12/31/91 . . . _______ % 1/1/92 - 12/31/92 . . . _______ % 1/1/93 - 12/31/93 . . . _______ %

What type of cargo is most frequently shipped using tankers:

7

Foreign Flag Liners

Please enter the number of foreign flag liners of less than 100,000 DWT that your company operates:
(If none, enter "none" and go to next type of vessel.)

_______ Foreign flag liners

What is the average age of these liners: __________ Years

What is the average number of crew per liner: ___________

Were any of these liners used for U.S. food aid cargo preference during the past 3 years? . . . . ☐ Yes ☐ No

If yes, what were the average number of operating days these liners were engaged in the food aid cargo preference trade for each of the last three calendar years?

1/1/91 - 12/31/91 . . . ______ Days 1/1/92 - 12/31/92 . . . ______ Days 1/1/93 - 12/31/93 . . . ______ Days

What was the average percent of time these liners were idle in each of the last three calendar years:

1/1/91 - 12/31/91 . . . ______ % 1/1/92 - 12/31/92 . . . ______ % 1/1/93 - 12/31/93 . . . ______ %

What type of cargo is most frequently shipped using liners:

8

Foreign Flag Tugs

Please enter the number of foreign flag tugs of less than 100,000 DWT that your company operates:
(If none, enter "none" and go to next type of vessel.)

_______ Foreign flag tugs

What is the average age of these tugs: __________ Years

What is the average number of crew per tug: __________

Were any of these tugs used for U.S. food aid cargo preference during the past 3 years? . . . . ☐ Yes ☐ No

If yes, what were the average number of operating days these tugs were engaged in the food aid cargo preference trade for each of the last three calendar years?

1/1/91 - 12/31/91 . . . _______ Days 1/1/92 - 12/31/92 . . . _______ Days 1/1/93 - 12/31/93 . . . _______ Days

What was the average percent of time these tugs were idle in each of the last three calendar years:

1/1/91 - 12/31/91 . . . _______ % 1/1/92 - 12/31/92 . . . _______ % 1/1/93 - 12/31/93 . . . _______ %

What type of cargo is most frequently shipped using tugs:

9

Foreign Flag Barges

Please enter the number of foreign flag barges of less than 100,000 DWT that your company operates:
(If none, enter "none" and go to next type of vessel.)

_______ Foreign flag barges

What is the average age of these barges: __________ Years

What is the average number of crew per barge: ___________

Were any of these barges used for U.S. food aid cargo preference during the past 3 years? .... ☐ Yes ☐ No

If yes, what were the average number of operating days these barges were engaged in the food aid cargo preference trade for each of the last three calendar years?

1/1/91 - 12/31/91 ... _______ Days 1/1/92 - 12/31/92 ... _______ Days 1/1/93 - 12/31/93 ... _______ Days

What was the average percent of time these barges were idle in each of the last three calendar years:

1/1/91 - 12/31/91 ... _______ % 1/1/92 - 12/31/92 ... _______ % 1/1/93 - 12/31/93 ... _______ %

Are barges: tankers .. ☐ Yes ☐ No liners .. ☐ Yes ☐ No bulk carriers .. ☐ Yes ☐ No

What type of cargo is most frequently shipped using barges:

10

Foreign Flag Integrated Tug/Barges (ITBs)

Please enter the number of foreign flag ITBs of less than 100,000 DWT that your company operates:
(If none, enter "none" and go to next type of vessel.)

_______ Foreign flag ITBs

What is the average age of these ITBs: __________ Years

What is the average number of crew per bulk ITB: ___________

Were any of these ITBs used for U.S. food aid cargo preference during the past 3 years? .... ☐ Yes ☐ No

If yes, what were the average number of operating days these ITBs were engaged in the food aid cargo preference trade for each of the last three calendar years?

1/1/91 - 12/31/91 ... _______ Days 1/1/92 - 12/31/92 ... _______ Days 1/1/93 - 12/31/93 ... _______ Days

What was the average percent of time these ITBs were idle in each of the last three calendar years:

1/1/91 - 12/31/91 ... _______ % 1/1/92 - 12/31/92 ... _______ % 1/1/93 - 12/31/93 ... _______ %

What type of cargo is most frequently shipped using ITBs:

11

Other Types of Foreign Flag Vessels

Please enter the number and specific types of other types of foreign flag vessels of less than 100,000 DWT that your company operates: *(If none, enter "none" and go to next type of vessel.)*

Type: ______________________ Number: ________

Type: ______________________ Number: ________

Type: ______________________ Number: ________

What is the average age of these other types of vessels: __________ Years

What is the average number of crew per vessel: __________

Were any of these vessels used for U.S. food aid cargo preference during the past 3 years? .... ☐ Yes ☐ No

If yes, what were the average number of operating days these vessels were engaged in the food aid cargo preference trade for each of the last three calendar years?

1/1/91 - 12/31/91 . . . ______ Days 1/1/92 - 12/31/92 . . . ______ Days 1/1/93 - 12/31/93 . . . ______ Days

What was the average percent of time these vessels were idle in each of the last three calendar years:

1/1/91 - 12/31/91 . . . ______ % 1/1/92 - 12/31/92 . . . ______ % 1/1/93 - 12/31/93 . . . ______ %

What type of cargo is most frequently shipped using other types of vessels:

12

II. Operations

6. In your opinion, to what extent, if at all, do the following factors associated with being U.S. flagged increase the cost of your shipping operations? *(Check one box in each row.)*

	To a very great extent (1)	To a great extent (2)	To a moderate extent (3)	To some extent (4)	To little or no extent (5)
a. Construction costs					
b. Crewing requirements					
c. Cost per crew					
d. Maintenance and repair					
e. U.S. Taxation					
f. Vessel insurance					
g. Other - Specify:					
h. Other - Specify:					
i. Other - Specify:					

13

7. A bill recently passed the House of Representatives entitled HR 2151 - Maritime Security and Competitiveness Act of 1993. The bill would change present policies that apply to the Food Aid Cargo Preference. Would your company favor or oppose each of the following proposed changes to the Food Aid Cargo Preference Program? *(Check one for each proposal.)*

a. Allowing foreign built ships to reflag U.S. and carry food aid preference cargoes:

1. ☐ Strongly favor
2. ☐ Generally favor
3. ☐ No opinion either way
4. ☐ Generally oppose
5. ☐ Strongly oppose

----

6. ☐ Unsure at this time

Please explain:

____

____

____

b. Averaging of MARAD's fair and reasonable guideline rates:

1. ☐ Strongly favor
2. ☐ Generally favor
3. ☐ No opinion either way
4. ☐ Generally oppose
5. ☐ Strongly oppose

----

6. ☐ Unsure at this time

Please explain:

____

____

____

c. Commercial terms for food aid cargo preference cargoes:

1. ☐ Strongly favor
2. ☐ Generally favor
3. ☐ No opinion either way
4. ☐ Generally oppose
5. ☐ Strongly oppose

----

6. ☐ Unsure at this time

Please explain:

____

____

____

d. If these three elements of HR 2151 were implemented, explain how your company's participation in the food aid program may be impacted.

____

____

____

____

____

____

____

____

14

8. Would your company favor or oppose each of the following proposed changes to the Food Aid Cargo Preference Program as they apply to tankers and tug/barges?

   a. Not allowing tankers to participate in some portions of the cargo preference food-aid trade.

      1. ☐ Strongly favor
      2. ☐ Generally favor
      3. ☐ No opinion either way
      4. ☐ Generally oppose
      5. ☐ Strongly oppose
      ----
      6. ☐ Unsure at this time

      Please explain:

      ____

      ____

   b. Not allowing tug/barges (not including ITBs) to participate in some portions of the cargo preference food-aid trade.

      1. ☐ Strongly favor
      2. ☐ Generally favor
      3. ☐ No opinion either way
      4. ☐ Generally oppose
      5. ☐ Strongly oppose
      ----
      6. ☐ Unsure at this time

      Please explain:

      ____

      ____

15

9. Would your company like to see the following features of food aid cargo preference contract terms eliminated, modified, or not changed at all? If you would like to see any of these terms eliminated or modified, please indicate why you would want it eliminated or how you would like it modified.

Common Food Aid Cargo Preference Contract Terms	Why eliminated or how modified?
a. Fumigation 1. ☐ Eliminated 2. ☐ Modified 3. ☐ Not changed	
b. Berth Terms (no demurrage and despatch) 1. ☐ Eliminated 2. ☐ Modified 3. ☐ Not changed	
c. Inland Transport 1. ☐ Eliminated 2. ☐ Modified 3. ☐ Not changed	
d. Payment for cargo transportation at discharge 1. ☐ Eliminated 2. ☐ Modified 3. ☐ Not changed	
e. Demurrage rate ceilings 1. ☐ Eliminated 2. ☐ Modified 3. ☐ Not changed	
f. Performance bonds 1. ☐ Eliminated 2. ☐ Modified 3. ☐ Not changed	
g. Other - Specify: ____________ 1. ☐ Eliminated 2. ☐ Modified 3. ☐ Not changed	

16

10. When your company bids on food aid cargoes, how often, if at all, are the additional contract terms identified below present? *(Check one box in each row.)*

Additional Contract Terms	Always (1)	Very often (2)	About half of the time (3)	Occasionally (4)	Never (5)
a. Fumigation					
b. Berth Terms (no demurrage and despatch)					
c. Inland Transport					
d. Payment for cargo transportation at discharge					
e. Demurrage rate ceilings					
f. Performance bonds					
g. Other - Specify: ______________					

11. In your opinion, will adoption of commercial terms for food aid preference cargoes reduce your shipping rates for these cargoes? *(Check one.)*

1. ☐ Definitely yes
2. ☐ Probably yes

Continue with Question 12.

3. ☐ Unsure at this time
4. ☐ Probably no
5. ☐ Definitely no

Skip to Question 13.

12. Please estimate what percentage the application of commercial terms for food aid cargo would save per metric ton?

Savings of _________ percent per metric ton

17

13. If the food aid cargo preference program were terminated:

a. Would your company change any plans to expand or modernize its U.S. flagged vessels?

1. ☐ Definitely yes
2. ☐ Probably yes
3. ☐ Unsure at this time
4. ☐ Probably no
5. ☐ Definitely no

If "Yes" (box 1 or 2) checked, please explain:

b. Would you get out of non-Jones Act U.S. flagged shipping?

1. ☐ Definitely yes
2. ☐ Probably yes
3. ☐ Unsure at this time
4. ☐ Probably no
5. ☐ Definitely no

c. Would you get out of the shipping business altogether?

1. ☐ Definitely yes
2. ☐ Probably yes
3. ☐ Unsure at this time
4. ☐ Probably no
5. ☐ Definitely no

18

14. If the food aid cargo preference program were terminated, what would your company do with the U.S. flagged vessels you currently use for food aid cargo preference?

Name of Vessel:	How vessel would be used:

19

15. I would now like to ask about how your company feels about MARAD's "Fair and Reasonable" guideline rates.

    a. Are the items included in MARAD's "fair and reasonable" rates sufficient?

    1. ☐ Definitely yes
    2. ☐ Probably yes
    3. ☐ Unsure at this time
    4. ☐ Probably no
    5. ☐ Definitely no

    If not, what else should be included:

    b. How do you believe the current method of calculating "fair and reasonable" guideline rates should be changed?

16. In your opinion, are there measures that can be taken by USDA, AID, or MARAD to reduce food aid cargo preference program costs?

    1. ☐ Definitely yes
    2. ☐ Probably yes
    3. ☐ Unsure at this time
    4. ☐ Probably no
    5. ☐ Definitely no

    Please explain:

20

17. The following questions (a through e) are for those companies that operate **any foreign flagged vessels**:

a. In your opinion, what can be done to make the U.S Merchant Marine more competitive internationally?

b. For a U.S. flag vessel of the same configuration as one of your foreign flag vessels, describe how operating costs differ?

c. Under what circumstances, if any, would you reflag a U.S. flag vessel to a foreign flag?

d. Under what circumstances, if any, would you reflag a foreign flag vessel to a U.S. flag?

e. Please identify the differences between the U.S. shipping market and the international shipping market.

21

18. The following questions (a through c) are only for those companies that operate **only American flag vessels**:

    a. Has your company ever considered operating in the international shipping market?

    1. ☐ Yes
    2. ☐ No

    Please explain why or why not:

    b. Under what circumstances, if any, would your company participate in the international shipping market?

    c. Has your company ever operated foreign flag vessels in the past?

    1. ☐ No

    2. ☐ Yes ----> If yes, please comment on your company's experiences (e.g., why your company no longer operates foreign flag vessels.

22

19. Did your company participate in the 1993 Russia $700 million Food for Progress program?

1. ☐ No ---> Has your company carried cargo to Russia within the past 3 years? . . . 1. ☐ Yes
2. ☐ No

Please explain:

2. ☐ Yes ----------> Please comment on your experiences with the <u>Food for Progress</u> program:

20. Within the past 3 years, has your company received any complaints concerning the <u>quality of cargo at discharge</u>?

1. ☐ No

2. ☐ Yes -------> Please describe these complaints and indicate the vessel type involved:

21. Within the past 3 years, has your company received any complaints concerning <u>cargo shortages</u>?

1. ☐ No

2. ☐ Yes -------> Please describe these complaints and indicate the vessel type involved:

23

22. Within the past 3 years, has your company had any problems meeting laydays requirements for loading cargo?

1. ☐ No

2. ☐ Yes ---> Please describe these problems:

23. Do you have any comments covering any of the topics we have covered during this interview?

Thank you very much for your time.

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March 17, 1994, Memorandum From the Office of the Under Secretary of Defense for Transportation Policy

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

Analysis
and Followup

MAY - 3 1994

U.S. General Accounting Office
7 World Trade Center, Floor 25
New York, NY 10048-1102
ATTN: Ms. Christina Porche

Dear Ms. Porche:

As you requested in your telephone conversation of May 3, the Department of Defense (DoD) response to your questions on GAO Code 280067, "Impact of Cargo Preference Laws on U.S. Food Aid Programs and the U.S. Merchant Marine" is enclosed. This follows up the copy telefaxed to you on March 17, 1994.

If you have any questions, or need further assistance, please contact my action officer, Ms. Pattie Cirino, (703) 693-0214. If she is not available, you can reach me at the same number.

Marcia J. Van Note

Marcia J. Van Note
Director
GAO Surveys and Reviews

Enclosure:
As stated

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

ACQUISITION AND TECHNOLOGY

REC'D GA[illegible](AFU)
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MAR 22 1994

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17 MAR 1994

MEMORANDUM FOR OIG, DOD LIAISON OFFICE FOR GAO SURVEYS/REVIEWS

FROM: ASSISTANT DEPUTY UNDER SECRETARY OF DEFENSE (TRANSPORTATION POLICY)

SUBJECT: Impact of Cargo Preference Laws on U.S. Food Aid Programs and the U.S. Merchant Marine, GAO Code : 280067

Attached are DoD's responses to questions submitted by the DODIG in reference to subject informal inquiry. The review was started at the request of Chairman John Breaux, Subcommittee on Merchant Marine Senate Committee on Commerce, Science and Transportation , and Chairman Timothy Penny, Subcommittee on Foreign Agriculture and Hunger, House Committee on Agriculture.

The responses were coordinated with United States Transportation Command, The Joint Staff and The Office of the Secretary of Defense (Program Analysis & Evaluation).

Mary Lou McHugh
Assistant Deputy Under Secretary
(Transportation Policy)

Attachment

GAO'S QUESTIONS ON: "IMPACT OF CARGO PREFERENCE LAWS ON U.S. FOOD AID PROGRAM & U.S. MERCHANT MARINE"

QUESTION:
1. Recognizing that food aid programs primarily carry cargo in bulk carriers, tankers, tug/barge combinations, and liners, how critical are the ships and crews used for food aid preference cargoes in fulfilling our national security objectives?

RESPONSE:
Bulk carriers, large crude oil tankers, and integrated tug/barge sets are important to national security from an economic standpoint rather than a militarily useful aspect. However, crews on all vessels are important as they are generally interchangeable, and can provide support for manning of the Ready Reserve Force (RRF). There are some areas of the world where tug/barge sets using Roll On/Roll Off (Ro/Ro) or clean petroleum barges could play a role in contingencies. Ships in liner service played a useful role in Operations Desert Shield/Storm, and will continue to do so in the foreseeable future. To determine whether ships that carry cargo for food aid programs are critical, DoD would have to assess the cost-effectiveness of providing crews via the food aid program.

QUESTION:
2. Are the ships used for food aid preference cargoes the appropriate types to fulfil our national security objectives?

RESPONSE:
The preferred method of transporting food cargo is by bulk carrier. The Department of Defense does not rely on these bulk ships because they have negligible military utility. Because of a shortage of U.S. bulk carriers, liner carriers and Ro/Ro vessels also transport food cargo, although less efficiently (more costly). Most liner and Ro/Ro vessels are militarily useful whether they are in the food cargo trade or liner trade. To put Defense needs in perspective, during Operation Desert Shield/Storm DoD used only about 10 percent of the U.S. merchant marine liner fleet cargo capacity to deploy more than 36 percent of the DoD cargo moved by sea.

QUESTION:
3. In DoD's view, what direct or indirect role do the ships and crews supported by food aid preference cargoes have in supporting our national security objectives?

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RESPONSE:
Bulk carriers, tankers, t'ween deckers, and integrated tug/barge sets are being used to transport bulk commodities associated with food aid cargo preference. These ships are not considered military useful from a national security point of view. Some of the crews on these vessels could be used to help man the Ready Reserve Force in time of contingency, but a more readily available source of manpower is from the liner service trade.

QUESTION:
4. What is DoD's position on H.R. 2151 the "Maritime Security and Competitiveness Act of 1993" which would establish a "Maritime Security Fleet"?

RESPONSE:
DoD supports the spirit of H.R. 2151, and is working with the Department of Transportation and other agencies to prepare Administration-sponsored legislation to implement the Maritime Security Program.

Question: **a**. Is this type of program needed or desired by DoD?

Response: The primary purpose of H.R. 2151 is to maintain U.S. presence in international commercial shipping. Of secondary value is for those vessels participating in that program to serve as a "naval auxiliary" in time of war or national emergency. This Act augments sustainment capacity needed during war, but is by no means the sole contributor to that requirement.

Question: b. What should be DoD's role in determining what type of ships to include in the fleet?

Response: H.R. 2151 is an economic stimulus program. Ships selected for inclusion in this Act should be selected based on their economic viability.

Question: c. What influence does DoD currently have on what types of ships are part of the U.S. merchant marine?

Response: The Merchant Marine Act of 1936 stipulates that DoD can only influence the design of those vessels being built in a U.S. shipyard for replacement of a vessel already receiving an operational subsidy. Also in the same act under "Military Useful Obligation Guarantees", DoD is consulted regarding a proposed

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vessel's military utility when a request is made for Title XI funds.

Question: d. Would the changes proposed in this legislation improve the quality, type, and number of ships and crew available to DoD in times of national security emergencies?

Response: H.R. 2151 clearly obligates vessel operators who receive subsidy payments to respond to the request of the President during time of war. If national security was the sole rationale for offering support, then the level of support offered should be set after consideration of the cost effectiveness of alternatives open to the Department.

QUESTION:
5. What impact would the loss of ships and crew supported by food aid preference cargo have on DoD?

RESPONSE:
There would be no significant impact to DoD in the loss of bulk ships used to transport food aid. Non-bulk type ships which currently transport food aid preference cargo have other economic utility. Therefore it is likely that they would be available to DoD in a crisis/emergency.

Question: a. What actions, if any, would DoD take to compensate for the loss of the ships and crews supported by food aid cargo preference?

Response: DoD would have to assess the magnitude of any hypothetical loss before taking action.

Question: b. Would DoD reallocate resources to compensate for the loss of ships and crew if the cargo preference for food aid was eliminated?

Response: It would depend on how non-bulk ships responded to the loss of food aid preference cargo subsidies.

Question: c. What types of ships used for food aid preference cargoes would DoD be willing to continue to support?

Response: The U.S. merchant fleet and the Effective U.S. Controlled (EUSC) fleets contain more than the capacity to meet DoD sustainment requirements.

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QUESTION:
6. What was the extent of participation of food aid cargo preference ships, directly or indirectly, in Operation DESERT SHIELD (ODS), Operation DESERT STORM (ODS), and in DOD's activities in the Gulf following DESERT STORM?

RESPONSE:
Of those ships participating in the food aid cargo preference program, 54 participated in the DESERT Operations either as chartered ships or as part of the Special Mideast Shipping Agreement (SMESA). In proper perspective though, only about ten percent of the U.S. merchant marine fleet was utilized in the operations and moved 36 percent of all sea-borne cargo during the war. Although a vessel may be counted in the statistics below, it should be emphasized that most, while carrying some food aid program cargoes, were not dedicated to the food aid cargo preference program.

Question: a. How many and what types of U.S.-flag ships participated?

Response: The 54 ships used during ODS that also have participated in the food aid program at the same time were the following types: seven breakbulk and/or breakbulk-container, 39 non-self-sustaining containerships, five Lighter-Aboard-Ship (LASH), and three Ro/Ro ships.

Question: b. How extensive was the participation of US flag ships?

Response: Of the 32 U.S.-flag ships chartered for service in ODS, 12 have participated in food aid programs at one time or another. Of the seven U.S.-flag ships chartered as Afloat Prepositioning Ships, one has participated in the food aid program. Of the approximately 50 U.S.-flag ships that were used under SMESA, 41 have participated in the food aid program.

Question: c. To what extent did bulk carriers, tankers, and tug/barge combinations directly or indirectly participate? How suitable were they and how did they perform?

Response: No US flag bulk carriers, integrated tug/barges, or tankers that have participated in the food aid program participated in ODS.

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Question: **d.** Were appropriate U.S.-flag ships of the appropriate type available to DoD? Were any U.S.-flag ships requested by DoD not made available to them?

Response: In August 1990, there were not sufficient Ro/Ro vessels in the U.S.-flag fleet to support DoD requirements for a contingency of the size of ODS. This was anticipated by DoD and is one reason why we maintain the Fast Sealift Ships in reserve status as well as Ro/Ro ships in the RRF. The U.S.-flag fleet was very responsive to our requests for vessels to charter and to our requirement for container capability via liner service.

Question: **e.** How satisfied was DoD with the service provided to them by U.S.-flag ships?

Response: The DoD was very satisfied with the service provided.

Question: **f.** In light of the experiences with U.S.-flag ships during ODS, has DoD revised its expectations for the future use of U.S. merchant marine ships, especially those used for food aid preference cargoes?

Response: The deployment of forces in Operation Desert Shield/Storm has not changed DoD's perspective on the U.S.-flag fleet or the value of the food aid program. Many of the types of ships that participate in the food aid program are not militarily useful (such as dry bulk carriers and the larger crude carriers) and these ships were not used in the deployment. Other ships under the U.S.-flag are useful for moving ammunition and supplies. We believe that, under current Administration programs and policies, the size of the U.S.-flag and the Effective U.S. Control (EUSC) fleets will be more than adequate to meet national security requirements for the types of vessels that are commercially attractive.

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Comments From the Department of Agriculture

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D. C. 20250

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Mr. Alan I. Mendelowitz
Managing Director
International Trade, Finance, and
Competitiveness Issues
General Accounting Office
441 G Street N.W. - Rm. 5492
Washington, D.C. 20548

Dear Mr. Mendelowitz:

Enclosed are the department's comments on the General Accounting Office Draft Report, GAO/GGD-94 - "Cargo Preference Requirements: Objectives Not Significantly Advanced When Used in U.S. Food Aid Programs".

Sincerely,

Dallas R. Smith

for Eugene Moos
Under Secretary for
International Affairs and
Commodity Programs

Enclosure

DEPARTMENTAL COMMENTS ON
GAO DRAFT REPORT ENTITLED
"CARGO PREFERENCE REQUIREMENTS: OBJECTIVES NOT SIGNIFICANTLY ADVANCED WHEN USED IN U.S. FOOD AID PROGRAMS"

General Comments

Our comments address the key points in this draft report; we have limited the amount of detail included due to the unusually short review period provided.

Chapter 2: Applying Cargo Preference Requirements to Food Aid Programs Does Not Significantly Further Objectives of 1936 Merchant Marine Act

See comment 1.

The draft report states that "...U.S.-flag rates can be as much as twice foreign-flag rates" (emphasis added). This is apparently based on average freight rates, shown in Figure 2.1. We believe that the report should state that the rate difference can be much higher in particular instances, and should specify whether the averages are weighted or not. For example, sixteen out of the eighteen U.S.-flag vessels used to carry the Food for Progress corn and wheat to Russia were over twice the average foreign flag rate offered for the same shipments; five of those vessels were over three times the average foreign flag rate offered.

Chapter 3: Cargo Preference Requirements Adversely Affect U.S. Food Aid Programs

See comment 2.

There will always be cases where it is infeasible or too costly to achieve seventy-five percent compliance on a country (or purchase authorization) basis. For that reason we recommend that the sentence preceding Table 3.1 read "Table 3.1 shows how commodity and transportation costs are funded and how cargo preference compliance is generally measured for each food aid program." In Table 3.1 itself, for example, it would be more accurate to describe the measurement of cargo preference compliance for the section 416(b) and Food for Progress programs, as "Seventy-five percent...is shipped...to the extent practicable." Measuring compliance must take into consideration the fact that U.S.-flag vessels are not always available in sufficient numbers to meet the percentage requirement, and that the rates may not be fair and reasonable.

See comment 3.

The draft report has correctly concluded that cargo preference may force the purchase of a more expensive commodity in order to permit the use of a U.S.-flag vessel. However, the relationship is generally more indirect than implied in the report. If commodities are purchased on a coastal range for which no U.S.-flag vessel offered, when U.S.-flag vessels and commodity were

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available at another coastal range, USDA would risk either failing to meet cargo preference tonnage requirements or paying an extremely high price for U.S.-flag freight for shipments later in the year. In order to avoid this potential drain on program resources, the general policy has developed that purchases for shipment on U.S.-flag vessels will be made on the lowest landed cost basis, taking into consideration the freight rate and the applicable commodity price. This may distort the purchasing pattern a country would adopt if purchasing commercially, by increasing their freight costs or reducing the amount of commodity purchased, but it was designed to meet cargo preference requirements at the lowest possible combined cost for commodity and freight. This point does not diminish the conclusion reached by GAO, but is made to more accurately state the cause and effect of cargo preference on the importers.

See comment 4.

The recipient country also is disadvantaged by cargo preference when we require that a U.S.-flag vessel be used to carry part of a purchase and the balance to be shipped on a foreign flag vessel. The foreign flag rate for the smaller quantity, which is generally the responsibility of the importing country under Title I, can be more than twice as much as the rate which would apply if the entire quantity were shipped on one vessel. This was the most difficult problem faced by El Salvador and Guatemala in their purchasing described in the draft report.

Chapter 4: USDA and AID Management Practices Affect Food Aid Transportation Costs

See comment 5.

The draft report refers to a proposed rule-making by MARAD which would require MARAD to approve all freight tenders for preference cargos and to require the use of a uniform charter party to be used by all agencies for bulk preference cargo. USDA is extremely concerned about the serious operational problems, including delays in shipping food aid, which would result from MARAD's imposing this rule on other agencies. USDA understands that MARAD is not currently planning to issue this rule; if this is the case, the GAO report should be changed in this regard.

(See the response to the first recommendation for a detailed description of the problems encountered by countries which receive food aid.)

Appendix II: Russian Food for Progress Program.

The draft report stated that U.S. shipowners faced problems in delivering commodities to Russia in part because of specific contractual terms, including "custom of the port" discharge. This term was used in Russia's commercial freight contracts. They wished to include it in the Food for Progress contracts as well so they would not risk demurrage payments. We agreed to the

- 3 -

use of "custom of the port" because Russia gave USDA a firm commitment to discharge vessels promptly upon arrival. As a result, the vessels carrying the Food for Progress bulk shipments encountered few abnormal delays. In fact, most were discharged in from four to twenty days, based on information contained in a table prepared by the Maritime Administration (relevant sections attached.) Weather was a factor in most of the instances where discharge time exceeded twenty days. According to the table, no discharge exceeded 27 days.

See comment 6.

Given the generally favorable discharge history described above, availability of rail cars for movement from the ports was not a serious problem, as implied by the draft report. The bulk grain cargoes actually arrived in Russia over a four-month period, from November 1993 - February 1994, rather than "in the fall" as stated in the report.

See comment 6.

The "Inland Transportation" section incorrectly implies that the shipowner was required to arrange inland transportation for bulk grains under the Russian Food for Progress program. (Some shipments to other CIS countries were made under section 416(b) and Food for Progress which did include inland transportation in the ocean freight rate.) For the Russian program, only two U.S.-flag vessels delivered grain at non-Russian ports and included in the freight rate the costs of inland transportation to the Russian border. Both vessels discharged at the Estonian port of Novotallinn. No problems with the inland movement through Estonia were reported.

See comment 7.

It should be noted that, due to the requirements of cargo preference, the Russians agreed to adjust their commercial tender terms in an attempt to increase participation by U.S.-flag vessels and to keep freight costs down. For example, they did not include a minimum speed requirement for vessels, they allowed large vessels to offer (with the option of discharging the cargo into smaller vessels which could berth at the discharge port), and permitted tankers to carry the bulk wheat. The draft report also states that no detention days were allowed for these cargos; however, the freight tenders did not prohibit payment of detention at discharge. Under the Title I program, the Russians also volunteered to pay U.S.-flag owners a portion of their freight shortly after loading, instead of after arrival. Even so, as described in the comment above on Chapter 2, the U.S.-flag freight rates were generally more than twice the foreign flag rates for the bulk grain shipments.

See comment 8.

In Table II.1, it appears that more funds were used for purchasing the corn and soybean meal than were provided for those commodities in the agreement. However, unused funds which had

See comment 9.

been slated for ocean freight differential were used to increase the commodity funding. In fact, the original commodity mix was amended several times at Russia's request in order to make the best use of the available $700 million.

GAO Recommendation

Experiment with the use of contract terms for the transportation of food aid cargos that are more consistent with contract terms used for similar commercial cargos to determine whether their use will reduce food aid transportation costs.

Departmental Response

See comment 10.

There is no single standard commercial freight contract for agricultural commodities; contract terms are negotiated between the two parties involved. The Norgrain contract (copy attached) mentioned in the draft report is only one of several standard forms which may be used as the basis for a freight contract. Even when such a contract form is used, the parties change some of the pre-printed terms, blanks in the form are completed as agreed between the two parties, and any number of additional contract terms can be added as "riders."

Enforcing "standard commercial contract" provisions could even work against U.S.-flag vessels. Some countries receiving food aid have purchased commercially using their own freight contracts. Because of cargo preference, we have required them to change some of these commercial terms to benefit U.S.-flag vessels when they contract for ocean freight to carry food aid. For example, few countries permit a tanker to carry commercially purchased bulk grain. However, we insist that tankers be given an opportunity to participate unless the importing country provides a valid reason to exclude tankers such as the need to maintain corn quality or the potential for damage to the receiving facility.

See comment 11.

USDA approved terms do not discriminate against U.S.-flag vessels, as implied by the draft report, nor are they "erratic." Contract terms are not identical because each recipient country faces a different set of constraints. In fact, freight contract terms in USDA programs are either the same for both U.S. and foreign-flag vessels or they are more favorable to U.S.-flag vessels. Also, U.S.-flag vessels may have different requirements on a particular voyage because of the inherent nature of the vessel, e.g., U.S.-flag vessels may have to lighten because they are generally larger than foreign-flag vessels.

See comment 12.

We agree that the use of the contract terms described in the report might reduce food aid transportation costs. However, the primary factor influencing rates at any time is market

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competition. We also must emphasize that food aid recipients cannot be compared with countries which import commercially. In fact, some of the differences are described in Appendix III of the draft report, which compares agricultural commodity shipments to Israel and Russia. Countries receiving food aid often have port facilities and infrastructure for moving the cargo from the port which are inefficient and poorly maintained. Little foreign exchange is available to cover costs of demurrage payments to the U.S.-flag owner, or, for landlocked countries, the costs of discharge at a foreign port and the inland movement from that port.

In summary, forcing commercial terms on countries which are not commercial buyers can defeat the purpose of the food aid we provide.

(See also comments under "General" regarding the Russian Food for Progress program.)

"Full berth terms."

To the extent compatible with the conditions in the recipient country, we will continue to use the recommended "free out" discharge provision rather than "full berth terms" for bulk grain shipments which do not include inland transportation. As noted in the draft report, ocean transportation contracts for bulk grain shipments under Title I seldom, if ever, use "full berth terms." However, when inland transportation is included in the freight rate, it is usual for the discharge to be on berth terms, regardless of the program. This permits the vessel owner to control the movement from the vessel to the inland segment of the transportation.

For the section 416(b) and Food for Progress donations programs, full berth terms for bulk grains are more common, because of the many problems facing most food aid recipients. Also, countries receiving donated food are unlikely to have foreign exchange available to pay demurrage costs, regardless of a contractual requirement to do so. If the country can't pay the demurrage, vessel owners will simply increase the base freight rate for future shipments to cover anticipated delays at discharge.

Timing of Freight Payments.

See comments 13 and 14.

We agree that paying the shipowner when the cargo is loaded, instead of on arrival at the destination, could lower freight rates to some extent. (The P.L. 480, Title I financing regulations currently provide that the shipowner can receive payment of up to 95 percent of the ocean freight or ocean freight differential before arrival at the discharge port if the firm furnishes financial coverage to CCC in the form of a letter of

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credit for that amount.) We do not agree, however, that the benefits of payment on loading without such financial coverage would outweigh the potential problems. As noted in the draft report, it would not provide an incentive for the owner to complete the delivery if difficulties arise. It would also put CCC funds at risk. Only under certain circumstances ("force majeure") is ocean freight due to the vessel owner if the vessel sinks, for example. Several U.S.-flag vessels have sunk in recent years with food aid cargoes aboard. It would have been very difficult and time-consuming to attempt to recover CCC's freight outlay in the event of a sinking. Under Title I, the importing country pays part of the freight costs and would also have funds at risk if payment were made at loading. Recovering their freight costs would be a serious burden for the country.

It should be noted that the Title I, section 416(b) and Food for Progress programs provide that claims against the ocean carrier are to be settled separately and not deducted from the ocean freight due.

Inland Transportation.

See comment 13.

We agree that it is preferable not to include inland transportation in the ocean transportation contracts, and do so only for the neediest countries, when the alternative would be to deny them food aid. These countries have little foreign exchange with which to pay discharge and transportation costs from the foreign discharge port. In addition, newly independent countries often lack experience in making inland arrangements on their own. It is crucial to insure that food aid arrives promptly and safely in the destination country to meet the urgent needs of the recipients.

See comment 15.

We also agree that it would be beneficial to look at ways to handle inland contracting other than requiring the ocean carrier to make the arrangements, and to limit payments to the actual costs of the movement. At present, section 416(b) and Food for Progress agreements do permit landlocked countries to contract for inland transportation, and request reimbursement from CCC. The draft report says that USDA does not want to reimburse the recipient country; we are willing to do so but few countries have been interested. They find it difficult to make the arrangements and/or to make the initial outlay of funds.

See comment 16.

The draft report says that for Title I, inland transportation is arranged and paid for by the importing country. However, some countries have requested that CCC finance the inland transportation. We have agreed to this request only when the country would otherwise have been unable to take advantage of the program, for one or more of the reasons described above.

See comment 13.

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We will look at the Title I program to see if separate inland contracting is feasible when it is financed by CCC. In this regard, we share the concern of A.I.D. expressed in the draft report regarding the lack of U.S. Government personnel in-country to assist in such contracting. Without staff in place it would be difficult to maintain the integrity of the contracting process. It is important to insure, for example, that all the interested parties have an opportunity to submit bids, and that the firms participating are responsible and able to carry out the contracts if awarded. Food aid that does not reach the destination is useless.

Fumigation.

If the costs of fumigation at discharge are routinely included in freight rates offered for bulk grains, we share the concerns in the draft report. First, there is an increasing trend to in-transit fumigation of bulk grain cargoes, which sharply reduces the need for fumigation on arrival. Second, A.I.D. proposed several years ago that a "two-tier" rate structure be considered, under which the vessel would offer one rate if there were no fumigation at discharge and a higher rate if the cargo required fumigation on arrival. Once the carriers develop standardized costs to be applied for different discharge ports, we will be able to experiment with that approach.

Until we can adopt a new approach to fumigation on discharge we believe that the compromise position which has been developed over the years for food aid shipments should remain in place. If a cargo is discovered to be infested at discharge, the U.S.-flag vessel pays for the fumigation while the time used to fumigate counts against the vessel's laytime. The fumigation proceeds promptly; there is no delay while the recipient country finds the necessary funds. The vessel owner can expedite the arrangements in order to discharge as quickly as possible. Requiring the importing country to arrange and pay for fumigation will certainly delay the discharge since it places the financial burden on the party least able to pay.

This compromise does not satisfy the receivers, who expect grain without infestation; they would prefer that the contract also exclude the time used for fumigation from the laytime, to reduce the possibility of paying demurrage. However, under the compromise the vessel can earn demurrage if the laytime is exceeded due to the fumigation.

GAO Recommendation

Encourage recipient countries to more evenly space their food aid shipments throughout the year.

See comment 17.

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Departmental Response

We agree that a more balanced movement of food aid throughout the fiscal year could help lower freight rates. We will continue our efforts to achieve that goal, which requires both early signing of agreements and prompt purchasing.

The Food, Agriculture, Conservation, and Trade Act of 1990 amended Public Law 480 to establish early signature of food aid agreements as a target for both Titles I and III. Section 407(f) of the amended law establishes a target for signature of agreements of 60 days after the beginning of each fiscal year, or enactment of appropriations for the fiscal year, whichever is later. However, in practice a number of factors - some directly related to the program's authorizing legislation - combine to delay agreement signings.

The most frequent reason for delay is the need to determine compliance with program requirements of previous years' agreements - e.g., reports on imports to meet usual marketing requirements, or measures taken to carry out agreed agricultural development activities. The prospect of a new agreement offers the only leverage available to obtain required compliance reports, and consequently agreements may be held up. A second form of compliance delay comes from USDA's efforts to collect arrears on payments due under previous Title I agreements. Other delays occur in negotiating commodity mixes. Such issues arise when importing country governments have to resolve competing internal demands for limited commodity financing, or countries may protract negotiations on the issue of their wish to export commodities which are the same as or similar to the commodities programmed - contrary to the multilateral convention on food aid programming. In some cases countries' internal approval processes prolong the development of agreements by months. In short, multiple impediments to quick conclusion of agreements serve to limit the time available in which to arrange purchasing and transportation after agreements are signed. Purchasing must be completed by September 30, the end of the fiscal year.

However, where agreements can be signed within or soon after the target period, USDA does urge participating countries to ship as early as possible (taking into consideration any constraints imposed by the storage or disincentive determination required by section 403(a) of the Act).

As noted above, under these food aid programs, section 403(a)(1) of Public Law 480 requires that, before commodities can be provided, the Secretary of Agriculture must determine that adequate storage facilities will be available at the time the commodities arrive in the importing country and that the distribution of the commodity will not result in a substantial

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disincentive to or interference with domestic marketing or production in that country. (Authority to make this determination has been delegated to the General Sales Manager, FAS.) As a result, the country must carefully time its purchases so that arrivals do not interfere with the storage needs of its own harvest and other commercial and food aid imports, or interfere with marketing or production within the country.

Once the agreement is signed, there are many reasons for the uneven distribution of purchasing, some of which are noted in the report. Many countries also follow the U.S. commodity markets in order to buy when prices are lower and maximize the amount of commodity they will receive. This often means buying in late summer.

Finally, a small amount of the Title I budget is held until the last few months of the fiscal year to cover emergency situations which may arise. If there are unused funds from this "reserve" they are used for additional Title I programming at that time, for which shipments would fall in the September - December period.

The following are GAO's comments on the Department of Agriculture's letter dated September 22, 1994.

GAO Comments

1. We agree that in some instances the rate differences between U.S.-flag and similar-sized foreign-flag ships can be greater than the amount we state in the report. We chose to use a more conservative difference in conducting our analyses. We also added a note to figure 2.1 to reflect our use of weighted averages.

2. The report language has been revised as suggested.

3. Language was added to chapter 3 of the report to more accurately reflect the impact of "lowest landed cost" on the ability of countries to purchase the lowest cost commodity.

4. Language was added to chapter 3 of the report to describe this additional impact caused by complying with cargo preference requirements for title I recipient countries.

5. According to MARAD officials, they intend to pursue the implementation of their uniform charter party for food aid preference cargos.

6. The report language was revised to include that for the specific Russia Food for Progress program according to USDA, no discharge exceeded 27 days and the availability of railcars was not a significant problem.

7. The report language was revised as suggested.

8. This point was added to the report.

9. The report language was revised to include this information.

10. While according to MARAD officials and the U.S. shipowners we talked to, NORGRAIN is the most widely used contract for bulk commercial cargos, we agree that it is only a start for the final terms agreed to between parties for the shipment of commercial cargos. (The blank copy of the NORGRAIN contract referred to in USDA's comment was not reproduced in this appendix.)

11. The report attributes these views to MARAD and the U.S. shipowners that carry food aid preference cargos, not GAO. They are provided so the

reader can understand why MARAD is pursuing a rule to require MARAD preapproval of freight tenders and a uniform charter party for food aid preference cargos.

12. See our response to agency comments at the end of chapter 4.

13. As stated in our response to agency comments in chapter 4, it is our intention that USDA and AID experiment with the use of terms that are more similar to those used for commercial cargos. By its nature, this recommendation asks USDA and AID to consider these terms and conduct experiments where they see a potential to reduce transportation costs. It is not our intention that reductions in food aid transportation costs increase total program costs. We also modified the text to reflect that some countries lack the necessary experience and financial resources to pay for inland transportation services.

14. Typical charter parties used for commercial shipments include provisions to ensure the delivery of a cargo to its intended destination and provide legal remedies if it is not.

15. The report language has been modified to reflect this comment.

16. The report language has been clarified as suggested.

17. USDA's agreement with our recommendation is reflected in the report.

Comments From the Agency for International Development

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

USAID

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

September 21, 1994

Mr. Allen I. Mendelowitz
Managing Director
International Trade, Finance and
Competitiveness Issues
General Government Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Mendelowitz:

I am pleased to provide the U.S. Agency for International Development's (USAID) formal response on the GAO draft report entitled, "Cargo Preference Requirements: Objectives Not Significantly Advanced When Used in U.S. Food Aid Programs" (September 8, 1994, GAO Code 280067).

Thank you for the opportunity to respond to the GAO draft report and for the courtesies extended by your staff in the conduct of this review.

Sincerely,

Larry B. Byrne
Assistant Administrator
Bureau for Management

Enclosure: a/s

320 TWENTY-FIRST STREET, N.W., WASHINGTON, D.C. 20523

USAID Comments on the GAO Draft Report
"Cargo Preference Requirements: Objectives
Not Significantly Advanced When Used in U.S. Food Aid Programs"
(Code 280067, dated September 8, 1994)

The U.S. Agency for International Development (USAID) appreciates the opportunity to review the GAO's draft report, "Cargo Preference Requirements: Objectives Not Significantly Advanced When Used in U.S. Food Aid Programs." The Agency has some comments which we believe will strengthen the final report.

I. General Observations

First, the draft report is the most thorough and important analysis of cargo preference in many years. It presents in an unvarnished manner the facts as the GAO sees them. Although we have a number of comments and concerns about specific points in the report, and disagree with some of the observations in Chapter 4, the Agency congratulates the GAO on the issuance of the report. We appreciate the great deal of time and effort spent by the GAO team in compiling the report, and note our belief that as a result of its hard work fundamental cargo preference issues will get their best airing in a long time.

Second, given the short internal and external deadlines for comments on the 150-page draft we have done the best we can under the circumstances to address the points of major significance to USAID. However, we have been limited in the amount of detail with which we have been able to cover these important points.

II. GAO Recommendations

Recommendation No. 1: "If Congress chooses to continue the application of cargo preference laws to food aid programs and acts to permit U.S.-flag foreign-built ships to immediately carry food aid preference cargos, we recommend that the Secretary of Transportation instruct the Administrator of the Maritime Administration to promote the efficiency of the ships that carry food aid preference cargos. One way this can be done is by changing the method of calculating guideline rates so that 'average' operating costs for all similar-size ships, instead of 'actual' operating costs for each individual ship, are considered. While implementing this change will not help the application of cargo preference laws to food aid programs achieve its intended objectives, it should reduce food aid transportation costs."

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Agency Comment: (1) Chapter 2 primarily addresses whether the application of cargo preference requirements to food aid shipments furthers the objectives of the underlying legislation. The two objectives are to maintain an auxiliary of militarily-useful ships for wartime, and to ensure a substantial U.S.-flag vessel presence in domestic and foreign commerce. Clearly and powerfully, the report lays out and examines the facts, concluding that cargo preference as applied to such shipments does not significantly further statutory objectives because (1) the non-liner ships carrying bulk cargoes are not considered militarily useful by the Department of Defense, (2) the U.S. flag presence in domestic commerce is already guaranteed by the Jones Act, and (3) U.S.-flag vessels carry a very small amount of cargoes in U.S. foreign commerce, of which food aid shipments form an even smaller part. This is the report's major conclusion. It would seem to merit a recommendation or reference for Congressional consideration specifically directed at the essence of its findings, i.e., that Congress consider either redefining the objectives of cargo preference as applied to food aid shipments, or removing such application. This would better match the report's thrust.

See comment 1.

(2) If Congress were to reconsider the application of cargo preference to food aid shipments, as noted on page 14 of the draft, one alternative approach which USAID and other shipper agencies have long supported would be to replace the preference with direct subsidies. Such subsidies, as GAO mentions later, are more effective than cargo preference in preserving U.S.-flag capacity. We would also note that they foster competition, and limit our administrative flexibility much less than cargo preference does.

Now on p. 9.
See comment 2.

(3) Another option that GAO might want to suggest for Congressional consideration would be to limit cargo preference to vessels that are (a) militarily useful and (b) commercially competitive. Such limitations would bring the stated objectives of cargo preference in line with the application. From GAO's analysis, the result would be that cargo preference would be limited largely or entirely to liner vessels and cargoes.

See comment 2.

(4) The recommendation as currently formulated includes a conditional clause ("If Congress...acts to permit U.S.-flag foreign-built ships to immediately carry food aid preference cargoes") relating to the "three-year rule". USAID has for many years favored rescinding or limiting the three-year rule. So too have other shipping agencies, and we believe the Maritime Administration (MARAD) as well. The report states that the three-year rule is a disincentive to U.S.-flag vessel owners to buy and utilize newer, more efficient and effective vessels, and that the disincentive helps ensure higher freight costs for U.S.-flag vessels. USAID agrees. We suggest that GAO add a

See comment 3.

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recommendation or reference for Congressional consideration that Congress consider rescinding, or at least narrowing the scope of, the three-year rule. The report contains a discussion of a prior waiver of the rule, but surely, while we certainly would be in favor of a waiver if authorized by Congress, occasional waiver measures are not the best answer in the long run. We believe that eliminating the three-year rule is in the interests of both U.S.-flag vessel owners and shipper agencies, and would help meet the present statutory objective of promoting the carriage of cargoes in U.S. foreign commerce by U.S-flag ships. Accordingly, we urge GAO explicitly to refer this idea for Congressional consideration.

(5) The recommendation urges that the Secretary of Transportation instruct MARAD to promote the efficiency of the vessels carrying preference cargoes. The specific measure suggested is to calculate guideline rates on an "average" of "all similar-sized ships" instead of actual costs. We will address the general point and the specific measure in turn.

See comment 4.

(A) USAID certainly agrees with promoting the efficiency of U.S.-flag vessels carrying preference cargoes. Our concern with this idea is that it not be cited by MARAD as a basis for broad mandates to shipper agencies such as USAID that negatively affect our food aid programs or limit our flexibility to administer such programs. We recommend that GAO revise this part of the recommendation in order to clarify that what is meant is for MARAD to revise its guideline rate regulations to provide incentives to U.S.-flag ships to become more efficient. This is something we fully and enthusiastically support. What we would not like to see, however, is a recommendation that, like the current text, might be interpreted as an endorsement of application, to a broader range of matters, of the prescriptive approach reflected in MARAD's proposed "uniform charter terms" regulation (discussed in more detail below). We hope GAO will clarify this point.

See comment 5.

(B) GAO may also want to consider moving the recommendation to a different part of the report, perhaps Chapter 4. Since it deals with cost reduction rather than furthering statutory objectives, it would seem to be logically more suitable for presentation in Chapter 4. A relocation of the point to Chapter 4 would also help clarify, as discussed in (A) above, that GAO is addressing cost efficiency of U.S.-flag vessels in terms of MARAD's guideline rates. It would also avoid any potential confusion between the powerful message of the bulk of Chapter 2 (that cargo preference as applied to food aid does not achieve Congress's statutory objectives) and the secondary, though of course still important, points concerning cost-saving measures.

(C) USAID fully agrees with GAO that the present guideline rate system is ineffective. It is in effect a "cost plus percentage of cost" approach, which is statutorily prohibited in other kinds of Government contracts. As GAO notes, basing the calculation of guideline rates on actual costs is a disincentive to cost efficiency. This has been USAID's position for years. We would also add, however, that the proposed measure utilizing average costs will not do very much to reduce program costs for several reasons. First, since many U.S.-flag vessels are older and less efficient, averaging will have only a limited effect on the cost basis. Only if foreign-flag vessels that compete with U.S.-flag ships were somehow added into the equation would there be a significant push to become more efficient. Second, the same is true with respect to the size of the U.S.-flag fleet, which is small for many types of vessels. Unless more, i.e. foreign-flag vessels, are considered, the pool will be too limited to result in much incentive to efficiency or downward pressure on rates. Third, the idea is not a new one. MARAD used a "fleetwide average" approach before, only to drop it at the request of vessel owners (e.g., for liner bulk cargoes, in its May 1992 rule revision). We are not aware that the approach substantially reduced guideline rates when it was applied.

See comment 6.

Recommendation 2. "If Congress chooses to continue the application of cargo preference to food aid programs, the GAO recommends the Secretary of Agriculture and the Administrator of the U.S. Agency for International Development take the following steps because of their potential to reduce food aid transportation costs:

-- Experiment with the use of contract terms for the transportation of food aid cargoes that are more consistent with contract terms used for similar commercial cargoes to determine whether their use will reduce food aid transportation costs.

-- Encourage recipient countries to more evenly space their food aid shipments throughout the year."

Agency Comments: USAID conditionally agrees to the recommendation. We are constantly refining our contracting approaches and terms, and some of the points discussed by GAO have already been adopted and/or explored in our programs. The issue of contracting terms and conditions is discussed in more detail below. In agreeing with GAO's recommendation, however, we request GAO to clarify that it is not taking a position on the MARAD "uniform charter terms" draft rulemaking, but is instead suggesting a collaborative inter-agency effort to experiment with different terms under controlled conditions in selected shipments. With that limitation, USAID can agree enthusiastically. A cooperative and experimental approach is

See comments 4 and 7.

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much preferred to the prescriptive approach utilized by MARAD in its "uniform charter terms" rule, which we strongly oppose.

We should also note one other point. While the report is correct that USAID lacks "empirical data" to demonstrate that the terms mentioned would not save costs, it should be equally noted that there is also no such data at present objectively demonstrating that adopting the terms would save program costs. MARAD's figures and other figures similarly derived are, we believe, inflated and based on information from vessel owners, who are interested parties. Accordingly, we request GAO to make clear in its recommendation that agencies may seek, either before experimenting with various terms or as an integral part of such experiments, to get better data on costs. With respect to some types of terms, it may be best to just do the experiment and see how it works. For others, however, we would like to have the flexibility to study the matter first, collecting data from all of the program shippers (not only the Government but also PVOs and WFP), port officials, commercial exporters, and others, in addition to vessel owners.

See comment 8.

III. "Commercial" Terms and Conditions

On page 13 and in Chapter 4, GAO examines the question of whether certain USDA and USAID affreightment terms accord with "commercial" terms, and whether they may increase freight costs. USAID agrees with GAO that some of the practices mentioned are not the same as those employed by many commercial exporters of agricultural products, and that many of them do increase freight costs. We are concerned, however, that the coverage of this issue in the report, does not tell the whole story and may leave the reader with the wrong impression. In this section, USAID offers additional comments and explanation on the "commercial terms" issue.

Now on p. 8.

The first point we would note is that the report does not call enough attention to, or delineate sharply enough, the differences between commercial export transactions and Government food aid donations. The objectives of commercial agricultural exporters, purchasers, and vessel owners, on the one hand, and those of Government food aid program administrators, on the other, are quite different. Commercial exporters and vessel owners seek to minimize their risks and maximize their profit. While earning their sales price and freight, respectively, they have very limited if any interest in broader objectives such as the meeting of emergency food needs, fostering the development of recipient countries, etc. Government program administrators have a much more extensive and difficult responsibility.

See comment 9.

This difference in objectives translates into many differences in terms of practices and policies. For example, a commercial agricultural exporter would not generally be concerned with

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fumigation. This is the purchaser's responsibility. The Government, however, as donor, requires that this service be performed for a number of programmatic reasons. Does this add to program costs? Certainly. But it serves important Governmental objectives. The only issue for shipper agencies, in such cases, is how to provide for fumigation. As is discussed further below, USAID currently places the responsibility on the vessel owners (compensating them fully in the freight rate). As the foregoing indicates, it would not, in USAID's opinion, be accurate to imply, as the report seems to, that USAID is failing to follow "commercial terms" in this respect. Instead, commercial terms are simply not applicable to the point in question. Some of the other terms are subject to similar considerations.

See comment 10.

The second point that we feel is not adequately covered in the draft report is the difference between "transportation cost" and "program cost". The former is the discrete cost of the affreightment contract. The latter is the cost to the program. In our view, the report does not sufficiently recognize the fact that certain steps that would obviously reduce transportation cost would not necessarily correspondingly reduce, and might even increase, total program cost. For example, if inland transportation were removed from the affreightment contract, it would certainly reduce the cost of the ocean freight contract. At the same time, however, inland transportation would still be a necessary service. Shipper agencies such as USAID would either have to directly contract themselves for inland transportation or find some means to finance the service through reimbursement of a contract between the receivers or the recipient government and a local or third country carrier. In the first case, USAID would have to add the necessary contracting, legal, and administrative staff overseas to handle the work. In the second case, there would be all of the uncertainties, risks and delays that are inherent, with respect to Title III shipments, in contracting by entities or governments of least developed countries. This is the calculus that USAID has to apply. We cannot simply consider ocean transportation costs in isolation--the additional "program costs" must be fully taken into account. Costs removed from the shipowners remain, and may even increase for the Government.

See comment 11.

The third general point USAID should make is that "commercial terms" refers to those terms bargained between particular buyers and sellers in a specific market at a particular point in time. They are not immutable, nor are they always uniform. USAID utilizes "commercial terms" in its contracting. For example, "full berth terms" (FBT), which GAO discusses, is a commercial term. It is used by some commercial agricultural exporters in some cases. There are of course other terms, and USAID does not maintain that it is the predominant or only term. We utilize FBT for some programs when we have programmatic reasons to do so. We understand that freight costs are higher, because risks are higher, under such terms. Once again, it should be noted that

See comment 10.

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the owners are fully compensated for any additional costs or risks in the freight rate. However, like commercial shippers, we exercise our judgment, based on long operational experience, to use FBT when there are reasons for it. U.S.-flag vessel owners in some cases do not like FBT because they do not wish to absorb the risks. We understand this. But we need to impose those risks on them sometimes. GAO should not imply, through use of the phrase "commercial terms", that terms such as FBT are non-commercial. This is wrong. Rather, USAID and other shipper agencies sometimes require additional services and/or allocate particular risks to shipowners, when deemed appropriate. This is the correct characterization, in our view.

See comment 12.

Finally, a fourth general point that is important to note in this respect is that USAID imposes the same terms and conditions on foreign-flag vessels as it does on U.S.-flag vessels. Contrary to the allegation often made by vessel owners and MARAD that shipper agency terms are "discriminatory", our terms apply equally regardless of flag. They are not, accordingly, related in any way to cargo preference, and should not be regarded as a cargo preference issue. We request GAO to revise its text to make this fact clear.

The following provides a discussion on each of the "commercial terms" issues mentioned by the report in turn.

Now on p. 57.
See comment 13.

FBT. USAID utilized FBT widely for Government-to-Government Title II programs several years ago. After discussions with vessel owners and MARAD, however, USAID changed the terms of most Title II and Title III charter parties to "Vessel Load" and non-berth discharge terms. This move was made to save costs and bring our terms more in line with the majority of commercial shipments (as GAO is now recommending). We continue, however, to utilize "Berth Terms Discharge"--FBT at discharge ports--for a few selected countries where we deem it appropriate (GAO is incorrect in stating on page 84 that 50% of cargoes are unloaded under FBT). Again, FBT is a "commercial term", albeit not the predominant one in bulk shipments. It is still useful under some circumstances. Shipper agencies should not be artificially precluded, any more than commercial shippers are, from utilizing whatever terms are determined to be appropriate under specific facts and circumstances. This is one reason we strongly oppose MARAD's rigid "uniform charter terms" rule.

It must also be noted that the alternatives to FBT are not problem-free either. When demurrage is provided for, someone has to pay these amounts. USAID charter parties generally state that the receivers are to pay them. Some vessel owners now complain that they do not want to assume the risk and cost of dealing with overseas receivers in this matter. These owners advocate requiring USAID and other shipper agencies to pay the charges. Under any demurrage arrangement at discharge ports, the ocean

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freight would go down. However, our program costs could be driven up, and we would be required to hire additional operational and legal staff, both in USAID/Washington and overseas.

Timing of Freight Payments. GAO notes that USAID and USDA generally pay upon confirmation of arrival of cargo at the discharge port rather than merely upon loading. USAID agrees with USDA's statement of the reasons why destination payment rather than loading payment is utilized. Again, we have a greater responsibility than commercial shippers to ensure that the food aid is delivered overseas in order to achieve our statutory objectives. We have also had cases in which vessels sank en route or diverted cargoes. Payment at the discharge port greatly lessens these risks.

See comment 8.

We should also note that payment at discharge is in accord with the general U.S. Government policy on financing performance under Government contracts. See, for example, Federal Acquisition Regulation (FAR) Part 32, "Contract Financing" (providing that contractor self-financing of performance is the preferred method) and Part 46, "Quality Assurance" (providing that payment for goods and services is to be made after such items are received, inspected and accepted). Changing charter party to terms to pay upon loading would not only increase program risks, but would also increase the costs to the Treasury because payments would be made in advance of services being rendered.

Inland Transportation. Inland transportation is a major element of the transporation picture. Without it, or if it is not managed with extreme care, food aid intended for some of the poorest countries in the world will fail to achieve its objectives.

See comment 4.

USAID adamantly opposes MARAD's "uniform charter terms" rule, which would compel shipper agencies to take inland transportation out of the ocean freight contracts and arrange for it separately. Such a system greatly increases the risk of delays, added program costs, and commodity deterioration. It also would require additional staff overseas to write, execute, administer and enforce the resulting third country transportation contracts. We simply don't have the staff to do that as it is now.

See comment 14.

The report's suggestion that inland transportation could be handled by reimbursing recipient countries for the service is completely unrealistic and untenable. Many landlocked countries, particularly Title III recipients, are among the poorest in the world. They simply do not have the financial or operational resources to contract for inland transportation themselves, even on a reimbursable basis. GAO's statement that "It seems reasonable to expect that landlocked countries should be familiar with transporting goods inland, and thus should be able to make

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these arrangements at lower cost than shipowners who are less familiar with making these arrangements" (page 86) is simply wrong. USAID would have to either do the contracting ourselves (with the problems noted in the previous paragraph), or we would need to oversee the process in such a close and detailed manner--though without ultimate control--that direct contracting would be preferable. This would be the only way to ensure that the food aid got through to destination.

Now on p. 58.

Fumigation. As mentioned above, fumigation is an expense that most commercial shippers/charterers do not have to worry about, but it is one that Government shipper agencies believe is necessary. The report indicates that U.S.-flag freight will be increased if owners cannot know at the commencement of the voyage whether the option to require fumigation will be exercised or not. USAID agrees with this assessment (although the issue is not limited to U.S.-flag owners--it applies equally to foreign-flag owners). Unfortunately, at the time the charters are fixed, USAID does not know whether fumigation will be required or not. This leads us to reserve the option. At meetings held with MARAD and the U.S.-flag vessel owners, we suggested that the option be separately priced; we suggested a "two-tier" rate system, with the base rate applying if fumigation were not requested, and the supplemental rate applying if the option were exercised. This approach would have removed any risk from the shipowners, as GAO seems to favor, and eliminated the contingency from the freight rates. To date, however, our proposal has not been accepted. As a result of the GAO report, we will retender the proposal.

See comment 15.

One final issue is the savings in ocean freight costs which might result from a switch to "commercial terms". On page 90, GAO estimates a savings of $59.2 million. We believe that this is greatly overstated even with respect to rates viewed in isolation (as opposed to total program cost). The figure is based on shipowner estimates. USAID's experience is that freight rates have much more to do with competition than they do with the terms and conditions of the charter parties. Given the limited, sometimes nearly monopolistic market that U.S.-flag carriers, particularly bulk carriers, have in certain cases as a result of cargo preference, owners tend to maximize profits and increase rates. We doubt that even if there were to be decreases in risks or costs to the shipowners substantial decreases in freight rates would result, except where strong competition among U.S.-flag owners obtained.

Now on p. 61.
See comment 16.
See comment 17.

USAID also believes that the cost of money is not factored into MARAD's calculation of guideline rates. Accordingly, even if vessel owners could be paid earlier, and even if this resulted, on those routes with strong competition among U.S.-flag vessels, in lower rates, the guideline rates would not reflect the decline in financing costs. We of course defer to MARAD on the scope of

See comment 18.

its guideline rate rules, but this is the way we read the rules. If our reading is correct, this point should be factored into the GAO report.

See comment 19.

Also, we believe that inland transportation costs are fully acccounted for in the calculation of fair and reasonable rates. Again, since this is factored in on an actual cost basis, the guideline rates would not change and thus only where strong intra-flag competitive conditions applied would any lower rates be realized.

Other matters relating to the report's discussion of "commercial terms" are covered under Section IV below.

IV. DETAILED TEXTUAL COMMENTS

See comment 9.

(1) **Methodology.** In general, USAID believes that GAO did a responsible and thorough job in approaching the report's basic topics. GAO obtained data from U.S. Government agencies, PVOs, WFP, vessel owners and some international shipbrokers. No contacts with commercial exporters of agricultural cargoes are noted, however. USAID believes that the report's consideration of "commercial" contracting terms does not take full account of the differences between U.S. Government financing/donation programs and "commercial" exports. In our view, the report, by not reflecting input from commercial exporters, somewhat overstates the differences between shipper agency contracting terms and those employed by exporters, and understates the important reasons for those differences. If time does not permit an examination of export practice and a comparison with the requirements and objectives of Government food aid programs, we recommend that this be noted as a limitation on the scope of the methodology.

Now on p. 4.
See comment 20.

(2) **Freight/Commodity Tradeoff.** On page 7, the reference to the fact that in "some" instances the higher cost of U.S.-flag vessels "may" reduce the funds available to purchase food aid commodities should be strengthened. For example, for the "dollar driven" Title III program which USAID administers, higher U.S.-flag freight rates directly reduce the amount of commodities purchased.

Now on p. 4.
See comment 21.

(3) **Adverse Impacts.** Also on page 7, additional adverse impacts can be noted. In some cases, cargo preference forces program participants to utilize individual U.S.-flag vessels, or types of vessels, that are slower, less efficient, older, or less appropriate than other available vessels. This can result in scheduling problems and increased risk of loss or damage to food aid cargoes.

Now on p. 8.
See comment 22.

(4) **"Choice".** On page 13, the sentence "USDA and AID choose to provide these services [e.g., inland transportation] through

the shipowners to give additional assistance to these needy countries" conveys the impression that the services are optional. Services such as inland transportation are not optional. They are a fundamental component of delivering the required food aid. The only issue is whether the transportation should be included in the ocean carrier's booking or done separately. For the reasons stated above, USAID believes this must be done through the shipowners. The report's wording on this page should be revised to indicate that the issue is through whom the services are secured, not whether they should be secured. Also, we should request that the report's coverage of the inland transportation issue fully reflect (1) the problems with trying to secure the services by reimbursement of the receivers, and (2) the fact that we do not have the staff to do direct contracting for the transportation.

See comment 23.

A more accurate text instead of the first two sentences under the heading "Certain USDA and AID Management...", on page 13 (and later on page 81) would, in our view, read:

Now on pp. 8 and 56.
See comment 23.

> "USDA and AID provide for the performance of these services under the prime contract with the shipowners, whether U.S. or foreign flag, because, in most cases, the recipient country does not have the financial or operational capability to provide them. While these additional services may increase transportation costs because they place additional risks and costs on the shipowner, they may in fact reduce the overall cost of the program by allowing the shipowner to maintain operational control over the service and thus its effective implementation. USDA and AID also regard this method as the only feasible approach for most of the services."

(5) **Fixed-Price Contracting.** Also on page 13, in our view the last sentence of the first paragraph should be revised to reflect the fact that risks are present with respect to any performance under fixed-price contracts. The wording of the present sentence seems to imply that there is something wrong, or undesirable, about fixed-price contracting and assumption of risk. Unless GAO is advocating cost-reimbursement contracts, it should revise the text to make this point clear.

Now on p. 8.
See comment 24.

(6) **Freight Rates.** U.S.-flag freight rates are described on page 53 as "significantly" higher than foreign-flag rates for food aid cargoes. GAO may want to consider whether the adjective "substantially" is more accurate than "significantly".

See comment 25.

(7) **Guideline Rates.** Page 62 states that since guideline rates are based on actual costs (plus, we would note, a guaranteed profit), incentives for U.S.-flag vessels to become more efficient are "reduce[d]". Surely a cost-plus-profit approach eliminates, not merely reduces, any incentive to become efficient.

Now on p. 41.
See comment 26.

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(8) **Costs and Efficiency.** As noted above, USAID's experience has been that costs are less determinative of U.S.-flag freight rates than competition. While we certainly agree with the report (page 65) that incentives to U.S.-flag vessel owners to acquire more efficient ships would be desirable, we do not think that such incentives would result in any major downward effect on freight rates unless some other means is found of increasing effective competition. We recommend that GAO reconsider this aspect and note the limited, though positive, effect of incentives.

Now on p. 42.
See comments 17 and 27.

(9) **Title III Compliance.** Table 3.1 on page 67 of the draft contains an error. The right-hand box for Title III states that USAID measures cargo preference compliance for this program by country. That is incorrect. USAID measures, and reports to MARAD, cargo preference compliance for Title III by (1) total program tonnage, for (2) each year, by (3) type of vessel, as required by the cargo preference laws. We do attempt to share the effect of higher U.S.-flag rates by evening them out by country, but this is solely an administrative approach utilized internally by our agency, and is not considered a method of cargo preference compliance.

Now on p. 47.
See comment 28.

(10) **NORGRAIN.** The report correctly notes that most U.S. agricultural exporters use NORGRAIN. It should also note, however, that NORGRAIN is only the starting point for negotiations, and that modification or supplementation of NORGRAIN by exporters and importers is common. Another point that should be noted is that MARAD's "uniform charter terms" rule, which we strongly oppose, does not consist merely of the text of the NORGRAIN charter party, but adds other items on the U.S.-flag owner "wish list" as well. As MARAD has noted, it contains additions necessary to reflect the special aspects of cargo preference programs. USAID's view is that our charter party is in essence a set of commercially acceptable, and largely commercially standard, terms, with only those modifications and additional services deemed necessary to meet the needs of our food aid programs, based on the long experience of our transportation staff. The MARAD rule would merely replace the set of adaptations determined by food aid program staff with a set of adaptations determined by MARAD staff. Neither MARAD's document nor USAID's is completely "commercial" in nature. USAID requests that GAO's report provide a more balanced and accurate account of the MARAD rule in this regard.

See comment 29.

(11) **MARAD RULE.** With respect to the MARAD "uniform charter terms" rule discussed on pages 91-3, USAID notes our current position. USAID disagrees with the Department of Justice opinion and has formally notified the Department that we request reconsideration. USAID is preparing a submission in support of the request. We believe that USDA intends to do the same. USAID's view is that the MARAD rule exceeds the authority of

Now on pp. 61-62.
See comment 30.

Now on p. 61.
See comment 31.

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MARAD, goes far beyond cargo preference into other terms and conditions of contracting, and disturbs the fundamental balance under the cargo preference laws between shipper agencies and the maritime promotional agency. Essentially, under MARAD's rule USAID would not be able to write its own contracts or control its own solicitations. There is no similar rigidity built into any other type of program USAID conducts. We believe that our program administration would be severely hampered and delayed if the MARAD rule were to be issued.

(12) **Page 98.** The reference to "higher U.S.-flag shipping rates" in sentence two is misleading. The requirement applies to all vessels, regardless of flag. It has nothing to do with cargo preference, and is not "discriminatory" in any way. Also, we would again note with respect to this page our earlier points concerning the difference between ocean freight costs and program costs, and the problems with alternative approaches.

The following are GAO's comments on the U.S. Agency for International Development's letter dated September 21, 1994.

GAO Comments

1. We believe we have demonstrated that the application of cargo preference requirements to food aid programs can adversely affect the operations of those programs and not significantly help achieve the objectives of the Merchant Marine Act of 1936, as amended. Nevertheless, the continuance of this application of cargo preference requirements is a matter of policy which, we believe, can be best determined by Congress. Chapter 2 contains a matter for congressional consideration related to this issue.

2. We agree that direct subsidies would offer a more efficient alternative for achieving the objectives of the Merchant Marine Act of 1936, as amended, by providing support to those ships that (1) could best serve as a naval auxiliary in times of war or national emergency and (2) could be competitive in carrying a substantial portion of the foreign commerce of the United States.

3. We agree and have made the appropriate addition to the matter for congressional consideration in chapter 2.

4. Our recommendation in chapter 2 is not intended to endorse MARAD's proposed "uniform charter terms." In chapter 4 of the report, we describe MARAD's efforts to establish such terms, but we do not take a position on the matter. Rather, we point out that there is a potential for food aid transportation cost savings if terms used for contracting food aid shipments were more consistent with those used for contracting commercial shipments of agricultural commodities. Furthermore, our recommendation in chapter 4 on this matter is limited to experimenting with such terms by the agencies responsible for shipping food aid.

5. MARAD's guideline rates are addressed in chapter 2 because we discuss the rate-determination process in terms of its being a disincentive for shipowners to reduce their operating costs. We do not believe that the discussion takes away from the main message of the chapter. Rather, we believe it buttresses the message by indicating that this disincentive to improving the efficiency of U.S.-flag ships helps keep the second objective of the Merchant Marine Act of 1936—i.e., the carrying by U.S.-flag ships of a substantial portion of U.S. domestic and foreign waterborne commerce—from being achieved.

6. We agree that the best chance for shipping rate reductions would be if Congress were to permit U.S.-flag foreign-built ships to immediately carry food aid preference cargos and MARAD were to include these new entrants in its average cost calculations. Our recommendation to MARAD is premised on Congress allowing the entry of U.S.-flag foreign-built ships into the food aid cargo preference trade. This provision would be the key difference from MARAD's previous "fleetwide average" approach.

7. See our response to agency comments presented at the end of chapter 4.

8. As stated in our response to agency comments in chapter 4, it is our intention that USDA and AID experiment with the use of terms that are more similar to those used for commercial cargos. By its nature, this recommendation asks USDA and AID to consider those terms and conduct experiments where they see a potential to reduce transportation costs. In conducting these experiments, we assume that USDA and AID will collect and track any cost data they believe are necessary to provide meaningful results. It is also not our intention that any reduction in food aid transportation costs increase total food aid program costs.

9. We appreciate that commercial agricultural exporters and government food aid programs may have different objectives and that not all commercial terms and practices will meet government needs.

10. The report language has been revised so it does not imply that AID's terms are noncommercial.

11. The report language has been revised to clarify that we are concerned with a reduction in food aid transportation costs, but only if it does not increase food aid program costs. This clarification is also included in the agency comments section at the end of chapter 4.

12. The report language has been clarified as suggested.

13. The report language was revised to remove its reference to 50 percent of cargos are unloaded under full berth terms.

14. We believe that it is reasonable to expect that some landlocked food aid recipient countries are capable of handling arrangements for inland transportation.

15. AID's proposal for a "two-tier" rate system to cover fumigation expenses is exactly the type of experiment we are suggesting be applied to food aid cargos.

16. The estimates for potential savings in food aid transportation costs through the adoption of terms that are more consistent with those used for similar commercial cargos presented in the report are based on MARAD and shipowner estimates. While these estimates may overstate potential savings, they are presented to illustrate that some cost reduction may be achieved through the use of contract terms more consistent with those used for similar commercial cargos.

17. We agree that competition is an important factor in reducing food aid transportation costs, which is why we include matters for congressional consideration and recommendations in chapter 2 directed at improving the efficiency and number of U.S.-flag ships that carry food aid preference cargos.

18. Regardless of whether or not MARAD includes financing expenses in its guideline rate calculations, the U.S. shipowners we talked to said that when they incur this expense, they factor it into their shipping rates.

19. Shipowners are reimbursed for the cost of inland transportation through their shipping rates. The amount allowed by MARAD to cover the cost of inland transportation is based on the shipowner's estimate of these costs. Given that these estimates can vary significantly among shipowners bidding on the same cargo, the actual cost of this service may not be accurately captured through the amount included in the shipping rates.

20. No change is being made since the current language reflects that the direct tradeoff between using funds for food aid versus its transportation is not present for all food aid programs.

21. Additional adverse impacts are noted in chapter 3.

22. We believe the report sufficiently implies that these additional services are not optional but are part of the total package that USDA and AID provide to food aid recipient countries. The word "choose" is used to describe the method by which these services are being provided.

23. AID's views on the problems associated with securing inland transportation are included in chapter 4.

24. It is not our intention to imply that something is wrong with fixed-price contracting. We are merely stating that handling the delivery of these services in a way that is more consistent with how commercial cargos are handled may result in USDA and AID paying something closer to the actual costs of these services.

25. We agree and have made the suggested change.

26. We say "reduce the incentives" because there are factors other than the method used by MARAD in establishing guideline rates that may also provide disincentives to more efficient operations. For example, the current requirement that U.S.-flag foreign-built ships must wait 3 years before being allowed to participate in the food aid cargo preference program also reduces shipowners' incentives to increase efficiencies.

27. We agree that shipping rates can be affected by the degree of competition among shipowners for particular food aid cargos. As noted in the report, there was a corresponding decrease in the amounts of ocean freight differential incurred in the food aid programs following the entry of seven new, foreign-built, U.S.-flag ships in the food aid cargo preference trade in the early 1980s. These seven new ships were more efficient than some of the older U.S.-flag ships participating in the program and, through competition, were able to acquire food aid cargos that might have otherwise been carried by less efficient U.S.-flag ships at higher shipping rates.

28. Table 3.1 represents how cargo preference compliance is generally measured for each food aid program. AID may measure and report compliance to MARAD for the title III program by (1) total program tonnage, (2) for each year, and (3) by type of vessel. But in practice, MARAD provides funding for each title III country separately and requires that 75 percent of the food aid tonnage purchased for each country be shipped on U.S.-flag ships. Table 3.1 has been revised to state that 75-percent compliance by country is a practice, not a requirement, for title III.

29. The report explains that MARAD's uniform charter party is based on North American Grain (NORGRAIN). We agree that NORGRAIN is only a start for the final terms agreed to between parties for the shipment of commercial cargos. In addition, as stated in our response to agency comments presented at the end of chapter 4, we have not evaluated MARAD's uniform charter party and do not take a position on it.

30. AID's opposition to MARAD's uniform charter party is noted in the report.

31. We are reflecting U.S. shipowners views.

Comments From the Department of Transportation

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

U.S. Department of Transportation

Assistant Secretary for Administration

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

September 21, 1994

Mr. Allan I. Mendelowitz
Managing Director
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Mendelowitz:

Enclosed are two copies of the Department of Transportation's comments concerning the U.S. General Accounting Office draft report titled, "Cargo Preference Requirements: Objectives Not Significantly Advanced When Used in U.S. Food Aid Programs."

Thank you for the opportunity to review this report. If you have any questions concerning our reply, please contact Martin Gertel on 366-5145.

Sincerely,

Jon H. Seymour

Enclosures

Comments on General Accounting Office (GAO) Study "Cargo Preference Requirements: Objectives Not Significantly Advanced When Used in U.S. Food Aid Programs"

I SUMMARY

The Maritime Administration (MARAD) conducted a preliminary review of the report titled, Cargo Preference Requirements: Objectives Not Significantly Advanced When Used in U.S. Food Aid Programs, and identified several areas of concern. MARAD is particularly troubled by conclusions and implications which are either not supported by verifiable data, or which mischaracterize the issues and factors affecting the conduct of the cargo preference programs. MARAD staff found it difficult to conduct a thorough and comprehensive analysis given the time constraints imposed by GAO; consequently, not all areas which MARAD finds open to comment have been addressed.

The principal areas of concern which should be addressed prior to the final publication of this report are: military usefulness, maritime subsidy programs, use of commercial terms and consecutive voyage charters, U.S.-flag vessel availability, cargo preference effect on food aid programs, average costs for fair and reasonable rates, inland transportation, and data issues.

II FINDINGS AND RECOMMENDATIONS

A. Military Usefulness

GAO Finding:

In Appendix V, a Department of Defense (DOD) memorandum states, "...crews on all vessels are important as they are generally interchangeable, and can provide support for manning of the Ready Reserve Force (RRF)...Some of the crews on these [bulk] vessels could be used to help man the RRF in time of contingency, but a more readily available source of manpower is from the liner service trade."

See comment 1.

The body of the GAO report states, "DOD...does not view the crew supported by these (non-liner) ships as critical in times of military contingency." Later in the report GAO states, "...crews on bulk carriers, tankers, and tug/barge combinations that transport food aid could be used to help crew the Ready Reserve Force. DOD currently believes that a more readily available and sufficient source of crew is from the liner service trade."

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MARAD Response:

See comment 1.

It appears that the GAO report misstates the national security requirement for seafarers employed on U.S.-flag bulk ships. The privately owned U.S.-flag industry today is comprised of a total of 367 ships. Of that, 190 -- or 52 percent -- are liquid (tanker) or dry bulk carriers. Excluding 17 liquid and dry bulk tug-barge units, bulk carriers now represent 47 percent of the fleet. On that basis alone, the number of seafarers employed in the bulk industry represents close to one-half of the seafaring labor pool that would be relied upon to operate both active and inactive U.S.-flag ships in support of DOD sealift operations during a crisis. Any assertion by DOD that the liner industry alone is a sufficient crewing source for the military's laid up fleet is incorrect. In fact, analysis of the data above as well as Desert Shield/Desert Storm statistics illustrate that the laid up fleet would not meet its readiness call up requirements without bulk fleet crews.

See comments 1 and 2.

During the surge phase of a sealift operation, there would be a nearly instantaneous requirement for merchant seafarers to crew the highest priority inactive ships: the Navy's Fast Sealift ships and the Roll-on/Roll-off ships in the RRF that are kept in 4-day Reserve Operating Status. Merchant seafarers would also be needed to crew the remaining ships in the RRF as they are activated. These seafarers would be obtained from the overall U.S. seafaring labor pool not actively serving on board U.S.-flag ships -- regardless of vessel type. It would be virtually impossible to crew ships in the RRF without the crews that operate the U.S.-flag bulk fleet. This fact is being demonstrated now during Operation MAINTAIN DEMOCRACY (Haiti) where about 40 percent of the unlicensed and 50 percent of the licensed seafarers on board the 14 ships activated from the RRF were previously employed on U.S-flag bulk ships. Furthermore, MARAD believes that the GAO finding on crews is not consistent with their draft report on the RRF or their special report on crewing the RRF.

B. Maritime Subsidy Programs

GAO Finding:

GAO states, "U.S. shipowners whose ships carry food and preference cargoes have reduced incentives to lower their costs."

MARAD Response:

See comment 3.

U.S.-flag shipowners do not lack incentives to lower costs, regardless of whether they carry commercial or preference cargo. Any owner operating in a high capital cost, competitive and highly cyclical market has substantial incentives to lower costs. In addition, the Administration has taken proactive steps to

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further lower U.S.-flag capital and operating costs. The Administration's Maritime Security Program currently pending in Congress will markedly reduce the cost of Federal assistance to the maritime industry by phasing out the current cost-based operating differential subsidies (ODS) program and replacing it with a declining flat-payment system. At the same time, various impediments to achieving operating efficiencies, such as trade route and service restrictions under the ODS program, would be eliminated and owners of all U.S.-flag foreign-trade vessels would have the flexibility to acquire less costly foreign-built vessels. Indeed, the legislation is fully consistent with GAO's recommendations by creating incentives to invest in more efficient U.S.-flag vessels to reduce food aid transportation costs.

C. Use of Commercial Terms

GAO Finding:

GAO states, "(g)iven that the estimated cost of these noncommercial items [terms] is built into food aid shipping rates, we believe that a potential may exist for some savings in food aid transportation costs by removing these terms and the uncertainty associated with estimating their actual cost, and adopting more consistent commercial terms."

MARAD Response:

See comment 4.

DOT has for some time been emphatic that significant costs savings could occur if consistent freight contracting commercial terms had been adopted. However, food aid agencies are averse to allocating certain costs and risks to buyers or recipients of cargoes. Adoption of MARAD's Uniform Charter Party (UCP) will reduce actual transportation costs by removing unnecessary risks and costs from carriers, thereby lowering ocean transportation rates. For example, shipper agencies refuse to permit payment upon vessel loading because problems enroute could induce shipowners to unload the cargo somewhere other than the specified destination. The shipper agencies maintain this practice despite the fact that all commercial charters contain provisions that either prevent this problem from arising or provide legal remedies.

See comment 5.

Inland transportation costs have also been used to overstate the ocean freight differential (OFD) since commercial vessels are typically fixed on "free-out" terms with carriers not responsible for inland transportation. Although MARAD does not include inland freight in its guideline rate calculations, these costs have been included in the reported OFD by the shipper agencies.

MARAD intends to pursue implementation of the UCP and expects all Federal agencies to recognize its authority to issue regulations

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on cargo preference as delineated by the Department of Justice Opinion dated April 19, 1994.

See comment 6.

MARAD has also urged agencies for many years to utilize consecutive voyage charters which provide economic incentives to position vessels in geographic areas and result in lower freight costs. U.S. Government shipper agencies have consistently rejected MARAD's advice.

Russian/Israeli Shipments

GAO was also asked to determine why grain shipped under the Israeli Side Letter Agreement was transported at lower rates than those incurred for the 1993 Russian aid program. MARAD found that the Israeli voyages were fixed on commercial terms and utilized consecutive voyage charters over an extended time period. Had the Russian program utilized similar terms, U.S. carriers could have moved a much greater portion of the program's requirements at lower costs.

See comment 7.

D. U.S.-Flag Vessel Availability

GAO Finding:

GAO concludes that cargo preference adversely affects food aid programs by preventing the procurement of food aid at the lowest available price or the purchase of a different variety of commodities than originally planned to meet the U.S.-flag shipping requirement. GAO cites examples of difficulty in procurement of white wheat due to the lack of U.S.-flag vessels on the U.S. West Coast.

MARAD Response:

See comment 8.

See comment 9.

Cargo preference requires that 75 percent of food aid tonnage be shipped on U.S.-flag vessels only to the extent that such vessels are available at fair and reasonable rates for U.S.-flag vessels. By its terms, the statute does not prevent shipper agencies from contracting with foreign-flag vessels when U.S.-flag vessels are unavailable. For example, during the $700 million Russian Food Aid program in 1993, over $454 million of food aid was sold to Russia under the P.L. 480 Title I program and about $59 million in food aid was donated under the Food for Progress program. Seventy-three percent of the shipments moved on foreign-flag vessels. Clearly, the cargo preference requirements did not impede commodity purchasing decisions in that instance.

See comment 10.

GAO also reports that due to the lack of U.S.-flag vessels in the region, the Department of Agriculture (USDA) prevented Tunisia from buying wheat on the West Coast. As a result, Tunisia was forced to purchase grain offered in the Gulf of Mexico at an additional cost of $4 per metric ton (MT). This example is misleading, however, because GAO fails to cite factors other than cargo preference which affected the price of this transaction. For example, port fees and stevedoring charges at West Coast and Pacific Northwest (PNW) ports are collectively 4 to 5 times greater than loading costs in the Gulf of Mexico. Furthermore, the geographic disadvantage in shipping grain to Tunisia from the PNW was not mentioned as an additional factor. Had GAO taken these factors into consideration, increased transportation costs alone would have been substantially higher (approximately $7 per MT to $10 per MT) than the additional $4 per MT Tunisia paid.

E. Cargo Preference Effect on Food Aid Programs

GAO Finding:

See comment 11.

The report focuses on the costs of cargo preference compliance and addresses its effect on food aid programs, but ignores the legislative intent and history of cargo preference.

MARAD Response:

Congress has repeatedly reaffirmed its "Buy American, Ship American" policy on cargo preference and acknowledged that this policy is more costly for both commodities and freight. It concluded that the benefits of a U.S. merchant marine justified the additional cost. (Attachment A provides a brief legislative history of Cargo Preference).

Clearly, less expensive commodity and freight could also be purchased elsewhere, just as elimination of our cargo preference law might reduce transport costs. But that is not the objective of cargo preference or the food aid programs. To sever the link between "Buy American, Ship American" would be a significant departure from our conduct in these programs over the last decade.

F. Average Costs for Fair and Reasonable Rates

GAO Finding and Recommendation:

GAO finds that averaging costs could reduce guideline rates and recommends that the Secretary of Transportation instruct the Maritime Administration to promote the efficiency of ships carrying food aid preference cargoes by using "average" operating costs for all similar-sized ships, instead of "actual" operating costs in calculating guideline rates.

MARAD Response:

MARAD agrees with GAO that averaging costs for similar-sized ships or some efficiency standard could reduce guideline rates. However, replacement of older ships with new efficient tonnage will provide greater savings. MARAD has testified to Congress that we will consider a change in the method of calculating guideline rates.

G. Inland Transportation - Type of Foreign Aid

Finding:

GAO states that the OFD is a significant portion of U.S. food aid program and transportation costs and implies that OFD expenditures reduce the level of assistance this Nation can provide.

MARAD Response:

See comment 12.

In 1954, Congress enacted the Cargo Preference Act to establish a permanent, uniform policy of assuring to privately-owned U.S.-flag vessels a portion of government generated waterborne cargoes. Congress correctly judged that the Nation receives substantial benefits from having a U.S. merchant marine, regardless of its higher costs relative to foreign-flag operators. There are many measures that ensure Americans a high standard of living with regard for safety, the environment and the well being of citizens. When Congress approves budgets that require aid shipments to foreign countries on oceanborne vessels, it is done with the knowledge of U.S.-flag compliance requirements and costs. Any reduction of freight costs could result in a corresponding budget reduction for the next year.

See comment 5.

However, during the years covered by the report, it has been the practice of shipper agencies to include not only ocean freight in the OFD calculation, but ancillary services as well. Ancillary services may include inland transportation, bagging and stacking, and storage which are generally land-based and not vessel-related costs. Furthermore, including ancillary services in the definition of ocean freight is contrary to the intent of the Memorandum of Understanding (MOU) between the Commodity Credit Corporation (an agency of USDA), MARAD and the Agency for International Development (AID). This MOU excludes the costs of ancillary services in the calculation of OFD. Furthermore, the mere closure of foreign missions, cited by AID as the reason for including inland transportation costs, is no justification for placing additional economic risk on the vessel owner. If the shipper agency desires to deliver the most commodity to a needy country for the budgeted amount, the shipper agency should solicit for the ancillary services separately to determine the lowest landed cost.

The inclusion of ancillary services unfairly inflates the actual difference between the cost of using U.S.-flag vessels versus foreign-flag vessels. For example, on a liner shipment to Russia under the Food for Progress program for fiscal year 1992, USDA/AID calculated the OFD to be $159 per MT while the actual ocean freight rate for the vessel was $140 per MT; and, for a bulk shipment to Zimbabwe under the Section 416 program during fiscal year 1993, the OFD ranged from $219 per MT to $232 per MT, depending on discharge port, while the ocean freight rate for this shipment was only $88 per MT and $93 per MT, depending on the discharge port. GAO's reliance on the use of USDA/AID's data for the determinations of OFD has unfairly reflected and exaggerated the cost of using U.S.-flag vessels. Additionally, the report incorrectly states that "(i)n determining the guideline rate for these cargoes, MARAD allows the inland transportation amount that shippers estimate based on these bids." Overseas bagging/stacking and overseas inland transportation costs are not provided for, or included, in the calculation of MARAD guideline rates.

H. Data Concerns

GAO Finding:

GAO states, "(o)ver the last 3 years, the food aid programs have paid U.S. shipowners almost $600 million in ocean freight differential."

MARAD Response:

See comment 13.

MARAD is unaware of any audit or independent evaluation by GAO of the [USDA] data which was used in estimating the cost of cargo preference and OFD. Upon evaluation, MARAD found that the USDA data significantly deviated from the data MARAD maintains in its own cargo preference database. For example, during fiscal years 1991 through 1993, MARAD reimbursed USDA $147 million for its OFD obligation. However, GAO reported that USDA paid U.S. shipowners almost $600 million in OFD. Based on the OFD MARAD paid USDA during this period, net OFD cost should have been about $441 million, not the $600 million represented in GAO's report. Thus, MARAD believes that the reader could easily be misled by GAO's representation of USDA's OFD costs which overstate its net or actual OFD obligation by $159 million. The report could have benefitted from auditing the data provided by the subject agencies to verify accuracy.

ATTACHMENT A: BRIEF HISTORY OF CARGO PREFERENCE

The Cargo Preference Act of 1954, PL 83-664, 68 Stat. 832 (1954), usually referred to as "PL-664," amended the Merchant Marine Act, 1936, by adding Section 901(b), codified at 46 App. U.S.C. §1241(b).

PL-664 applies:

> "[w]henever the United States shall procure, contract for, or otherwise obtain for its own account, or shall furnish to or for the account of any foreign Nation without provision for reimbursement, any equipment, materials, or commodities, within or without the United States, or shall advance funds or credits or guarantee the convertibility of foreign currencies in connection with the furnishing of such equipment, materials, or commodities, . . ."

The "appropriate" Government agencies are required to take such steps as may be necessary and practicable to assure that at least 50 percent of the gross tonnage of certain Government-sponsored cargoes impacted by PL-664--

> ". . . (computed separately for dry bulk carriers, dry cargo liners, and tankers), which may be transported on ocean vessels shall be transported on privately-owned United States-flag commercial vessels, to the extent such vessels are available at fair and reasonable rates for United States-flag commercial vessels, in such manner as will insure a fair and reasonable participation of United States-flag commercial vessels in such cargoes by geographic areas. . . ."

The legislative history of PL-664 indicates:

> "[T]he bill applies in four kinds of situations: (1) Where the United States procures, contracts, or otherwise obtains for its own account, equipment, materials, or commodities; (2) furnishes equipment, materials, or commodities to or for the account of any foreign Nation without provision for reimbursement; (3) advances funds or credits; (4) guarantees the convertibility of foreign currencies in connection with the furnishing of such equipment, material, or commodities. It has no application to purely commercial transactions where a broker or exporter sells to a firm abroad without the participation of the U.S. Government."

H.R. Rep. No. 2329, 83d Cong., 2d Sess. 1-2 (1954).

Purely private commercial cargoes are not affected. In the words of the author of PL-664, "[t]he bill covers only cargoes which are being paid for or owned by the Government. It has nothing to do with any other commerce of the United States. It applies only to the giveaway and United States owned cargoes." 100 Cong. Rec. 8227 (June 15, 1954) (statement of Sen. Butler).

The legislative history of PL-664 centered largely, but not exclusively, on its application to foreign aid cargoes. Senate Report No. 1584, 83d Cong., 2d Sess. 5 (1954), states that the legislation "is desirable as a codification and extension of present provisions in the several foreign economic and military-aid statutes in that -- (a) It lays down a permanent, uniform policy for all current and future aid programs; (b) It plugs existing loopholes, particularly with respect to offshore purchasing, and programs financed in any way by Federal funds[.]" See also, 100 Cong. Rec. 4159 (1954) ("The time has come when fifty-fifty should be permanently enacted so as to apply generally to all foreign-aid type programs") (explanation of the chief sponsor, Sen. Butler).

Congress evinced a clear intent that PL-664 be interpreted broadly. Senator Butler, the primary sponsor of PL-664, stated during a Senate hearing that Congress intended PL-664 to "make permanent and all-inclusive the principle embodied in the various foreign aid bills that would insure to the U.S.-flag vessels at least 50 percent of cargoes financed in any way by Federal funds." Cargo Preference Bill (50-50 Cargo): Hearings Before a Subcommittee of the Senate Committee on Interstate and Foreign Commerce, 83rd Cong. 2d Sess. 31 (1954). The statute has been described as applicable "in the clearest and most unequivocal terms . . . in all cases where the normal channels of international trade are disrupted by virtue of United States Government controlled programs financed by Federal funds in whatever form they might take." H.R. Rep. No. 80, 84th Cong. 2d Sess. 4 (1955).

House Report No. 80, 84th Cong., 1st Sess. 3 (1955), sets out the reasons for passage of the Cargo Preference Act of 1954. "Without some form of assurance of participation by U.S.-flag vessels in the transportation of relief and aid cargoes, it became clear that the shipping of the recipient and other maritime Nations with lower operating costs would be able to underbid American-flag vessels and eventually transport much, if not all, of these cargoes to the irreparable detriment of the American merchant marine."

An extensive review of the legislative history of the Cargo Preference Act is contained in Transportation Institute, et al. v. Dole, 603 F. Supp. 888, 896-902 (1985). The court reviewed particularly Congress' consideration of the cost of cargo preference.

"When Congress enacted S. 3233 [PL-664], it specifically addressed the cost issue. The 50-percent rule is subject to the availability of U.S.-flag vessels 'at fair and reasonable rates for U.S.-flag commercial vessels . . .' For Congress to make reasonable U.S.-flag vessel rates one of the criteria to be met when applying the 50-percent requirement, it follows that it did not also intend to allow departure from that rule whenever foreign-flag vessels could be attained at a lower cost. Despite the extensive testimony in opposition to the bill because of increased cost, there is no suggestion in the legislative history that the 'necessary and practicable' clause could be interpreted to overcome increased cost objections.

"In the House hearings, Mr. Klemmer of the Department of State questioned the 'wisdom' of applying the 50-percent rule to programs that foster the sale of agricultural surpluses. He believed that such a requirement might reduce the chances of selling such commodities abroad and, therefore, interfere with that export program. Later, during the hearings, Congressman Bonner restated that concern. Congressman Bonner and Dies considered an amendment to S. 3233 which would exempt sales of surplus commodities from the 50-percent requirement, but no such amendment was ever offered. It is reasonable to conclude that the House Committee must have intended the 50-percent requirement to apply to sales of surplus commodities, regardless of the effect higher costs of U.S.-flag shipments might have on those exports." 603 F. Supp. at 904-5 (Citations omitted; emphasis added).

The court also noted favorably the opinion of Attorney General Kennedy, 42 Op. Att'y Gen. 203, that Congress intended the 50-percent (now 75 percent) requirement to apply despite the potentially adverse effect it might have upon export sales of commodities. Id.

Congress vested broad regulatory powers under the statute in the Secretary of Commerce (now Transportation) through Section 27 of the Merchant Marine Act of 1970. In doing so, it stressed that:

"There is a clear need for a centralized control over the administration of preference cargoes. In the absence of such control, the various agencies charge with administration of cargo preference laws have adopted varying practices and policies, many of which not American shipping oriented. Since these laws are designed by Congress to benefit American shipping, they should be administrated to provide maximum benefits to

> the American merchant marine." House Cong. Rept. No. 91-1555, p. 6. (Emphasis added).

Congress later passed the Food Security Act of 1985, PL 99-198, which amended the 1936 Act to increase the U.S.-flag share of cargo generated by certain USDA and AID programs and to exempt other programs. This legislation authorized the Secretary of Transportation to reimburse the Secretary of Agriculture for the increased cost of U.S.-flag shipment necessitated by the Food Security Act of 1985, as an apparent balancing of the needs of the agricultural and maritime sectors.

Thus, a review of the original intent of the cargo preference laws, as well as subsequent amendments, must conclude that such intent was and is to foster the U.S.-flag merchant marine.

The following are GAO's comments on the Department of Transportation's letter dated September 21, 1994.

GAO Comments

1. The sentences that DOT referenced in its comment have been revised based on DOT's comments and technical comments made by DOD on these same sentences. DOD's amendments were aimed at clarifying DOD's position on crew needs for the Ready Reserve Force (RRF).

We disagree that we misstate the national security requirement for seafarers employed on U.S.-flag bulk ships. According to information previously provided to us by the MARAD:

- Sixteen to 18 dry bulk carriers transported food aid cargos during the last 3 cargo preference years. These ships supported approximately 800 mariners. It is these ships, and their crews, that transported the majority of food aid cargos and are the main focus of the report.
- The overwhelming majority of the 190 bulk ships that DOT refers to in its comment are tankers. Only 25 of those tankers have carried food aid preference cargos during the last 3 cargo preference years, and those instances generally occurred when traditional petroleum cargos were not available.

2. We have not evaluated the use of merchant mariners being used in Operation Maintain Democracy.

With the revisions made to the sections of the report regarding DOD's position on crews, the report is consistent with the GAO reports referred to by DOT.

3. We continue to believe that the current application of cargo preference requirements to food aid tonnage contains disincentives to lower costs for those U.S.-flag shipowners who contract to transport such tonnage. However, we concur with DOT that the proposed Maritime Security Program would help U.S.-flag shipowners achieve operating efficiencies.

4. We are recommending that USDA and AID experiment with contract terms that are more consistent with those used for similar commercial cargos. This recommendation does not endorse MARAD's uniform charter party as contract terms we expect USDA and AID to adopt. As we have stated in our response to agency comments presented at the end of chapter 4, while it is our intention that USDA and AID experiment with these terms to reduce

food aid transportation costs, it is not our intention to recommend adoption of changes that result in an increase in food aid program costs.

5. In contracting for food aid cargos, we found that both USDA and AID use consistent terms for U.S.-flag and foreign-flag ships. Therefore, a comparison of U.S.-flag and foreign-flag rates for food aid cargos should accurately represent the difference (the OFD) in these rates. It would not be appropriate to compare U.S.-flag rates for food aid cargos with either U.S.-flag or foreign-flag rates for commercial cargos. But since all discussions in the report of the differences in U.S.-flag and foreign-flag rates are based on food aid cargos, the OFD amounts presented appropriately represent the difference between U.S.-flag and foreign-flag shipping rates for these cargos.

In addition, the report language has been modified to clarify that inland transportation costs are not part of the guideline rate determination, but an allowance, based on the shipowner's estimate, is added to the calculated guideline rate to cover these costs.

6. This issue can be pursued under our recommendation that USDA and AID experiment with the use of contract terms that are more consistent with those used for similar commercial cargos.

7. Using terms for the Russian Food for Progress program that more closely resembled those used for grain shipments to Israel under the side-letter agreement may have resulted in lower transportation costs. However, as presented in appendix III, MARAD stated the extent to which the terms similar to those used for Israeli grain shipments could be used to lower rates for food aid shipments to Russia is uncertain.

8. This point was made in chapter 1, but was added to chapter 3 for clarification.

9. As explained in appendix II, almost all U.S.-flag ships that bid on Russia Food for Progress cargos were awarded those cargos. Although 75 percent of these cargos were not shipped on U.S.-flag ships, it was due to the nonavailability of U.S.-flag ships. While cargo preference may not have impeded commodity purchasing for this program, it is clear, as we describe in chapter 3, that there are instances where U.S.-flag ships are not available and commodity purchasing decisions are affected.

10. Chapter 3 states those factors that cause U.S.-flag ships to typically not be available on the U.S. West Coast. It is true that if a U.S.-flag ship had been available on the West Coast, its shipping rate may have more than offset the savings available from purchasing the lowest-priced wheat. But because no U.S.-flag ships were available on the West Coast, Tunisia did not have the opportunity to consider this option.

11. We disagree that we ignore the legislative intent of cargo preference. We carefully reviewed all relevant legislation, including the legislation DOT refers to in its comment and its attachment, and have concluded that the intent of cargo preference is to help support the objectives of the Merchant Marine Act of 1936, as amended. We also recognize in the report that cargo preference does support some U.S. ships and crews and that Congress has repeatedly reaffirmed its support for maritime industry subsidies.

12. As explained in chapter 1, cargo preference is one of several programs established by Congress to support the U.S. merchant marine. In applying cargo preference to food aid programs, we agree Congress understood that it would increase food aid transportation costs, which is why it required that U.S.-flag ships only be used if they are available at "fair and reasonable rates." In addition, to pay for this requirement, food aid program budgets include estimated food aid transportation costs. Yet, because of (1) how each food aid program is funded, (2) how cargo preference compliance is measured, and (3) how limited the availability is of efficient U.S.-flag ships to carry these cargos, the operation of U.S. food aid programs is adversely affected.

In addition, as discussed in chapter 2, the application of preference cargos to food aid cargos does not significantly contribute to ensuring that an adequate and viable U.S. merchant marine is maintained to meet the objectives of the Merchant Marine Act of 1936, as amended.

13. Our estimate of almost $600 million spent on ocean freight differential over the last 3 years was based on data provided by USDA. USDA's data are derived for each food aid shipment from the actual shipment "bill of lading." We had asked for these data from MARAD officials but were informed that they were uncomfortable with the accuracy of their data for a portion of the time period included in the scope of our work. We had also asked AID for these data, but AID referred us to USDA, since USDA keeps all the official records on the total amount of OFD paid for the food aid programs. We accepted USDA's data as the best available.

Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

ACQUISITION AND TECHNOLOGY

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23 SEP 1994

Mr. Allen I. Mendelowitz
Managing Director
International Trade, Finance, and Competitiveness Issues
General Government Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Mendelowitz:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "CARGO PREFERENCE REQUIREMENTS: Objectives Not Significantly Advanced When Used In U.S. Food Aid Programs," dated September 8, 1994 (GAO Code 280067), OSD Case 9787.

The DoD generally agrees with the report. A few technical comments were provided separately to the GAO staff.

The DoD appreciates the opportunity to comment on the draft report.

Sincerely,

Roy R. Willis
Principal Assistant Deputy Under Secretary
of Defense (Logistics)

The following is GAO's comment on the Department of Defense's letter dated September 23, 1994.

GAO Comment

1. DOD suggested several technical changes to the specific wording of sentences in the draft report. The most significant changes involved sentences that reflected DOD's position on its need for crews supported by the bulk carriers that transported the majority of food aid tonnage. Based on DOD's suggestions, we revised the appropriate sentences to more accurately reflect DOD's position.

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Related GAO Products

Public Law 480 Title I: Economic and Market Development Objectives Not Met (GAO/T-GGD-94-191, Aug. 3, 1994).

Strategic Sealift: Summary of Workshop on Crewing the Ready Reserve Force (GAO/NSIAD-94-177, June 6, 1994).

Foreign Assistance: Inadequate Accountability for U.S. Donations to the World Food Program (GAO/NSIAD-94-29, Jan. 28, 1994).

Former Soviet Union: Agricultural Reform and Food Situation in Its Successor States (GAO/GGD-94-17, Nov. 19, 1993).

U.S. Food Aid Exports: The Role of Cargo Preference (GAO/T-GGD-93-34, June 17, 1993).

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Foreign Assistance: Non-Emergency Food Aid Provided Through Private Voluntary Organizations (GAO/NSIAD-90-179, July 24, 1990).

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Status Report on GAO's Reviews of P.L. 480 Food Aid Programs (GAO/T-NSIAD-90-23, Mar. 21, 1990).

P.L. 480 Title I Transportation Issues (GAO/T-NSIAD-90-08, Nov. 7, 1989).

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