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CARGO PREFERENCE REQUIREMENTS

Objectives Not Met When Applied to Food Aid Programs

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CARGO PREFERENCE REQUIREMENTS: OBJECTIVES NOT MET WHEN APPLIED TO FOOD AID PROGRAMS

SUMMARY OF STATEMENT BY ALLAN I. MENDELOWITZ, MANAGING DIRECTOR INTERNATIONAL TRADE, FINANCE, AND COMPETITIVENESS GENERAL GOVERNMENT DIVISION

"Cargo preference" is the reservation of government-financed or -sponsored oceangoing cargos specifically for U.S.-flag ships. Due to cargo preference requirements, the government has incurred almost $600 million in additional transportation costs associated with transporting food aid tonnage on U.S.-flag ships, rather than on lower-cost foreign flag ships, over the past 3 years.

The objective of cargo preference is to help maintain a U.S. merchant marine (1) to serve as a naval and military auxiliary in times of war or national emergency and (2) to carry a substantial portion of U.S. domestic and foreign waterborne commerce. However, applying cargo preference requirements to U.S. food aid programs contributes little to meeting this objective. The bulk commodity-carrying U.S.-flag ships that transport the majority (84 percent) of food aid tonnage--largely as a result of cargo preference requirements--are not viewed as militarily useful by the Department of Defense (DOD). Furthermore, as for the crews that support those ships, DOD believes that they could be a potential source of manpower for the Ready Reserve Force but does not believe that applying cargo preference to food aid programs is a cost effective means of providing for crews. The U.S.-flag ships that DOD does view as militarily useful, and which carry some food aid cargos (16 percent), are liners.

In addition, all domestic waterborne commerce, i.e., cargos shipped between U.S. ports, are required to be carried by U.S.-flag ships under the Merchant Marine Act of 1920, commonly referred to as the "Jones Act." As for foreign commerce, U.S.-flag ships now carry only about 4 percent of all cargos imported into or exported out of the United States, and food aid cargos account for less than one-fourth of that 4 percent.

GAO also determined that cargo preference requirements adversely affect operations of the food aid programs. Given the findings, GAO suggests in its report that Congress consider a more efficient alternative for helping support the U.S. merchant marine. GAO also recommends ways to reduce food aid transportation costs should Congress choose to continue applying cargo preference requirements to food aid programs.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to testify before this Subcommittee on the results of our review of the application of cargo preference laws to U.S. food aid programs. During each of the past 3 years, an average of about $200 million in government funds have 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. This cost has been incurred to meet the cargo preference requirement that at least 75 percent of U.S. food aid tonnage be transported on U.S.-flag ships. Although it 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 and military auxiliary in times of war or national emergency and (2) to carry a substantial portion of U.S. domestic and foreign waterborne commerce.

My testimony today will provide an overview of our findings--which are more fully discussed in our report on this subject that we issued today to this Subcommittee and to the Subcommittee on Merchant Marine, Senate Committee on Commerce, Science, and Transportation.[1] I will discuss the (1) extent to which applying cargo preference requirements to U.S. food aid programs is meeting the intended objective, (2) how cargo preference requirements affect U.S. food aid programs, and (3) how the practices currently used by the U.S. Department of Agriculture (USDA) and the Agency for International Development (AID) to manage food aid transportation affect its cost.

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 4 percent.

Food aid tonnage also accounts for a small portion of all U.S. agricultural exports. For example, during fiscal years 1991-93, U.S. food aid tonnage represented 6.7 percent of all U.S. agricultural export tonnage and 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

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[1]See CARGO PREFERENCE REQUIREMENTS: Objectives Not Significantly Advanced When Used in U.S. Food Aid Programs (GAO/GGD-94-215, September 29, 1994).

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.

Since the passage of the Cargo Preference Act of 1954,[2] 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." Initially, the requirement was that 50 percent of all food aid tonnage be transported on U.S.-flag ships. Beginning in 1986, this requirement was gradually increased to 75 percent. The food aid programs subject to this requirement include those carried out under the Agricultural Trade Development and Assistance Act of 1954,[3] as amended, widely know as "Public Law (P.L) 480," and under section 416(b) of the Agricultural Act of 1949,[4] 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.[5]

In addition to cargo preference, the Merchant Marine Act of 1936,[6] as amended, established subsidy programs to help support the U.S. merchant marine. Congress developed these programs to respond to general downturns in the U.S. maritime industry and to help support a U.S. merchant marine sufficient to meet the objectives of the Merchant Marine Act of 1936. One of these subsidy programs helped offset the high costs of constructing ships in U.S. shipyards, although no funding has been provided since 1982. Any substantial new funding under this subsidy program is unlikely in the near future as the United States has entered into an agreement with the Organization for Economic Cooperation and Development to eliminate government subsidies for shipbuilding by January 1, 1996. Another subsidy program helps U.S. shipowners compete with their foreign competitors by offsetting high U.S. operating costs. Current subsidies under this program will expire by December 1998. However, the administration has submitted proposed legislation to Congress

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[2]The Cargo Preference Act of 1954 (Ch. 936, 68 Stat. 832, Aug. 26, 1954), as amended by the Food Security Act of 1985 (Public Law 99-198, Dec. 23, 1985), amended section 901(b) of the Merchant Marine Act of 1936 (Ch. 858, 49 Stat. 1985, June 29, 1936) to require that at least 75 percent of U.S. food aid tonnage be shipped on U.S.-flag commercial ships.

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

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

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

[6]Ch. 858, 49 Stat. 1985, June 29, 1936.

that would continue such support by establishing a similar subsidy program.

Yet even with the support provided by these programs, the status of the U.S. merchant marine has continued to decline. The Maritime Administration (MARAD) reported that between 1982 and 1992, the number of U.S.-flag privately owned ships decreased from 574 to 394 (a decrease of 31.4 percent). During this same period, the deadweight tonnage capacity[7] of these ships decreased from 21.5 million tons to 19.7 million tons (a decrease of 8.5 percent). In addition, the average monthly U.S. seafarer employment decreased 11.3 percent--from 16,308 in fiscal year 1991 to 14,466 in fiscal year 1992.

From cargo preference years[8] 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. A majority (84 percent) of this food aid tonnage was bulk commodities such as wheat or corn and was shipped on bulk carriers, tug/barge combinations, and tankers that were typically chartered for specific voyages. The remaining food aid tonnage (16 percent) was processed products such as cans of vegetable oil or bags of flour or rice. This tonnage was transported on ships that provided a regularly scheduled service between specific ports known as "liner" service.

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[7]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.

[8]A 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.

OBJECTIVES OF MERCHANT MARINE ACT OF 1936 NOT SIGNIFICANTLY ADVANCED BY FOOD AID PREFERENCE CARGOS

The application of cargo preference to food aid programs does not significantly contribute to meeting the intended objectives of the Merchant Marine Act of 1936, as amended.

The Contribution of Food Aid Preference Cargos to Maintaining a U.S. Merchant Marine as a Military and Naval Auxiliary

While applying cargo preference requirements to food aid programs does help support some U.S.-flag ships and their crews, these ships are not generally viewed by the Department of Defense (DOD) as being militarily useful in terms of serving as a naval and military auxiliary. DOD officials indicated to us that the U.S.-flag ships that transported 84 percent of food aid cargo preference tonnage--bulk carriers, tankers, and tug/barge combinations--would be used for military or military support purposes only as a last resort. While these U.S.-flag ships may have been military useful at one time, DOD officials explained that this view has changed because of DOD's changing national security needs, the shift in the shipping industry to the use of containers, and the increase in the size and weight of military equipment.

Those U.S.-flag ships that DOD said are militarily useful and that participate in the food aid programs are those engaged in providing liner service. DOD officials told us that these ships are a more efficient way to transport ammunition, equipment, and supplies. DOD officials also told us that liners will become more useful as DOD continues to expand its use of containers for packaging supplies and equipment for ocean transport.

In addition, while the crews on bulk carriers, tankers, and tug/barge combinations that transport food aid could be used to help crew the Ready Reserve Force,[9] DOD does not believe that applying cargo preference to food aid programs is a cost effective means for providing for crews. However, DOD officials also recognize that as the number of U.S.-flag ships--and their crews--continues to decrease, and the number of ships in the

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[9]The Ready Reserve Force is a specific component of the National Defense Reserve Fleet. Ships in the Ready Reserve Force are to be kept in 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.

Ready Reserve Force increases, they may need to consider options such as a merchant marine reserve program to ensure that adequate crews are available in the future.

MARAD officials disagreed with DOD's assessment of its need for the U.S.-flag ships and crews supported by food aid preference cargos. MARAD said that food aid preference cargos are very important to the support of a significant number of U.S.-flag ships and crews. MARAD said it views these ships as militarily useful because they were built to DOD specifications in order to fulfill some military purpose. While DOD officials agreed that the ships in question could be used for military purposes, they also said that given their current needs, these ships would be one of their last choices to transport military equipment. The investment required to modify them to carry military supplies and equipment would be too high, they said, and the ships could only be loaded or unloaded in modern ports, given the type of gear that would be required to handle heavy military equipment. In addition, while DOD recognized its future needs for crew for the Ready Reserve Force, it said that it is not an efficient use of resources to provide for these needs through supporting U.S.-flag ships with food aid preference cargos.

The Contribution of Food Aid Preference Cargos to Maintaining a U.S. Merchant Marine to Carry a Substantial Portion of U.S. Waterborne Commerce

The Merchant Marine Act of 1920,[10] commonly referred to as the "Jones Act," restricts domestic waterborne commerce to U.S.-constructed, U.S.-flag ships and requires that U.S.-flag ships carry all domestic waterborne commerce of the United States. Therefore, food aid cargo preference requirements are not relevant to satisfying this objective of the Merchant Marine Act of 1936.

Food aid cargo preference requirements are relevant in the case of foreign commerce, as they reserve 75 percent of all U.S. food aid tonnage exclusively for U.S.-flag ships. In addition, 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. However, U.S.-flag ships carry only about 4 percent of all U.S. export and import foreign commerce, and less than one-fourth of that is food aid preference cargos. Therefore, food aid preference cargos contribute little to the objective of maintaining U.S.-flag ships to carry a substantial portion of U.S. foreign commercial cargos.

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

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

Most U.S.-flag bulk carriers and tug/barge combinations, which typically do not receive or use operating differential subsidies, are virtually dependent on food aid preference cargos to operate as U.S.-flag ships because they are unable to compete successfully for other commercial cargos in foreign commerce. Almost all U.S.-flag tankers that carry bulk food aid preference cargos do receive annual operating subsidies to help them compete for foreign commercial cargos. However, since these subsidies are expiring, tankers have, and probably will, become more dependent on food aid preference cargos. U.S.-flag liners also carry some food aid tonnage but are able to compete successfully for foreign commercial cargos because they either operate with operating differential subsidies,[11] operate as part of an ocean liner conference,[12] or do both. While U.S.-flag liners carried 16 percent of the food aid tonnage transported on U.S.-flag ships from cargo preference years 1991 through 1993, for a majority of these liners--about 75 percent--food aid preference cargos made up no more than 4 percent of their cargos, and were not the reason why they maintained their U.S. flag status. For the other 25 percent of the liners, food aid preference cargos made up between 5 and 40 percent of their cargos. In addition to food aid cargos, U.S.-flagged ships carried other U.S. government preference cargos, or domestic or foreign commercial cargos.

U.S. Laws and Regulations Affect Shipping Costs

Without operating differential subsidies, U.S.-flag ships generally cannot successfully compete for foreign commercial cargos. According to MARAD and the U.S. shipowners we talked to, this is due, in part, to the costs associated with complying with the U.S. laws and regulations governing U.S.-flag ships. These costs help explain why U.S.-flag shipping rates for the food aid

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[11]U.S.-flag liners that receive operating differential subsidies may carry food aid preference cargos and still receive their subsidy because food aid cargos typically represent such a small portion of their total cargo.

[12]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.

programs are as much as twice foreign-flag shipping rates for comparable ships.

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--are significant, according to the U.S. shipowners we talked to who have carried food aid preference cargos, their cost impedes their ability to compete with foreign-flag ships. The most costly U.S. laws and regulations are those related to ship construction, ship maintenance and repair, and crewing requirements.

U.S.-flag ships are required to be constructed to U.S. Coast Guard safety standards, whether they are built in a U.S. or a foreign shipyard. These standards are more stringent than international standards, which adds 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 us 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 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. The article did not specify the countries in which the foreign-flag ships used for this comparison were registered. 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 said that the daily crew costs for their U.S.-flag ships are at least three times those of their foreign-flag ships.

Moreover, U.S. shipowners whose ships carry food aid preference cargos do not have many incentives to lower their costs. For example, one of the primary ways that U.S. shipowners can reduce 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 before they are eligible to carry food aid preference cargos. 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 the costs would be too high to be price competitive compared to foreign-flag competition. Furthermore, since there is a limited number of U.S.-flag ships available to carry these cargos, and MARAD's "fair and reasonable" guideline rates[13] establish rate ceilings for each individual ship based on its actual costs irrespective of its efficiency, shipowners are able to secure food aid preference cargos despite the high cost of operating their older, inefficient U.S.-flag ships.

CARGO PREFERENCE LAWS ADVERSELY AFFECT U.S. FOOD AID PROGRAMS

Cargo preference laws can adversely affect the operation of U.S. food aid programs. The most significant effect of applying cargo preference to food aid programs is the additional costs associated with using U.S.-flag ships to transport food aid. From fiscal years 1991 through 1993, almost $600 million in government funds have been paid to U.S. shipowners in ocean freight differential. Ocean freight differential is the difference between the cost of the less expensive foreign-flag ships and the U.S.-flag ships used to carry food aid cargos. Generally, USDA pays two-thirds of this cost, and MARAD pays one-third. This $600 million in ocean freight differential represented 9 percent of all food aid program funds and 34 percent of all food aid program funds spent on transportation for fiscal years 1991 through 1993.

For several of the food aid programs, the amount spent on ocean freight differential reduces the amount available to purchase commodities. For example, for the P.L. 480 title III program, the funds available for each country must be used to purchase both the commodity and its transportation. While the estimated cost of transporting food aid is included in the total amount provided to each recipient country, in many instances the amount spent to transport food aid on U.S.-flag ships can exceed this estimate. Therefore, the amount spent on U.S.-flag transportation can directly affect the amount of commodity that can be purchased.

This situation occurred for Sri Lanka's wheat purchase made during the cargo preference year ending March 31, 1994. Sri Lanka received $58.9 million to purchase wheat and its transportation. Due to the high rates charged by U.S.-flag

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[13]MARAD is responsible for calculating guideline rates for food aid preference cargos to ensure that U.S.-flag shipping rates are "fair and reasonable."

ships, 35 percent, or $20.6 million of the funds, was spent on transportation and therefore was not available to purchase wheat. About $10.8 million, or 52 percent of these transportation costs, was spent on ocean freight differential. AID officials explained that Sri Lanka's experience was significant because the amount spent on the ocean freight differential was more than expected and reduced the amount of wheat Sri Lanka had hoped to purchase. AID officials said they believed the reason that these differential expenditures were so high for Sri Lanka was because its shipments were competing for the U.S.-flag ships capable of carrying 50,000 metric tons with those shipments sent to Russia under the Food for Progress program in the last quarter of fiscal year 1993. Due to the limited number of large U.S.-flag ships available to meet cargo preference requirements, this competition required Sri Lanka to split its wheat shipments among smaller U.S.-flag ships at higher rates.

Applying cargo preference to U.S. food aid programs can also adversely affect their operation by precluding recipient countries from purchasing commodities at the lowest available price or requiring a purchase of a different variety of commodity than originally planned. 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. This can force commodity purchasing decisions to be driven by the availability of U.S.-flag ships, not the availability of the lowest cost or most desired commodity.

For example, for a recent P.L. 480 title I wheat purchase for Tunisia, Tunisia was unable to take advantage of the four lowest wheat offers because no U.S.-flag ships were available at the times when and locations where the wheat was available. To comply with cargo preference requirements, Tunisia was required to obtain more expensive wheat (over $4 more per metric ton) that was available where U.S.-flag ships were also available.

In addition, several P.L. 480 title I countries have been interested in obtaining western white wheat that is available from the West Coast of the United States. However, the availability of U.S.-flag ships on the West Coast is limited because West Coast cargos tend to be infrequent, and West Coast port charges are much higher than those in the Gulf of Mexico. This has forced the countries to obtain a different variety of wheat available in the Gulf of Mexico where U.S.-flag ships are available. Due to the limited availability of U.S.-flag ships, as well as on the overall difficulty that title I recipient countries experience with cargo preference requirements, USDA said that cargo preference requirements interfere with its ability to develop future commercial markets for U.S. agricultural products. This mission is one of the primary objectives of the title I program.

CERTAIN USDA AND AID MANAGEMENT PRACTICES MAY AFFECT FOOD AID TRANSPORTATION COSTS

Finally, several of the practices USDA and AID used to manage food aid transportation may affect transportation costs. One of these practices, used by both USDA and AID, was to require shipowners to accept contract terms that dictate that they arrange and pay for services that are typically the responsibility of the commodity supplier or buyer in commercial sales. These terms may increase transportation costs because they place additional costs and risks on the shipowners. These are then passed back to the food aid programs through higher shipping rates and may increase the total cost to transport U.S. food aid.

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 provide additional financial assistance to these needy countries. 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.

MARAD officials, and the U.S. shipowners we talked to who carry food aid preference cargos, said they believe that adopting terms that are more closely aligned with terms used for transporting private sales of commodities would reduce the cost of transporting food aid. They said that using these types of terms would eliminate items for which actual costs are difficult to project and that increase shipping rates. As shipowners may overestimate the costs of providing these additional services--to cover their uncertainties about anticipated actual cost--providing the services through another means, such as reimbursing recipient countries for actual costs, could result in lower expenditures on the part of the government.

USDA and AID agreed that their contract terms added to food aid transportation costs, but they did not agree that adopting contract terms that are more consistent with those used for similar commercial cargos would reduce their food aid transportation costs. This is because items currently paid through shipping rates would still have to be paid through the food aid programs. While this may be true, given that estimated costs are used to pay the shipowners for these services, we believe that a potential may exist for some savings in food aid transportation costs by adopting transportation terms that are more consistent with those used for commercial transport of private commodity sales.

Another practice that increases food aid transportation costs is the concentration of food aid shipments into the last half of the year instead of spacing them more evenly throughout the year. For example, in 1992, 94 percent of the food aid tonnage under the P.L. 480 title I 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. This situation has resulted in higher U.S.-flag shipping rates as higher cost U.S.-flag ships have been used to meet the increased demand to transport food aid preference cargos.

USDA and AID officials said there is no conclusive reason why the majority of food aid tonnage is shipped in the last half of the calendar year. However, one reason they cited is that recipient countries delay signing their annual agreements with the U.S. government. Both USDA and AID officials said that while signing agreements earlier could result in some countries purchasing and shipping their food aid purchases sooner, there are other factors unrelated to the signing of agreements that could also affect the timing of shipments. These factors include the amount of commodity storage available in the country and the availability of alternative food sources. USDA and AID officials explained that they are reluctant to place pressure on recipient countries to sign agreements earlier and request food aid sooner because they believe it may discourage the countries from participating in the programs. Nevertheless, USDA said it will try to obtain the early signing of agreements and prompt purchasing of food aid commodities.

CONCLUSIONS

The application of cargo preference requirements to food aid programs does not significantly contribute to helping achieve the objectives of the Merchant Marine Act of 1936. The U.S.-flag ships that are most dependent on food aid preference cargos are not currently viewed by DOD as militarily useful. In addition, food aid preference cargos do not significantly contribute to ensuring that U.S.-flag ships carry a substantial portion of either U.S. domestic or foreign waterborne commerce.

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 on operating subsidies, which are expiring, to successfully compete for foreign commercial cargos because their costs are substantially greater than their foreign competitors. In addition, U.S. shipowners are discouraged from taking the necessary steps to reduce their costs by investing in new ships because of the 3-year waiting period currently imposed on cargo preference eligibility for foreign-built U.S.-flag ships, and because it is possible to successfully operate inefficient ships in the food aid cargo preference trade. Thus, applying cargo preference laws to food aid programs makes 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, and which increase the cost to transport U.S. food aid preference cargos.

In addition, the higher cost of using U.S.-flag ships, and their limited availability, can adversely affect the operation of U.S. food aid programs by (1) reducing the amount of commodity that can be purchased and (2) prohibiting a country from purchasing the lowest priced, or the variety of, commodity desired. This situation occurs because commodity purchasing decisions are driven more by the availability of U.S.-flag ships than the availability of commodities.

Food aid transportation costs can also be affected by USDA and AID management practices. USDA and AID have been using ocean transportation contract terms as a means to provide additional services to recipient countries. The shipowners must comply with these terms even though they may result in higher shipping rates. We believe that some potential may exist for savings in food aid transportation costs by removing the uncertainty associated with estimating the costs of these services by adopting terms more consistent with those used for similar commercial cargos.

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. While there is no conclusive reason why this happens, it is clear that food aid transportation costs could be reduced if food aid shipments were more evenly spaced throughout the year.

MATTERS FOR CONGRESSIONAL CONSIDERATION AND RECOMMENDATIONS

In the report that we issued today, we included matters for congressional consideration regarding the continuance of cargo preference requirements for food aid programs. We also included recommendations to heads of agencies which, if implemented, should help reduce the transportation costs of food aid cargos.

Regarding the 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 operating subsidy program, which will expire 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 laws 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, such as allowing new, foreign-built, U.S.-flag ships to immediately carry food aid preference cargos.

Regarding our recommendations, 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 the following:

-- The Secretary of Transportation should 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.

-- The Secretary of Agriculture and the Administrator of the Agency for International Development should 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 would reduce food aid transportation costs, and

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

While implementing these changes will not help the application of cargo preference laws to food aid programs achieve its intended objective, it should reduce food aid transportation costs.

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

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GAO
Permit No. G100

Official Business
Penalty for Private Use $300

Address Correction Requested