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Food Aid and Agricultural Cargo Preference

By **Elizabeth R. Bageant**, **Christopher B. Barrett***, and **Erin C. Lentz**
Cornell University

The Issue

The past decade has brought considerable reforms in food aid policies among most of the world's largest donors. However, the United States, the world's largest food aid donor, has been the slowest to undertake much-needed food aid reforms. Delays arise not only from the inertia created by the large size and long history of US food aid programs, but also due to the retention of specific requirements that have long outlived their usefulness as policy tools and in fact work against national economic interests. One particularly difficult stumbling block has been the little-understood agricultural cargo preference (ACP) requirements levied on US food aid.

Cargo preference laws were originally designed with multiple objectives: to provide essential sealift capability in wartime, maintain skilled jobs for American seafarers, and avoid foreign domination of US ocean commerce. Our findings – based on the most comprehensive and the only peer-reviewed analysis to date of available shipping data and shipping vessel ownership records – suggest that despite more than 50 years under ACP laws this policy is not effective. It contributes little to its stated national security objectives and provides very expensive support to only about 1,400 ACP vessel crew members while it squanders scarce aid agency resources intended to alleviate global hunger. Furthermore, cargo preference supports foreign ocean carriers whose parent companies indirectly own many ACP vessels.

Direct subsidies to the US shipping industry could more effectively advance national security and maritime goals while liberating US food aid programs from inefficiencies that complicate the humanitarian task of food delivery and add substantial cost for taxpayers. More efficient and effective ways can be designed to fulfill the multiple objectives of agricultural cargo preference policy.

How ACP and Related Programs Work

Enacted in 1954 as part of the Cargo Preference Act, ACP requires that 75 percent of US food aid commodities be shipped on privately owned, US-flag commercial vessels that have been registered in the United States for at least three years and employ a crew of at least 75% US citizens. The two agencies responsible for delivering US food aid, United States Agency for International Development (USAID) and United States Department of Agriculture (USDA), must comply with ACP regulations. Compliance is monitored and enforced by the Department of Transportation's Maritime Administration (MARAD).

Food aid freight contracts are awarded according to MARAD's priority system, with Priority 1 bids involving shipments that that use only US-flag vessels, Priority 2 bids comprised of US-flag to foreign-flag trans-shipments, and Priority 3 bids comprised of only foreign-flag vessels. Bids compete within a priority level; lower priority bids are only accepted when higher priority bids are unavailable. In effect, the priority system limits ocean freight supply and drives up shipping costs.

MARAD compensates USAID and USDA for a portion of the costs of ACP compliance, using two distinct reimbursement mechanisms. The primary one, calculated annually, compensates the aid agencies for one-third of the ocean freight differential (OFD), which amounts to the difference between competing US and foreign flag

bids on a given shipment. An additional reimbursement mechanism, known as the Twenty Percent Excess Freight (TPEF) provision, compensates USAID and USDA for excessive shipping costs incurred during periodic spikes in transport prices, when the cost of shipping exceeds 20 percent of the value of the commodities shipped.

Although these reimbursement mechanisms are designed to lighten the financial burden of ACP compliance borne by aid agencies, MARAD reimbursement substantially under-represents the true costs of ACP. The shortfall arises for multiple reasons. First, older, less efficient, not-militarily useful vessels are excluded from the reimbursement calculations even though they are ACP eligible. Second, the priority ranking system inherently discourages foreign flag vessels from bidding on food aid shipments; but OFD cannot be calculated for shipments on which foreign flag carriers have not bid, thus no reimbursement is made for such shipments.

More recent legislation aggravates the problems posed by ACP. In 1996, the federal government passed the Maritime Security Act, a provision of which, known as MSA-17, mandates that 25 percent of bagged food aid cargo be "handled" in Great Lakes ports. MSA-17 was designed to mitigate the negative impact of ACP laws on the Great Lakes port range, where smaller, foreign-flag vessels dominated the waterways. Under MSA-17, up to 25 percent of food aid shipments are exempt from the priority ranking system so long as they are handled by Great Lakes ports. Almost all of this 25 percent of food aid is therefore shipped on more competitive foreign flag vessels. MSA-17 has ensured that Great Lakes port facilities continue to handle a fixed percentage of US food aid, albeit via intermodal (such as truck-to-rail) rather than purely waterborne transportation. At the same time, MSA-17 obligates virtually all non-Great Lakes shipments to be carried on US-flag vessels. Thus, MSA-17 has become possibly the single most anti-competitive influence on the US food aid shipping market by creating substantial disincentives for foreign flag vessels to bid on non-Great Lakes food aid shipments.

A more recent federal government program directly addresses the same goals as ACP, duplicating effort and expense. MARAD's Maritime Security Program (MSP) was established in 1996 to ensure the US military's access to vessels, crews and a global, intermodal transportation network during wartime. MSP subsidizes US-flagged liner vessels that are less than 15 years old in return for the right to call up these vessels and crews for national security or Department of Defense (DoD) shipping needs. Although vessels can qualify for ACP eligibility and the MSP program simultaneously, and receive payments from both programs simultaneously, ACP-eligible vessels are frequently more than 15 years old or do not offer liner service, which prevents them from being classified by MARAD as military useful. MSP provides a more direct method of subsidizing militarily useful sealift capacity than do older ACP rules.

Data and Analytical Approach

In order to evaluate the costs of ACP and its effectiveness in meeting its legislated objectives, we statistically analyzed every USAID food aid shipment in fiscal year 2006 (1,741 transactions), the most recent year for which comprehensive data were available. A variety of robustness checks suggest the data are reasonably representative of the program more broadly and may, in fact, understate the costs of ACP to taxpayers and food aid agencies. We also gathered publicly available information on the ownership structures and crew sizes of vessels participating in the ACP program. To compute the total taxpayer cost and the distribution of these costs across agencies, we used the pre-existing inter-agency guidelines, as outlined in a 1987 Memorandum of Understanding between USAID, USDA and MARAD.

Key Findings

Our analysis of the costs and consequences of ACP reveals that ACP does not appear to be the most efficient or effective means of achieving the policy's stated objectives. Key findings of the data analysis include:

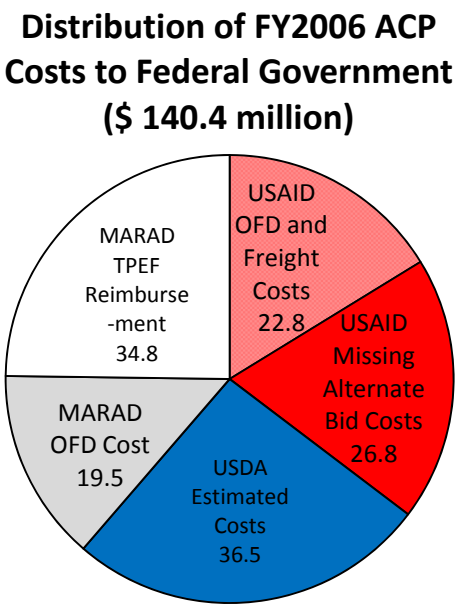
(1) In FY2006, meeting ACP requirements for USDA and USAID programs cost US taxpayers roughly $140 million, a 46 percent markup over competitive freight costs. This cost roughly equals the full value of USAID's Title

II non-emergency food aid to Africa that year. Without ACP, the US government could double non-emergency food aid to Africa. This would help advance both President Bush's 2005 pledge to double US aid to Africa and President Obama's Feed the Future initiative.

(2) Contrary to the national security objectives of cargo preference laws, 70 percent of US-flag vessels eligible to carry food aid in 2006 failed to qualify as militarily useful under MARAD criteria. Indeed, the priority system used to award bids under ACP directly disadvantages the most militarily useful US-flag vessels, those that are MSP eligible.

(3) ACP provides minimal supplementary support to militarily useful vessels. Less than 7% of ACP expenditures support vessels selected by DoD for inclusion in the Maritime Security Fleet. For those vessels in both programs, MSP payments were almost ten times as large as ACP support received.

(4) More than 60% of the total cost of ACP is not reimbursed by MARAD. The food aid agencies – USAID and USDA – pay for most of the ACP subsidies to ocean freight carriers. Most of this cost arises because existing rules discourage foreign flag carriers from bidding on food aid shipments, which disqualifies the shipment from overseas freight differential reimbursements from MARAD.



(5) A large share of the remaining unreimbursed ACP costs arise because the program includes vessels 25 years or older that are no longer deemed militarily useful and that are 48-64% more expensive than younger vessels. The technical details of the governing inter-agency agreement do not permit reimbursement for the full costs of these older vessels.

(6) "Buy American" objectives are not met. US flag vessels are commonly held within complex structures of nested holding companies, many of them privately held, such that we conclusively pinned down the ultimate ownership of less than half the vessels in the ACP program. 40% of the food aid tonnage definitively linked to ultimate owners was hauled on vessels whose companies are ultimately owned by foreign corporations.

(7) There has been no documented call-up of citizen mariners for national security purposes in the 56 years since the ACP program began, spanning seven major US military operations. The cost of maintaining this untapped pool of roughly 1,400 mariners on ACP vessels in FY2006 amounted to approximately $99,300 per mariner. This comes on top of the MSP costs to maintain the same pool of vessels and crews.

Conclusions

More efficient and effective ways could be found to fulfill the multiple objectives of agricultural cargo preference policy. Perhaps the most effective means of achieving ACP's national security objectives would be to augment the Maritime Security Program. The $140 million cost of ACP could be used to support an additional 40 MSP vessels at the FY2006 MSP subsidy level. Alternatively, eligibility for ACP could be restricted to only those vessels that are clearly militarily useful, thus eliminating the substantial, costly support to older, more expensive vessels that presently account for more than two-thirds of the ACP fleet.

Other reforms could increase competition and efficiency in shipping American food aid. Relaxing or eliminating MSA-17 would allow for greater price-based competition among ocean carriers. Additionally, the ACP program's mandatory three-year waiting period prior to entry could be eliminated to allow the US-flag shipping industry

to meet short term changes in demand for US-flag ocean freight services. Prioritization rules for awarding bids might also be updated to be more compatible with modern commercial practices in liner services and to stop disadvantaging militarily useful vessels. To better support American ownership of ocean carriers, more stringent guidelines regarding corporate parentage of eligible carriers could increase the benefits afforded to American carriers, American merchant mariners and other ocean freight industry employees.

Eliminating costly ACP provisions could also enable a doubling of non-emergency food aid to Africa to meet unfulfilled commitments the federal government has made over the past five years, or modest reduction of federal budget deficits.

The peer-reviewed analysis summarized in this brief offers the clearest, most comprehensive evidence to date on the costs and effectiveness of agricultural cargo preference restrictions in advancing their stated goals. Present ACP policy promotes ineffective shipping subsidies under the guise of humanitarian assistance, national security and "buy American" objectives. But it largely fails to advance these important goals. It is time to revisit the role of ACP as it applies to international food assistance in order to enhance welfare and security both in America and abroad.

Further Reading

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About the authors: Elizabeth R. Bageant recently completed her B.A. in Development Sociology at Cornell University and now works in Ghana. Christopher B. Barrett is the Stephen B. & Janice G. Ashley Professor of Applied Economics and Management and International Professor of Agriculture, Charles H. Dyson School of Applied Economics and Management, Cornell University. Erin C. Lentz is a Research Support Specialist at Cornell University.

*Chris Barrett is the corresponding author at cbb2@cornell.edu, 315 Warren Hall, Charles H. Dyson School of Applied Economics and Management, Cornell University, Ithaca, NY 14853-7801. Telephone: (607) 257-7434.