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Report to Congressional Requesters

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INTERNATIONAL TRADE

FAS Management of Livestock Cooperator Program

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National Security and
International Affairs Division

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The Honorable E (Kika) de la Garza
Chairman, Committee on Agriculture
House of Representatives

The Honorable Edward R. Madigan
Ranking Minority Member
Committee on Agriculture
House of Representatives

As requested in your December 17, 1986, letter and in subsequent m ings with Committee representatives, we examined certain aspects (livestock cooperator activities under the Cooperator Foreign Marke Development Program administered by the Foreign Agricultural Ser (FAS) of the U.S. Department of Agriculture. Under this program, FA contracts with private, nonprofit agricultural organizations, known cooperators, to increase foreign consumer and commercial uses of U agricultural products, develop long-term markets abroad, and provi marketing and technical services to U.S. exporters and foreign buye enhance the quality of U.S. agricultural exports.

FAS spent $39.7 million for this program in fiscal year 1986, of whic cooperators in livestock and livestock products received $4.1 millio fiscal year 1987, FAS funds budgeted for the four livestock cooperat included in our examination were as follows: Holstein-Friesian Asso tion of America (HFAA), $293,250; Brown Swiss Cattle Breeders Ass tion, $31,960; National Association of Swine Records (NASR) $46,877 and the American Jersey Cattle Club, $8,075.

Our examination focused on several livestock exporters' allegations conflict of interest and unfair competition by these four cooperator Although the exporters believe that cooperators are beneficial in pr moting livestock abroad, they alleged that it is unfair when such no profit cooperators, through their subsidiaries or selected exporters, benefit from commercial sales or receive commissions from sales th result from trade leads developed from FAS-funded trips. We focuse whether such trade leads are being distributed by cooperators in a timely manner to other livestock exporters. As requested, we also examined HFAA's commercial subsidiary's role in an April 1987 sale 2,750 dairy cattle to a private buyer in the Canary Islands.

Standards of Conduct for Cooperator Activities

Existing legislation does not contain any specific restrictions concer cooperators' market development activities, and FAS has not issued ı lations for the program. Instead, FAS has guidelines setting forth the cies and procedures for carrying out the program; however, these guidelines carry less force than regulations. The guidelines presentl; not prohibit or otherwise preclude a cooperator or its subsidiary frc engaging in the export of the same commodity that the cooperator p motes, nor do they specifically address the handling of trade leads t may be developed on FAS-funded trips. FAS officials told us that theiı general policy is that cooperators or their subsidiaries will not expo the commodity that they promote using project funds. However, an exception to this policy has been the FAS sanctioned export activities certain livestock cooperators to improve the quality of U.S. livestocl exports (see p. 17).

For at least a decade, FAS has been aware of livestock exporters' con plaints of conflict of interest and unfair competition because certain livestock cooperators through their subsidiaries, export the same co modity as they are promoting with government funding. The Assist: Administrator of Commodity and Marketing Programs told us that F changed its policy concerning livestock exports in August 1986 (abo the time FAS reported its findings on the livestock cooperator progra the House Agriculture Committee), to one of opposing livestock cooı tors or their subsidiaries exporting the commodities they promote w program funds. FAS made this change when it realized that certain li stock cooperators and exporters would not resolve their differences

FAS officials told us that they viewed themselves as facilitators rath than regulators and that they preferred to have the cooperators poli themselves. FAS believed that too much intervention would undermiı the cooperative nature of the program, and it had not penalized cooı tors or terminated their participation in the program because of exp sales-related activities. However, the Director of FAS' Dairy, Livestoc and Poultry Division told us that self-policing has not occurred in th livestock industry, apparently because certain cooperators, in their efforts to maintain the integrity of the breed through quality export and to generate income for their organizations in this competitive in try, have tended to direct foreign sales to their wholly owned subsid aries. As a result, these conditions continued with no corrective acti taken and the complaints escalated in intensity.

The need for a change in the livestock cooperator program was discussed at the June 1986 annual meeting of the U.S. Agricultural Exp

Development Council, an umbrella organization composed of agricultural cooperators. In a letter to a House Agriculture Committee staff member in June 1986, the Executive Coordinator of the Council state that the Council's Executive Committee and the Council/FAS Relation Committee concluded that the perception of program misuse should l cleared up as soon as possible and that FAS should initiate some type appropriate action.

Proposed Conflict of Interest Provision

As a result of increased livestock exporters' complaints, urging from cooperators, and inquiries from Congress, FAS reviewed the livestock cooperator program and reported to the House Agriculture Committe on August 11, 1986, that ethical questions did exist involving the fou cooperators, but there were no violations of program guidelines. The ethical questions concerned (1) timely distribution of trade leads dev oped on FAS-funded trips, (2) exporters paying commissions to coope tors, (3) cooperators using restrictive standards which precluded the membership of a majority of exporters, and (4) cooperators competin with other exporters through for-profit export subsidiaries.

In its report, FAS included a proposed Conflict of Interest Provision (s app. II) that would amend the cooperator program guidelines and sta that it would be issued in the near future. This provision would appl the entire cooperator program. Its basic purpose would be to prevent the extent possible, the recurrence of these problems by specifying in greater detail the intended role of cooperators in the market development program. Subsequent to its report, FAS decided to make the prov sion a regulation in order to strengthen its regulatory force.

FAS distributed the Conflict of Interest Provision to all participating cooperators for comments in December 1986 and to its own commodi divisions in May 1987. Livestock exporters generally believe that, if properly implemented and monitored, the provision will resolve the majority of the problems. One of the livestock cooperators that woul primarily affected by the provision responded that it would drop out the cooperator program if forced to choose between the program and continuing to market exports and services. FAS livestock officials beli that if cooperators retired from the program, the level of overseas ma ket development would be reduced. Another livestock cooperator pointed out that the provision does not address the process that FAS would use in dealing with cooperators found to be in violation of the provision. Non-livestock cooperators generally had no problems with provision. A more detailed discussion of these comments is contained appendix I.

Over a year has passed since FAS drafted the Conflict of Interest Prov sion. According to the Deputy Assistant Administrator, Commodity a Marketing Programs, the provision has been revised many times in th interim because of the complexity of the subject matter and because the impact that the provision might have on the credibility of the coo erator program; the furnishing of technical services by cooperators to foreign buyers; the activities of cooperators and their members; the nature and extent of market development overseas; and the value, vo ume, and quality of U.S. agricultural exports.

Trade Leads

Trade leads consist of information from foreign companies, governme purchasing agencies, brokers, distributors, and others seeking to buy U.S. agricultural products. The current FAS cooperator guidelines do n specifically cover the disposition of trade leads developed on FAS-func travel. Our examination showed that the four cooperators have varyi practices in handling and distributing trade leads developed with gov ernment funding. HFAA provides trade leads on a monthly basis at no to interested recipients. It also provides copies of FAS-funded trip repc for a fee. Jersey Cattle furnishes trade leads that it develops on FAS tr upon request. Brown Swiss generally does not prepare and distribute trade leads. NASR forwards its trade leads only to its approved export Under the proposed Conflict of Interest Provision, cooperators will be required to provide "on a timely basis, upon request by any U.S. trad entity, any and all data developed by the Cooperator and produced w project funds or Cooperator contributions..." FAS officials told us that this requirement will be difficult to monitor and that FAS' normal com ance review probably would not identify violations. They stated they may have to rely on complaints of cooperators' noncompliance.

Canary Islands Dairy Cattle Sale Under the EEP

Holstein-Friesian Services (HFS), a subsidiary of HFAA, was the succes bidder in the April 1987 sale of 2,750 dairy cattle to the Canary Islan under the Export Enhancement Program (EEP), which provides subsi to U.S. exporters to enable them to compete better with the subsidize exports of other countries[1]. The contract price to the buyer was $1,00 per head; the exporter received an FAS-approved bonus of $1,379 per head. HFS was able to bid on this contract because HFAA asked that HF given qualified exporter status under the EEP and FAS granted the request. Since HFS was designated a "qualified exporter" by FAS, HFAA not act contrary to any specific EEP restrictions or requirements.

However, the functioning of HFS as an exporter under the Canary Isla contract appears to be inconsistent with representations HFAA made t FAS that, under its January 1986 reorganization, it would not seek or respond to public tenders and/or invitations to bid on cattle for expo purposes and that all HFS employees were to be transferred to HFAA a HFS would exist only for tax, income, legal and other considerations. retain HFAA's non-profit status, net income from the marketing of tec cal services would flow through HFS.

Some reasons given by HFAA for the reorganization were to (1) focus providing its services and programs versus being engaged in direct co mercial activity, (2) remove confusion that existed among foreign cli about the HFAA/HFS relationship, (3) reduce the perception by cattle exporters that HFS was engaging in unfair competition, (4) eliminate t financial drain upon the organization since HFS for several years had reported operating losses, and (5) remove FAS concern about its comm cial practices.

The FAS cooperator guidelines presently do not prohibit or otherwise preclude a cooperator from having a subsidiary which engages in the export of the same commodity that the cooperator promotes. We reviewed cooperator and FAS documents and found no evidence that t Canary Islands EEP sale resulted from cooperator-related market dev opment trips.

[1] Under the EEP, established in May 1985, the Commodity Credit Corporation (CCC) makes avail surplus agricultural commodities as bonuses to U.S. exporters to expand sales of specific U.S. agr tural commodities in specific markets. In practice, the bonuses are subsidies in kind paid to U.S. exporters in the form of generic certificates of a specified value which can be redeemed for a like value of designated commodities in the CCC inventory. See GAO/NSIAD-87-7BR, International Trade: Implementation of the Agricultural Export Enhancement Program, Mar. 1987.

However, the Assistant Administrator, Commodity and Marketing Programs, told us that if the proposed Conflict of Interest Provision had been part of the cooperator program guidelines at the time of the contract, HFAA would have been in violation of the guidelines because the proposed provision precludes cooperators' subsidiaries from participat ing in the export of a commodity promoted by the cooperator.

In July 1987, HFS was the successful bidder on two additional dairy cat tle contracts for Egypt under the EEP. On one contract for 200 dairy cat tle, the price with the buyer was $1,200 per head with an FAS-approvec bonus of $1,800 per head. On the other contract for 410 dairy cattle, th price with the buyer was $925 per head with an FAS-approved bonus of $1,385 per head. FAS officials told us that the higher price on the first contract was mainly due to the requirement for air rather than ocean transportation.

Brown Swiss Enterprises, Inc., a subsidiary of Brown Swiss Cattle Breeders Association, was also approved by FAS as a qualified exporter under the EEP on September 26, 1986. From November 1986 through March 1987, the subsidiary was awarded five contracts resulting in EEF bonuses for the delivery of 668 holstein and 5 brown swiss dairy cattle to Morocco. The contract sales price and EEP bonus per head under thes contracts averaged $1,000 and $1,500, respectively.

Conclusion

FAS has been aware of the problems associated with certain livestock cooperators for over a decade but no action has been finalized to alleviate the conditions that have permitted the conflict of interest and unfai competition situations to occur.

It has been over a year since FAS provided the proposed Conflict of Inte est Provision to the House Agriculture Committee. We recognize that this is a complex issue; however, FAS has not acted expeditiously to finalize the provision, thus allowing some livestock cooperators to ente into EEP contracts to export dairy cattle which, according to FAS' Assistant Administrator, Commodity and Marketing Programs, would have violated the provision if it had been in effect.

The existing FAS Cooperator Foreign Market Development Program guidelines do not specifically address the problems reported by livestoc exporters and verified by FAS that certain livestock cooperators have been (1) withholding or delaying the distribution of trade leads, (2) receiving commissions from sales made by exporters, (3) operating for-profit subsidiaries and (4) using restrictive standards that prevent th(majority of exporters from becoming members of cooperator associa- tions. We believe that the proposed Conflict of Interest Provision, onc(implemented, will address these problems. FAS and cooperators have pointed out the difficulty in monitoring some of the requirements of tl provision, and the possibility that a few cooperators will withdraw fr the program, with a potential resultant decrease in market developme activity.

Recommendation

We recommend that the Secretary of Agriculture direct the FAS Admin trator, in finalizing and implementing the proposed Conflict of Interes Provision as a regulation, (1) include a requirement for cooperators to certify that their activities under the program will comply with the re ulation and applicable FAS guidelines and agreements, and (2) set out procedures for handling cases of cooperator noncompliance, including possible corrective actions to be taken by cooperators and the potenti sanctions to be levied by FAS (e.g. withholding of funding or being declared ineligible for participation in the program).

Views of Agency Officials

A draft of this report was reviewed by program-level officials, and th(Assistant Administrator for Commodity and Marketing Programs whc told us that they agreed with our recommendation. Agriculture's Offic of General Counsel is currently reviewing the Conflict of Interest Prov sion in preparation for placing it in the Federal Register for public con ment. The Assistant Administrator stated that after receipt of public comments, FAS plans to issue a final regulation and incorporate it in th provisions of all cooperator contracts. FAS plans to require the coopera tors to certify that they are in compliance with the regulation. It also plans to include in the cooperator agreements the process to be follow and the penalties to be levied when cooperators are found to be in non compliance with the Conflict of Interest Provision.

Additional details on the results of our work are in the appendixes, including a description of our objectives, scope and methodology. We a sending copies of this report to the Secretary of Agriculture, the Admii istrator of FAS, and cognizant congressional committees and subcommit tees. We will also make it available to others upon request.

Frank C. Conahan

Frank C. Conahan
Assistant Comptroller General

Contents

Abbreviations

CCC	Commodity Credit Corporation
EEP	Export Enhancement Program
FAS	Foreign Agricultural Service
HFAA	Holstein-Friesian Association of America
HFS	Holstein-Friesian Services
JMS	Jersey Marketing Services
NASR	National Association of Swine Records

FAS and Livestock Cooperator Relationship

In enacting the Food Security Act of 1985 (Public Law 99-198), Congre endorsed the continuation of the Cooperator Foreign Market Development Program to develop new markets and expand and maintain existing markets for U.S. agricultural commodities, using nonprofit agı culture trade organizations to the maximum extent practicable (7 U.S.(1736 u). Cooperator programs usually fall into three categories: trade servicing, technical assistance and consumer promotion. Activities and programs are geared to increasing consumer and commercial uses of U agricultural products and developing long-term markets rather than to achieving immediate sales.

FAS has published guidelines which set forth the policies and procedur for carrying out the program. The FAS Assistant Administrator, Commodity and Marketing Programs, has authority to approve any change in the policies and procedures in the cooperator program guidelines an to approve and sign all project agreements on behalf of FAS. The guidelines state that the cooperators will endeavor to contribute funds annu ally equal to or greater than the project funds they use under project agreements. Project funds cannot be spent until FAS approves an annua marketing plan which describes the cooperator's proposed activities ar the planned contributions of each party.

For fiscal year 1986, the FAS budget was $79.4 million, including $46 million for foreign market development activities. FAS spent $39.7 million for the Cooperator Foreign Market Development Program, of whic $4.1 million was expended by cooperators in livestock and livestock products. In fiscal year 1987, the following amounts were budgeted in the marketing plans of the four livestock cooperators included in our examination: Holstein-Friesian Association of America, $293,250; Brov Swiss Cattle Breeders Association, $31,960; National Association of Swine Records, $46,877; and the American Jersey Cattle Club, $8,075.

Existing legislation does not contain any specific restrictions concernin cooperators' market development activities. FAS has not issued regulations for the program. Instead, FAS guidelines set forth the policies and procedures for carrying out the program but they carry less force than regulations. FAS guidelines presently do not prohibit or otherwise preclude a cooperator or its subsidiary from engaging in the export of the same commodity that the cooperator promotes; nor do the guidelines specifically address the handling of trade leads that may be developed on FAS-funded trips. FAS officials told us that their general policy is thal cooperators or their subsidiaries will not export the commodity that they promote using project funds. However, the exception to this polic has been the FAS sanctioned export activities of certain livestock cooperators.

Holstein-Friesian Association of America

The FAS-livestock cooperator relationship has been the subject of concern for livestock exporters and FAS for at least 10 years. For example, in May 1978, the FAS Deputy Assistant Administrator for Foreign Market Development cautioned the Holstein-Friesian Association of America (HFAA), stating that:

"The Holstein-Friesian Association of America, as a market development cooperator, occupies a unique position due to the fact you operate a wholly-owned subsidiary, Holstein Friesian Services (HFS), which is active in commercial exports. This relationship, HFAA/HFS,has been, as you know, the source of some industry criticism of FAS and our relationship with HFAA. This criticism has centered on, but has not been limited to, the use of market development funds for travel of HFAA/HFS personnel. We believe this criticism has reached the point at which time we must reach a clear understanding of, and separation of, the functions of HFAA and HFS in so far as market development project activities are concerned."

This former Deputy Assistant Administrator told us that maintaining the credibility of the cooperator program is the primary consideration. He stated that HFAA and Brown Swiss both had subsidiaries involved in exporting and that they had developed trade leads on FAS-funded trips but did not share leads with other exporters.

These problems continued, and in August 1985, FAS again formally advised HFAA that several U.S. cattle exporters had complained that trade leads developed by HFAA on FAS-funded trips were being furnished only to HFS. FAS stated that such practices violated the letter and spirit of the HFAA/FAS market development project agreement. FAS also noted that HFS's use of HFAA letterhead and name cards led potential overseas customers to believe that HFS was the only exporter that HFAA recommended.

On September 30, 1985, FAS met with HFAA officials who announced that a reorganization effective in January 1986 would transfer HFS personnel to HFAA's international services division. This division would concentrate on technical and marketing services and would not seek or respond to public tenders and/or invitations to bid for cattle, except when (1) requested by previous regular clients of HFS, (2) cattle were an integral part of a request to purchase technical services, and (3) cattle were included in a technical services program. HFS would continue to exist for tax, income, legal, and other considerations as advised by counsel. To retain the Association's non-profit status, net income from the marketing of technical services would flow through HFS.

Some reasons given by HFAA for the change were to (1) focus on provid ing services and programs of the Association versus being engaged in direct commercial activity, (2) remove confusion that existed among fo eign clients about the HFAA/HFS relationship, (3) reduce the perception by cattle exporters that HFS was offering unfair competition, (4) eliminate the financial drain upon the HFAA, since HFS for several years had reported operating losses, and (5) remove FAS concern about commercia practices.

FAS officials told us that as a result of the reorganization, they assumed that HFS was out of the international cattle bidding business. On May 2(1986, in preparation for a meeting with an exporter to discuss its charg that FAS was unfairly subsidizing competing livestock exporters throug the cooperator program, the Acting Director of FAS' Dairy, Livestock an Poultry Division advised the FAS Administrator that:

"...we have heard these arguments before, however, this effort appears to attack FAS more directly rather than to be only concerned with the setting of exporter standards by breed associations and the distribution of trade leads....As you are aware, the Holstein Association reorganized in January and no longer is an active livestock exporter."

Complaints from other cattle exporters continued, however, generally stating that HFAA/HFS was carrying on "business as usual" with no perceived changes.

On June 18, 1986, HFAA applied to FAS for qualified exporter status for HFS under the Announcement for Acquiring a Commodity Credit Corporation Bonus under the EEP, and on June 24, 1986, FAS agreed to grant HFS this status. In March 1987, HFS was the successful bidder on a tende for 2,750 holstein cattle to a private buyer in the Canary Islands under the EEP. The contract price with the buyer was $1,000 per head with an FAS-approved bonus of $1,379 per head. In July 1987, HFS was awarded two contracts for the sale of 610 dairy cattle to Egypt under the EEP. These EEP activities are discussed in more detail beginning on p. 24.

Brown Swiss Cattle Breeders Association

Brown Swiss, a nonprofit association, has been in the livestock coopera tor program for 7 years. It has 1,100 members and maintains records o ancestry and production and promotes brown swiss cattle, semen and embryos domestically and internationally. In 1969, Brown Swiss became concerned over reports that cattle being sold as registered were not registered, that production records could not be verified, and that cattle delivered were not of the quality the buyer expected. To correct these practices, the Board of Directors voted to market cattle as well as semen and embryos. To limit the liability of the Association and to avoid the possibility of jeopardizing its nonprofit status, it formed Brown Swiss Enterprises, Inc. (BSE), a wholly-owned subsidiary dealing in exporting cattle. This relationship, like HFAA's, has been the subject of complaints by livestock exporters.

In addition, like HFAA, BSE was approved by FAS as a qualified exporter under the EEP on September 26, 1986. From November 1986 through March 1987, BSE was awarded five contracts with EEP bonuses for the delivery of 668 holstein and 5 brown swiss dairy cattle to Morocco. The contract sales price and EEP bonus per head under these contracts averaged $1,000 and $1,500, respectively.

The American Jersey Cattle Club

Jersey is in its second year as a cooperator. Its primary function is the registry of Jersey cattle, and it has 2,700 active members. Jersey established a subsidiary, the Jersey Marketing Services, that sells cattle domestically and internationally.

National Association of Swine Records

This Association (NASR) represents eight purebred swine associations in the United States, helping them to be more productive and maintaining high standards of quality in its services to breeders and industry groups producing superior genetics.

Exporters have complained that NASR

- provided trade leads to only one approved exporter during the 20-month period ended April 1987 (in April 1987, it approved two other exporters);
- signed an agreement in September 1985 with its only approved exporter that provided for a commission to be paid to NASR from sales made by the exporter that result from NASR trade leads; and
- established standards for approved exporters which were too restrictive, had unnecessary requirements, and would add costs that would make U.S. swine less competitive.

On September 11, 1985, NASR entered into a 3-year agreement (renewa ble annually) with an exporter to be NASR's exclusive promotions and consultation agency for international services, subject to certain term: and conditions. One of the conditions was that the exporter would rebate to NASR a 5-percent, on-farm price (the price paid to the breede: and 5-percent, exporter on-farm price (for animals owned by the exporter) for each purebred pig exported except those sold (1) to repe customers, (2) by agents of the exporter, or (3) to buyers who were negotiating with the exporter before the contract became effective. Other livestock exporters stated that the cooperator program guidelin did not provide for cooperators to receive commissions in any form fr sales made as a result of federally funded promotion.

On December 12, 1985, NASR distributed to other livestock exporters f their information a list of criteria or standards for approved exporter: stating that these standards had been approved by FAS. On December : 1985, the Livestock Exporter's Association, another cooperator, wrot to NASR stating that at its December 17, 1985, meeting it had been concluded that the NASR standards were too restrictive, contained unnece sary requirements, and would lead to expanded costs that would hurt U.S. competitiveness. It noted that if the objective of the standards w to eliminate all of the established exporters save one, then NASR was o the right track. The letter also stated that an FAS representative attended the meeting and said that FAS had reviewed the standards bu had not approved and endorsed them.

NASR's FAS coordinator told us that trade leads received from FAS or developed on FAS-funded travel were sent only to NASR's approved exporter. This exporter accompanied NASR on an FAS-funded development trip to Mexico in January 1986. In the May 20, 1986, memorand to the FAS Administrator, the Acting Director of the Dairy, Livestock a Poultry Division stated that:

> "In the case of the National Association of Swine Records, an exporter who was contracting with them did receive an export order for swine to Mexico shortly aft returning from an FAS approved activity in Mexico. We advised the Association t they should exercise caution with regard to activities of this type."

FAS Participation With Livestock Cooperators

FAS officials told us that livestock cooperators began participating in direct exporting of animals in the late 1960s when foreign customers were complaining about the quality of U.S. livestock and few U.S. exporters were considered reliable or capable of exporting quality livestock. To address this quality problem, HFAA and Brown Swiss, with FAS encouragement, established wholly-owned subsidiaries to export cattle (for example, HFS was actively exporting cattle in 1969) and NASR developed quality standards for U.S. swine exports. This was an exception to FAS' general policy that cooperators or their subsidiaries not export the commodity that they promote using FAS program funds. However, according to FAS, several new export companies have been formed over the years capable of exporting livestock of excellent quality. According to the Deputy Assistant Administrator of FAS for Commodity and Marketing Programs, in recent years, as complaints about livestock cooperators' export activities have intensified and the number of quality livestock exporters has increased, FAS has informed cooperators that such activities are no longer appropriate because of conflict of interest and related unfair competition implications.

FAS' Assistant Administrator for Commodity and Marketing Programs told us that it was not until August 1986 (about the time FAS reported its findings on the livestock cooperator program to the House Agriculture Committee), that he concluded an agreement would not be reached between the cooperators and livestock exporters and that FAS changed its policy to oppose certain livestock cooperator subsidiaries from exporting the commodity that the cooperator promotes with FAS funding.

On August 26, 1985, the Assistant Administator had written the Executive Secretary of HFAA to express his concern over exporter complaints about the HFAA/HFS relationship, specifically that trade leads developed by HFAA on FAS-funded trips were being withheld from exporters and channeled to HFS. He said that, if true, this action violates the letter and spirit of the HFAA/FAS market development agreement and that these charges of conflict of interest have increased and have come from exporters that FAS considers reliable and responsible as well as from FAS' own personnel overseas. He also charged that the use of HFAA letterhead and name cards by HFS travelers confuses and misleads potential overseas customers. He called for a meeting to discuss these issues.

On the day of the meeting (September 30, 1985) the Assistant Administrator was advised by the Director, Dairy, Livestock and Poultry Division, of the issues to be discussed, namely (1) the use of HFAA letterheads and name cards by HFS personnel, (2) HFAA recommending only HFS to foreign buyers, (3) the passing of trade leads developed by HFAA travelers using FAS project funds to HFS first rather than simultaneously to other exporters, and (4) the appearance of cross-utilization of HFAA/HFS personnel. He recommended that FAS make it absolutely clear to HFAA that FAS could not tolerate the operation of the HFAA/FAS program for the benefit of one exporter (HFS) and that more reliable exporters must be brought into the program. He concluded that it was only a matter of time before the program would be challenged by other exporters and the Congress. It was at this meeting that HFAA announced its reorganization which was previously described.

FAS has been aware of the exporters' complaints about cooperators' unfair competition and conflict of interest but has been reluctant to take effective action to remedy this condition. FAS officials told us they viewed themselves as facilitators rather than regulators and that it has been their aim to have the cooperators police themselves. However, because of the intense competition and risk that exists in the livestock exporting business, this management philosophy has not been effective. The Director, Dairy, Livestock and Poultry Division, addressed the likelihood of self-regulation in July 1986, when he advised the Director, Compliance Review Staff, concerning NASR's standards for approved exporters that:

"Unfortunately, the standards are written in such a way that only the most conscientious of exporters can qualify and the vast majority of U.S. exporters would not wish to meet the standards since most are not able to meet them without incurring additional costs for labor and facilities. In addition, this industry is not generally amenable to any self-regulation, but rather operates on the principle of only meeting those standards dictated by federal law, i.e. minimum export and import standards administered by APHIS Veterinary Services."

The Director of FAS' Dairy, Livestock, and Poultry Division told us that this self-policing has not occurred in the livestock industry, apparently because certain cooperators, in their efforts to maintain the integrity of the breed through quality exports and to generate income for their organization in this competitive industry have tended to direct foreign sales to their wholly-owned subsidiaries. As a result, no corrective management action has been taken and the complaints have escalated in intensity.

FAS Conflict of Interest Provision

In June 1986, the U.S. Agricultural Export Development Council, which represents commodity organizations participating in the cooperator program, discussed exporters' complaints of conflict of interest and unfair competition by certain livestock cooperators. In a letter to a House Agriculture Committee staff member in June 1986, the Executive Coordinator of the Council advised that the Council's Executive Committee and the Council/FAS Relations Committee concluded that the perception of misuse of the livestock cooperator program should be cleared up as soon as possible and that FAS should initiate some type of appropriate action. FAS personnel proceeded to draft a Conflict of Interest Provision for inclusion in the cooperator program guidelines that would specify in greater detail the intended role of cooperators.

On July 29, 1986, the Chairman and the Ranking Minority Member of the House Committee on Agriculture sent a letter to the Department of Agriculture's Under Secretary, International Affairs and Commodity Programs, concerning the status of an earlier inquiry about the livestock cooperator program and specifically requesting a report on the status of Agriculture's review of the program.

On August 11, 1986, the FAS Administrator replied to the House Committee on Agriculture that FAS had completed its review of the exporters' allegations against the livestock cooperators and had

> "...found that while no violations of FAS guidelines occurred, questions of an ethical nature did arise. Those questions included (1) the timely distribution of trade leads developed by U.S. Government funded market development project travel; (2) the payment of commissions to Cooperators by exporters for sales of animals made by exporters; (3) the establishment by the Cooperator of membership standards which preclude membership of a majority of exporters and (4) the practice of some Cooperators operating a for-profit export business in competition with other exporters."

In the letter, FAS included the proposed Conflict of Interest Provision to amend the cooperator program guidelines (see app. II) and stated that it would be issued in the near future. The basic purpose of the provision would be to prevent, to the extent possible, the recurrence of these problems by clarifying the intended role of cooperators in the market development program.

To ensure that the benefits generated by the program would be as broadly distributed throughout the relevant agricultural sector as feasible and that no firm or organization would derive an unfair advantage or benefit from project activities funded by the program, the provision would require the cooperators to (1) develop selection criteria for industry representatives to participate in approved program activities and to enable participation on an equitable basis by a representative cross section of the relevant U.S. agricultural industry, (2) provide, on a timely basis, upon request by any U.S. trade entity, any and all data developed with cooperator program funds, (3) not participate in the export of agricultural commodities which are promoted by the cooperator using program funds, (this prohibition applies to the cooperator, the cooperator's parent organization, and affiliates), and (4) not assess fees for services provided by the cooperator to exporters in facilitating export sales if project funds have been used for any promotional activities intended to result in that specific export sale.

On December 15, 1986, FAS sent the Conflict of Interest Provision to all participating cooperators for comments to be received by January 15, 1987. Only 13 of the 53 cooperators responded, including HFAA and Brown Swiss. We contacted Jersey and NASR and obtained their oral comments.

Cooperator Comments on Conflict of Interest Provision

HFAA

HFAA officials questioned the language "not participating in the export trade," stating that the interpretation could cover all functions of export, such as market development, promotion, trade barriers, and delivery. They believe that cooperators that do not have checkoff fee systems should be given an opportunity to raise funds and that cooperators should be able to provide services to facilitate exports and/or technical services and to assess fees for these services.

Brown Swiss

Brown Swiss stated that if the provision is implemented, Brown Swiss would be excluded from the cooperator program, since the key word would be "subsidiaries." Its marketing arm does export cattle as well as semen and embryos, so if forced to choose between the two, it would maintain its subsidiary.

Jersey

Jersey established a subsidiary, Jersey Marketing Services (JMS), that exports cattle. According to Jersey's Director of Information, if the Conflict of Interest Provision is implemented, Jersey is undecided whether it would choose the cooperator program or its international sales. It would probably continue JMS's domestic operations which is the greatest part of JMS's business, but would prefer to continue in the cooperator program and with JMS. Since Jersey did not travel abroad to promote the breed prior to becoming a cooperator, it believes its promotion and market development efforts overseas would be hurt substantially. Jersey has not developed many trade leads overseas but does furnish the few trade leads it may have to other exporters who request them.

NASR

NASR's President said he had no problem with the proposed Conflict of Interest Provision. We asked him about disallowing commissions on sales made by exporters and he referred to an FAS official's statement that such practice was NASR's business. He mentioned that NASR had approved two new exporters in April 1987 and did not propose commission agreements with them but would not prevent them from making such payments if they choose to do so.

Other Comments

The Livestock Exporter's Association, which has a membership of about 20 livestock exporters, stated that the members who did comment believed that the proposed Conflict of Interest Provision, if adopted and enforced, would solve a long-standing problem and they were in favor of it. Other cooperators that responded, representing the major commodities, such as the U.S. Feed Grains Council, the American Soybean Association, and the National Cottonseed Products Council, generally had no objections to the provision. Also, the Executive Committee of the U.S. Agricultural Export Development Council told us in August 1986 and February 1987 that it had no major problems with the provision.

FAS Processing of the Provision

On May 5, 1987, FAS's Assistant Administrator, Commodity and Marketing Programs, sent the latest version of the proposed Conflict of Interest Provision to FAS's Commodity Divisions for comment. He stated that particular emphasis should be given to the provision's potential impact, if any, on the cooperators and whether there would be any effect on export value and volume of cooperator commodities, were any cooperators forced to retire from the program because of noncompliance. He requested that they consider the provision's effect on cooperator contributions which depend on revenues generated by fees or charges, which the provision would prohibit.

The Director, Dairy, Livestock and Poultry Division, responded on May 14, 1987, that the provision would have the following impact on livestock cooperators.

- Two and possibly four cooperators would retire from the program because of noncompliance.
- Cooperators would find it difficult to comply with the provision's language dealing with the timely distribution, upon request by any U.S. trade entity, of all data produced with project funds or cooperator contributions.
- There could be a long-term impact on the exports of products, as overseas promotion and technical and trade servicing would be essentially nonexistent.

FAS is currently reviewing the Provision internally with its General Counsel in preparation to placing it in the Federal Register for public comment prior to issuing the Provision as a regulation. It believes that regulations would provide a stronger basis than guidelines for enforcing the provision. FAS also intends to make the provision part of individual cooperator agreements, which, in addition to the guidelines also govern cooperator activities. FAS plans to require the cooperators to certify that they are in compliance with the guidelines and the agreements and to include in the cooperator agreements the process to be followed and the penalties to be levied when cooperators are found to be in noncompliance with the Conflict of Interest Provision.

Over a year has passed since FAS drafted the Conflict of Interest Provision. According to the Deputy Assistant Administrator, Commodity and Marketing Programs, the provision has been revised many times in the interim because of the complexity of the subject matter and because of the impacts that the provision might have on such areas as the furnishing of technical services by cooperators to foreign buyers; the activities of cooperators and their members; the nature and extent of market development overseas; and the value, volume, and quality of U.S. agricultural exports.

Although it has been aware of the conflict of interest/unfair competition situation in livestock for over a decade and has discussed these matters numerous times with livestock cooperators, FAS has not yet completed effective action to alleviate the problems. It appears that FAS's basic management philosophy of functioning as a facilitator rather than a regulator (FAS believes that too much intervention will undermine and have a negative influence on the cooperative nature of the program) and having the cooperators police themselves has not been effective in livestock because of the highly competitive nature of the industry and the involvement of certain cooperators in the sale of the commodity they are promoting with government funding.

FAS drafted the proposed Conflict of Interest Provision in response to inquiries from Congress, complaints from livestock exporters, and the urging of cooperators to maintain the credibility of the cooperator program. FAS has decided to finalize the proposed Conflict of Interest Provision which, with proper implementation and monitoring, should address the majority of these problems.

Cooperator Trade Leads

Trade leads consist of information from foreign companies, government purchasing agencies, brokers, distributors, and others seeking to buy U.S. agricultural products. The current FAS cooperator guidelines do not specifically cover the disposition of trade leads developed on FAS-funded travel, stating only that on travel the cooperator is responsible for

- keeping records to justify the purpose and accomplishments of each trip,
- ensuring that a trip report is prepared and distributed to the Commodity Division and to the attaches/counselors in all posts visited, and
- obtaining transportation tickets.

However, the proposed Conflict of Interest Provision states that cooperators must provide "on a timely basis, upon request by any U.S. trade entity, any and all data developed by the cooperators and produced with project funds or cooperator contributions, and in connection therewith, may charge a fee, not to exceed the costs incurred in assembling, duplicating and distributing the requested material."

The four cooperators we examined have varying practices in handling and distributing trade leads developed with government funding. HFAA is the only livestock cooperator distributing trade leads and other related information on a monthly basis. It has systemized its procedures, providing trade leads on a monthly basis at no charge to interested recipients upon request. It also provides copies of FAS-funded trip reports for a fee.

Jersey provides trade leads that it develops on FAS funded trips upon request.

According to Brown Swiss' Secretary-Treasurer, Brown Swiss does not prepare and distribute trade leads as a regular practice, and he is not aware of receiving requests for trade leads.

According to NASR's FAS coordinator, NASR receives trade leads from its telex or directly from FAS. NASR also develops trade leads on its FAS-funded foreign travel. NASR's practice has been to forward these trade leads only to its approved exporters.

FAS officials told us that the proposed provision's requirement regarding the timely distribution of trade leads could be difficult to monitor and that the normal compliance review probably would not identify violations. They said that they may have to rely on voluntary submission of complaints by participants to surface instances of noncompliance.

Canary Islands Dairy Cattle Sale Under the EEP

On August 6, 1986, FAS announced the invitation for offers to acquire a Commodity Credit Corporation (CCC) bonus under the EEP for up to 3,000 dairy cattle for export to the Canary Islands. In early 1987, the Spanish agent of Hays Farms International Ltd, a Canadian export firm, informed Hays that a Canary Islands buyer was interested in purchasing cattle under the EEP. Hays put HFS in touch with the buyer. These parties met in Spain in mid-February 1987 to discuss the sale. On February 18, the buyer placed ads in two Canary Islands newspapers for approximately 1,650 registered, pregnant holsteins with an option to increase it to 3,000, with bids to close on March 5, 1987. On February 24, HFS signed its bid as the "Coordinator"[1] for 2,750 head at $1,000 each subject to award of an acceptable CCC bonus. On March 11, 1987, the buyer signed the contract subject to HFS receiving the CCC bonus through the EEP.

On March 31, 1987, HFS submitted its initial bid for a CCC bonus of $1,500 per head. This submission was rejected by FAS as being too high, as were a few other subsequent requests. On April 8, 1987, the Acting Director of FAS's CCC Operations Division queried HFAA's managing director, International Marketing Services, regarding the use of the term "Coordinator" for HFS's function in the Canary Islands contract. The

[1] As the Coordinator, HFS took "complete responsibility and costs for coordinating the procurement, health testing, vaccinations, assembling, inland transportation, preinspecting, proper documentation and shipping all U.S. Holsteins required by the buyer."

GSM-501 announcement for acquiring a CCC bonus defines a sales contract as between an exporter and an eligible buyer.

To justify HFS as an exporter the HFAA representative responded that:

"The term coordinator, as used in this context, refers to Holstein-Friesian Service's role as an exporter coordinating the animal shipments from several different domestic suppliers. The use of the term coordinator in the Canary Islands contract is synonymous with the definition of exporter in the GSM-501 announcement. In other words Holstein-Friesian Services is the legal entity which is submitting offers to CCC under the GSM-501 Announcement. The role of Holstein-Friesian Services, Inc. as exporter is further enhanced by the fact the HFS will be the sole beneficiary of the letter of credit from the Canary Islands buyer and will disburse all funds to the domestic breeders and suppliers who are providing cattle for this project."

On April 10, 1987, FAS accepted HFS's offer for a bonus of $1,379 per head for 2,750 registered, pregnant holstein dairy cattle.

Based on our review, HFS did not violate any provisions of the EEP since it was designated a "qualified exporter" by FAS. However, this contract appears to be inconsistent with HFAA's representations made to FAS in September 1985 that under its January 1986 reorganization, it would no longer seek or respond to public tenders and/or invitations to bid on cattle for export purposes.

The FAS cooperator guidelines presently do not prohibit or otherwise preclude a cooperator from having a subsidiary which engages in the export of the same commodity that the cooperator promotes. We reviewed cooperator and FAS documents and found no evidence that the Canary Islands EEP export sale resulted from cooperator related market development trips.

The FAS Assistant Administrator of Commodity and Marketing Programs told us that had the Conflict of Interest Provision been part of the cooperator program guidelines at the time of this HFS contract, HFAA would be in violation of the guidelines. We agree with this assessment. In this regard, in July 1987 FAS awarded HFS two additional cattle contracts for Egypt under the EEP. For one contract the buyer's price was $1,200 per head with an FAS-approved bonus of $1,800 per head for 200 head of dairy cattle. On the other contract, the buyer's price was $925 per head with an FAS approved bonus of $1,385 per head for 410 head of dairy cattle. FAS officials told us that the higher prices on the first contract were mainly due to the requirement for air rather than ocean transportation.

Objectives, Scope, and Methodology

We examined the allegations made by livestock exporters that, although cooperators are beneficial in promoting livestock abroad, problems arise when these nonprofit cooperators through their subsidiaries or certain selected exporters benefit commercially through sales of these commodities or through commissions from sales that result from FAS-funded market development efforts. The exporters believe this results in unfair competition and conflict of interest and that if cooperators continue these practices FAS funding should be discontinued. We also focused on whether trade leads are being distributed by cooperators in a timely manner to other livestock exporters. We also examined the involvement of HFS in a dairy cattle purchase under the EEP for the Canary Islands. We talked with and obtained documents from officials of the FAS Dairy, Livestock and Poultry Division, Commodity Credit Corporation Operations Division, Commodity and Marketing Program, and Compliance Division; the four livestock cooperators; and various other livestock exporters and producers.

We performed our work from February to August 1987, in accordance with generally accepted government auditing standards.

Conflict of Interest Provision

Figure II.1: Current Version

Exhibit A-4
11 FASG 200

EXHIBIT A

(UNIFORM PROJECT AGREEMENT PROVISIONS - ARTICLE II -- Cont'd.)

F. REPORTING REQUIREMENTS. The Cooperator shall submit reports to the Administrator in accordance with the instructions set forth in II FASG Chapter 3, as amended.

G. FAS GUIDELINES. Reference in this agreement to provisions of II FASG implies all revisions and amendments thereto including those implemented via the "FMD Memo" system. The Cooperator acknowledges receipt of a copy of such guidelines with amendments currently in effect.

H. PROGRAM BENEFITS AND INDUSTRY PARTICIPATION. The Cooperator shall ensure that the benefits generated by this agreement are as broadly distributed throughout the relevant agricultural sector as feasible and, particularly, that no firm or organization derives an unfair advantage or benefit from project activities, whether funded with project funds or Cooperator contributions. Therefore, the Cooperator shall:

1. Submit to the Administrator along with the annual marketing plan, criteria for selection by the Cooperator of industry representatives to participate in program activities such as trade teams, sales teams, trade fairs, etc. and selection of firms to participate in U.S. brand identified promotions that enable participation on an equitable basis by a representative cross section of the relevant U.S. agricultural industry.

2. Provide, on a timely basis, upon request of any U.S. trade entity, any and all data developed by the Cooperator and produced with project funds or Cooperator contributions, and in connection therewith, may charge a fee, not to exceed the costs incurred in assembling, duplicating and distributing the requested material.

I. EXPORT ACTIVITIES AND RELATED SERVICES.

1. Neither the Cooperator, the Cooperator's parent organization or affiliates shall export the agricultural commodities which are promoted by the Cooperator utilizing project funds during the term of the agreement.

2. Cooperators may not assess fees for services provided by the Cooperator to exporters in facilitating export sales if project funds have been used for any promotional activities intended to result in that specific export sale. Checkoffs or membership dues may be assessed by the Cooperator based on commodity sales when such assessments are a condition of membership in the Cooperator association.

3. Cooperators and entities participating in approved program activities shall not use the activities to promote private self-interests or conduct private business, except as part of a sales team, if the use of sales teams is specifically approved in the Cooperator's annual marketing plan.

Figure II.2: December 15, 1986, Version to Cooperators for Comments

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

DEC 15 1986

TO: All Cooperators
Directors, Commodity Divisions

FROM: W. L. Davis
Assistant Administrator
Commodity and Marketing Programs

W L Davis

SUBJECT: Proposal to Amend 11 FASG to Include "Conflict of Interest Provision"

Please review the attached draft amendment to 11 FASG and provide your comments to Marketing Programs Staff (Room 4932-S), Commodity and Marketing Programs, FAS, no later than January 15, 1987.

Attachment

United States Department of Agriculture

Foreign Agricultural Service

Washington, D.C. 20250

DRAFT

FASG Amendment #1
(Date)

TO: All Holders of 11 FASG

FROM: W. L. Davis
Assistant Administrator
Commodity and Marketing Programs

SUBJECT: Addition of Language to 11 FASG 103 Regarding Equitable Distribution of Benefits and Information Generated by Project Activities

In response to recent questions raised by Congressional members and the Government Accounting Office, the following language is being added as a new section under 11 FASG 103 (these provisions apply only to Cooperators and not to the private U.S. firms participating in the Export Incentive, Brand Incentive or VAPP programs):

"103.3 Conflict of Interest Provisions. Since the foreign market development program is funded with Federal resources and Cooperator contributions, Cooperators share with FAS the obligation of ensuring that the benefits generated by the program are as broadly distributed throughout the relevant agricultural sector as feasible and, particularly, that no firm or organization derive an unfair advantage or benefit from project activities, whether funded with project funds or Cooperator contributions. Therefore, Cooperators have an obligation to avoid the possibility, or appearance, of conflict of interest by:

a. Developing selection criteria for individuals or other entities participating in approved program activities (trade teams, trade fairs, etc.) to enable participation on an equitable basis by a representative cross section of the relevant U.S. agricultural industry. While engaging in activities specifically approved in the Cooperator marketing plan, participants represent the interests of the particular U.S. agricultural commodity sector and may not use the activity to promote private self-interests or conduct private business; except as part of a sales team, if the use of sales teams is specifically approved in the Cooperator's annual marketing plan.

b. Providing, on a timely basis, upon request by any U.S. trade entity, any and all data (trip reports, research reports, trade leads, etc.) produced with project funds or Cooperator contributions. Cooperators may charge a fee sufficient to reimburse costs incurred in assembling, duplicating and distributing the requested material.

2

c. Not participating in the export trade of agricultural commodities which are promoted by the Cooperator utilizing project funds and not receiving a commission from such transactions. This prohibition also applies to the Cooperator's parent organization and subsidiaries. Checkoffs or other membership or dues assessments based on commodity sales or export values are excluded from this prohibition when such assessments are a condition of membership in the Cooperator association."

Figure II.3: Version Used Before December 15, 1986

DRAFT DRAFT DRAFT

FASG Amendment #2
(Signed _______, 1986)

TO: All Holders of 11 FASG

FROM: W. L. Davis
Assistant Administrator
Commodity and Marketing Programs

SUBJECT: Addition of Language to 11 FASG 103 Regarding Equitable Distribution of Benefits and Information Generated by Project Activities

In response to recent questions raised by Congressional members and the Government Accounting Office, the following language is being added as a new section under 11 FASG 103 (these provisions apply only to cooperators and not to the private U.S. firms participating in the Export Incentive, Brand Incentive or VAPP programs):

103.3 Conflict of Interest Provisions. Since the foreign market development program is funded with Federal resources, Cooperators share with FAS the obligation of ensuring that the benefits generated by the program are as broadly distributed throughout the relevant agricultural sector as feasible and, particularly, that no firm or organization derives an unfair advantage or benefit from project activities, whether funded with project funds or claimed Cooperator contributions. Therefore Cooperators have an obligation to avoid the possibility or appearance of conflict of interest by:

a. Developing selection criteria for U.S. participants in approved program activities (trade teams, trade fairs, etc.) that ensure participation on an equitable basis by a representative cross section of the U.S. industry promoted in the activity. While engaging in activities specifically approved in the Cooperator marketing plan, participants represent the interests of the U.S. commodity and may not use the occasion to promote private self-interests or conduct private business.

b. Providing, on a timely basis, upon request by any U.S. source, data generated by or produced at project expense. This data may include, but is not limited to, trip and research reports, trade leads, claimed Cooperator contributions and other information not covered by provisions of the Privacy Act. Cooperators may charge a reasonable fee sufficient to reimburse costs incurred in assembling, duplicating and distributing the requested material.

c. Neither Cooperators nor their subsidiaries may trade in agricultural commodities or their related services, or receive a commission from such transactions for commodities which are promoted by the Cooperator utilizing project funds. Checkoffs or other membership or dues assessments based on commodity sales or export values are excluded from this prohibition. The receipt and sale of commodity certificates in connection with carrying out approved Targeted Export Assistance Program activities are also excluded from this prohibition.

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