

**OVERSIGHT AND REAUTHORIZATION OF
THE FEDERAL GRAIN INSPECTION SERVICE (FGIS)**

Y 4. AG 8/3: S. HRG. 103-165

Oversight and Reauthorization of th... **RING**

BEFORE THE
SUBCOMMITTEE ON
AGRICULTURAL RESEARCH, CONSERVATION,
FORESTRY, AND GENERAL LEGISLATION
OF THE
COMMITTEE ON AGRICULTURE,
NUTRITION, AND FORESTRY
UNITED STATES SENATE
ONE HUNDRED THIRD CONGRESS

FIRST SESSION

ON

PROPOSED LEGISLATION AUTHORIZING FUNDS FOR THE FEDERAL
GRAIN INSPECTION SERVICE, DEPARTMENT OF AGRICULTURE, FOCUS-
ING ON INDUSTRY VIEWS ON THE DECLINE IN OFFICIAL INSPEC-
TIONS AND INSPECTION COSTS

MAY 13, 1993

Printed for the use of the
Committee on Agriculture, Nutrition, and Forestry



U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1993

67-951

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ISBN 0-16-041374-5

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OVERSIGHT AND REAUTHORIZATION OF THE FEDERAL GRAIN INSPECTION SERVICE (FGIS)

THURSDAY, MAY 13, 1993

U.S. SENATE, SUBCOMMITTEE ON AGRICULTURAL RESEARCH, CONSERVATION, FORESTRY AND GENERAL LEGISLATION OF THE COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,

Washington, DC.

The committee met, pursuant to notice, at 9:00 a.m., in Room SR-332, Russell Senate Office Building, Hon. Tom Daschle, chairman of the subcommittee, presiding.

Present or submitting a statement: Senators Daschle and Craig. Senator DASCHLE. The hearing will come to order.

I want to thank everybody for being here this morning. Let me begin by making a few opening remarks.

The official grain inspection system is a critical part of this Nation's grain marketing system. The honesty it brings to grain transactions, in my view, is well worth its minimal cost. It would be impossible to conduct trade as efficiently or smoothly, without nationally uniform grades and standards, backed up by a system of independent inspectors. Even unofficial grain inspectors rely upon the official system for baseline standards and quality control.

I am committed to preserving an official grain inspection system. Its design and operation may have to change over time, but I don't expect to see a day when it will not be needed. Even in Canada and Australia, where there is substantial control over the grain going into the marketing system, export inspections provide verification to foreign buyers.

The United States, in contrast, exercises virtually no control over what goes into the grain marketing funnel. Therefore, inspection is absolutely essential to determine what is coming out of the funnel at New Orleans or Portland or Houston.

The future competitiveness of the U.S. grain industry and American farmers depends upon the achievement of two goals. First, we have to maintain the highest possible level of honesty and integrity in our commercial relationships. And second, our marketing system must create incentives and rewards for improvements in grain quality.

The Federal Grain Inspection Service (FGIS) was last reauthorized in 1988. The authority for Congress to appropriate funds to FGIS expires at the end of this fiscal year. We are here today to ensure that that authority is extended and to address other issues

affecting those who depend upon the integrity and viability of the grain inspection system.

It was October 22, 1991, when this subcommittee conducted the last FGIS oversight hearing. At that time, the Federal Grain Inspection Service was suffering serious financial losses and drawing down its trust fund reserves to cover expenses. Exporters subject to mandatory official inspection complained about the high cost of official inspections, brought about, they said, by the bureaucratic inflexibility at FGIS. Discretionary official inspections offered by designated States and private agencies were in the midst of a decline that was claimed to be undermining the entire domestic inspection system.

After that hearing, the subcommittee, along with Chairman Leahy and Senator Lugar, asked the General Accounting Office to investigate the problems cited and recommendations made at the hearing. A year and a half has gone by and the GAO has just completed its report. So today, with some assistance from the General Accounting Office, we will revisit the issues raised at the last hearing.

At the beginning of the hearing, I would ask that unanimous consent be given that the entire GAO report be submitted as part of the official hearing record today.

[The GAO report is retained in the committee file.]

Our hearing will focus upon the Nation's grain inspection system, how it is organized and operated, what it costs, who pays the costs, and how we should amend the law to meet the objectives of competitiveness, equity and quality.

I look forward to hearing the answers to these questions from the excellent witnesses who have come to provide their best advice to this subcommittee this morning.

With that, let me invite all of our witnesses to come to the table. I would call them at this time: Dave Galliard of FGIS, accompanied by Dave Shipman; John Harman of the General Accounting Office, accompanied by Jim Hoffman and Carl Aubrey; Robert Gore, Jon Jacobson, Marion Hartman, Boyd Schwieder, and Dr. Charles Hurburgh.

Gentlemen, let me welcome all of you. Over the past couple of years, I have come to know some of you better than others, but I am delighted that each of you could be here. Let me begin by calling upon FGIS and Mr. Dave Galliard first, for the testimony provided by that agency.

**STATEMENT OF DAVID R. GALLIART, ACTING ADMINISTRATOR,
FEDERAL GRAIN INSPECTION SERVICE, UNITED STATES DEPARTMENT OF AGRICULTURE; ACCOMPANIED BY DAVID SHIPMAN, DIRECTOR OF THE FIELD MANAGEMENT DIVISION OF FGIS, WASHINGTON, DC**

Mr. GALLIART. Mr. Chairman, it is a pleasure to be here to discuss the importance of and the challenges facing the official grain inspection system. A complete written statement has been submitted for the record.

As you know, I am David Galliard, Acting Administrator of the Federal Grain Inspection Service, and joining me is David Shipman, Director of the Field Management Division of FGIS.

I would like to address three primary topics: The General Accounting Report on the national grain inspection system, the President's 1994 budget, and the administration's request to amend the United States Grain Standards Act to reauthorize FGIS.

The GAO report focused on the decline in domestic inspections, the cost of domestic inspections, and the cost of export inspections. The report concluded that despite the decline, the official system continues to provide two key services: standardization and impartial service. Standardization programs, which include the grading standards and uniform testing procedures, promote fair and efficient trade, both for users of the official system and for unofficial and in-house inspection processes.

The second critical feature of the official system is that it provides buyers and sellers with fair and impartial assessments of grain quality and quantity. Without official inspections, the domestic market would lack the option of obtaining standardized impartial inspections and an avenue for authoritative resolution.

In addressing the cost of domestic inspections, the report focuses on three key areas: the Agricultural Marketing Act of 1946 services, designated territories, and centralized quality control. The report states that further centralization of functions and contracting services under the Agricultural Marketing Act would not result in a significant cost savings to official agencies. It also suggests reviewing current policy that designates exclusive geographical areas to official agencies.

To capture the benefits and avoid the potential shortcomings of open competition, FGIS is evaluating greater consideration of fees in the designation process and allowing competition in geographic areas where the incumbent agency's fees are substantially higher than those of adjacent areas.

Finally, greater centralization of quality control activities has taken place. Objective tests, including measurements of wheat protein and aflatoxin, are directly monitored by FGIS from our Technical Center in Kansas City.

Centralizing subjective quality assurance would have several drawbacks, including removing several FGIS personnel from inspection locations and compromising their ability to supervise licensed inspectors, identify and prevent potential grading problems in local markets, and provide appeal inspection services.

The final issue addressed by GAO is of utmost importance to FGIS. That is the cost of export inspections. Over the past 17 years, FGIS has developed an export program that accurately measures grain quality and quantity, uses resources efficiently, and maximizes service delivery.

While State and private agencies can technically provide export inspection services with FGIS oversight, FGIS does not believe it would be as efficient and effective as the current system. It also is important to consider that under the current system, official certificates are the accepted, trusted, worldwide common language for trading grain.

Moving on to the topic of the 1994 budget. The President's fiscal year 1994 budget proposes appropriating \$4.7 million to FGIS for compliance activities. Standardization activities, budgeted at a total of \$6.8 million, would no longer be funded through appropriations and would be covered by users' fees.

Standardization activities, which include marketing standards, research and development, and quality assurance programs, benefit the entire grain industry from producer to end user.

The final topic involves reauthorization. Under separate correspondence, the Department is or will be submitting for consideration by the Congress a draft bill to amend the U.S. Grain Standards Act to reauthorize FGIS to charge and collect fees for inspection and weighing services. The current authorization expires at the end of the fiscal year.

In closing, I would like to emphasize that the official inspection system plays an integral role in U.S. agriculture. FGIS and our partners in the official inspection system continue to provide accurate and unbiased inspection and weighing services to buyers and sellers of U.S. grain.

Our standardization activities remain the backbone of the U.S. grain marketing system by helping ensure fair and efficient trade. Our records show that FGIS has responded to the financial and program challenges presented by today's competitive market. I am confident that we will continue to meet future challenges.

Mr. Chairman, this concludes my statement. I would be glad to respond to any questions.

[The prepared statement of Mr. Galliard follows:]

PREPARED STATEMENT OF DAVID R. GALLIART, ACTING ADMINISTRATOR, FEDERAL GRAIN INSPECTION SERVICE, U.S. DEPARTMENT OF AGRICULTURE, WASHINGTON, DC

Mr. Chairman and members of the subcommittee, it is a pleasure to appear before you with the opportunity to emphasize the importance of the official grain inspection system to U.S. agriculture and to discuss the challenges facing the system. I am David Galliard, Acting Administrator of the Federal Grain Inspection Service (FGIS).

The recently released General Accounting Office (GAO) report on the national inspection system, the President's 1994 budget calling for additional FGIS user fees, and the administration's proposal to amend the United States Grain Standards Act (USGSA) to reauthorize FGIS to charge and collect fees are all interrelated and raise important issues worthy of our full consideration.

GAO REPORT

Permit me to begin my remarks today with the GAO report which will serve as a basis for my later comments concerning the budget and amendments to the USGSA.

The GAO report focuses on some of the main challenges facing the official grain inspection system. The first issue presented in the report addresses the use of official inspections in the domestic market. The report echoes many of the remarks made by witnesses during testimony heard by this subcommittee in October 1991 concerning the decline in the number of official domestic inspections. Consolidation and integration of companies, improved in-house quality control, the trend towards establishing and promoting supplier/buyer product quality relationships, transportation changes, and modifications in certain Government policies are cited as factors contributing to the decline in official inspections.

The question is whether the decline in official grain inspection is good or bad for U.S. agriculture. We would not classify the current decline as detrimental to U.S. agriculture. The official inspection system greatly benefits the grain industry, and we encourage the market to capitalize on the high quality of service available. Market conditions have reduced the need for official service. We must recognize these conditions and respond to them in a positive and timely fashion to ensure that

the official system continues to improve its ability to meet customer demands. Although service use has declined, we still maintain a domestic infrastructure that permits buyers and sellers to obtain official inspection service. In fiscal year 1992, over 2.1 million inspections, representing over 137 million metric tons, were performed in the domestic market.

The official inspection system provides U.S. agriculture with two critically important services—*standardization* and *impartial service*. The standardization process promotes fair and efficient trade. This includes grading standards which reflect a consensus of the market and serve as a common language for merchandizing. It also includes standard testing procedures that promote uniform application of the grading standards.

The standardization process is also beneficial to the unofficial and in-house inspection processes. Unofficial inspection firms and in-house inspectors routinely use FGIS developed and approved techniques to compare their results to those issued by the official system. This enables the unofficial inspection firms to make the necessary adjustments to provide satisfactory results. Without the official system, unofficial inspection firms would lack standardization which could cause costly market disruptions.

It is true that the unofficial and in-house inspectors pay a nominal fee for direct services received. The average cost of a submitted sample inspection (the method often used to compare results), is \$7.03 per sample. However, this payment does not support the standardization of the official system and, therefore, does not nearly compensate for the many benefits received. For example, FGIS develops moisture charts based on national surveys and extensive testing and provides these data upon request at no charge. Likewise, widely used protein calibrations that cost FGIS thousands of dollars to develop are available at no charge. Finally, when crop conditions demand special attention, the industry uses the official inspection system as a "safety net" to supplement unofficial inspections. Without this, unofficial testing could not meet the market's inspection needs.

The second critical feature of the official inspection system is its ability to provide the market with an impartial inspection service. This ensures that everyone in the market has the opportunity to receive a fair and unbiased assessment of the grain quality and quantity they are buying or selling. The official system includes an appeal process which permits the buyer or seller to challenge the initial findings of an official inspector. Furthermore, several States and even the Department's Agricultural Stabilization and Conservation Service (ASCS) rely on the official system to ensure that those buying or selling grain have the opportunity to receive a fair and honest assessment of their product's quality and quantity. ASCS includes clauses in its "Commodity Delivery Notice" and its "Uniform Grain Storage Agreement" that permit a farmer to request official inspection if they disagree with the grade and quality determination of the warehouseman. Several States have similar procedures to guarantee the option of obtaining results for dispute resolution.

The official system plays a critical role in the domestic market. The current system is constantly responding to market conditions with new procedures and improved service delivery. The domestic market works because the official system serves as a check and balance to promote fair marketing practices and minimize costly disruption. If the domestic system degrades to a level whereby producers, grain handlers, and end users are unable to rely on official inspection whenever there is a question or concern over quality, the check within the system will be lost. As members of the grain industry have stated to you repeatedly, the grain industry is extremely competitive and operates on incredibly thin margins. Without an official inspection system providing an option to everyone in the market for a standardized, impartial inspection, and an avenue for authoritative resolution, market competition may result in unethical practices.

The very success of the U.S. grain marketing system is the result of innovative improvements in production, handling, transportation, and processing; all of which occurred due to open market competition. The United States has the most sophisticated and reliable grain marketing system in the world, an accomplishment all Americans should be proud of. And we strongly believe the official grain inspection system is an essential part of that marketing system.

We believe the industry as a whole recognizes the essential role of the official inspection system in the U.S. grain marketing process and will continue to support the system. We also recognize the need for the inspection system to be efficient, cost effective, and productive. Under FGIS leadership and with industry support, we are exploring new and innovative ways to improve the official inspection system, such as the Official Commercial Inspection Service, which allows designated agencies the

option of offering customized inspection services without having to purchase a full set of services.

We must evaluate information presented in the GAO review, consider the benefits of greater centralized quality control, seize every opportunity to improve program efficiency, and finally, we must accelerate our ability to introduce new technology and respond to market conditions.

The next area examined by GAO is the cost of domestic inspections. The report shows that FGIS receives an average of about five percent of the total fee charged by agencies. The report also explains that while further centralization of functions and contracting of the Agricultural Marketing Act of 1946 (AMA) services are options for consideration, they do not represent significant cost savings to official agencies.

The three important issues raised in this section of the report are (1) AMA services, (2) designated territories, and (3) centralized quality control. It has been the practice of the Department of Agriculture to enter into cooperative agreements with States to carry out AMA responsibilities whenever it is in the best interest of the Department. FGIS currently has 20 State cooperative agreements, ranging from State employees providing only a sampling service to State agencies operating the entire program.

We are considering the option of contracting with private firms to provide AMA services and will reach a decision based upon what is in the best interest of the inspection system.

The second concern regards the designation of exclusive noncompetitive geographical service territory to each designated agency. The concept of competition may have certain benefits, but we advise great caution. Competition can create two potential problems. First, there will be a tendency for agencies to compete only for the high profit service locations, leaving FGIS with the responsibility to provide service in less active and remote locations. Currently, official agencies are responsible for providing service throughout the entire assigned area. Second, with more than one agency serving an area, buyers and sellers have an open door to pressure agencies to provide favorable results because they have the option of finding another agency. These shortcomings of competition could lead to conflicts of interests, confusion, lack of uniformity, and unnecessary market disruption.

How can we capture the benefits of open competition and avoid these potential shortcomings? The GAO report offers two options: (1) make fees a major consideration in the designation process, and (2) allow official agencies to compete in geographic areas where the incumbent agency's fees are substantially higher than those of adjacent agencies. We intend to work with industry and the official agencies to evaluate both of these options. We need to determine whether the cost of domestic inspection is excessive, and whether competition or stricter designation requirements would expand the use of official inspection. It is likely we will discover that some grain firms will not use official inspection regardless of the cost, while others will use it if the cost is more competitive.

At this time, we believe the first option presented in the GAO report is more desirable than the latter option of open competition. We will consider this option and explore ways to increase competition during the triennial renewal process. However, the existence of both State and private official agencies complicates this process. In most cases, State agencies will not seek territory outside their respective State. Likewise, few private agencies are interested in servicing an entire State.

Centralizing quality control activities within the Agency has been examined on several occasions and has resulted in greater centralization of this activity. The establishment of the Quality Assurance and Research Division at the FGIS Technical Center in Kansas City was an initial step toward greater centralization. From the Technical Center, we now directly monitor several objective tests, including wheat protein testing, soybean oil and protein testing, falling number service, aflatoxin analysis, and free fatty acid testing in rice. We have also developed a field quality assurance specialist program to ensure greater uniformity in determining subjective grading factors. These individuals are viewed as an extension of the Board of Appeals and Review and are responsible for overseeing the quality assurance activities at the local level.

Centralizing the quality control process for objective tests is cost effective and practical. Meaningful data can be transmitted electronically between the Technical Center and local officials to ensure the system is uniform and accurate.

Quality assurance efforts for subjective grading factors present a different and more complex challenge. This process involves standardizing the determinations of hundreds of inspectors. Does the grain smell sour? Has the kernel of corn been discolored enough to be labeled damaged? Does the wheat exhibit hard red winter or

spring kernel characteristics? These and many more subjective determinations are made by inspectors every day.

Completely centralizing the subjective process would remove the local FGIS representatives from the mainstream of events and could significantly compromise their ability to carry out their important function. The local FGIS officials play an important role in standardizing the subjective grading function. They supervise the actual performance of licensed inspectors, identify potential grading problems in the local market, and work with the licensed inspectors to prevent market problems, and provide appeal inspection service.

The final issue addressed by GAO is the cost of export inspection. This is of utmost importance to FGIS. Inappropriate practices in the export market led to the establishment of FGIS. Over the past 17 years, FGIS has developed an export program that ensures an accurate measurement of grain quality and quantity. We have made and continue to make every effort to optimize the efficient use of resources and to maximize service delivery. To reduce our operating expenses and the cost of official personnel needed to provide service, we are working with the industry to automate export elevator operations. We are also continuing to look for new technology that will improve and streamline the inspection process. The use of NIRT technology for wheat protein requires an initial capital outlay but will provide significant labor and equipment savings in the long term. Furthermore, we are working on automating the export inspection plan and certain administrative functions. Finally, we are evaluating the potential benefits of further consolidating our field office structure. All of these efforts will result in cost savings over the next few years at export locations.

Concerning the issue as to whom should provide export inspections, we believe it is in the best interest of U.S. agriculture to retain the current arrangement. While FGIS believes State and private agencies can technically provide export inspection service with FGIS oversight, FGIS does not believe it would be as efficient or effective as the current system.

The United States has built a worldwide reputation on the integrity of the quality and weight certificates issued by FGIS on U.S. grain exports. Buyers and sellers alike have come to rely on FGIS certificates. Although exporters are required by the U.S. Grain Standards Act to have all exported grain officially inspected by FGIS, they are not required to use our certificates and grades as a basis of trade. But, the marketplace has chosen to do so. The certificates issued by FGIS are the accepted, worldwide common language for trading grain.

For many years, FGIS has informed importers, millers, overseas traders, and trade teams visiting the United States about the integrity of our export certificates and the role FGIS plays as an independent third-party entity. Every year, trade teams from many countries visit FGIS offices to study the national inspection system. The teams are impressed with the quality control offered by FGIS, and many have asked FGIS to train their inspectors. Some have changed their inspection systems to imitate ours. This demonstrates the faith and trust they place in the national inspection system and the FGIS-issued certificates. We believe importers of U.S. grain would lose confidence in the inspection process if private companies were permitted to provide export inspection service.

For nearly 17 years, FGIS has operated under a user-fee funding arrangement. This has fostered the development and application of numerous cost-effective operating procedures, from employee scheduling and cross-utilization to space management and inspection procedures. We are streamlined with limited overhead and a high level of productivity. This has allowed us to maintain low staffing levels at marginal export locations and to utilize staff from other offices as needed. We do not believe a State/private arrangement at the major export locations now serviced by FGIS would provide equivalent service for less cost to the grain industry. When considering the cost of maintaining an adequate FGIS staff to provide appeal inspection service and to oversee private agencies operating 24 hours a day in the mandatory export inspection program in addition to the direct cost of service, and considering the potential loss of foreign buyer confidence, we believe the current system best serves U.S. agriculture.

FY 1994 BUDGET

In both FY 1993 and FY 1994, collections for inspection and weighing services are estimated to be \$42.8 million. For salaries and expenses, funding for FY 1993 is \$11.4 million, of which \$4.6 million for compliance activities and \$6.8 million for standardization is being funded through appropriations. In FY 1994, while funding increases to \$11.6 million, the total being requested through appropriations (for com-

pliance activities) is \$4.7 million, while the remainder (for standardization activities) of \$6.9 million is to be funded through user fees.

We are currently examining alternative procedures for assessing a user fee for standardization activities. As we proceed with this effort, it is important to understand what a standardization activity is and who benefits from such an activity. In brief, standardization activities include:

Marketing Standards: The development and maintenance of marketing standards for grain, oilseeds, rice, peas, beans, and lentils.

Research & Development: The research, development, and application of new technologies that better reflect the quality and value of U.S. grain, oilseeds, rice, peas, beans, and lentils.

Quality Assurance: The maintenance and quality assurance of instruments and inspector performance to national standards. This serves as a reference from which the entire U.S. grain marketing system operates.

The beneficiaries of these activities vary from the direct users of the official inspection system to anyone who buys and sells grain and grain products. Nearly anyone marketing grain, rice, peas, beans, or lentils in the United States relies on the Official U.S. Standards. Most of these individuals are not direct FGIS customers. They simply use the Official U.S. Standards as an agreed upon terminology to describe grain quality for trading purposes.

Those who measure the percent of moisture in grain, rice, beans, peas, lentils, and processed products rely on the FGIS moisture program as a reference. In fact, State officials use the FGIS moisture method and calibration as the basis for the enforcement of accurate moisture measurement in commerce.

Those who rely on wheat protein as a marketing tool also benefit from standardization activities. The official wheat protein program is one of our largest and most market-sensitive programs. It is imperative that we maintain an adequate control system to ensure consistent and accurate protein results. Our control system involves everything from the initial instrument evaluation and calibration development to continuous monitoring, training, and reverification. This control system directly influences the delivery of over 500,000 official protein tests per year and indirectly influences countless unofficial protein tests. The market often measures the accuracy of unofficial protein test results based on their relationship to official results. FGIS maintains similar control programs for moisture determination, grain grading, soybean oil and protein, aflatoxin determination, falling number analysis, and sunflower seed oil.

Beneficiaries of FGIS research and development represent the broadest group of recipients of standardization activities. Performance standards for aflatoxin measurement established by FGIS have been adopted by the industry and other organizations, such as the Association of Official Analytical Chemists Research Institute. The entire grain industry, from producer to end user, benefits from research and development projects that increase inspection efficiency and adds to our ability to measure grain quality.

U.S. marketing efforts also benefit. The Food and Drug Administration monitors grain products for pesticide residues to ensure consumers receive a safe and healthy food supply. And FGIS has begun to collect additional survey data on pesticide residues on wheat for market promotion efforts. Data from market wheat samples clearly show that the U.S. crop has no pesticide levels that would have public health consequences. Our competitors in Canada have been conducting similar surveys for years and have used it quite successfully in their marketing efforts.

In summary, standardization activities benefit a wide segment of the grain industry. There are several alternatives for assessing fees to cover these activities. We could increase the existing user fees charged to those requesting official inspection and weighing service. We could assess a fee for the release of specific information, such as protein calibrations which cost thousands of dollars to develop and maintain. We could develop a method for assessing both direct and indirect users, such as an assessment on grain elevators or a producer checkoff. These and any other alternatives identified will be considered for possible application of the final FY 1994 budget.

USGSA AMENDMENTS

The final area I would like to discuss is the Department's request to amend the USGSA. Under separate correspondence, the Department is or will be submitting for consideration by the Congress, a draft bill to amend the USGSA. The bill includes the necessary amendments to reauthorize FGIS to charge and collect fees for inspection and weighing services, which expires at the end of this fiscal year.

CLOSING

The official inspection system plays an integral role in U.S. agriculture. FGIS and our partners in the official inspection system continue to offer accurate and unbiased inspection and weighing services to buyers and sellers of U.S. grain.

And, our standardization activities continue to serve as the backbone of the U.S. grain marketing system by helping ensure fair and efficient trade. The U.S. grain standards, developed and maintained by FGIS, are the common merchandizing language of the United States and many of our export markets. Standard testing procedures promote uniform application of the grading standards. Official standardization activities serve not only the users of the official system, but the unofficial and in-house inspection processes as well. Throughout the years, our record shows that FGIS has responded to the financial and program challenges presented by today's competitive market. I am confident that we will continue to meet future challenges.

Mr. Chairman, this concludes my statement. I will be glad to respond to any questions you or other members of the subcommittee may have.

Senator DASCHLE. Thank you, Mr. Galliard.
Mr. Harman.

STATEMENT OF JOHN HARMAN, DIRECTOR, FOOD AND AGRICULTURE ISSUES AREA, GENERAL ACCOUNTING OFFICE, WASHINGTON, DC; ACCOMPANIED BY JIM HOFFMAN, EVALUATOR-IN-CHARGE, GENERAL ACCOUNTING OFFICE, WASHINGTON, DC, AND CARL AUBREY, ASSISTANT DIRECTOR, GENERAL ACCOUNTING OFFICE, KANSAS CITY, KS

Mr. HARMAN. Thank you, Mr. Chairman.

We are also pleased to be here today to discuss results of our report on selected aspects of the official grain inspection system, which is administered by FGIS.

I would like to again introduce my colleagues at the table with me this morning. On my far right is Carl Aubrey. Carl has been involved in agriculture issues for some time and operates out of our Kansas City office as assistant director. Jim Hoffman is the person who did the legwork on this report. He's the one who knows all the answers, so that's why he's here today.

As you said, this work was done at both your request and that of several other Senators, and this request asked us to answer a number of questions which we categorized and really deal with: First, with the decline in official inspections in the domestic grain market and the impact of that decline; fees that official inspection agencies charge for official domestic inspections; thirdly, fees that FGIS charges for export inspections; and then, finally, potential options for reducing inspection fees.

I will be summarizing the prepared statement which has been submitted for the record.

Regarding the decline in official inspections, I will refer to appendix II.¹ Do you have that?

Senator DASCHLE. I do.

Mr. HARMAN. I will be referring to appendixes II and IV. Appendix II shows that this occurs from 1985 to 1992. The number of inspections had declined from about 2.7 million in 1985 to a little over 2 million in 1992. This represents a 19 percent decline in the number of official inspections. In terms of metric tons, it was about 150 million, a little over 152 million metric tons in 1985. That's de-

¹ See pages 17-18 for appendixes I-VI.

clined to about 137.5 million metric tons in 1992, which represents a 10-percent decline.

If you look at appendix IV, it will show that this decline was not spread evenly across the official agencies. Thirty of the agencies actually had an increase over that time period and 40 had a decrease. Most of those increases and decreases occurred in the smaller agencies which had 25,000 or less inspections.

You will note, as a good GAO auditor, I will point out that only adds to 70, which two agencies didn't change at all.

Now, the industry representatives that we talked to cited several factors influencing the decline, including the costs of official inspections and a trend to improved internal quality assurance programs. They also said that the decline has not resulted in increases in buyer complaints that sellers are not delivering the quality of grain purchased.

Now, the second issue, regarding domestic inspection fees for official domestic inspections, they vary widely among State and private agencies.

Senator DASCHLE. Mr. Harman, could I just stop you there?

Mr. HARMAN. Sure, go ahead.

Senator DASCHLE. I hate to interrupt any of our witnesses, but just to clarify, was it the cost, in your view, in the view of the GAO, that was most responsible for the decline? You said there were a number of factors, and you mentioned cost, and then you alluded to some other matters, but I just want to put that in proper perspective. Could you just elaborate a little bit more on that?

Mr. HARMAN. Cost is one of the factors. I don't think we could accurately determine whether it was the primary factor. Sometimes you'll get a cost as a reason when there really are some other reasons involved. This market has changed, too, to some extent. There's been some consolidation of the market, which means there are fewer transfers of grain. As the process works its way through, there are issues involving, as I said, the internal quality control. There's a need there. These companies told us that they have an express need for internal quality control procedures, and if they can do that at less cost and it meets their need, they're going to go with it.

I think it really comes down to the relationship that exists between the buyer and the seller. If there's a good relationship there, they may be willing to go with the unofficial inspection. If there's not, then they may want to have an official inspection. So the cost in that second situation may not enter into it. They'd be willing to do it at any cost.

Senator DASCHLE. You didn't mention whether there was any increase in the confidence level of unofficial inspections. Is that a factor?

Mr. HARMAN. We know, what we were told is that there's not a decrease, that there is a confidence in those unofficial inspections, that the companies and the merchandisers have a confidence in that and they believe, as well as FGIS, I believe, believes that there's not been a deterioration in the quality of the grain that's being sold.

So what you seem to be looking at here is some change in the market and some need for services, that the official inspection

system is either not providing or is providing it at a cost that the customer is not willing to pay for at this point. I think the key is going to be at what point does that market deteriorate. Is that need going to continue, the lack of that need going to continue, and at what point does that become uneconomical for the official inspection system?

So those kinds of issues, I think, have to be addressed and the pilot, which I'll talk about in just a second, is one good way, I think, that gives the official inspection system the ability to be more competitive.

As I've said, the fees vary widely among the State and private agencies, each operating exclusively in a specified geographical area, and I'll refer to appendix VI.

We looked at the agencies that carry most of the business within each of these types of inspections, basically about 90 percent of the business. As an example, if you look at trucks, there's about 11 agencies that do about 90 percent of the inspections on the truck mode of transportation for grain, and the fees range from a low of \$5.30 to a high of \$16.55, for a weighted average of somewhere around \$9.60.

Now, the FGIS' fees in total represent about 5 percent of the 72 agencies' estimated fee charges of \$28 million in 1992. Now, that doesn't look to be substantial enough to make that much of a difference unless you're on the margin. If you're on the margin, it would make a difference, that 5 percent. If you're not on the margin, obviously it may not make as much difference. But the range is pretty significant.

The third set of questions, that is FGIS' fees for verifying the grade and weight of export grain. Those fees averaged an estimated .47 cent per bushel, forty-seven one-hundredths of a cent per bushel. The eight States that perform these services, they averaged about .41 cent per bushel, and those State agencies ranged from about three-tenths of a cent to nine-tenths of a cent per bushel.

In total, the exporters paid FGIS and State inspection agencies about \$17.7 million in 1992 for required export inspections of grain. That grain is valued at about \$14.5 billion, or those fees represent about one-tenth of 1 percent of the value of the grain.

Now, the final issue, which is options for reducing fees, we discussed this a great deal, and industry representatives told us that the fee-setting process which essentially provides a monopoly for official domestic inspection agencies in a specified geographic area needs to be more competitive. The potential options that they mention include developing a more competitive process for designating inspection agencies to perform official domestic inspections and approving the inspection fees, and then, secondly, turning export inspections performed by FGIS over to State and private inspection agencies.

Some of the options—and there are several variations of these options—can be considered and acted upon by FGIS; others cannot, because a change in statutes would be required.

Also I might mention that there was really not a good consensus, especially for export inspections.

In any event, what we would urge is that we maximize the use of pilots and pilot tests as we make changes to this system. We had a

situation in the mid-70's in which GAO was heavily involved in things that we prefer we not get involved in again, and this system seems to have corrected that problem. What we need to do is make sure as we make these changes that we do it with good data and with our eyes open, and many times that does not involve making wholesale changes to the system.

That concludes my summary, Mr. Chairman. We would be pleased to answer any questions you may have.

[The prepared statement of Mr. Harman follows:]

PREPARED STATEMENT OF JOHN HARMAN, DIRECTOR, FOOD AND AGRICULTURE ISSUES AREA, GENERAL ACCOUNTING OFFICE, WASHINGTON, DC

Mr. Chairman and members of the subcommittee, we are pleased to be here today to discuss our report on selected aspects of the official grain inspection system, administered by the U.S. Department of Agriculture's (USDA) Federal Grain Inspection Service (FGIS).² The Congress enacted the U.S. Grain Standards Act of 1976 in response to widespread abuses in the quality and quantity of grain delivered in the mid-1970s. The act requires official inspection and weighing of all grain of a specified grade for export and provides for official inspection as an option in the domestic market. Export inspections are carried out by FGIS or by State-operated agencies under delegation from FGIS; voluntary official inspections in the domestic market are carried out by 72 State-operated and privately owned inspection agencies designated by FGIS. FGIS supervises State-operated and private agencies and collects fees for some of the services it provides.

Our testimony is based on work we did at the request of Senators Daschle, Kerrey, Leahy, and Lugar. Specifically, we answered several questions about (1) the decline of official inspections in the domestic grain market and the impact of that decline, (2) fees that official inspection agencies charge for official domestic inspections, (3) fees that FGIS charges for export inspections, and (4) potential options for reducing inspection fees.

In summary, we reported the following:

- Official domestic inspections performed by the 72 agencies declined by about 19 percent from 1985 to 1992, even though 30 of the agencies performed more official inspections of grain in 1992 than in 1985. Industry representatives cited several factors influencing the decline, including the cost of official inspections and a trend to improved internal quality assurance programs. They also said that the decline has not resulted in increases in buyer complaints that sellers are not delivering the quality of grain purchased.
- Fees for official domestic inspections vary widely among the State and private agencies, each operating exclusively in a specified geographical area. For example, the fee for inspecting any size truckload of grain varies from \$5.30 to \$16.55 among the official agencies that perform most official truckload inspections with FGIS' supervision fees averaging about 5 percent of the 72 agencies' estimated fee charges of \$28 million in 1992.
- FGIS' fees for verifying the grade and weight (i.e., official inspection and weighing) of export grain averaged an estimated .47 cent per bushel. The eight States performing identical services charged an average of .41 cent per bushel. In total, exporters paid FGIS and State inspection agencies about \$17.7 million in 1992 for required export inspections of grain valued at about \$14.5 billion, or about one-tenth of 1 percent of the value of the grain.
- Industry representatives said that the fee-setting process, which essentially provides a monopoly for official domestic inspection agencies in a specified geographic area, needs to be more competitive. Potential options mentioned include (1) developing a more competitive process for designating inspection agencies to perform official domestic inspections and approving the inspection fees and (2) turning export inspections performed by FGIS over to State and private inspection agencies. Some of the options can be considered and acted on by FGIS; others cannot because the law does not give FGIS any discretion.

² "Grain Inspection: Industry Views on the Decline in Official Inspections and Inspection Costs," GAO/RCED-93-147, April 30, 1993.

BACKGROUND

Following widespread disclosures of misgrading and "shortweighing" of grain in the mid-1970s, particularly of export grain, the Congress amended the U.S. Grain Standards Act (USGSA) (7 U.S.C. 71-87) by enacting the U.S. Grain Standards Act of 1976 to reform the system. In sum, the 1976 act gave the FGIS Administrator the responsibility for promoting, facilitating, and regulating the merchandising of U.S. grain in an orderly, objective, and timely manner by establishing official standards for grain and uniformly applying those standards through a system of official inspection and weighing.

Wanting to ensure that the quality of grain exported is correctly represented, the Congress in the 1976 act required that shipments of grain of a specified grade for export be inspected and weighed at the export terminal. FGIS performed about 82 percent of the export inspection and weighing in 1992.³ FGIS may also delegate its authority to State government agencies to perform the services under FGIS' supervision, if the agencies meet specified requirements of the act. Under delegations from FGIS, eight State agencies perform export inspection and weighing services.

The 1976 act made official inspections of grain optional in the domestic market. It authorizes FGIS to designate private and State agencies to offer and perform official inspections in the domestic market. FGIS has designated 72 official agencies (20 State and 52 private), each of which operates in an exclusive geographical area under FGIS oversight.⁴

FGIS and the official agencies also provide other types of services, including measuring wheat and soybean protein content and soybean oil content, as well as measuring for the presence and amount of aflatoxin. In addition, under the Agricultural Marketing Act (AMA) of 1946 (7 U.S.C. 1621 et seq.), the Secretary of Agriculture has delegated to the FGIS Administrator responsibility for developing inspection and weighing standards and inspecting specified commodities (rice, pulses, beans, and processed grain products, such as flour and corn meal). FGIS collects fees to cover its costs of performing inspections under the AMA.

As shown in appendix I, FGIS' expenditures for 1992 totaled \$40.5 million. Fee income for its supervision and services totaled about \$29 million.

DECLINE OF OFFICIAL INSPECTIONS IN THE DOMESTIC MARKET

As shown in appendix II, from 1985 to 1992, the most recent period for which FGIS has separate data for domestic inspections, the number of official domestic inspections performed by official inspection agencies declined from about 2.7 million to 2.2 million, or about 19 percent. During the same period, the number of total metric tons inspected declined from about 152 million to 137 million, or about 10 percent. Appendix III indicates that the decline in volume of grain was less severe than the decline in the number of inspections because of changes in the mix of inspections performed. For example, the number of inspections of rail cars hauling grain was greater in 1992 than in 1985, while the number of inspections of trucks hauling grain was less.

Our interviews with Government and industry representatives indicated that several factors, in addition to cost, have contributed to the changes in demand for official domestic inspections, beginning in the 1970s. First, consolidations in the grain industry have reduced the number of times the ownership of grain changes hands from the farmer to the end-user; fewer changes in ownership require fewer third-party inspections. Second, there is a trend among grain merchandisers to "in-house" grading, prompted by cost considerations and the need for internal quality assurance programs. Third, buyers have greater confidence than in past years that sellers will deliver the quality of grain agreed upon and work out acceptable solutions in those instances in which problems occur. Fourth, the Agricultural Stabilization and Conservation Service (ASCS), which manages the Government's grain inventories obtained under farm commodity programs, has changed the way it manages its inventories and has substantially lower grain acquisitions, which has resulted in fewer movements of grain.

According to industry representatives, the decline in demand for domestic inspections has not harmed the integrity of grain merchandising. That is, they do not believe that the decline has resulted in increased buyer complaints that sellers are not delivering the quality of grain that buyers purchased. One grain association's representatives said that the number of arbitration cases has not increased in recent

³ All years presented are fiscal years.

⁴ One of the 72 designated agencies performs weighing services only.

years, which is one indication that the integrity of grain transactions has not been harmed.

FGIS representatives believe that integrity has not been compromised because the official system serves as a safety net for the unofficial system. According to FGIS, unofficial agencies obtain samples regraded by official agencies to measure the accuracy of their grading and to settle disputes between buyer and seller when an official inspection was not initially obtained.

The major benefits of official inspections, according to industry representatives, are that the inspection is performed by an independent third party and that the grading results are highly reliable. Nonetheless, those we interviewed unanimously opposed amending the USGSA to require official domestic inspection.

At some point, continuing declines in the number of official inspections will make it financially infeasible to continue an official domestic inspection system. However, the level of inspections necessary to maintain the economic viability of an agency varies from agency to agency. Moreover, the number of inspections performed by the official agencies in 1992 ranged from under 1,000 to just over 235,000. As shown in appendix IV, 30 of the 72 agencies increased their number of inspections compared with 1985. As shown in appendix V, 16 of the 72 agencies performed over 50,000 inspections and accounted for 63 percent of the inspections, while more than one-half of the agencies performed 25,000 or fewer inspections.

FGIS representatives said that they are not sure what impact a continuing decline in the use of the official system in the domestic market might have on the integrity of grain transactions. If an agency relinquished its charter, FGIS would try to get a new agency or have an existing agency add the area to its operation.

FEES FOR OFFICIAL DOMESTIC INSPECTIONS

The 72 official domestic inspection agencies charged their users an estimated \$28 million (excluding variable charges)⁵ for 2.2 million official inspections in 1992. Each official agency sets its own fees, although FGIS must initially approve agencies' fee schedules as well as any changes. The official agencies paid FGIS about \$1.5 million in fees for its supervision in 1992, or an average of about five percent of the total fees they charged. Thus, on average, 95 percent of the costs of official domestic inspections are controlled by the agencies.

As shown in appendix VI, the official agency fees, as of November 1992, varied widely for the same inspection service even when comparisons are limited to those agencies performing most of a particular type of inspection. The variance in fees was greatest for trucks, ranging from \$5.30 to \$16.55.

Although FGIS' regulations require that each agency's fees be reasonable and supported by cost data, official agency inspection fees vary widely even among agencies operating in adjacent areas. For example, one agency charged \$23.70 for inspecting a rail car of grain, while agencies operating in adjacent geographic areas charged from \$9.45 to \$18.20.

The FGIS fee for supervision does not include its total cost of overseeing the official agencies performing domestic inspections. Following its regulations, FGIS does not include in the fee the cost of (1) regrading samples of grain graded by the official agencies to verify the accuracy of the grading and (2) FGIS' annual management review. FGIS' costs for these oversight activities, which it pays from appropriated funds, totaled \$2.57 million for 1992.

Recognizing that its procedures governing an official inspection might be too stringent and costly to meet some of the needs of potential domestic customers, FGIS developed the new official commercial inspection. This new inspection, approved in April 1992, allows agencies to deviate from the requirements for the standard official inspection and tailor inspections to the customers' needs. FGIS also believed that the new inspection would enable the official agencies to better compete with the price of unofficial inspections; it estimated that fees for the new inspection should be from 10 percent to 40 percent below the standard fees. Some official inspection agencies' representatives explained that the official commercial inspection enabled them to obtain inspection business that they would not have otherwise attracted. Use of the new inspection had increased to about five percent of the

⁵ The estimate is based on each official agency's 1992 inspection activity reported to FGIS, multiplied by the price shown on each agency's fee schedule for each type of inspection for grade. The estimate excludes any additional variable charges for travel time or mileage for drawing samples, which FGIS estimates at about \$10 million. Also, the estimate excludes any charges for performing additional services, such as protein measurements or aflatoxin tests.

total domestic inspections by early 1993. However, many industry representatives we interviewed were unfamiliar with the inspection.

FGIS FEES FOR EXPORT INSPECTIONS

Of the \$14.5 billion in grain exports that FGIS and State official agencies inspected and verified weight for,⁶ the exporters paid FGIS \$14.9 million and paid the State agencies \$2.8 million for a total of about \$17.7 million in 1992, or about one-tenth of 1 percent of sales. This amount includes charges for inspection and weighing required by the USGSA for all grain exported, but it does not include any additional services requested by exporters, such as testing for wheat and soybean protein content and soybean oil content, or measuring for the presence and amount of aflatoxin.

To compare FGIS and State inspection fees, we calculated an average price per bushel for both FGIS and the eight State agencies. FGIS' charges for inspecting and weighing export grain for 1992 averaged an estimated .47 cent per bushel while the eight State agencies charged an average of .41 cent per bushel. FGIS performed about 82 percent of the export inspection and weighing services in 1992. FGIS' export inspection fees are expressed in hourly rates per person needed to perform the inspections at each location. The eight States charge by the bushel or short ton, which ranges from three-tenths to nine-tenths of a cent per bushel.

Our review of FGIS' accounting records indicates that direct costs charged to the FGIS services-performed account for 1992, which is predominantly FGIS export inspection activity, were appropriate. However, FGIS used a questionable methodology to allocate indirect costs, which may have resulted in an undercharge of \$695,000. The FGIS Acting Administrator said that the agency would review its methodology for allocating indirect costs.

POTENTIAL OPTIONS FOR REDUCING INSPECTION FEES

The American Association of Grain Inspection and Weighing Agencies (AAGIWA), an association of official inspection agencies, suggested that FGIS could reduce its operating costs and possibly official agencies could reduce their costs by combining USGSA's and AMA's inspection functions. In addition, industry representatives suggested that more competition should be introduced into the fee-setting process. However, the extent to which implementation of these options would result in savings is unclear because no studies are available showing the costs of the alternatives compared with current practices.

Combine USGSA's and AMA's Inspection Functions

AAGIWA recommends that official agencies be allowed to conduct AMA commodity inspections as well as grain inspections, which they are not now permitted to do. AAGIWA believes that combining the two functions would allow FGIS to consolidate more field offices, more effectively utilize personnel, and allow official agencies to operate more efficiently by performing AMA inspections when demands for grain inspection are low.

Although FGIS' field offices do much of the inspection work under the AMA, the agency does have cooperative agreements with 20 States to perform some of these services, including such things as grading rice and drawing samples of processed commodities for inspection by FGIS. According to a FGIS representative, if all AMA rice work could be performed by outside inspection agencies, some field offices could be consolidated or closed.

Under existing AMA and USGSA legislation, the Secretary of Agriculture and the Administrator of FGIS do not have the authority to create a national, unified inspection system. At present, the inspection of grains is conducted under authority of the USGSA, and the inspection of certain other commodities (such as beans and lentils) is conducted under the AMA. Under the AMA, the Secretary would have to decide whether to enter into arrangements with private firms to perform AMA inspection services. FGIS' position is to be supportive of efforts to allow official agencies to handle AMA commodity inspections. According to FGIS, the skills and knowledge used for grading grain and edible beans, peas, and lentils are very similar. However, FGIS representatives pointed out that, if AMA inspections are opened to private firms, official agencies would have to compete with any other qualified applicants to perform the inspections.

⁶ The total bushels for each of the eight types of grain that FGIS and State official agencies inspected and weighed for export multiplied by the average sales price provided by USDA's Economic Research Service for 1992.

Domestic Inspection Fees

Some industry representatives suggested that FGIS could make the periodic chartering of official domestic agencies and approving fee increases more competitive.

In accordance with the USGSA (7 U.S.C. 79 (g)(1)), FGIS issues a charter for a period of up to 3 years to State and private agencies performing official domestic inspections. The charter authorizes the agencies to perform official inspections exclusively in a specified geographical area. As the end of the charter period approaches, FGIS invites and considers applications from interested parties before issuing a new charter or renewing an existing charter.

In determining who should be awarded the charter, FGIS evaluates the degree to which the applicant meets the requirements for designation set out in the USGSA (7 U.S.C. 79 (f)(1)). One of the requirements is that the agency will not charge unreasonable inspection fees. FGIS' implementing regulations provide that the Administrator may decline to renew an incumbent's designation if the agency does not comply with *any* of the criteria set out in the USGSA. However, we noted that the incumbent is usually chartered for another three years, unless an agency has had major performance problems. Although FGIS solicits proposals for each designated area as charter expirations approach, competition has been limited. When each of the 72 charters last came up for renewal, only 13 had proposals from other than the incumbent.

Some industry representatives have stated that they would be supportive if FGIS introduced more price competition into the process for setting official domestic inspection fees by (1) more actively encouraging applications when a charter is up for award and placing greater emphasis on the reasonableness of fees both in evaluating the incumbent's performance and selecting the designated agency and/or (2) eliminating exclusive territories. However, one large merchandiser said that, while more competitive inspection fees are desirable, he is not sure that he would like to see ownership of official agencies changing every three years. He said that there are some merits in having stable ownership and building good working relationships with the industry.

FGIS can consider and, if it deems appropriate, place greater emphasis on fees when chartering agencies. However, the USGSA (7 U.S.C. 79 (f)(2)) requires that the official agencies operate in an exclusive geographical area. This provision was included in the act, according to a FGIS representative, with the thought that FGIS could more easily attract an agency to develop customers in an entire area if the area was protected from the threat of competition from other official agencies.

FGIS is concerned that any increased regulatory effort on its part to oversee official agencies' fees could be viewed as setting rates, which would result in additional regulatory requirements. FGIS does not view additional regulation as desirable.

FGIS' Export Inspection Fees

Because industry representatives believe, and FGIS generally agrees, that FGIS is limited in further reducing its fees for export inspections, they suggest that FGIS turn export inspection and weighing activities over to State-operated and privately owned official agencies.

Although the USGSA precludes FGIS from turning export inspection and weighing over to a number of State-operated agencies and to any privately owned inspection agencies, FGIS representatives said that doing so is conceptually feasible. Because FGIS would still have the supervisory authority over official agencies provided to it by the 1976 act, FGIS representatives believe that they could prevent a recurrence of the inspection and weighing abuses that occurred in the 1970s. However, whether such a change would produce any savings to exporters is unclear because no comparative cost study has been made. FGIS representatives said that FGIS' supervision fees would have to be added to State and private inspection fees, which could increase the combined costs above those FGIS now charges.

FGIS opposes the further delegation of export inspection and weighing to State-operated and privately owned inspection agencies at the major export locations now serviced by FGIS. FGIS pointed out that the current user-fee arrangement has been in place for 17 years and that during that period FGIS has developed a streamlined inspection and weighing process resulting in a high level of productivity. Furthermore, FGIS does not believe State and private agencies could perform the services at less cost.

Mr. Chairman, this concludes my formal statement. We would be happy to respond to any questions you or other members of the subcommittee may have.

APPENDIX I

FGIS' Expenses and Fee Income for Fiscal Year 1992

Fund/program title	Thousands of dollars	
	Expenses	Fee income
USGSA trust funds.....		
FGIS services performed.....	\$18,814	\$19,074
FGIS supervision of official agencies.....	1,443	1,577
Montreal, Canada, office.....	299	264
Registration of exporters.....	9	16
Subtotal.....	20,565	20,931
USGSA appropriated funds.....		
Standardization.....	7,216	0
Compliance activities.....	3,555	0
Subtotal.....	10,771	0
Total—USGSA.....	31,336	20,931
AMA trust funds.....		
Rice inspections.....	3,347	2,870
Other commodity inspections.....	5,338	5,159
Subtotal.....	8,685	8,029
AMA appropriated funds.....		
Standardization.....	461	0
Total—AMA.....	9,146	8,029
Total USGSA and AMA.....	40,482	28,960

APPENDIX II

Total Number of Official Domestic Inspections and Metric Tons Inspected, 1985 to 1992

Fiscal year	Inspections		Metric tons	
	Number	Percent increase (decrease) since 1985	Number	Percent increase (decrease) since 1985
1985	2,692,661		152,246,527	
1986	2,710,696	1	147,506,564	(3)
1987	3,071,179	14	172,591,628	13
1988	2,934,696	9	174,810,526	15
1989	2,572,576	(4)	163,630,359	7
1990	2,559,225	(5)	159,280,149	5
1991	2,228,685	(17)	145,785,818	(4)
1992	2,168,063	(19)	137,436,699	(10)

APPENDIX III

Total Number of Official Domestic Inspections by Type of Sample and Total Tons Inspected, 1985 to 1992

Year	Inspections					Total no. of inspections	Total no. of metric tons
	Truck	Rail car	Barge	Samples submitted	Total no. of inspections		
1985	594,712	893,926	37,265	1,166,758	2,692,661	152,246,527	
1986	536,428	933,195	31,483	1,209,590	2,710,696	147,506,564	
1987	553,568	1,164,663	35,089	1,317,859	3,071,179	172,591,628	
1988	514,048	1,227,698	35,891	1,157,059	2,934,696	174,810,526	
1989	416,099	1,125,772	37,408	993,297	2,572,576	163,630,359	
1990	451,208	1,122,475	34,347	951,195	2,559,225	159,280,149	
1991	403,115	983,110	35,184	807,276	2,228,685	145,785,818	
1992	426,330	961,979	30,512	749,242	2,168,063	137,436,699	

Note: For truck, rail car, or barge, the official agency draws the sample and grades it; the results are applicable to the universe from which the sample was drawn. For samples drawn and submitted by the customer, the official agency grades the sample, but the results are applicable only to the sample.

APPENDIX IV

Number of Agencies with Increases in Domestic Inspections Since 1985 and Number with Decreases

Number of inspections in 1992	Agencies with increases		Agencies with decreases	
	Number	Combined increases	Number	Combined decreases
Over 100,000	2	44,572	2	34,329
75,001-100,000	0	0	2	43,901
50,001-75,000	6	80,548	4	96,509
25,001-50,000	3	32,139	8	147,815
25,000 or less	19	67,919	24	352,275
Total	30	225,178	40	674,829

Note: Two agencies had no change between 1985 and 1992.

APPENDIX V

Number of Domestic Inspections that Official Agencies Performed in 1992

Number of inspections	Number of agencies	Percent of inspections	
		Total	Cumulative
Over 100,000	4	26	26
75,001-100,000	2	9	35
50,001-75,000	10	28	63
25,001-50,000	11	18	81
25,000 or less	45	19	100
Total	72	100	

APPENDIX VI

Range of Fees Charged by Official Agencies Performing Most of Each Type of Inspection

Type of inspection	Number of agencies ¹	Range of agencies' fees ²		Weighted average	FGIS' fees
		Low	High		
Truck	11	\$5.30	\$16.55	\$9.59	\$30
Rail car	30	9.45	23.70	15.15	.95
Barge	17	122.27	184.15	153.98	6.15
Submit ³	25	4.30	10.80	6.70	.30

¹ Because some inspection agencies perform fewer inspections of a particular type than others, we compared fees for agencies performing the vast majority of each type of inspection to minimize any differences in fees that might be related to the volume of inspections. Collectively, the agencies included in the analysis account for about 90 percent of each type of inspection performed by all agencies combined.

² The fees shown do not include any additional variable charges for travel time or mileage to draw the sample.

³ Submits are samples drawn and submitted by a customer.

Senator DASCHLE. Thank you very much for that statement. We have a lot of questions and I know we'll be talking about a number of the points you raised in the discussion period afterwards.

Our third witness is Mr. Robert Gore, American Association of Grain Inspection and Weighing Agencies.

Mr. Gore, we're pleased you're here and invite you to proceed.

STATEMENT OF ROBERT GORE, WASHINGTON DEPARTMENT OF AGRICULTURE, GRAIN INSPECTION PROGRAM, OLYMPIA, WASHINGTON; ACCOMPANIED BY KEVIN L. REA, PRESIDENT, AMERICAN ASSOCIATION OF GRAIN INSPECTION AND WEIGHING AGENCIES, AND PAUL S. WELLER, EXECUTIVE DIRECTOR, AMERICAN ASSOCIATION OF GRAIN INSPECTION AND WEIGHING AGENCIES

Mr. GORE. Mr. Chairman, we appreciate the opportunity to present this statement before your subcommittee on behalf of the Nation's official grain inspection agencies.

My name is Robert Gore, a member of the board of directors of the American Association of Grain Inspection and Weighing Agencies and a professional in the industry as Grain Inspection Program Manager with the Washington State Department of Agriculture.

I am accompanied by AAGIWA president Kevin L. Rea, president of Lincoln Inspection Service, Lincoln, Nebraska, and Paul S. Weller, executive director of our national association.

We represent AAGIWA, whose private and State agencies comprise the bulk of the Nation's official grain inspection system. Our national trade association was founded nearly half a century ago, as a professional association serving agencies that inspect, weigh, and grade the Nation's grain. Its member agencies are located throughout the major grain-producing regions of the United States. Our members adhere to the 75-year-old U.S. Grain Standards Act, which mandates a national, uniform grain grading program.

Nearly two years ago, we appeared before your subcommittee to report that the official grain inspection system was in trouble. Since that time, through your efforts and the cooperation of the U.S. General Accounting Office, the Federal Government has taken a closer look at this ailing system and the Federal agency that supervises and regulates it. We want to thank you for your leadership in making this study possible and for allowing us to present our current thoughts on the system and its operation.

As your subcommittee studies the reauthorization of the Federal Grain Inspection Service and evaluates the GAO report on the official grain inspection system, we would like to present our organization's observations and recommendations.

The current FGIS Fiscal Year 1994 budget calls for a shift of \$7 million from appropriations to industry-paid user fees. These dollars would be used to fund standardization activities. The development of reference standards, maintaining equipment calibrations, measuring intermarket differences, and the review of national industry standards benefits everyone from consumers to producers. We feel that the appropriated funds should continue to be used for activities that benefit such a wide array of public programs.

We sincerely believe that placing this added financial burden on a small segment of the grain industry will ultimately be counterproductive and will add to the further decline in use of our official system.

We feel that a combination of additional revenues and further FGIS cost-cutting is a better solution. It is our belief that additional revenue can be earned by FGIS by licensing or otherwise charg-

ing for the use of its standards data. Although the official system has been expected to pay for developing these standards and procedures, many other groups receive the data without cost. FGIS-generated data should be made available through licensing, annual fees, royalties, or other revenue-producing techniques.

We feel that FGIS' major role should be that of a regulatory and supervisory agency, providing national standards and procedures and protecting the integrity of the Nation's grain inspection system. We do not think that a Federal agency with taxpayer funding should be providing services that can be provided at like or lower cost by the private sector and/or the delegated State grain inspection agencies.

We have been assured by the General Accounting Office that FGIS is capable of providing proper supervision of private agencies and in protecting the public interest. Accordingly, we believe that it is time to return export inspections to the private and State sector. We recommend that at least two pilot programs be established in the near future on the west and gulf coasts to evaluate the cost and feasibility of private/State agencies performing export grain inspection services.

It continues to be our belief that services currently provided by FGIS field offices could be provided at a cost savings by a central laboratory located near existing FGIS facilities at Kansas City. The savings would result from more efficient utilization of staff and equipment resources. It should also provide greater accuracy and increased uniformity of inspection results throughout the national inspection system.

Mr. Chairman, we believe that still further cost savings would be realized by allowing existing agencies to perform services under the Agricultural Marketing Act. FGIS reports that it is currently running a deficit of \$703,000 for the first half of this fiscal year for performing services under the AMA. Many of our official agencies are staffed and equipped to perform these added services. GAO's attorneys have indicated that such services can be legally opened to us through proper bidding procedures. We ask that our agencies be permitted the opportunity to bid on this new source of business that has been costing FGIS money, but which would increase our revenues and levels of efficiency.

Finally, it is our belief that there would be further cost savings if official agencies' redesignation cycle would follow that of FGIS itself. In other words, we recommend that redesignations be increased from every three years to either four or five years. FGIS reports that it currently spends \$450,000 annually on triennial review and redesignation of official agencies. Funds could be saved and disruption of our agencies reduced by lengthening this cycle.

It has been brought to our attention through the GAO report that there is a wide disparity in fee schedules between neighboring official grain inspection agencies. Some of these differences are due to the lack of flexibility in the FGIS fee approval process. We are unable to tailor our fees to the needs of our individual customers.

In addition, our agencies suffer costly downtime at low volume inspection points and must factor this into their fee schedules. This results in higher unit costs and higher fees.

Industry marketing practices, coupled with readily available third party inspections, have created keen competition for grain inspection dollars. We agree with the GAO report that the cost of official inspections is not the primary reason for the decline in official inspection volume. Consolidation of the grain industry, a desire for in-house quality control, and reductions in grain stocks under the USDA programs are primarily responsible for the reduction of inspection volumes.

Such industry trends require a more aggressive and flexible official inspection system, with added emphasis on customers' costs and service. Our agencies are dedicated to these changes. We ask that the priorities of FGIS be likewise.

It is our association's recommendation at this time that FGIS make no changes in its policy of official agency territories. We further believe that there is adequate competition in the marketplace from such external sources as unofficial inspection agencies, in-house quality control personnel, and the option of having these services performed at destination.

Mr. Chairman, the Nation's grain industry has indicated to GAO the need for a credible and viable official inspection system. We of the official grain inspection agencies are dedicated to providing the most credible and efficient service. But we need the flexibility to respond to the marketplace. It is our belief that by providing official agencies with additional business opportunities—under the auspices of a more flexible FGIS—that we can work together to serve the industry needs.

Thank you again for this opportunity to present our comments on this important grain industry matter.

Senator DASCHLE. Thank you, Mr. Gore, for your statement.

Mr. Jon Jacobson, the Grain Exporters and Marketers.

STATEMENT OF JON JACOBSON, CONAGRA-PEAVEY, MINNEAPOLIS, MN; ON BEHALF OF THE NORTH AMERICAN EXPORT GRAIN ASSOCIATION, TERMINAL ELEVATOR GRAIN MERCHANTS ASSOCIATION AND NATIONAL GRAIN TRADE COUNCIL

Mr. JACOBSON. Good morning, Mr. Chairman. My name is Jon Jacobson, with Peavey Company, one of the ConAgra companies, which is headquartered in Minneapolis, Minnesota. I am testifying today on behalf of North American Export Grain Association, Terminal Elevator Grain Merchants Association, and National Grain Trade Council.

Mr. Chairman, you have raised a number of appropriate specific questions to be addressed during the reauthorization process. We do not have all the answers for these questions, but we look forward to working with you to find constructive answers to the challenges facing the grain inspection system.

We believe FGIS should be reauthorized, but the agency is at a critical juncture and some hard decisions need to be made to ensure the future viability of the official system.

In 1992, the industry paid \$28 million, or 72 percent of FGIS expenses, which totaled roughly \$40 million. Appropriated funds made up the balance. The level of grain inspection fees has become a point of controversy within the grain marketing system. Buffered

by economic forces, the grain industry has contracted at an accelerated pace over the last 10 years. The number of firms engaged in the industry has shrunk and the survivors have cut costs dramatically in an effort to remain competitive.

Despite this environment, the fees for inspection and weighing services have continued to increase. We believe that FGIS fees are presently too high, and higher than they would be if the same services were provided by the private sector inspection services.

To make matters worse, the President's budget proposes to shift the cost of FGIS standardization activities to user fees. Adding the cost of this \$7 million program to user fees would require an increase of at least 17 percent to current fee levels.

Grain standards facilitate efficient grain marketing. As such, most FGIS standardization services are not directly traceable to any easily identifiable user group. Therefore, we continue to believe that the cost for standardization activities should be borne by the appropriated funding. However, if appropriated funding for standardization is eliminated, we would recommend that the agency's goal should be to absorb the loss without increasing fees.

This will necessitate a reassessment of its program activities, especially within the standardization program, to determine if its work activity is still relevant, whether the work serves an identifiable clientele, and whether there is any way to allocate equitably the indirect costs for standardization services to all the indirect beneficiaries in the absence of a Federal appropriation.

In our prepared statement, we recommend a number of areas for consideration in reducing the cost of standardization activities. The question of fees highlighted by the potential in funding for the standardization program points out the broader challenges facing FGIS.

We see three basic policy choices: First is to maintain the status quo, but we believe this option is untenable. Second would be to narrow the focus of FGIS, re-examine the mission of FGIS, and emphasize the agency's core function as an objective third party that accurately and consistently measures grain quality. Keep the FGIS structure essentially intact but streamline it wherever possible. Third, refocus FGIS as a supervisor of inspection and weighing services. In particular, allow designated State or private agencies to perform mandatory export inspections under FGIS supervision. Such a step would involve a more dramatic downsizing of FGIS and arguably should produce commensurate cost savings.

Mr. Chairman, we hope our comments are constructive. We look forward to working with you during the next few months to resolve these matters in a manner that is beneficial to all parties involved.

Before closing, please let me ask that the formal statement of our colleagues at the National Grain and Feed Association be included for the hearing record.

Senator DASCHLE. Without objection, they will be made part of the record.

Mr. JACOBSON. Thank you.

They make several suggestions. I will just touch very briefly on five.

First, reauthorize FGIS for one year to allow all parties to fully consider the future of the official inspection system.

Second, eliminate all facets of standardization not necessary for the maintenance of accuracy and consistency in grades.

Third, explore ways to introduce the benefits of a market approach to the official inspection system.

Fourth, within six months after reauthorization, FGIS should implement a cost-cutting procedure or steps to bring their budget in line with budget realities.

Fifth, eliminate the FGIS advisory committee.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Jacobson follows:]

PREPARED STATEMENT OF JON JACOBSON, CONAGRA-PEAVEY, MINNEAPOLIS, MN

Mr. Chairman and members of the subcommittee, the grain marketing industry appreciates this opportunity to present its views on the Nation's grain inspection system as the subcommittee prepares legislation to reauthorize the Federal Grain Inspection Service (FGIS). I am Jon A. Jacobson, vice president-marketing, Peavey Company, which is headquartered in Minneapolis, Minnesota. I am testifying today on behalf of the North American Export Grain Association (NAEGA), Terminal Elevator Grain Merchants Association (TEGMA), and the National Grain Trade Council (NGTC).

Mr. Chairman, you have raised a number of appropriate, specific questions to be addressed during the reauthorization process. We do not have all the answers for these questions, but we look forward to working with you to find constructive answers to the challenges facing the grain inspection system. We believe FGIS should be reauthorized, but the agency is at a critical juncture and some hard decisions must be made to ensure the future viability of the official system.

In our testimony, we will provide some background on FGIS, discuss the agency's funding challenge, and present some ideas for change.

BACKGROUND

The nature of the official grain inspection system has evolved considerably since the U.S. Grain Standards Act was adopted by Congress in 1916. FGIS was created in 1976 and assumed the responsibilities previously held by the Grain Division of USDA's Agricultural Marketing Service.

The mission of FGIS, as set forth in the Agency's 1992 Annual Report to Congress, is:

to facilitate the marketing of grain, oilseeds, pulses, rice, and related commodities by establishing descriptive standards and terms; accurately and consistently certifying quality; providing for uniform official inspection and weighing; carrying out assigned regulatory and service responsibilities; and providing the framework for commodity quality improvement incentives to both domestic and foreign buyers.

The Grain Standards Act provides that official inspection is mandatory at export and voluntary at domestic points. At export locations, FGIS either performs the service directly or delegates its authority to state-operated agencies. At domestic locations, official services are provided by designated agencies which are either State agencies or privately owned companies. FGIS supervises the services provided by these delegated or designated agencies.

To carry out its responsibilities, FGIS had 625 full time permanent employees in fiscal 1992. The agency is organized into four primary divisions: Field Management Division, Quality Assurance and Research Division; Resources Management Division; and Compliance Division.

FUNDING THE INSPECTION SYSTEM

In 1992, the industry paid \$28 million or 72 percent of FGIS' expenses which totaled roughly \$40 million; appropriated funds made up the balance. Users have long paid for the cost of actual inspection and weighing services, as well as related supervision and overhead expenses. The agency's compliance and standardization activities are the only expense categories funded through appropriated monies.

The level of grain inspection fees has become a point of controversy within the grain marketing system. Buffeted by economic forces, the grain industry has contracted at an accelerated pace over the last 10 years. The number of firms engaged

in the industry has shrunk and the survivors have cut costs dramatically to remain competitive. Despite this environment, the fees for inspection and weighing services have continued to increase.

The combination of industry consolidation and fee levels has caused a decline in the amount of grain officially inspected at domestic locations where users have a choice of whether to use the service. Export facilities are required to use official services and the cost of official services is a major operating expense for these companies. Plainly said, we believe that FGIS fees are too high and higher than they would be if the same services were provided by private sector inspection services.

STANDARDIZATION ACTIVITIES

To make matters worse, the President's budget proposes to shift the cost of FGIS standardization activities to user fees. Adding the cost of this \$7 million program to user fees would require an increase of at least 17 percent in current fee levels. If the Omnibus Budget Reconciliation Act directs the transfer of FGIS standardization costs to user fees, then the Congress must also authorize user fees in the reauthorization bill. Presumably, these fees will be charged to the users or beneficiaries of the services, but in some cases this will be difficult, if not impossible, to ascertain.

It is important to realize that standardization activities now include such diverse, but extremely important support functions as equipment evaluation, calibration and maintenance; quality assurance; grain standards reviews and revisions; and the portion of the Board of Appeals and Review associated with the Quality Assurance program. Unfortunately, most FGIS standardization services are not directly traceable to any easily identifiable user group.

Grain standards facilitate efficient grain marketing. As such, FGIS standardization activities benefit producers, country and terminal elevator operators, foreign buyers, processors, equipment manufacturers, exporters, commodity exchanges and American taxpayers. Standardization activities lead to higher returns for farmers, more efficiency in the market system, and allow the U.S. system to provide the most diverse array of qualities and classes of grain or oilseeds of any country in the world. Who benefits from the standardization services? We think everyone benefits and that everyone should continue to help pay for the relatively small cost for these services. The best way to fairly accomplish this is through appropriated funding.

However, if Congress requires FGIS, via the Omnibus Budget Reconciliation Act, to assess and collect new user fees to cover standardization costs, we would recommend providing FGIS with broad flexibility in dealing with the loss of \$7 million in appropriated funding. We believe the agency's goal should be to absorb the loss without increasing fees. This will necessitate a reassessment of its program activities, especially within the standardization program to determine if its work activity is still relevant, whether the work serves an identifiable clientele, and whether there is any way to allocate equitably the indirect costs for standardization services to all the indirect beneficiaries in the absence of a Federal appropriation.

As FGIS reassesses its program activities, we believe the following ideas merit consideration.

1. Over the years, FGIS has developed elaborate systems for monitoring its inspection methods and procedures. Are these systems still relevant, or could they be restructured to reduce cost and improve efficiency?

2. Currently FGIS inspects, without charge, domestic, and occasionally shipload, wheat samples as a part of periodic quality surveys at the request of U.S. market development organizations. No one questions the value of this information as a market development tool. However, such surveys are costly and perhaps the group requesting the survey should pay for the costs associated with inspecting the samples and compiling the data for these and similar surveys.

3. FGIS routinely examines inspection equipment which may improve inspection accuracy or provide productivity improvements. In the past this work, and the related work to maintain equipment calibrations, has been funded by appropriated funding. Perhaps these costs should be charged back to the equipment manufacturers and the FGIS activities in this regard should be linked with those of the National Institute of Standards and Technology.

4. In some cases FGIS' standardization program provides benefits that ought to be funded under some other Government program. Two examples come to mind:

—FGIS currently monitors crop samples for pesticide residues. This information is not appropriate to be included as a part of the inspection process on every sample, but it has been used to provide assurances and an indication to certain foreign customers regarding what they may expect to find in U.S. crops.

—The second example relates to work being done to identify and determine how to incorporate mycotoxin screening kits into the grain inspection system. These kits are helpful tools for the grain trade and farmers can feel more confident that their grain is being graded accurately as a result of the FGIS involvement with the kit manufacturers. However, the real beneficiaries are American consumers and the Food and Drug Administration that is charged with protecting their interest. In both examples—testing for pesticide residues and for mycotoxins—it would seem that this evaluation work has a broad constituency that goes well beyond just the grain handling industry. To simply transfer that cost to exporters is unfair and does not correlate the costs with the benefits.

These examples point out a few of the many challenges in identifying and assessing the end users of FGIS standardization services.

IDEAS FOR CHANGE

The question of fees, highlighted by the potential change in funding for the standardization program, points out the broader challenges facing FGIS. We see three basic policy choices.

1. Maintain the status quo. Assume that rising FGIS costs can be paid for through increasing user fees and that appropriated funding will continue to be available for standardization and compliance. We believe this option is untenable.

2. Narrow the focus of FGIS. Re-examine the mission of FGIS and emphasize the agency's core function as an objective third party that accurately and consistently measures grain quality. Keep the FGIS structure essentially intact, but streamline wherever possible.

- The FGIS mission has expanded over the last several years, especially in the area of grain quality improvement. There is always a temptation to ask FGIS to study a particular issue or evaluate a potential change in standards.

- An example is the number of studies undertaken to evaluate U.S. grain quality and the feasibility of revising U.S. grain or oilseed standards. These activities have cost American taxpayers large sums of money and have had no discernible effect on U.S. exports or competitiveness. Perhaps in the future when such additional proposals are made, they should be accompanied by proposals for how the effort will be funded, not unlike Congress' mandate for "pay as you go."

- As proposals to streamline FGIS are discussed, Congress could help minimize the human impact on employees by authorizing early retirement opportunities for the agency's most tenured workers. This may require special authorization from Congress to grant credit for years of service in State or private inspection agencies prior to and during the takeover by FGIS in the mid 1970's. Congress can also direct the Office of Personnel Management to support FGIS efforts in this regard. Another area that should be addressed in streamlining the agency is the inflexibility of Federal, and many State, work rules that preclude FGIS management from being able to deliver services in a cost-effective and competitive manner.

- As an example, FGIS inspection crews at export elevators are structured to utilize GS 5 personnel (\$18,340 per year) to gather samples and perform other technical tasks, GS 7 personnel (\$22,717 per year) to prepare the samples and conduct certain mechanical procedures, and the GS 9 journeyman inspector (\$27,789 per year) performs the more technical and subjective grading. GS 5 and 7 employees tend to be the newer, less tenured personnel and the first to be removed from the work force, whenever reductions in force occur. As a result of agency cost cutting via "reduction in force" actions during the past few years, which has impacted most heavily on the less tenured, lower cost employees, the agency is now using higher cost, journeyman GS 9 employees to perform tasks that could be performed by a lesser skilled employee.

- Many in FGIS management clearly understand the problem, but Federal civil service rules restrict managers from undertaking prudent actions, which would be taken in a private for-profit business. For their part, the FGIS labor union fails to correlate its demands with its customer's bottom line.

3. Refocus FGIS as a supervisor of inspection and weighing services. In particular, allow designated State or private agencies to perform mandatory export inspections under FGIS supervision. Such a step would involve a more dramatic downsizing of FGIS and, arguably, should produce commensurate cost savings. The labor issues that were previously mentioned, for example, could be minimized under such an approach.

• In the same vein, perhaps one should evaluate whether to once again make FGIS a division of the Agricultural Marketing Service. Such a step should not harm the integrity of the system, but should allow for a reduction in the agency's administrative costs.

Mr. Chairman, we thank you for the opportunity to testify. We hope that our comments are constructive. The grain industry, quite frankly, has mixed emotions on a number of the questions we have raised, but they are issues deserving of public debate. We look forward to working with you during the next few months to resolve these matters in a manner that is beneficial to all parties involved.

Senator DASCHLE. Thank you, Mr. Jacobson.

Mr. Hartman.

STATEMENT OF MARION HARTMAN, CORN PRODUCER, NATIONAL CORN GROWERS ASSOCIATION, HILLSBORO, OH

Mr. HARTMAN. Good morning, Mr. Chairman and members of the subcommittee. My name is Marion Hartman. I'm a farmer from Hillsboro, Ohio. I am here today on behalf of the National Corn Growers Association.

We appreciate this opportunity to discuss reauthorization of the Federal Grain Inspection Service. The NCGA is committed to assuring our customers the highest quality corn possible. We realize that in a competitive world market, customer satisfaction is essential to maintaining U.S. market share.

Since all grain exports must be officially inspected, the FGIS plays an integral role in assuring that the grain delivered to foreign customers meets contract specifications. NCGA supports reauthorization of the FGIS to continue to provide the most accurate information possible to enhance corn exports.

Most costs associated with official inspections are covered by user fees. Fees charged for official inspections tend to be higher than unofficial inspections. This cost differential discourages interior handlers from using the official inspection system, which results in fewer official inspections and higher costs per lot inspected.

We applaud past FGIS efforts to contain costs and improve efficiency. While FGIS will have to continue efforts to modernize and automate testing procedures and to reduce administrative overhead, the agency must also consider the importance of providing timely, accurate, and reliable test results.

NCGA supports continuation of the current funding structure which relies on user fees to cover the costs of official weighing and inspection, while using appropriated funds to pay for services such as standardization activities which benefit the entire society. Obviously, standardization is most beneficial to the grain trade. Benefits also accrue to the consumers in the form of affordable, high quality food and feed.

FGIS has worked closely with producers, the grain trade, and the academic community to identify the information needed by end users and the available technology to provide that information.

FGIS has initiated research into new testing procedures that can provide grain users with the information they need. This information will become more valuable as new industrial uses of corn are developed and become commercially viable.

As customers become more sophisticated and demand corn with specified percentages of starch, oil, or protein, the grain handling

system will have to adapt to provide that information or the current system will be abandoned for one in which producers will raise specialized crops directly for their customers.

While we expect the demand for specialty corn to increase, we believe that it is important to improve the current system by expanding the information that can be made available to potential customers.

FGIS can best perform the necessary research and testing to develop the equipment to quickly and accurately assess the grain characteristics users demand. As I stated earlier, since these activities benefit not only grain handlers and end users, but ultimately consumers, it is appropriate that such activities be funded with Federal tax dollars. However, if appropriated funds are not available to conduct necessary standardization activities, then alternative funding options must be considered.

NCGA would oppose increasing inspection fees to pay for standardization. Because standardization activities directly benefit the entire grain trade, the costs should be borne by the broader industry. To impose additional costs of official inspections would further discourage the voluntary use of official inspections, would be unfair to the export sector, and could threaten U.S. competitiveness in world markets.

A possible option would be a fee on all grain handlers. We recognize that this option may have inherent inequities and that in many instances the costs would be passed back to producers, but the standardization activities are important and must be funded.

Mr. Chairman, thank you for the opportunity to appear before your subcommittee, and the National Corn Growers Association looks forward to working with you.

[The prepared statement of Mr. Hartman follows:]

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Mr. Chairman, thank you for the opportunity to appear before your subcommittee. The National Corn Growers Association looks forward to working with you.

Senator DASCHLE. Thank you, Mr. Hartman.

Let me call upon my colleague, Senator Craig, for the introduction of our next witness.

Senator CRAIG. Thank you very much.

Mr. Chairman, let me thank you, and I apologize for running late. There was a breakfast and another commitment that caused me to get here late. It's a real pleasure to introduce to the committee and to have testify today the president of the Idaho Grain Producers Association, Boyd Schwieder.

Boyd operates a family farming operation in the Idaho Falls area, both dry land and irrigated. He's an excellent spokesman for our industry in Idaho, and we're pleased to have him before the committee this morning.

Boyd, welcome.

STATEMENT OF BOYD SCHWIEDER, PRESIDENT, IDAHO GRAIN PRODUCERS ASSOCIATION, IDAHO FALLS, ID

Mr. SCHWIEDER. Thank you for the introduction, Senator Craig.

Mr. Chairman, my comments today will focus on the importance of maintaining the Federal Grain Inspection Service (FGIS) with an adequate funding base and our industry's concern with the proposal to increase user fees for FGIS.

In today's highly competitive world grain market, maintaining a reliable, independent, and adequately funded grain inspection service is essential, not only to my survival as a grower, but is also necessary for the United States to successfully compete in the domestic and international market place.

I'd like to discuss four present issues.

Of all the major grain exporting countries, only the United States will accept all grain delivered to an elevator or terminal and let the appropriate premiums or discounts based on quality and grade decide the market price. All other major exporting countries have a minimum quality standard that is acceptable for export. This method of price discovery requires that we have a reliable inspection service to protect that process.

Because the United States has a system of marketing that has the ability to market all grain received and set prices based on quality, it is incumbent on us to assure the quality of the grain we market. We must be able to make this quality assurance independently of the producer or buyer. Our fear in production agriculture is that if we allow unofficial grain inspections to become the standard or develop FGIS user fees that will provide incentives to use unofficial inspections, we could jeopardize this marketing system. We could also jeopardize our markets because of our inability to provide uniform shipments of grain in the absence of a single source of grain standards.

We saw the results of that years ago, back in the 70's.

The second reason: Maintaining standardization throughout the United States and ensuring that all who use the service help pay for it is also important to the grain industry.

The growers of Idaho and the National Association of Wheat Growers believe that the continued upgrading of grain standards and equipment to determine grain quality will not only benefit those who choose to use official grades, but also those who want to take advantage of the available standards from which to base their own inspection standards. The proposed budget for 1994 calls for increased user fees to offset standardization costs. To ask that only those who wish to use official inspections bear the increased cost is unfair.

Three: Ensuring that FGIS continues to provide export inspections is necessary to maintain the credibility of our export shipments. Since the creation of FGIS, credibility in the world markets to deliver grain without requested specifications is much improved. If we allow for export without official inspections, we run the risk of jeopardizing our credibility as a supplier.

However, one agency responsible for setting quality, resolving disputes, and not competing for business has done a great deal to enhance trust in the delivery of our export products.

Four: Producers are more confident in knowing that an independent third party is always available to provide testing. From the producer to the end user, the confidence that all grain tests were conducted by an independent third party is very important and essential.

This has been pointed out earlier, but the real benefactors of this service are the consumers. I'm talking about the people right here in this room. The consumer ultimately sets the standard that best fits their needs. FGIS established standards to best measure fulfilling those needs. Researchers will develop the varieties of grain that are best suited for the consumer needs. Producers will produce varieties that are demanded by the consumer. Whether the inspections are done by in-house inspectors or by an official agency, availability of the service and standards has benefited everyone in the

industry. The cost of this service must be spread across the entire industry.

It's also important to growers that they have the assurance that an independent third party is establishing grain standards through proper procedures, monitoring of tests, calibration of the equipment, and licensing people to perform the inspections.

Now, producers are willing to pay for this service if the cost continues to be reasonable enough to continue encouraging the grain industry to use official inspections. The report of the General Accounting Office on grain inspections confirms a decrease in official inspections at county elevators with no harm to the integrity of grain quality moving from country elevators to export positions. Producers, however, remain concerned that if costs continue to increase for official inspections, the option to use this independent service will continue to decline.

In looking at the future of the FGIS, I'd like to point out two or three observations. One, in Idaho we have begun to do some residue testing on a voluntary basis. This is the combined effort of producers, the Idaho Wheat Commission, and the University of Idaho. We want to establish a data bank to help prepare for any problems that might result from, say, chemical residues and so on. The FGIS is also working to develop the capacity to provide pesticide testing services.

The end user is the consumer. We want to provide safe food for the consumer. The Federal Grain Inspection Service will have to be an integral part of helping us provide that safe food.

FGIS is providing the first steps now to protect the quality of grains for the consumer. They are also working to develop tests that will predict end use qualities, such as flour yield. This is a quality factor that is financially important to flour millers, and very likely FGIS will be able to provide that service also.

I consider, in closing, the United States as a country that provides the world consumer with the safest food possible. It's important that we keep our Federal Grain Inspection Service in place to protect the real end users, the people here, the consumers. We should all share in the cost of this service.

On behalf of the Idaho Grain Producers Association and the National Association of Wheat Growers, and I am accompanied by one of the staff of the National Association of Wheat Growers, we thank you for this opportunity to share our views.

[The prepared statement of Mr. Schwieder follows:]

PREPARED STATEMENT OF BOYD SCHWIEDER, PRESIDENT, IDAHO GRAIN PRODUCERS ASSOCIATION, IDAHO FALLS, ID

Mr. Chairman and members of the committee. My name is Boyd Schwieder and I represent the Wheat and Barley Producers of Idaho who annually produce 95 million bushels of wheat and 50 million bushels of barley. I am also here representing the National Association of Wheat Growers. I operate a diversified grain and livestock farm in southeastern Idaho near Idaho Falls.

My comments today will focus on the importance of maintaining the Federal Grain Inspection Service with an adequate funding base and our industry's concerns with the proposal to increase user fees for FGIS.

In today's highly competitive world grain market, maintaining a reliable, independent and adequately funded grain inspection service is essential, not only to my survival as a grower; but, it is also necessary for the United States to successfully

compete in the domestic and international marketplaces. I say this for the following reasons:

1. Of all the major grain exporting countries, only the United States will accept all grain delivered to an elevator or terminal and let the appropriate premiums or discounts based on quality and grade decide the market price. All other major exporting countries have a minimum quality standard that is acceptable for export. This method of price discovery requires that we have reliable inspection service to protect the process.

2. Maintaining standardization throughout the United States and ensuring that all who use the service help pay for it is also very important to the grain industry.

3. Ensuring that FGIS continues to provide export inspections is necessary to maintain the credibility of our export shipments.

4. Producers are more confident knowing that an independent third party is always available to provide testing. From the producer to the end user, the confidence that all grain tests were conducted by an independent third party is very important and essential.

Because the United States has a system of marketing that has the ability to market all grain received and set prices based on quality, it is incumbent on us to assure the quality of our grain we market. We must be able to make this quality assurance independently of the producer or buyer. Our fear in production agriculture is if we allow unofficial grain inspections to become the standard or develop FGIS user fees that will provide incentive to use unofficial inspections, we could jeopardize this marketing system. We could jeopardize our markets because of our inability to provide uniform shipments of grain in the absence of a single source of grain standards.

Standardization and its funding is our next concern. The growers of Idaho and the NAWG believe that the continued upgrading of grain standards and equipment to determine grain quality will not only benefit those who choose to use official grades, but also those who want to take advantage of the available standards from which to base their own inspection standards. The administration's proposed budget for 1994 calls for increased user fees to offset standardization costs. To ask that only those who wish to use official inspections to bear the increased cost is unfair.

The real benefactors of this service are the consumers. The consumer ultimately sets the standards that best fit their needs. FGIS establishes standards to best measure fulfilling those needs. Researchers will develop varieties of grains that are best suited to the consumer needs. Finally, producers will produce varieties that are demanded by the consumer. Whether the inspections are done by in-house inspectors or by an official agency the availability of the service and standards has benefited everyone in the industry. The cost of this service must be spread across the entire industry.

Official export inspections must continue to be the responsibility of FGIS. Since the creation of FGIS our credibility in the world market to deliver grain within requested specifications is much improved. If we allow for the export of grain without official inspections, we run the risk of jeopardizing our credibility as a supplier of quality grain. Having one agency responsible for setting quality, resolving disputes and not competing for business has done a great deal to enhance trust in the delivery of our export product. Again, this system has benefited the entire industry. In addition to assuring the consumer, it has also protected the exporter from unwarranted claims and has helped to reassure producers that the quality grain they produce is being delivered to our customers.

As producers it is very important that we have the opportunity to utilize an independent third party to inspect the grain we produce. We currently pay for that service each time we submit a sample for grain inspection.

It is also important to growers that they have the assurance that an independent third party is establishing grain standards through proper procedures, monitoring of tests, calibration of the equipment and licensing people to perform the inspections. Producers are willing to pay for this service if the costs continue to be reasonable enough to continue encouraging the grain industry to use official inspections. A report by the General Accounting Office (GAO) on grain inspection confirms a decrease in official inspections at country elevators with no harm to the integrity of grain quality moving from country elevators to export positions. Producers however, remain concerned that if costs continue to increase for official inspections the option to use this independent service will continue to decline.

In conclusion, Mr. Chairman and members of the committee, maintaining a reliable and adequately funded Federal Grain Inspection Service is essential to the grain industry of this country. The Service benefits everyone from the consumer to

the producer and in our view everyone should share in the cost to maintain this agency.

On behalf of the Idaho Grain Producer Association and the National Association of Wheat Growers we thank you for this opportunity to share our views.

Senator DASCHLE. Thank you very much, Mr. Schwieder. Excellent comments, and we appreciate your contribution this morning.

Our final witness is Dr. Charles Hurburgh of Iowa State University.

Dr. Hurburgh.

STATEMENT OF CHARLES HURBURGH, JR., PROFESSOR, AGRICULTURAL AND BIOSYSTEMS ENGINEERING DEPARTMENT, IOWA STATE UNIVERSITY, AMES, IA

Mr. HURBURGH. Thank you, Senator Daschle.

I'd like to spend the next few minutes providing some visions for the future of FGIS and the challenges that it will face in the new market realities that we're going to have in the next 10 to 20 years.

Accuracy and uniformity in measures of trade have always been important responsibilities of Government. FGIS is but one of the organizations created to fulfill these responsibilities. Grain traders as a group recognize that the United States must have universal standards and procedures, but individual traders do whatever is possible to reduce costs without losing sales, and therein lies the dilemma for FGIS and Congress.

Traders seek cheaper alternatives to Government inspection, but desperately need the underlying uniformity they bring. It does little for FGIS to applaud them for maintaining accurate official standards and then seek ways at all times to try to cut the costs and not provide them the revenue to provide those services. The United States needs accurate professional inspection.

The world grain industry is changing rapidly to meet both competitive and technological pressures. Grain suppliers, beginning at the farm, will provide raw materials for manufacturing processes rather than trade commodities, and this is the essence of the worldwide total quality industrial movement.

A key attribute of this movement is Government/industry partnerships, rather than adversarial relationships. Some of the new realities are rapid data exchange via computer network; sophisticated buyers looking for very detailed attributes in addition to the current physical factors in the grades; rapid development of testing and data-handling technologies; smaller margins per bushel, with greater efficiency required; and tight linkage between users and sellers, reducing the incentives for deception and increasing the market responsibility for testing both intrinsic quality and food safety.

FGIS has to operate within this changing market. The issues raised in the background paper are specifics relating to the overall question of how Government and industry can partner for progress.

Following is a list of attributes I think will be necessary for the official system in the future:

1. Maintain universal definitions for price-determining factors.

2. Use industry-accepted procedures and laboratories for the reference basis of grain tests, particularly the new intrinsic value tests.

3. Stimulate new technology and facilitate its use in trade.

4. Promote competition among inspection service alternatives, but assure that all are covered by standards of quality control.

5. Understand changing user needs and allow maximum flexibility for the grain market to respond efficiently.

6. Concentrate resources on quality control, market analysis, and data management.

Concepts inevitably must lead to actions, and here are a few possible ones, without any assessment of implementation procedures:

Expand FGIS data management and quality control abilities through automation, computer networking, and centralization.

Develop an overall long-range plan to incorporate more inspection entities into the national quality control network with competition on price and service. Professional inspectors will inevitably be successful as the emphasis on quality increases.

To partially replace lost appropriations, spread the fees for the use of the grades or factors therein to all users of those factors, not just export elevators. The grades and the procedures are intellectual properties similar to copyright fees on books, software, and other information and could be treated in the same manner.

Design a flexible group of industry partnership activities. Some examples: Consensus and laboratory sharing on basic reference methods; more programs like official commercial inspection; applications for new technology; acceptance/elevation of instrument performance data generated by labs other than FGIS.

The last item: Expand the clientele base for professional inspection services in some form. Total quality management dictates accurate testing from seedmen clear through local elevators to end users.

FGIS will be an integral part of food industry quality control. Some of its challenges are technical and others are philosophical. Given proactive visionary support from the agency, FGIS itself, the network of official agencies can be extremely successful and competitive as professional inspectors. The key concept is that Government and industry must regard each other as partners in sales, not adversaries in trade.

I appreciate the opportunity to spend some time with you today. [The prepared statement of Dr. Hurburgh follows:]

PREPARED STATEMENT OF CHARLES HURBURGH, JR., PROFESSOR, AGRICULTURAL AND BIOSYSTEMS ENGINEERING DEPARTMENT, IOWA STATE UNIVERSITY, AMES, IA

VISIONS FOR THE FUTURE OF FEDERAL GRAIN INSPECTION SERVICE

Accuracy and uniformity in measures of trade have always been important responsibilities of government, from Hammurabi in the 4000's BC to Roman law to modern national and international standards. FGIS is but one of the organizations created to fulfill these responsibilities. Grain traders, as a group, recognize that the United States must have universal standards and procedures, although individual traders will do whatever is possible to reduce costs without losing sales.

Therein lies the dilemma for FGIS, and for Congress. Traders seek cheaper alternatives to Government inspection, but desperately need the underlying uniformity it brings. The answers, in my opinion, are to upgrade the quality control abilities of FGIS, to reduce the emphasis on direct Government participation in inspections and

to eliminate activities/administration that potentially duplicate other Government capabilities. The United States needs accurate professional inspection, regardless of who inspects.

The world grain industry is changing rapidly to meet both competitive and technological pressures. Grain suppliers, beginning at the farm, will provide raw materials for manufacturing processes, rather than trade commodities. This is the essence of the worldwide "Total Quality" industrial movement. Some of the new realities are:

- Rapid data exchange via computer network.
- Sophisticated buyers looking for very detailed attributes, more than the current physical factors in the grades.
- Rapid development of testing and data handling technologies.
- Smaller margins per bushel, greater efficiencies required.
- Tight linkage between users, sellers, reducing incentives for deception.

FGIS has to operate within this changing market. The four issues raised in the committee's background paper are specifics relating to the overall question of how Government and industry can partner for progress in a dynamic time. Following is a list of attributes I believe are necessary for the official system in the future.

- Maintain universal definitions for price-determining factors.
- Use industry-accepted procedures, labs for reference basis of grain tests.
- Stimulate new technology and facilitate its use in trade.
- Promote competition among inspection service alternatives, but assure that all are covered by standards of quality control.
- Understand changing user needs, and allow maximum flexibility for the grain market to respond efficiently.
- Concentrate resources on quality-control, market analysis, and data management.

Concepts inevitably must lead to actions. Here are some general options, without assessment of implementation procedures.

- The next Administrator will need to be visionary.
 - Examine the relationship between the research segment of FGIS and other public research entities.
 - Expand FGIS' data management/quality control abilities through automation, networking, and centralization.
 - Develop an overall, long-range plan to incorporate more inspection entities into the national quality-control network, with more competition on price and service quality. Professional inspectors will inevitably be successful as the emphasis on quality increases.
 - To partially replace lost appropriations, assess fees for use of the grades or factors therein to all users of those factors, not just export elevators. This is similar to copyright fees for books, software, or other information, and could be done as part of existing licensing programs.
 - Design a flexible group of industry-partnership activities. Examples: Consensus and laboratory sharing on basic reference methods, more programs like official commercial inspection, applications for new technology, acceptance/evaluation of instrument performance data generated by labs other than FGIS.
 - Expand the clientele base for professional inspection services in some form.
- Total quality management dictates accurate testing from seedsmen through local elevators to end users.

FGIS will be an integral part of food industry quality control. Some of its challenges will be technical, others philosophical. Given proactive, visionary support from FGIS itself, the network of official agencies can be extremely successful and competitive as professional inspectors. The key concept is that Government and industry must regard each other as partners in sales, not adversaries in trade.

Senator DASCHLE. Thank you, Dr. Hurburgh, and thank all of our witnesses for their contribution this morning.

We had a number of witnesses that were either invited to testify or requested to testify in writing, and I would like to ask unanimous consent that all of their statements be made a part of the record at this time.

I think that one of the big questions that we face in reauthorization is how do we ensure that we retain confidence in the system?

Mr. Schwieder did an excellent job in his testimony in clarifying some of the concerns that producers have with regard to confidence. In fact, his last point of the four points he made in the early part of his statement is that producers are more confident knowing that an independent third party is always available to provide testing. "From the producer to the end user, the confidence that all grain tests are conducted by an independent third party is very important and essential."

He went on to say a little later that if unofficial inspections become the standard, we jeopardize that confidence and therefore jeopardize the market, and pointed to our experience in the 1970's.

Would anybody differ with that point of view? Everyone shares that point of view?

The question, I guess, then comes as to the degree to which we require mandatory export inspections and voluntary and/or mandatory inspections for domestic grain marketing. Does anyone disagree, of those who are here this morning, with the idea that we ought to maintain a mandatory system of official inspection for export marketing?

There are those who made the recommendation that we ought to have a pilot or a couple of pilot projects with regard to exporting, and the GAO had mentioned that and I think, if I recall, it was AAGIWA that also indicated that we ought to look at the possibility of using pilot projects.

What is the reaction of the group with regard to the utilization of a couple of pilot projects to determine the degree to which we can turn the export inspection services over to either private or State sectors?

Mr. HARTMAN. I think if you turn it over to a private or State, you're starting to diffuse the accuracy. You would have this State saying this is good enough and that State saying it's good enough. You won't have one agency.

Senator DASCHLE. So are you saying, Mr. Hartman, that even on a pilot project basis, we jeopardize confidence in quality?

Mr. HARTMAN. On a pilot project, probably no. But you get into a pilot, then pretty soon you're wanting to move on further, and I would say the end results down the road would be more inaccurate testing and also possibly jeopardizing our confidence in our overseas customers.

Senator DASCHLE. Yes, Mr. Schwieder?

Mr. SCHWIEDER. Mr. Chairman, could maybe John Harman explain how these pilot tests would be run?

Senator DASCHLE. Go ahead.

Mr. HARMAN. Our position in my statement is more from a generic standpoint. There's so much that we have seen in the work we've done where we made decisions to make wholesale changes in programs without really knowing what's going to happen as a result of those changes. And so we have at least taken positions in several cases where we ought to go to a pilot type situation, instead of making wholesale changes.

For example, doing away with the required official export inspection introduces more competition in the process. But it may result in consequences that you really didn't want.

So structuring a pilot project with specific goals in mind of what you're trying to do and specific identification of what you want to measure, followed by an evaluation should enable you to make informed decisions on the basis of the pilot project results.

As for your concern about whether it would cause a lack of uniformity throughout the system if we went to some sort of private or State-operated system, there are ways that that could be taken care of through the role of the Federal Government. But you'd have to look at that through a pilot project, and it has to be fairly well structured, and it may involve additional cost to the Federal Government we're not aware of. So we'd have to find that out. We certainly wouldn't want to go into something that's going to end up costing the Federal Government more, as well as doing some harm to the system.

Senator DASCHLE. Mr. Gore, how do you respond to that?

Mr. GORE. On the first issue of the creation of pilot programs and perhaps intermarket differences or even foreign complaints generated from that because of differences from the way Federal inspectors inspect grain, I think there are certain safeguards built into the system. The same standards would be applied, the same equipment would be used, the same supervision, or maybe possibly increased supervision would be applied to assure that uniformity maintains the same as it does throughout the official system.

I think from the cost standpoint, Mr. Chairman, that the State of Washington is in the official export business and while the average of the eight States was around four-tenths of a cent per bushel, we're a fairly large State agency, program of State government, and our fees are about a third of a cent per bushel. So I think there is a possibility for some cost savings to the industry, also.

Senator DASCHLE. One of the concerns raised by the General Accounting Office report was the variance in the fees associated with various inspections, fairly dramatic variances, as the GAO pointed out, variances that range anywhere from—I don't have it in front of me here, but—

Mr. HARMAN. It's on page 23.

Senator DASCHLE [continuing]. Page 23. There it is, yes. A low for trucks of \$5.30 to a high of \$16.55; rail cars, \$9.45 to \$23.70; and then barge, \$122 to \$184.

I'd like to explore that a little bit. Why the variance? Then, along with that, the GAO has said one of the biggest reasons there may be that degree of variance is that there isn't really a lot of competition in some areas. So I know the two are connected and I'd like some discussion on that. Who can enlighten us with regard to the variances and the degree to which the lack of competition is responsible for it?

Mr. Gore.

Mr. GORE. Well, I'd at least like to address a couple of comments to that area, Mr. Chairman. After informally polling our association, we find that yes, there are these disparities of prices, but there are some reasons for it.

Number one, in the low volume places where this work is not a regular occurrence and yet they keep people on call, if you will, to handle these service requests when they materialize, the cost of those agencies are higher.

What we found out, Mr. Chairman, is that while there are these price disparities, that they're probably the bulk of the inspections that are performed in those individual categories are performed closer to the weighted average than either into the extreme of those price disparities.

We further feel that more flexibility in our fee-approval process would allow us to tailor our service and cost to the industry demands. In other words, one unit fee does not have to fit all users.

Senator DASCHLE. Are you then saying that, in your view, there really isn't a problem of lack of competition?

Mr. GORE. We have pretty intense competition in the domestic market through the unofficial agencies, the in-house quality control process, and also the option of having this inspection performed at another location, at destination.

Our association believes that we have to maintain some cost competitiveness to stay in business. I know of at least several instances where agencies have offered to match the cost of unofficial agencies and they had nobody participate, even. They chose to stay with the system they had in place.

Senator DASCHLE. Mr. Harman, Mr. Gore says it's really just a combination of things. First of all, they have a lot of location where volume is so low it costs more on a per unit basis to maintain an inspector, and second, that most agencies really charge nearer the weighted average. The extremes are the exception rather than the rule. Is that—

Mr. HARMAN. Well, we kind of hoped that we could make that correlation between volume and price and we couldn't.

Senator DASCHLE. You couldn't?

Mr. HARMAN. No, we couldn't. We have some high volume inspection agencies that have high volumes and high fees and others with low volume with lower fees. And I know the staff's looking for that information right now.

But we also looked at the possibility of some other correlation. We really couldn't, given the time we had, get down into depths into why these variations were occurring. Also, another thing was that the variations occurred in adjacent areas that were very close to each other. So it was not very clear why some of these things were happening. I think you'd have to get down into individual case studies to try to determine that.

But I know one of the issues that has been raised is the lack of competition, and we are not sure to the extent that it could be a factor.

He's correct, Mr. Gore's correct. There is competition in the sense that these unofficial agencies are providing services and that's one reason that official agency inspections are declining.

Senator DASCHLE. Mr. Gore, the State agency costs range from slightly less to nearly twice the Federal level of costs. It gives little assurance of lower inspection costs. Does the possibility of such high State agency costs undermine the argument and cause you some concern?

Mr. GORE. Yes, it does. Once again, I think that costs are tied to volume and there are some States involved that don't have very large volumes. Out in the State of Washington, export volumes are

fairly consistent from year to year and we're able to provide some assurances that our people are going to stay busy.

Senator DASCHLE. Do exporters favor replacing Federal inspectors with State or private inspectors?

Mr. GORE. I don't have that knowledge, Mr. Chairman.

Senator DASCHLE. How about the exporters? Can you tell us?

Mr. JACOBSON. I'd be happy to speak to that question. As a member of the board of North American Export Grain Association, let me just say that this is a very controversial issue at the moment. Of course, the GAO report, which I believe personally was very, very thorough, very helpful to me and others in the industry in analyzing a number of questions. That has just become available in the last couple of weeks.

There are companies that would prefer going to an independent or State basis with a strict FGIS oversight role. As you mentioned earlier, we are all committed to confidence in the system and as Charlie mentioned, it's of key importance internationally. We're all much more quality oriented now, as we must be because of end use interests on the other side.

But at this stage, I'd just like to say that there's a rather even vote, perhaps, between streamlining FGIS in such a way as to maintain the integrity of the system, the existing system, and streamlining it still further and going to an FGIS oversight role only.

As I mentioned earlier, we look forward to working with you on that. Each of the groups involved in export is taking this very seriously.

Senator DASCHLE. Do you think a skeptic might say, well, the exporters just want lower costs? Is there something more to it than just lower costs, in your view?

Mr. JACOBSON. Well, being the largest source of revenue for FGIS, I think the exporters have an interest in cost control. We must. We talked earlier about the consolidation in the industry, you know. This is very real, very serious, and it continues.

Where you can't do a great deal about the top side of the balance sheet, you must focus on the bottom side, controlling the costs, and FGIS inspection fees at this time in our export elevators, it's safe to say, would be the second highest variable expense in any export elevator in the United States.

The three highest export variable expenses at an elevator, of course, are your own in-house labor throughout the facility, power and light—power is a big element—and FGIS inspection. We can have an ability to impact our power consumption and we're making efforts on that all the time, to control that expense. We can through our own work with our labor unions reduce costs there. There has been some inflexibility in reducing the FGIS side, and personally I feel that FGIS has a fine reputation, an exceptional reputation for integrity. There's no real question about that on the export side.

I've spent a lot of my time out of the country, as well, and they are certainly well respected around the world. At the same time, at the elevators, we do feel very seriously that there are certain inflexibilities that could be eliminated and that could result in a different fee structure.

Senator DASCHLE. Without undermining quality?

Mr. JACOBSON. Yes, absolutely. The quality orientation, again, is very serious, right from the acre out in the origin point to the export elevator. We have to be. The export buyers around the world are requiring much, much more, as Dr. Hurburgh said earlier. We have to be destination-oriented.

Senator DASCHLE. We were diverted a little bit from the original question. It occurred to me as we were talking about this that obviously there are motivations for reduced costs that play into this, but I go back to the original question in trying to better understand what I consider to be one of the most relevant findings in the GAO report, which was this significant degree of variance and what it is, as we look at reauthorization, we need to do about it, if anything.

Mr. Gore points out that there is some relationship to the numbers of inspections and the costs involved on a per inspection basis. However, the GAO report indicates that there doesn't appear, from their study, to be much of a discernible relationship between numbers and costs per inspection.

So I'm not satisfied thus far that the committee has a good explanation as to why that variance has occurred. We seem to have two explanations that, in some ways, are in conflict.

Mr. HARMAN. Yes, I found that information, Mr. Chairman, which we would be glad to submit for the record, if you'd like to do that. But what this shows is that in trucks, for instance, the agency that has the highest volume does have a fairly low fee of \$6.50, but then the third one down, the third highest in volume has the highest fee. They're the highest in the range.

You can go on down the list to those agencies that have a very low volume and they also have low fees. There's no rhyme or reason to how these rates are showing up here, at least in the short run, just to look at the information, to look at the data. It doesn't give you a clue as to why those rates, that volume is an issue here.

Senator DASCHLE. Mr. Schwieder?

Mr. SCHWIEDER. Just to comment a little bit on these fees, simply—for instance, I submit samples to the Idaho Grain Inspection Service. Now, the fee that they charge me depends on the analysis that I want for that sample. If I want a protein analysis, it's going to cost me more for that service. Whether that has an effect on these costs that you're talking about here, I don't know.

Mr. HARMAN. No, this is not the option or the submitted samples. In fact, I believe—and I'd have to look it up here, but I believe the submitted samples did not have quite as big a range, which, you know, goes the opposite direction. You just can't make any generalizations off of this data.

Senator DASCHLE. We are all concerned about costs. Rightfully, I suggest. In this context, I am interested in what the GAO report said about costs for official inspection as a percent of the value of grain exports. I asked my staff if they could give me just a little bit of a cost comparison between commodities.

Peanut handlers in Georgia pay eight-tenths of one percent of the value of their peanuts for inspection and grading. In Idaho, Mr. Schwieder's State, potato processors and packers pay 1.5 percent of the value of their potatoes for inspection and grading. If all official

inspections, both domestic and export, are assumed to be connected to export sales—a conservative assumption—the grain trade is still paying only about three-tenths of one percent of the value of grain exports for official inspection services.

So, it would seem to me that export inspection costs of even as much as three-tenths of one percent of the value of the grain do not appear unreasonable when compared to other commodities, at least compared to peanuts or potatoes.

Mr. Aubrey, were you going to make a point?

Mr. AUBREY. I was just going to say about the rates for the domestic official inspections and the variance, this is raw data and it doesn't consider, someone pointed out, the number of locations where these come into or the workload at any given location. But I think the questions raised by the raw numbers comes back to what role should FGIS be playing and what role should they be playing in approving the rates.

It seems to me that part of their leadership role is to be aware of these rates and have adjacent agencies in a given territory understand what the comparison with official agencies next door shows, and perhaps even over time make those available to all of the agencies and maybe even the industry so that people aren't operating without information.

Maybe one of the others who testified here about the FGIS role being to collect and analyze data and disseminate part of it, this would be a part of that leadership role in order to perhaps in a soft way encourage agencies to be more efficient and assure that they're holding rates at levels that are commensurate with others in that area.

Senator DASCHLE. The GAO recommended that there be more competition. I don't know how feasible that is. There may need to be some kind of a governmental regulatory determination as to what is fair and what is appropriate.

To what extent would FGIS asserting a regulatory framework for fees be appropriate in this case?

Let me ask the GAO first.

Mr. HARMAN. Yes, I thought you were going to ask me that. By and large, we don't think it would be a very good idea to exert a whole lot more regulation over this process. That does change FGIS' role.

Now, we would not see the type of situation that Carl talked about as being increased regulation. That is a matter, he said, he used the word soft, you could use the word jawboning, you know, there are ways that you can bring some more conformity to the price-setting structure within their current authority.

I don't think we'd advocate or recommend that we make this a—although it is to a certain extent a franchise-type operation—that we make it into a cable or utility operation where they come up with the rates and set the rates. That's a quagmire I don't believe we want to get into. The question I would have to ask in that is what are we trying to solve with that, and I'm not sure we know quite what the problem is.

Senator DASCHLE. I guess what somebody would say is that you're trying to solve a problem like Mr. Schwieder going in and getting charged three or four times the going rate for an inspection

when somebody else in another part of the country is paying a third or a fourth of what he's having to pay. Is that variation justifiable for the same service in selling the same grain under the same circumstances?

One can argue that there's a better way, and I think that's what you're saying. I think that's the problem you're trying to address.

Another point that was made by several of our witnesses today is that there ought to be a greater role for non-FGIS inspection. Should we use FGIS as more of an oversight agency and let private inspection agencies play a greater role?

To what extent, if that happens, does FGIS then find itself in a regulatory mode, rather than being actively involved in doing official inspections?

Mr. HARMAN. That would make the role of FGIS more like that of the FDA—setting standards and then establishing a system that makes sure those standards are being complied with. But the industry is carrying those out. I mean, that's basically the system you'd be looking at. There's nothing to say that system couldn't work, but given the problems that some of the stakeholders may have with that system, the producers, for example, you'd have to go into that very carefully.

Again, I would try to do it on a pilot basis and not go into it on a wholesale basis. But there's nothing to say that system could not work. The system we have is certainly not the only way to skin a cat. I would have a hard time believing that. But you can't use some processes in the current system to do something differently. It may not match up, so if you're going to change FGIS' role, you have to make sure you understand what that role is, what you're trying to achieve, and what the role of industry is in that, and how you're going to operate this.

There are a lot of problems with food safety because of the similar kind of issues. We have meat that's being inspected on a day-to-day basis. We have many other foods just as susceptible to food safety problems that are inspected once every five years. There's all kinds of issues that we'd have to—this system right now is really much better than the food safety system as it exists.

So let's go into it and make sure we understand what's going to happen, both in Federal costs as well as what's going to impact the different customers. Dr. Hurburgh talked about that. I think he made a lot of excellent comments.

Really what I would suspect, what I hope we're after here is the customer satisfaction all along the line. I mean, the producers may not be comfortable with it, but I suspect the producers would become comfortable if the customers are comfortable and they're buying the product.

So that's really what you've got to focus on, and to focus on some side issues may take us away from the customer.

Senator DASCHLE. Mr. Galliard, you had your hand up. Did you want to say something?

Mr. GALLIART. I want to talk a little bit about the fees charged by the official agencies. In past years, we generally used as the policy a consideration of the surrounding agencies and what they charged, in order to evaluate the fees that the central agency, the

one we were considering, is charging, and felt there was a pretty fair index of how to evaluate those fees.

Secondly, we've known for many years that the unofficial system offered competition to the official inspection agencies with regard to their fees.

Several months before the GAO report came out, we decided to have another look at the way we were examining the fees of the official agencies, and we have found and are finding that we should be looking more critically at the fees that are on the schedule of the official agencies.

We know that there are differences. Whether they represent all the differences or not, some official agencies have much higher labor costs. Some are involved with unions and their costs are higher. Some official agencies pay much more rent or the leases are more expensive. Some have to go through extra effort to provide the inspection service: distances traveled and more of their staff on the job to provide the services.

Senator DASCHLE. But you heard what I heard from the GAO. I don't want to misstate what I thought to be their position. Their position was that in spite of all those differences, there didn't seem to be much of a correlation between cost and fees.

Mr. GALLIART. And what I'm saying is that, starting some months ago, we began to look at this to see what we could find out and what we might change in looking at the fees of official agencies.

Senator DASCHLE. And?

Mr. GALLIART. Well, we're still involved in this study.

Senator DASCHLE. When do you expect you're going to have some results?

Mr. SHIPMAN. Senator, let me add a couple of things here. It's been very difficult in the past to look at all the fee schedules because they are separately designed by independent companies or States, and some may charge for travel time, some may not, to provide the service. Some have hourly rates, some have unit rates. Recently we got together with the industry and the agencies, sat down and worked out more of a standardized format for presenting fees so we can more easily compare agency fees.

We're moving in that direction. We're trying to work as a partner with both AAGIWA and the industry to get a better handle as to what the fees are and whether they are reasonable. We feel as though our reviews over the years have shown that the fees are reasonable for the costs and the activities that the agency incurs.

The GAO reports no correlation between volume and fees. I'm not sure, and correct me if I am wrong, please, I'm not sure that they looked to see if there was a correlation between cost and fees.

Mr. HARMAN. We did not.

Mr. SHIPMAN. So there are a wide range of costs that these agencies are confronted with.

Senator DASCHLE. That seems to me to be a fairly significant question. Why would you not have the opportunity to—let me rephrase that. Why would you not look into the association between cost and fees?

Mr. AUBREY. I think Mr. Shipman hit right on the answer. When we started this review, data was simply not there. If you looked at

the fee schedules, you had to look at 72 differently designed fee schedules, and as he said, halfway through our review, as they examined this information tool, they began to see the need for information in a more consistent format to be used, as he just talked about the meeting which we attended, too, with the industry and AAGIWA, to start discussing some of the very issues we're discussing.

So in a very large way, I feel like over the last 9 or 10 months that people have begun to come to recognize not only the need for some information consistently organized, but the need once they have this information to sit down at the table and share it together in order to say, "What are we trying to achieve and what's the best way to achieve that?"

I think we've seen movement in the last 5 or 6 months, but we couldn't get the data without visiting all 72 agencies, which given the time we had we couldn't do, to determine what their costs are and how they relate to the fees.

Senator DASCHLE. I see.

Mr. AUBREY. Appendix VI represents the rates for the agencies that collectively did 90 percent of those inspections, and as you look down the one column, that eliminates over half of the agencies in every category.

So when you're looking at just the fees, without adding travel time or any additions, these are the fees for the agencies that did most of each type inspection. And there is still considerable variance in the fees.

Senator DASCHLE. Mr. Shipman, obviously this has some relevance to reauthorization and how we look at the question of variance and what, if anything, might be done. I certainly hope that you can provide us with the information as soon as it becomes available. There's no reason why we can't proceed, in any case, but it would be very helpful. So I would simply urge you to provide that as soon as you can.

Any other comment on fees, because I want to move on.

Yes, Mr. Hartman?

Mr. HARTMAN. In our geographic area, I can sell to a lot of different handlers, and if I sell to one, they charge me \$3 for every—that's an inspection fee, that's on a semi-load, which is approximately three-tenths of a cent per bushel. That organization is there in that company every day and they take in approximately 180 to 200,000 bushels of corn per day.

I have another opportunity to sell closer to home and they bring the inspector in periodically. The inspectors have to move probably 28 miles and they don't charge me anything there, so I don't know how they hide that cost. But I could just see a lot of variance right there in the one location to another.

Senator DASCHLE. Would it help you at all if the fees, around the country or at least in the region, were published? I mean, would that draw attention to the variance and perhaps make the fee system more user sensitive?

Mr. HARTMAN. I don't think the farmer would pay any attention to it.

Senator DASCHLE. You don't? Okay.

Publishing really wouldn't have much effect. That's the good, old-fashioned blunt answer. [Laughter.]

Mr. HARTMAN. The farmer only pays attention to it when it is taken out of the check.

Senator DASCHLE. Okay.

Mr. Jacobson.

Mr. JACOBSON. A couple of comments. On the domestic fees, and of course FGIS has a different role domestically, like was mentioned, there is competition. In-house inspection is on a rapid increase and perhaps the exporters and the domestic grain companies would look at it if it were published. It would make it easier for us to make our analysis.

But in any case, let me just say there is competition. There are alternatives, and we're all becoming much more oriented to quality control, as we must.

Now, let's just for a moment flip back to your question that I wouldn't want to leave unanswered. You were talking about the dollar sales of grain exports from the United States and the inspection fees of FGIS as a fraction of that dollar sale figure. One very important distinction needs to be made between grain exports and the domestic commodities you pointed out.

Dollar sales are very important to the U.S. economy in terms of our balance of trade. Our balance of trade looks at those dollar sales of grain export. Dollar sales, on the other hand, internally, in terms of profitability, as any accounting firm will tell you, are more or less meaningless. I mean, there are a number of grain companies that operate at a significant loss while having a tremendous sales figure in any one given year. So dollar sales are not reflected on our balance sheet. It's all net sales.

If we were involved in some of the products—well, as sister companies of mine are, as a matter of fact, in potatoes, certainly, and peanuts as well—there it's a cost-plus, sort of an agricultural equation, you know, where the costs are added until you get to the supermarket, whereas as our producer friends well understand, export is a market price at the Gulf and you back that off to the acre, and whether or not that leaves a profit, as we all know, for either the farmer or the exporter, the grain company, are two totally different subjects.

So it really isn't fair to look at the percentages of the dollar sales between the two. Naturally, we have international competition that sets what that grain is worth FOB the Gulf or FOB the PMW or wherever the export elevator is located.

Senator DASCHLE. Well, you're the expert, Mr. Jacobson, but it sure seems to me that competition is just as keen in many respects domestically. You've got regional competition, you've got competition between commodities, in some cases, for certain things. You've got extraordinary price pressure on the domestic side, as well. So I'm not sure I understand your distinction.

Mr. JACOBSON. Well, I'm not saying there's no competition domestically, but when we're talking export, we're talking destination markets, third country markets, comparing the EC values to the U.S. values in a third country, and that's a different type of competition altogether.

Senator DASCHLE. Oh, I understand.

Mr. JACOBSON. Unfortunately, it's much different with the EC policy.

Senator DASCHLE. Do I understand you to say, though, that it's your view that domestic competition is not as keen?

Mr. JACOBSON. Yes, I'd say that, because there aren't as many origins involved in the mix. But transportation plays a major role in any competition and internationally, of course, geography gets into the picture. There is competition domestically, please don't misunderstand.

Senator DASCHLE. No, that's why I'm asking the question.

Mr. JACOBSON. But it's different when you're talking international competition and you're analyzing half a dozen origins on wheat, as an example, to a third country destination and, of course, the CAP policy in Brussels complicates that considerably.

But again, the common accounting practice in the United States for grain sales is not on a gross dollar sales basis. It would distort things. We would move up on the Fortune 500, but it would be a total distortion, so I didn't want to let those questions of yours go unanswered.

Thank you very much.

Senator DASCHLE. You bet.

Yes, Mr. Hartman?

Mr. HARTMAN. I had forgotten to mention also, the agency that—the company where I see the grain to that charged me \$3, that's a private agency and FGIS gets none of that income, and there's one of the things that's happening. FGIS gets very little internal and the internal system is using them constantly.

If there is ever a problem, then that will be submitted sample to FGIS, and I'm sure that they have a file sample that they go back to once in a while for their inspectors to see, yes, we're doing it right. They only use them when they need them, and I think that's income that is escaping the organization.

Senator DASCHLE. Thank you for that clarification.

Mr. Shipman.

Mr. SHIPMAN. Yes. If I may, I'd just like to make a comment. Several witnesses today talked about using private agencies at the export locations, rather than Federal employees. Mr. Gore brought that up and the GAO representatives have mentioned it as a pilot possibility.

I just have a couple of comments on that. Over the past 17 years FGIS has built an export inspection system recognized worldwide as reliable and accurate. I believe most everybody at the table would recognize that when you go around the world and you talk to buyers of U.S. grain, they recognize that there's the Federal system in place with the States.

I think the bottom line for why they're advocating privatization is really cost, not the service or the integrity that's provided. It comes back down to cost, and the belief that as a Federal agency, we carry too much excess baggage to be able to provide cost-effective service.

I guess I need to challenge that. I think that as an agency, over the past 17 years we have constantly been confronted with the need to reduce our costs and streamline our operations, and we're continuing that to this day. We have numerous activities under

way right now such as working hand-in-hand with some of the grain elevators in an automation process that will reduce our labor costs. We have work underway with our union representatives to help us streamline that process to hopefully reduce overtime, and again, our labor costs.

In recent days I've looked into our Workmen's Compensation costs as a percentage of our labor costs, unemployment costs that we're confronted with when we lay people off, and I do not believe that they're out of line with what many people in the private sector actually are confronted with. So when you compare—

Senator DASCHLE. You estimate that it is three-tenths of 1 percent? That's the figure I was given.

Mr. SHIPMAN. I have been told by certain facilities that it's three-tenths of 1 percent. GAO came up with .47 compared to .41 at the State levels. You need to recognize that they were looking at only the required inspection and weighing, not the other services, the optional services that are asked for.

We recently took, after getting the GAO report, the fee schedules for all eight delegated States and applied it to five grain elevators that we service currently. We picked and chose high volume versus low volume facilities. We found that in all but seven cases, our fees to that elevator would have been cheaper, if you looked at all the work that was being done. Granted, if the State agency had the high volume location, their fees may have been different.

I think the other thing we need to look at is that we service some very low volume markets, for example, export markets in South Carolina and the Southern Texas area, where the volumes are not anywhere near as high as you have in New Orleans, and our national fee is applied at those locations. So if we were privatized, so to speak, so a private agency serviced those low volume areas, some of those ports would experience higher fees.

Senator DASCHLE. Do you think, Mr. Shipman, that a pilot project would be harmful in any way? It would seem to me that a pilot project would allow one to compare the advantages and the disadvantages and come to some conclusion. What you're saying is, the system isn't broken so why try to fix it. I guess that's a pretty good argument, but if you can improve upon a system that isn't broken, there's an argument to be made for that, too.

Mr. SHIPMAN. I'm always confronted with that on the other side of the table when we're trying to make changes. Industry representatives constantly say, it's not broken, so don't fix it. So I'm not going to say that we shouldn't be looking at a pilot study.

I guess at this moment I'm a little concerned as to how do we define it so that it's fair, so that where we run the pilot study we're not giving that company or companies involved an advantage over others. I'd have to sit down and really think about how you could run it to make sure it's equitable and we're not giving somebody a market advantage.

Senator DASCHLE. Getting a true comparison may be difficult?

Mr. SHIPMAN. Yes.

Senator DASCHLE. Let me move on to another question relating to the GAO study, because I find it probably to be the second issue of greatest concern, and that has to do with the decline of the

number of official inspections. They've gone down by about 46 percent since 1985.

The GAO report says that the volume of grain officially inspected has declined by 11 percent. AAGIWA has maintained that this poses some serious problems in maintaining the integrity of the whole system. Obviously, if this trend continues, and we see additional declines, we're going to be facing this confidence threshold that we've talked about in various ways this morning.

I'd like a little discussion about that. The GAO also indicated that they didn't detect any decline in confidence, even though there has been a very significant decline in inspections, a marked decline over a period of time.

Mr. Gore, could you elaborate a little bit, if that is the case, what concerns that may inspire?

Mr. GORE. Yes, Mr. Chairman, I'd like to address that. There are about three facets of the GAO report, including this one, that call for greater cost control of private agencies. At the same time, we are experiencing decreasing volumes in large part due to unofficial third party inspections.

If that trend continues, I think the number of official agencies will be reduced and then the credibility of the in-house and the unofficial systems will be at stake, and that may not be as viable an option as it is right now.

The GAO report referenced official agencies as a safety net for the in-house and unofficial inspections—if basically we're used as an appeal service for that unofficial process, to resolve disputes between buyer and seller. So I think that has lent credibility to that service up to this point. But if the trend continues towards the decline in official inspections, I think official agencies will become fewer and fewer and it will negatively impact on the credibility of the unofficial system, also, if that safety net is removed.

Senator DASCHLE. Mr. Galliard, do you have any comment in that regard?

Mr. GALLIART. Certainly, if the official inspections continue to decline in the interior, there's going to be a point in time when it's going to have an impact. It probably would be delayed somewhat by the absorption of some of the smaller agencies by the larger agencies, and by those that can offer more competition in their fee schedules.

In my view, at this point in time, the system is not sick or ill, as some would indicate, but declining, and I think it may continue to decline but still stay healthy.

Not too long ago, someone from an official agency told me that he thought they'd be out of business in 10 years. Of course, this could happen. We are of a mind that the system will stay intact.

Senator DASCHLE. Well, I tell you, I don't think Congress is going to let that happen. I know that we've seen some very significant reductions in the overall tax dollars and revenues associated with your agency. You've seen a dramatic reduction in the amount of Federal dollars that go into your operating responsibilities. But, I must say that we've watched with great interest as you've attempted to deal with that. Like others have said, I think that FGIS has retained a very high degree of credibility and a high degree of confidence with regard to its responsibilities in the future.

But if that confidence erodes, and if we see deterioration in your ability or in the overall system ability to do the job, I guarantee you some radical actions will be taken to ensure that it doesn't affect exports, doesn't affect the domestic market, doesn't affect the very sensitive fabric that we've got out there with regard to ensuring that we not only maintain, but improve upon, the confidence in the longer term.

Quality markets, as everyone knows, are going to continue to become a very significant part of our marketing strategy, and as those quality markets are maintained, so must inspection, so must the oversight responsibilities, both privately as well as with FGIS.

Yes, Dr. Hurburgh?

Mr. HURBURGH. There are at least three factors which affect the decline in official inspections that we cannot solve in this room: Larger container units used in transportation to capture greater efficiencies; better overall grain quality in the system, requiring less critical inspection; and finally, the trend toward fewer handlings of the grain so that elevators and users are more tightly linked with fewer trans-loadings, which will reduce the need for inspection. Those we can't solve, and yet those things are going to reduce the number of official inspections.

Senator DASCHLE. Mr. Galliard mentioned the difference between the FGIS export inspection costs—I think he said it was .47 cents per bushel—compared to .41 cents for State agency export inspections. However, the State agencies' inspections, as the GAO indicated, range from .3 to .9 cents. How accurate is that comparison?

Can the GAO comment? Nobody wants to or can tell me?

Mr. AUBREY. Well, I think it's accurate for what it does. We took the cost of the required inspections and compared them on average. We did not include in that comparison any of the optional inspections, to try to keep it on the same base. I think Mr. Gore mentioned that as you look to the States there are some different volumes in the range of State agency fees. I think within the FGIS export inspections, you'll find different volumes at their export locations, as Mr. Shipman indicated.

Now, we were not able to go as far as to break the FGIS costs down by export locations, so we put together all of their locations and came up with the average, and we worked through that calculation with them.

Senator DASCHLE. Yes, Mr. Jacobson?

Mr. JACOBSON. Thank you for answering one of my earlier questions. I was curious to learn more about the range on the export fees of FGIS. I think it's important to point out, and you've answered the question, of course, it's not a location-by-location analysis.

I suspect it would be a pretty wide range, if you were able to look at all the grain elevators in the United States that are export elevators. Some houses, we have one in the Gulf of Mexico and Louisiana, for an example, that's solely dedicated to wheat. We move a lot of spring wheat through there, very large quantities of spring wheat, and the nature of the beast is to ask more of FGIS. We do a lot more testing there than the minimum requirement.

Our fees are significantly higher than .47 at that elevator, as a result. Some other elevators, due to efficiency or lack thereof, may

see significantly higher numbers, as well. I'm sure Dave Shipman has witnessed some of that, as well as Mr. Galliard.

So, you know, it's a broad range. It's a very broad range. At the State level, it's generally a very easy analysis to make because it's so much per metric ton, whereas FGIS rates are hourly, and we may or may not move a lot of tons that hour.

I'm very encouraged by the type of internal cost control study that Mr. Shipman has discussed earlier and I want to definitely encourage that to continue. The cost control areas, I think, of greatest interest to the exporters are those in the flexibility area. There are two FGIS hourly rates in the Gulf: one, an annual contract, and two, an hourly.

The hourly, I believe, is about \$30.50; the annual—pardon me. The contract is \$30.50; the short-term, short-notice would be \$40.50. Exporters right now are required to call that for a 12-month period, I believe, and I would like to recommend that they seriously consider reducing that to something more commercially viable, such as a 90-day period. Right now with Brazilian beans coming out, as an example, there are a number of grain elevators that have several FGIS crews booked, paid for, and very little going through the house, as Dr. Hurburgh can understand.

So that's the kind of inflexibility area that I think could certainly be improved, and just by shortening the window from a 12-month period to a 90-day period, it would result in a significant change.

Thank you.

Senator DASCHLE. The GAO estimated that FGIS spends about \$2.5 million from appropriated funds for activities that fall in the realm of oversight and supervision. Some have suggested that these costs ought to be provided through supervision fees, rather than appropriated funds.

We got into that a little bit in some of the testimony, but what comment is there on that? Is that a more appropriate approach?

Mr. HARMAN. Mr. Chairman, from our perspective, it would seem to be easier to do that than to come up with \$7 million through the other approaches that have been suggested, applying fees for standardization. Of course, that does increase fees, and looking at the legislative history of that, fees for that, for supervision, were originally passed, it was not intended that those fees would cover everything. So that's why we didn't recommend necessarily that be done. But we brought it out as the point of information, that it is a possibility that would certainly be more equitable than what we might try to do to find fees for standardization.

Senator DASCHLE. Some have argued, I think with some degree of success, that there are a lot of beneficiaries out there of a good standardization program, a good inspection program. Certainly the benefit to the industry, to the country, to the markets ought to be reflected somehow in costs passed through them, rather than just costs to the producer, or just to the shipper. I guess there's always the question of the practicality of making that happen.

Can anybody enlighten us, as to how that might be done?

Silence. [Laughter.]

Mr. SHIPMAN. Senator, we're in the process right now of considering different options of how to cover the \$6.8 million that will

have to be covered by user fees. The Department has not made any decision on how to do it. I guess the range could be everything from simply increasing our current user fees, which means the current customers pay for the increase, to considering options such as assessing a user fee to all grain handlers or millers and processors that buy and sell grain.

I've heard discussions, not in the Department but within groups in the industry, that some sort of producer check-off should be used. So those things are being looked at right now by the Department as options for charging user fees even more directly to the beneficiaries of the service, in lieu of appropriated funds.

In terms of the compliance money that you talked about, we view the oversight of the agencies as more of a regulatory function. Are these agencies, or in some cases grain handlers, complying with the law and the regulations that they are required to operate under? It's more of a compliance activity. We have in the past and even currently considered that a function where appropriated funds should be used.

The standardization activities, the \$6.8 million, is a different story, where we're looking to propose fees to the users of that service.

Senator DASCHLE. Any other comments?

Mr. Hartman.

Mr. HARTMAN. Our organization has looked at this, and we look at it, the guy that buys, the ultimate housewife out here buys a box of cornmeal. She is benefited. Has any of that cost been borne by that product? Probably at the point of first sale, and that's all. And maybe not even there, if it went through a producer-contractor with—you know, I might contract my specialty corn with the company and then there would be no benefit come back. None of that cost would come back to FGIS.

Senator DASCHLE. Well, we face some real serious questions this year with regard to this very issue, and our first opportunity to reflect some consensus will be in the reconciliation effort, and obviously there is a good deal of concern at this point as to what is the fairest and most appropriate way.

I think it's safe to say that appropriated funds are going to come harder and harder in years to come. So, I think if that's the reality, we've got to find ways to ensure that what Mr. Galliard said a couple of minutes ago, about the decline and ultimate demise of FGIS, just doesn't happen. We've got to find ways to ensure adequate funding is provided in some way.

I frankly don't know what the most appropriate way is. I'm concerned about the practicality of some elaborate scheme. I'm concerned, I guarantee you I'm concerned about a producer check-off, and I'm not real wild about user fees. [Laughter.]

Which is, I'm sure, the dilemma facing everybody at this table. But in any case, I think we do have to face it. As we look at reauthorization, we're going to be in a much better position to consider our structural options, and by then I hope we have a better appreciation of what it is we need to do.

Let me move on to commercial inspections for a minute. The options given inspection agencies to tailor official commercial inspections to client needs have appeared to some to give the agencies

flexibility to compete with unofficial inspectors, and the question is, are the inspection agencies using official commercial inspections to maintain and increase their business volume?

Can anybody address that?

Mr. HARMAN. We looked at that and it is occurring, but it's fairly minor on the numbers. Carl, you may want to give the specifics of that, but our overall view is that there's much more opportunity than what some of the official agencies are taking advantage of.

Any time you get into change, there's always some resistance and particularly in a market where you've had less competition—and it could be we didn't look at this correlation—but with less competition in a particular market, there's less of an incentive to make that change. So it's a marketing, it's a business decision. If you're not making the kind of business decisions you need to make, sooner or later you're going to go out of business.

That's sort of what our view here is, that there are opportunities here that some are not taking and we're not sure why.

But Carl, you may be able to give the actual numbers.

Mr. AUBREY. I would just make the observation that as an official agency is doing business and the industry is going through its changes or consolidation and in-house quality assurance and maybe some customer they've had is considering change, that the new official commercial would offer the opportunity to deal with that customer who's considering an unofficial agency or some unofficial system.

What we found in the official agencies that we interviewed is that, I think, about 25 or 30 percent said that they had successfully used that instrument to attract business that they would not otherwise have had.

The other roughly two-thirds that we talked to said that they have offered it to industry but none had accepted it.

In our discussions with association representatives and industry representatives, we found many of them who said they were unfamiliar with it. So I think in the short time we've had from last April until now is not sufficient to really see what it will do; I think the importance of it is how it's used in the future. But at least in early 1993, I think the total number of inspections equalled about five percent of the total official inspections, so at least it is getting off the ground with some agencies.

Senator DASCHLE. Let me ask you, if the costs were comparable, do you think that dealers and handlers would go back to using official agencies, rather than in-house inspectors?

Mr. AUBREY. I have a sense, and I'll qualify it as a sense, from some of the official agencies that we talked to, particularly where they had an ongoing daily relationship with a customer, perhaps Mr. Gore would be the better one to answer this, that once they've lost the customer to an internal quality assurance program, it's going to take time to work their way back into that operation. But, with that said, I think that's a better question for Mr. Gore, perhaps, to answer.

Senator DASCHLE. Isn't there an advantage to an official inspection? If costs are comparable, it would seem logical that they would move in that direction again?

Mr. Gore.

Mr. GORE. I would agree with that logic, but in practice it hasn't really happened. We've had several instances where commercial official was offered at the same price that unofficial was being performed at, and they elected not to go with the commercial official.

I think it's been our association's observation to this point that industry's acceptance of commercial official has limited application. Primarily where it's successful is for quality control on an inbound truck-receiving operation at perhaps a processing plant. That seems to have been the application that this thing has gravitated toward. Trading of rail cars, grower lots, we haven't experienced much success with it.

I, like many of the members, have advertised the service and was hopeful that this would generate new business and not substitute business, but it hasn't really gained industry acceptance in many instances. Whether it be the color of the certificate that's offered or the variance from procedures that are used that may have some adverse effects on some industry confidence of that inspection, but for whatever reason, the application of commercial official has been quite limited up to this point.

Senator DASCHLE. Do you think the—I won't call them excessive—but, do you think the fees at times ought to be a relevant issue in license renewals?

Mr. GORE. I think it should be a matter of consideration, but short of instituting cost controls, I would suspect that the higher end of the spectrum that was referenced in the GAO report for certain inspections were from high-cost State agencies and probably not from the privates, and GAO could probably address that better than I.

But I guess our concern is that if excessive bidding or competition increases for certain areas, that it's going to adversely impact impartiality of the system.

Senator DASCHLE. Adversely impact?

Mr. GORE. Yes, if excessive bidding, official agencies setting against one another. Grade shopping could become an issue as well as impartiality. It could have an adverse impact on that, and those all speak to the integrity of the system which we're very adamant about maintaining.

Senator DASCHLE. The GAO talked about these territorial franchises and expressed some concern about what effect they may be having. Can one make a good case to eliminate exclusive territories? Is that something that we ought to look at?

Mr. GORE. Our association is opposed to it for the reasons I just cited.

Mr. HARMAN. The major reason seems to be to go looking for grade shopping. That is a fear, more than a fact, right now. Until you tried it, you wouldn't know.

I think the ultimate arbiter here, as I said before, is the customer. If the merchandiser is pleased with the service that they're getting in-house, it's probably going to take a cost that's less than what they're spending to do it, because there are some advantages in having in-house inspectors.

Now, if you can give a quality or a service that goes beyond that, as this would do because it's official, but maybe they're not willing

to accept it, maybe they don't need the official. They just don't need it because their customers are happy with the product they're getting. Then you enter a situation, well, how do we keep this official business, these official agencies in business, because they do have a safety net. Are we willing to take the risk of eliminating that safety net?

I think you said politically that's not going to happen, and then there's the trade-off with the cost to the system.

Mr. AUBREY. But I would add, even in terms of the territories, I think our position would be that if you're going to move in this direction to consider that, it ought to be on some sort of pilot basis, rather than change the system without knowing or having some sense of what the consequences of that outcome would be.

Mr. SHIPMAN. Senator, there's another factor involved. Not only the grade shopping that it's called or the integrity issue, but when we designate somebody to have a specific geographical area, we require that person to provide official service to anyone and everyone within that territory. If we open it up to competition, I think the concern about the small facility in an outlying area receiving adequate service is going to be in question also.

That is one of our concerns. It's not solely the integrity of shopping for a grade, but it's making sure that the system is available to everyone.

Senator DASCHLE. Let me ask the last question in this section, and that has to do with a proposal somebody made recently that we ought to be subsidizing private official inspection agencies if the domestic official inspection business continues to decline. Is that a proposal that deserves consideration?

I wish you wouldn't all speak at once. [Laughter.]

Mr. JACOBSON. It's probably safe to say we don't have universal support for that at this table.

Senator DASCHLE. Obviously, one could argue—

Mr. JACOBSON. I think it's better to leave it to the market, perhaps.

Senator DASCHLE [continuing]. One could argue that FGIS alone is having trouble coming up with adequate funding, but there have been concerns expressed to us about the domestic agencies.

Let me just move a little bit to standardization and then we'll finish up the hearing.

There is a good deal of discussion about what, if anything, we ought to address with regard to standardization, and I think I'd start just by asking sort of a basic question, if anyone cares to respond: Are buyers and processors becoming more demanding in terms of factors and tolerance specifications of grain today?

Mr. HARTMAN. I would say most buyers give me less leeway than they used to.

Mr. GORE. Mr. Chairman, it's my experience that they're requesting more and more tests and more end use-related tests and more intrinsic quality value than just physical determinants than ever before, and a lot of these are at the request of importing countries and written into export contracts. That relates back to the interior, too. I think that we're definitely going to see a trend toward that.

Senator DASCHLE. Does it follow, then, if that's the case, that there's a greater demand for FGIS activities and expenditures for standardization?

Mr. Galliard, maybe I can ask you to comment.

Mr. GALLIART. I appreciate that. There's no question that the buyer is more sophisticated than he's ever been. There is no question that people we are in contact with, the buyers, that is, continue to ask us about different end use factors and results. And that's going to continue.

So to start pulling back or reducing our activity in standardization would be folly. The fact is, I think we're going to have to increase it.

Let me give you an example of what I want to convey to you, and that is pesticide residues. It's a food safety issue. Nationally it's an issue that is going to continue to grow.

Some time back, we thought we needed to get into the business of determining just what kind of a problem we have in grain. We used appropriated money, in excess of a half million dollars, to set up the equipment, to bring on the staff, to do the kinds of things one does to develop a new test. We are now, in fact, on-line sufficiently to do survey work, and we have found that for the most part there is no major concern with regard to pesticide residues in grain. All of the results show us that the residues are within the established tolerances.

By using that example, I want to stress the point that here was a need not requested by the industry, or anyone, for that matter, but perceived by FGIS and the Department to be of real value. We are now being asked by customers, the foreign customer, about pesticide residues.

Senator DASCHLE. It does, thank you. So let me ask you the degree to which you feel you are able to meet those demands for additional clarification, let's say, of quality and standardization? Are you able within current budget constraints to do that? Or, are some projects sacrificed?

Mr. GALLIART. To answer the first part of your question, to date we have been getting along fairly well with the funds that are available to do the kinds of things that I mentioned, and there are certainly more areas that we're exploring.

If we were on a user fee basis with regard to our standardization activities, I'm not so sure that we would start looking into areas like food safety or pesticide residue testing, because the immediate value to the industry would be in question.

We look at it from two bases. One is the national good, and the second is what it would do for our customers.

Senator DASCHLE. Can I assume from your answer that, at least at this point, you've been adequately funded to meet your responsibilities in this regard, given your current budgetary constraints?

Mr. GALLIART. Yes.

Senator DASCHLE. Do most of the factors included in the standards get included in grain purchase and delivery contracts?

Mr. GALLIART. Most of them, along with specifications from the buyer. For instance, the grade does not include protein results. Protein results are asked for in wheat, for instance. So that's an extra result to include in the grading.

Senator DASCHLE. Do commercial handling facilities use official inspections to evaluate quality?

Mr. GALLIART. I think so, if I understand your question.

Senator DASCHLE. The impression I have is that they use unofficial inspectors and in-house inspectors to evaluate quality.

Mr. GALLIART. They do, but they are aware that the unofficial system is undergirded by the official system.

For instance, an in-house grader can submit a sample to the official system. If he feels that he may not be interpreting a particular factor at the same level as the official system, he can submit the sample and compare results. He can do that any time he wants and for the price of a submitted sample, which I think GAO indicated costs around \$7. He can do that every day or he can do that once a month.

They depend on and use the unofficial system, but they are undergirded by the official system.

Senator DASCHLE. Yes. The impression I have is that ultimately this all gets passed on somehow, that it ends up as a factor in grain purchases and delivery contracts. Is that not a fair assessment?

Mr. GALLIART. I would say yes.

Senator DASCHLE. Would you say it ultimately ends up being paid for by the user?

Mr. GALLIART. Yes.

Mr. HARTMAN. Mr. Chairman?

Senator DASCHLE. Yes, Mr. Hartman?

Mr. HARTMAN. In my case, it's according to who I'm selling to. If I'm selling to the one which is the direct processor, I pay for that when I sell to them. The other, if it's going down the export chain, they absorb it, but I'm sure it's put back to me in the bid.

Senator DASCHLE. Mr. Gore, Mr. Jacobson?

Mr. GORE. My comments were that I believe everybody uses the standard as a baseline and many grain purchases, the factors within those standards are minimum performance requirements for grade level, and if they don't meet those minimum performance requirements per factor, there are usually discounts associated with it, so that the cost of this inspection alone, in many cases, is the least expensive of those options.

Mr. JACOBSON. Just addressing briefly the question of passing on the costs, it's a little bit like the export equation I discussed earlier. I think you can see we have no one to pass on the costs of four inspectors for each eight hours times three shifts daily that we won't be shipping any beans against a couple of weeks from now.

So, you know, there's always a marketplace that sets the number and then it backs off. And quite honestly, as the producers know, as the expenses of handling the product go up, whatever those expenses are—transportation is a popular subject lately—they tend to be passed back to the acre, originally, because you can't add them on the other end. They tend to be deductions getting back to the acreage.

So it's easy to understand why you're treating those seriously.

Thank you.

Senator DASCHLE. Yes, Dr. Hurburgh?

Mr. HURBURGH. Your original question, I think, was would increased emphasis on different quality factors bring on greater needs for standardization expense on FGIS' part.

The answer I would give is yes, if the buyer is willing to accept FGIS' laboratory results, procedures, et cetera, as being a standard for them. If not, then it won't. Other methods, just as has been happening in the domestic market, of getting this information will be put in the contract and that, too, is happening. That's one of FGIS' greatest challenges, to make sure that the data they provide are in line with the way the customer perceives that particular number ought to be gained or reported or what-have-you.

Senator DASCHLE. But by definition, do other methods have the ability to attain the same degree of confidence in maintaining standards that FGIS does?

Mr. HURBURGH. Yes, particularly in some of the intrinsic value factors like protein or other things, where the methods of which are established by professional societies and international collaboratives and things like that.

So yes, it can be. The FGIS official system has some inherent advantages in being able to take tests to the marketplace, but nonetheless, the customers can find information if they want to.

Senator DASCHLE. If they want to. Do we have examples of where they have wanted to and where in the private sector, within the industry, we've developed standards generally accepted outside of FGIS' involvement?

Mr. HURBURGH. Certainly, perhaps, in parallel to FGIS, oil and protein testing of soybeans would be an example.

Senator DASCHLE. Parallel?

Mr. HURBURGH. Yes, that's right. There are many private labs that at the point of export provide that service. The service is also available through FGIS, but for one reason or another the customer chooses to use a different route.

Senator DASCHLE. And the confidence level in those different routes is as high?

Mr. HURBURGH. They seem to be recurring on the contracts, so I would assume that the buyer and seller are satisfied.

Senator DASCHLE. Well, I have no additional questions, unless there are comments to be made by any of the witnesses?

We're going to be following this with great interest. Obviously, with reauthorization, all of these issues are before us. We want to be sure that we provide as much of an opportunity as possible for FGIS to continue its work under these very difficult circumstances. We know that is in the interest of everybody at this table, and we want to do it in the most suitable way and certainly in the way that continues what Mr. Schwieder said is of paramount importance, retaining the confidence and maintaining the degree of credibility that FGIS has enjoyed.

So with that, let me thank all the witnesses, and the hearing is adjourned.

[Whereupon, at 11:25 a.m., the subcommittee was adjourned.]

A P P E N D I X

BACKGROUND ON FGIS FUNDING AND REAUTHORIZATION

ISSUE: FINANCING FGIS STANDARDIZATION ACTIVITIES

The Clinton budget proposal calls for a shift away from appropriations to user fees for standardization activities of FGIS. In FY 1993, FGIS spent about \$6.8 million on standardization activities. The standardization function (management code 610) encompasses such activities as: 1) the establishment of grain standards, 2) development of inspection methodologies, 3) development of reference standards, 4) development of new tests and testing instruments for determining grain quality, 5) development of criteria and specifications for instruments to improve the reliability of grain inspection, and 6) the application of quality assurance systems.

FGIS now collects fees to cover the cost of its own export inspection services. It also collects fees to cover the cost of supervising delegated and designated agencies. If standardization activities are financed through fees, the cost would likely fall upon those now paying fees unless significant changes are made in the FGIS fee system.

What are the benefits to the U.S. grain industry from the standardization activities of FGIS? Do the benefits of standardization activities accrue only to the users of official inspection services? Some examples of standardization benefits include: The selling and buying of grain based on grade standards, the use of FGIS moisture and protein standards as references to facilitate grain marketing, and the establishment of performance standards for aflatoxin test kits to promote accurate and equitable mycotoxin testing. If other segments of the grain industry benefit from standardization activities, are they willing to pay for the continuation of these activities? Is there a practical way to administer user fees among all beneficiaries of standardization (i.e., assessments on grain handling facilities, producer check-off collections, licensing fees for instrument calibration)? Will cutbacks in standardization diminish the long-term ability of the Nation's grain industry to compete in global markets?

ISSUE: CONTROLLING THE COST OF DOMESTIC OFFICIAL INSPECTIONS

The users of grain inspection services complain about the high cost of official inspections, and some have hired their own house inspectors. At the same time, the FGIS-designated inspection agencies complain about the loss of business as grain companies hire house inspectors. The GAO report points out a sizable range in prices charged by different agencies for the same service. The GAO report also points out that agencies are given exclusive territories with prices approved but not regulated by FGIS. Critics contend that the lack of competition results in cost and price increases that drive business away. Designated agencies counter that competition exists due to in-house inspection and unofficial laboratories. The original justification for territorial boundaries was to prevent direct competition and ensure that official service was available nationally, both in high volume and marginal markets. It was felt that direct competition could result in "grade shopping," which might undermine the objectivity and accuracy of inspections. Should FGIS give greater emphasis to prices in awarding or renewing inspection agency contracts? Should competition be introduced as a way of controlling costs and encouraging good service (i.e., eliminating exclusive territories)? Should FGIS regulate prices for inspection services?

ISSUE: OFFICIAL COMMERCIAL INSPECTIONS

The providers of official inspections, including designated and delegated agencies and States as well as FGIS, now have the option of providing official commercial

inspections (except for export shipments). Official commercial inspections are designed to include the test factors and level of reliability specified by the customer. These inspections can be provided at a cost comparable to that of house inspections. While the cost is lower than official inspections, they are performed by FGIS-licensed inspectors using approved equipment under the supervision, quality assurance, and compliance standards of FGIS.

Are the official agencies willing to offer official commercial inspections and at a cost competitive with house inspections? With comparable costs, will grain dealers and handlers utilize the services of official agencies rather than maintain house inspectors or unofficial agencies?

ISSUE: DELEGATING ALL EXPORT INSPECTIONS TO STATES OR PRIVATE AGENCIES

Two arguments have been made in favor of replacing Federal export inspectors with State or private agency inspectors. One argument is that State and private inspection agencies can conduct official export inspections at less cost to exporters. The other argument is that Federal employment could be reduced by privatizing export inspections. Official grain grading is now being done at interior locations by designated private agencies, thereby demonstrating the capability and potential to privatize Federal export inspections. Alternatively, eight States are now delegated the responsibility for mandatory export grain inspections, and the same arrangement could be established in the remaining States with port terminals. Presumably, FGIS would have continuing responsibility for licensing inspection personnel, conducting management reviews, overseeing quality control, maintaining compliance monitoring, and conducting investigations.

Would the quality and integrity of the official inspection system be compromised or diminished in the eyes of foreign grain buyers? If privatized, should export inspection agencies be given exclusive territories or allowed to compete with one another? Would a profit-motivated private inspection agency require more quality control and compliance monitoring in a mandatory inspection environment than is the case with Federal or State inspectors? What would constrain the costs of mandatory export inspection if it were given to States or private agencies with exclusive territories (under current law, export inspection fees can be used to maintain the inspection system or pay for other agricultural programs operated by a State or local government)?

LETTER OF U.S. WHEAT ASSOCIATES

U.S. WHEAT ASSOCIATES
Washington, DC, May 7, 1993.

Honorable TOM DASCHLE,
Chairman, Subcommittee on Agricultural Research, Conservation, Forestry, and General Legislation, United States Senate, Washington, DC 20510

Dear Mr. Chairman: I am writing to express the views of U.S. Wheat Associates regarding the issues you are reviewing during the reauthorization hearing for the Federal Grain Inspection Service. As you are aware, U.S. Wheat Associates represents American wheat producers in export markets around the world, and we do have the opportunity to work closely with the FGIS and to make some analysis of the role that the agency plays in the U.S. grain export system.

There are two primary issues concerning FGIS which U.S. Wheat Associates would like to address: (1) the funding of standardization activities; and (2) FGIS' responsibility for export inspections. U.S. Wheat Associates believes that the standardization activities of FGIS are of essential importance throughout the wheat industry, and the cost of maintaining this valuable service must be shared much more widely than just by those who use official inspection services. U.S. Wheat Associates also believes that FGIS and official State agency inspection of all exports has brought credibility and respectability to the U.S. grain export system among importers. The value of this respect far outweighs the possible cost savings, if any, that might be achieved by privatizing or otherwise removing FGIS from immediate responsibility for export inspection. The following paragraphs will describe the basis for these beliefs.

STANDARDIZATION

Existing standards adopted and maintained by FGIS are used throughout the industry, not only by official agencies, but also by private inspection agencies, grain

handlers, producers and plant breeders who perform their own quality measurements. Wheat-related examples of established standards used throughout the industry include the NIR protein calibrations, Motomco moisture meter calibrations, damage-determination line slides, as well as the standards for grades and classes. To require that only those persons who obtain official inspections bear the entire cost of maintaining these standards would be unfair and unreasonable.

Development of new procedures accounts for a relatively small percentage of the standardization budget. However, many of the procedures undergoing development have the potential to become commonly used and of major importance, not just for official agencies but throughout the industry. Success of efforts to develop an objective wheat classification method, for example, will provide direct benefits to plant breeders, who will know much more clearly and early how new test varieties will be classed; producers, who can likewise be confident they know the class of a new variety; grain handlers and exporters, who can be confident of much greater consistency of classing, whether done in-house or by private or official agency; and to domestic millers and importers, who may be able to specify and expect greater uniformity in the wheat they receive.

FGIS is also working to develop tests that are predictive of end-use qualities. For example, a method to predict flour yield, a quality factor of critical financial importance to flour millers, would likely be used throughout the industry, from plant breeder to importer or domestic miller. It could at least partially replace the grade factor test weight, which many producers feel is used unfairly as the basis for price discounts. In the case of wheat, such information would be of great value in competing in highly sophisticated cash markets such as those of North and Southeast Asia. The Canadian and Australian Wheat Boards control wheat quality from variety development through export. While those controls do not necessarily mean better quality, they can mean more uniform quality or quality that more closely suits an importer's requirements. In the U.S. system, the only way to meet specific end-use quality requirements is to develop rapid, affordable technology to measure those quality characteristics throughout the industry and allow the market to assign values to them. In this way, the end user can specify a quality requirement which can also be measured by the grower or country elevator. We believe that the development of this technology will be a very positive and important competitive factor for U.S. wheat producers and the U.S. grain trade in both domestic and foreign markets. Since the benefits of this technology will be available to all segments of the industry, the cost of development should be spread over the entire industry and not just by those handlers who directly use the FGIS inspection service.

FGIS has also been working to develop the capability to provide pesticide and mycotoxin testing services. Concern about food safety is growing rapidly, not only domestically but also among importing countries. In recent years, Japan and Korea have both requested U.S. Government certification of pesticide residue levels in wheat cargoes—a service which is not currently available. These countries are rapidly adding to the list of compounds to be controlled, and other countries are likely to follow suit in the next few years. Information developed by FGIS about residues found in exports has been invaluable in quieting importer concerns about potential residues and in responding to false importer claims of unacceptably high residue levels. The ability to provide information on such issues, now and perhaps later, to satisfy requests for U.S. Government testing plays an important role in maintaining exports to cash markets, and thus provides benefits throughout the industry far beyond those who might actually request such testing services from an official agency. While FDA does monitor wheat, the limited number of samples tested provide little basis on which to judge the risk of selling to importers with differing (and changing) requirements.

EXPORT INSPECTION

FGIS should continue to be solely responsible for providing export inspection. There should be no question that the credibility of U.S. inspection services is much improved compared to the mid-70's when FGIS was created. Suggestions that the competitive environment today would prevent any repeat of the abuses of that time are difficult to support. On the contrary, anecdotal evidence suggests that in those cases where testing for a quality factor is not available from FGIS or is not required to be performed by FGIS, "shopping" for results from one or more labs is fairly common.

FGIS is well known and respected among importers. The existence of a single agency responsible for quality determination ensures consistent results and means importers know who to call when they dispute a quality certificate. Because FGIS is

not competing for business, there is no potential for conflict of interest. At the same time, U.S. exporters enjoy a degree of protection from frivolous quality claims because of the FGIS certificate that might not be achievable in a system of multiple, competing inspection agencies.

SUMMARY

In conclusion, there is little justification for funding FGIS standardization services from fees on official inspections alone. Costs for standardization should be more widely spread. The use of appropriated funds for this purpose has spread this cost and been an effective and sound use of Federal funds. Alternatively, a method needs to be developed that could spread the standardization cost throughout the industry among all who use or benefit from procedures developed by FGIS.

Regarding FGIS' responsibility for export inspection, there seems to be little justification for changing a system that works well and commands a great deal of respect around the world.

Sincerely,

(Signed) WINSTON WILSON,
President.

STATEMENT OF THE RICE MILLERS ASSOCIATION, ARLINGTON, VA

The Rice Millers' Association (RMA) thanks the subcommittee for the opportunity to provide comments on the activities and operations of the U.S. grain inspection system, in particular the challenges faced by the Federal Grain Inspection Service (FGIS).

RMA is the national trade association of the U.S. rice milling industry. Its membership includes 27 rice milling firms, both farmer-owned cooperatives and privately owned mills, which operate in six States in the southern United States and in California. RMA's 36 Associate Member firms include rice inspection firms, exporting companies, warehouses, freight forwarders, stevedores, port authorities, bag manufacturers, food manufacturers and others, with headquarters and branch offices located in multiple regions of the United States and around the world.

FGIS is the agency designated by the Secretary of Agriculture to carry out rice inspections under the Agricultural Marketing Act (AMA). The Rice Inspection Program is currently funded by the combination of hourly fees and a dock inspection fee for bagged rice at rest at export locations.

Beginning in fiscal year 1988, rice inspection revenues began to trail FGIS costs on an annual basis. In recognition of this problem, RMA and FGIS jointly agreed in 1990 to a schedule by which hourly fees would be incrementally increased by five percent in 1991, six percent in 1993 and seven percent in 1995. Additionally, a unit fee of \$.03 per cwt. for inspection services performed on bagged rice at rest at export locations was initiated. Also, at that time it was agreed that regular meetings would be conducted between RMA and FGIS personnel to review FGIS revenues and costs.

In spite of fee increases, revenues generated by the Rice Inspection Program are still not covering costs as determined by FGIS, resulting in accumulating net losses. Consolidation and integration of companies, improved in-house quality control, more direct supplier/buyer relationships and increased utilization of unofficial inspection services have all affected the level of FGIS rice inspections.

RMA believes additional fee increases are not the solution to cover FGIS revenue shortfalls. Additional fee increases would likely only result in decreased utilization of the program, constricting total revenues even further. The association also opposes any effort to institute mandatory official inspections, in addition to those already in place.

Development of legislation to reauthorize FGIS offers an opportunity to re-examine the agency's role and structure in today's rice marketing and trading environment. In general, RMA would recommend ways be found to streamline FGIS. The industry does not see long term viability for the agency as currently structured. RMA Member and Associate Member firms have offered the following general observations as to how some streamlining of activities could be accomplished:

1. Allow rice mill employees to collect or assist in collecting samples under FGIS supervision. Rice mill labor costs are generally lower than FGIS labor costs. In most milling operations, a single FGIS person could perform required supervisory functions.

2. Allow FGIS to certify rice mills as approved to collect samples and issue grades. FGIS would then monitor compliance of these certified mills. Appropriate sanctions could be developed for those who violate certification requirements.

Another area which RMA would like to address for the subcommittee is FGIS work in the area of standards and quality. FGIS developed and approved techniques can further assist the U.S. rice industry in improving quality. RMA believes there is a need for more standardization of equipment and calibration methods. For example, FGIS will currently accept the weights of only certain types of scales. These standards were developed some years back and need to be reviewed as new technology now offers better and safer ways of checkweighing. RMA recommends FGIS review its approved scale list. RMA also requests that FGIS take the lead in resolving recognized problems in moisture testing in rough rice. A laboratory intercomparison involving FGIS and the National Conference on Weights and Measures in early 1992 produced a wide disparity of results.

The Rice Millers Association would be pleased to answer any questions on issues raised by this testimony or any other questions the subcommittee members or staff may have. The association thanks the subcommittee for the opportunity to submit this statement.

STATEMENT OF LOWELL D. HILL, L. J. NORTON PROFESSOR, AND KAREN L. BENDER, SENIOR RESEARCH SPECIALIST, DEPARTMENT OF AGRICULTURAL ECONOMICS, UNIVERSITY OF ILLINOIS AT URBANA-CHAMPAIGN

MAINTAINING THE INTEGRITY OF THE U.S. GRAIN INSPECTION SYSTEM

The beneficiaries of a nationally uniform grading and inspection service for grain include many people in addition to those directly involved in marketing grain. Anyone who produces, markets, or consumes grain and grain products receives direct and indirect benefits from an accurate and reliable grading and inspection service. Quality and food safety are closely related, and consumers certainly benefit from information about and regulation of food safety and nutritional quality. Consumers also benefit from the lower marketing costs associated with a uniform grading system that increases marketing efficiency, thereby reducing the cost of grain and grain products to consumers. An unbiased system of grades, inspection and grading is essential to maintain equitable treatment of producers as well as marketing firms.

The purposes of grades and standards are to describe as accurately and objectively as technology permits, those characteristics that influence the value of grain in end use and in the marketing channel. History has demonstrated that a Federal system of grades and supervision is essential in a sophisticated market in order to maintain efficiency, reduce transaction costs, and assure equitable treatment of all parties engaged in buying and selling grain. The chaos at the turn of the century when more than 300 grade designations existed in the grain marketing channel was resolved only by the 1916 Grain Standards Act, which gave the Federal Government the responsibility for setting standards and supervising private inspection agencies. The final bill authorizing Federal standards and private inspection under Federal supervision required 25 years of heated debate and compromise among industry, Congress and producers. [Hill, 1990.] The inefficiencies of having a public good, such as standardization, in the hands of private firms created an overwhelming demand for uniformity, and even the private traders conceded that Federal legislation was the only workable alternative. Current proposals to increase user fees and to replace Federal export inspectors with private agencies will move the industry back to the chaos of the late 1880's and the abuses of the mid-1970's. "Those who cannot remember [or choose to ignore] the past are condemned to repeat it." [George Santayana, *Life of Reason*.]

Congress had very good reasons for placing Federal inspectors in charge of the export inspections and for placing grading and weighing under the authority of a Federal agency. The rotation of the inspectors and the strict separation of inspection agencies from marketing activities would be impossible to enforce if port inspections were turned back to private agencies. Private employees are no less honest than Federal employees, but the opportunities and incentives for error and fraud is certainly much greater under the private system than under the Federal system that has operated so successfully over the past 15 years. The cost of this service is small compared to the value of the grain being exported and the importance of these markets to U.S. producers, marketing firms and our balance of trade.

Research and standardization are clearly public goods that must remain the responsibility of a public agency. No industry could operate efficiently if every firm were allowed to set its own standards of measurement, and units of weight, length and volume which are the basis of commercial transactions. The measurement of moisture and defects such as kernel damage, have as much influence on the value of grain as does the measurement of quantity using scale weights regulated by State and Federal agencies. The logic for nationally determined uniform standards is irrefutable. The arguments for Federal supervision of private inspection agencies are less compelling than those for Federal standards. Grading and inspection in the commercial market channel can be accomplished by private agencies under Federal supervision. However, one cannot overlook the loss of credibility that was revealed during the 1975 Federal investigations. [Hill, 1990.] Federal supervision is required to assure uniform application of the standards in commercial transactions, just as Government supervision is required to assure that scales are accurately calibrated and properly operated. Uniform application of standards for measuring the protein and moisture contents of grain is as important to an impartial market system as is proper calibration of the truck scales that determine quantity.

Export sales of grain are essential to farm income, employment, and balance of trade. Public and private efforts to increase exports have been successful in maintaining U.S. market shares in the face of increased competition in international grain markets. One of our competitive strengths has been a system of mandatory export inspections providing foreign buyers the assurance of objectivity and accuracy. Foreign complaints have generated concern on the part of producers as well as Congress, but despite the number and diversity of these complaints FGIS has been found to be an impartial judge of quality and value for both domestic and foreign buyers. This third party objectivity, administered by technically trained inspectors, has had a positive effect on customer satisfaction around the world. Returning responsibility for export inspections to private agencies under a voluntary inspection system would damage the credibility of the inspection certificate and would diminish the effectiveness of the effort and money expended to increase our grain exports.

Our system of Federal grades and inspections gives us an advantage over competitors in the export market who are now relying on private inspection agencies who answer directly to either the buyer or the seller. [U.S. Congress, 1989.] This places them under pressure to provide the "desired grade" and despite their honesty and integrity the subjective decisions will lean towards the person who is paying the salary. Although foreign buyers will seldom admit the advantages of the U.S. system, they have always respected the integrity of U.S. grades to the extent that nearly all purchases are made "origin grade" in the United States. A higher proportion of purchases from other countries is made on the basis of grade determined at destination, despite the higher cost of inspecting. This reflects the confidence in the U.S. inspection system and must surely give us a competitive advantage on that criterion.

"Grade shopping" in the domestic market is a real concern and was the basis for providing exclusive territories for private inspection agencies. But grade shopping can also occur at the national level in the export markets if several agencies are permitted to compete for the business of inspecting grain being loaded on ocean vessels. The lack of an objective third party may also lead to double inspections, because both the buyer and the seller will want their own inspection teams present to provide a guarantee of fair play.

As more of the cost of establishing uniform grades and standards is shifted to those who request the service, the cost for that service will increase and the economic incentives will become stronger to either avoid official inspections, to use company employees to provide unofficial inspections, or to deliver the goods on faith and reputation. This strategy will gradually shift the domestic trade and perhaps the international trade away from the objective third party determination of quality and value. The inspection system of the twenty-first century may well resemble the problematic inspection system of the nineteenth century. Surely we can review the mistakes of the past and develop a system that will assure objectivity and equitable treatment for all parties in measuring quality and determining value of grain with different characteristics. The abuses of the mid-1970's and their impact upon the confidence of foreign buyers in the U.S. system were resolved after careful thought, extensive deliberations and congressional hearings. Several thousand pages of testimony document the fallacy of private inspection agencies and the dangers associated with placing the burden of a public good such as quality assurance on the back of a small segment of the population. We need not repeat the same mistakes and spend another half century trying to resolve the problems for which we already know the solutions. History, logic, and economic principles all support public fund-

ing of export certification, standardization, and supervision of private inspection agencies in the domestic market. Requiring that Federal employees inspect grain for export eliminates many potential problems of quality control and enhances the credibility of U.S. inspection certificates. The expenditures of public funds are justified by increased exports, by increased marketing efficiency, and by assurance of safety and quality for domestic consumers of grains and grain products.

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STATEMENT OF THE NATIONAL FARMERS UNION, WASHINGTON, DC

Mr. Chairman, my name is Leland Swenson. I am president of the National Farmers Union. On behalf of the 250,000 members of NFU, I would like to thank you for the opportunity to comment on the operations of the U.S. Department of Agriculture's Federal Grain Inspection Service (FGIS).

In March of 1993, at the National Farmers Union's 91st Annual Convention in Sioux Falls, South Dakota, NFU delegates adopted the following policy statement relating to FGIS:

We reaffirm our position for high standards in grain inspection and support the weighting system as authorized under the original Federal Grain Inspection Act.

To protect and improve our reputation as exporters of American farm commodities, we support legislation which would prohibit and penalize exporters adding foreign material to any commodity for overseas shipment. Export customers should pay for shipments on a clean grain basis, just as farmers are paid on a clean grain basis.

To enforce this provision, grain inspection personnel should be provided to spot check United States grain at foreign ports to determine whether it is of the same kind, class, quantity and condition that was certified upon shipment.

We continue to oppose the imposition of user fees for the inspection and grading of agricultural commodities. Federal inspection and grading of such commodities is in the public interest and should not be charged to the producer.

We oppose the use of 'house graders' for establishing Federal grades, and we call for an investigation into the effects of this practice on farm prices.

With the above statement as a guideline, I offer the following comments, observations and concerns.

FGIS should be commended for the part it has played in helping to provide buyers of American agricultural products with commodities that meet the standards agreed to at the time of the order. Complaints from our trading partners have decreased, and that helps enhance the American reputation as a supplier of high quality grain. This is in the best interest of every American farmer.

But while great strides have been made, National Farmers Union feels that more could be done. We believe that farmers do their utmost to deliver the finest grain possible to the elevator.

We continue to hear about the addition of moisture and other matter which can lower the quality of grain which exceeds specifications. We believe that shippers should try as hard as farmers do to provide their customers with the best quality products possible. To do less is an insult to American farmers and to America itself.

If FGIS is to continue to be the policeman of United States grain shipments, it has to remain strong and independent for the following reasons:

1. The inspection, grading and quality reporting of U.S. food and feed transactions in interstate and international commerce is in the best interest of all U.S. taxpayers and consumers. The credibility of FGIS is best maintained and enhanced through appropriated funds rather than through user fees.

2. While the checks or payments for user fees may be provided to FGIS by grain buyers, grain companies, or exporters, those fee costs will either be passed back to farmers through lower prices or passed on to foreign buyers through higher prices. Either way, the U.S. grain economy or U.S. grain competitiveness is weakened.

3. The credibility of the U.S. grain marketing system in international trade is best served through a Federal inspection system. Privatizing Federal export inspections will cause the United States to lose credibility with foreign buyers. Our major export competitors use Federal inspection systems, high quality and tight standards to enhance their export positions. The United States should not weaken its export inspection system by turning it over to private companies.

4. Premiums paid by foreign buyers or domestic buyers for higher quality grains and oilseeds should be passed back through the domestic marketing chain from the domestic processor or exporter to the country elevator and on to the farmer.

5. FGIS standardization activities are in the public interest and serve as a tool for both enhancing the quality of food and feed movement in interstate and international commerce and improving the competitiveness of the U.S. grain industry worldwide. Creating competition among inspection agencies for the purpose of lowering inspection costs may result in loss in the quality and credibility of inspections and make the United States less competitive in the world market, because foreign buyers are more quality and service conscious. Just lowering U.S. grain prices does not make the United States more competitive in the world export market. The lowest cost inspection system may ultimately decrease the value of U.S. grain and oilseed exports, thereby diminishing the balance of trade to the U.S. economy.

While we agree that FGIS must be scrutinized like any other agency to make sure that it is operating as efficiently as possible, efficiency must not come at the expense of effectiveness. That would be a disservice to farmers and could lead to the same abuses of the past. Those abuses are still remembered by some of our customers.

We understand that fewer inspections have been made in recent years for many reasons, not the least of which is the continued trend toward vertical integration in the path grains must follow from the field to the family cupboard, wherever that cupboard might be. We are concerned that trends toward fewer inspections and the trend toward "house graders" will allow for backsliding in grain inspection quality. FGIS must remain strong to prevent that from happening.

Lastly, we strongly oppose the imposition of user fees for grain inspection services. These fees will simply increase the cost of marketing grain at every level where they are required. Any and all cost increases are ALWAYS borne by the farmer. The grain trade will not pay the user fees by benevolence. The family farmer will pay them by lower prices for his grain.

Of all agricultural producers, grain farmers already have the smallest share of the retail price of groceries on a percentage basis, and the gap is widening more quickly than for any other commodity. ANYTHING that lowers the price a farmer is paid for his grain is but another nail in a coffin that is already nearly shut.

Thank you for the opportunity to share with you the views of National Farmers Union.

STATEMENT OF THE AMERICAN SEED TRADE ASSOCIATION, WASHINGTON, DC

The American Seed Trade Association (ASTA) is the national trade association representing more than 700 companies directly engaged in the marketing and development of varieties of seeds. In addition, a membership category also represents the interests of companies providing unique services and support to the seed industry.

ASTA is pleased to participate in this hearing and believes that the many challenges facing the Federal Grain Inspection Service deserve frank and honest debate. Indeed, the future direction and ability of FGIS to serve American agriculture merits careful consideration and input from the ASTA.

ASTA would first like to comment on the administration's proposal to fund FGIS standardization through user fees. While this is not a new proposal, the increased urgency to control and monitor Federal spending reinforces the need for careful analysis. ASTA's concern over the fee increases is justified because of the potential erosion in the actual use of the official system. It is our fear that such increases would inevitably compromise our ability to remain competitive in export markets. The industry concurs with the recent GAO report that reiterates the trend of declining use because of high costs, and an increasing acceptance of unofficial grades.

Another area of concern for the ASTA membership is the apparent differences in fee schedules. Specific reference to the GAO study confirms this trend. In addition, the GAO study also reported that competition was limited in some circumstances. In these two particular instances, the ASTA would maintain that competition was compromised and that there is little agreement and conformity in fee schedules and "reasonableness."

Like many interested parties, ASTA polled its committee charged with monitoring and assessing activities involving grain quality and inspection. Our members are quite concerned over the proposed fees, but feel that reauthorization for FGIS should consider a number of issues that further include export inspections and relationships at the State level.

The administration proposal would shift FGIS standardization activities from appropriated funds to user fees. This would include: (1) a review and updating of grain standards; (2) moisture, protein and calibration activities; (3) testing of grain grading and weighing equipment; (4) training and demonstration to "outside" testing of groups such as farmers and students; (5) collecting information on foreign complaints; (6) pesticide residue testing; and many other areas.

ASTA concurs that the objective of standardization hinges on the ability to provide consistent, reliable and up-to-date standards that serve and support the interests of the market. Accordingly, in the interest of meeting this goal, we believe that the private sector has a responsibility to share the risk and investment and development of testing equipment. FGIS can best serve in the role of evaluating such equipment and procedures.

In the final analysis, if it is determined that some level of new user fees must be imposed, we believe that it should be a shared burden between the Government, grain handlers and producers. Like others in the industry, we would caution against some type of check-off program. Other check-off programs reinforce this advisement.

Finally, we believe that whatever amount is agreed to after consultation with affected parties, it must be affordable and practical. Ultimately, the danger of assessing unreasonable fees will foster a service that is underutilized and one that offers little value and incentive.

ASTA applauds this committee and its leadership for beginning this discussion. In a time of constraints and limitations it is easy to dismiss many ideas that potentially change the effectiveness of an agency. It is not, however, easy to gain a consensus.

The challenge before the committee is to find substantive ways to support and nurture the grain inspection service and fulfill a responsibility to American producers and related supporters. Thoughtful and deliberate actions will demand a system that is competitive and efficient.

STATEMENT OF THE U.S. FEED GRAINS COUNCIL

Mr. Chairman, members of the subcommittee, I would like to present this written testimony on behalf of the U.S. Feed Grains Council. I appreciate this opportunity to present our views on the activities and operation of the grain inspection service.

The U.S. Grain Standards Act of 1976 was passed to reestablish the integrity of U.S. grain in the international trading community and also to give the domestic market an opportunity to utilize the inspection system in its marketing function. This has been accomplished and is now in review to see if it should be reauthorized and can be further improved.

The Council would like to add the following comments for your consideration in the review process.

- Importers of U.S. grain depend on the Federal Grain Inspection System (FGIS) official inspection as a part of its trading terms. It is important that the inspection be performed by an independent third party in order to eliminate any question of partiality. FGIS must retain its supervisory function to maintain the integrity of the grading system.

- An important function of FGIS is the development of standards and inspection systems that address the needs of the marketplace. This is accomplished through separate funding by Congress. This activity also requires impartiality in its function so that research and development is directed to market necessary standards. These activities benefit not only the export market, but also all phases of the domestic market and food chain. One segment of the market should not be required to pay the costs of the entire program. The Council strongly supports separate funding by Congress of the research and development functions.

• The cost of the inspection fees is under constant review by all members of the trade looking for any opportunity to reduce their operating costs. Exported grain is required by law to have FGIS inspections; fees are charged to cover the cost of those inspections including supervisory and overhead expenses. The GAO reports that there might be some inappropriate allocations of costs in the accounting function. These should of course be reviewed.

STATEMENT OF THE AMERICAN SOYBEAN ASSOCIATION, WASHINGTON, DC

The American Soybean Association (ASA), representing this Nation's soybean farmers, appreciates this opportunity to present its views and recommendations concerning reauthorization of the Federal Grain Inspection Service (FGIS). While soybean standards and the official inspection system are designed largely to create marketing efficiency and facilitate commerce, as opposed to aiding with production agriculture, the work of FGIS is vital to profitable farming and a globally competitive U.S. agriculture. Grain standards are the link between farmers and end users. Well-designed standards and an accurate inspection system create incentives for a continually improving product. This is good for farmers and consumers.

Uniform national grades and standards along with the official inspection system are essential to the efficient marketing of this Nation's grain. This is true for soybeans as well as other grains. FGIS has successfully carried out its responsibilities to create and maintain uniform grades and standards. In addition, the official grain inspection system is recognized domestically and globally as accurate and honest. This reputation for accuracy and integrity serves the United States well in a competitive world economy. Every effort should be made to see that nothing undermines the integrity of this Nation's official inspection system. FGIS should be reauthorized and its activities continued.

We are alarmed by the Clinton budget proposal that would shift FGIS standardization activities from appropriated funds to user fees. Standardization activities provide universal benefits to the grain industry and the Nation. These benefits are not a service that can be provided to businesses willing to pay and withheld from those who refuse to pay. If grain standards exist at all they are available to everyone and everyone benefits. Financing grain standardization with user fees would be analogous to asking businesses to pay user fees to the National Institute of Standards and Technology whenever they utilize measures of length, weight, density, velocity, or heat in their business operations.

While official inspection is a service and is rightly financed with user fees, standardization activities provide public benefits that are properly funded by the taxpaying public. The inability to withhold standardization from a business unwilling to pay a user fee verifies the public character of the activity.

Not only does the standardization work of FGIS have broad economic benefit, it will be increasingly important to meeting the specialized demands of end users of grain in both the domestic and international markets. Intermediate and end users of grain are gaining increased knowledge about the intrinsic characteristics of grain and how those characteristics affect their own yield and profitability as processors and producers of livestock feed and manufactured food and industrial products. Standardization work by FGIS will facilitate the grain production and marketing sectors' ability to efficiently identify and deliver the unique quality characteristics that meet the needs of end users. Such marketing efficiency will be critical to creating a competitive advantage for the United States.

Standardization work that replaces subjective tests with objective tests offers the best opportunity for reducing the cost and speeding up the process of grain inspection. Certainly exporters want to see the cost of mandatory export inspection reduced. Farmers would also benefit from advanced inspection technology that could be utilized in country elevators. These are additional reasons for continued standardization work by FGIS.

The newly released General Accounting Office report, titled "Grain Inspection: Industry Views on the Decline in Official Inspections and Inspection Costs," addresses the question of cost for mandatory export inspections. Some attention is given to the policy option of replacing Federal inspectors with private or State agencies. ASA is very skeptical of this proposal as a cost saving measure and is concerned that the integrity of export inspections could be undermined.

As the GAO report shows, State agency inspection costs are only marginally lower on average than FGIS costs. The added Federal supervision, monitoring, and compliance associated with replacing FGIS inspectors with State agencies at major export

locations would likely more than offset any anticipated savings. It would also disrupt a system that is working well and has earned worldwide respect for accuracy.

The replacement of FGIS inspectors with private agencies at export locations is absolutely unacceptable to ASA. Export inspection is mandatory and must therefore be provided by an independent third party. Private inspection agencies are profit-making businesses and would never be viewed as independent from the exporters paying for inspection services. There is a long history of corruption in grain inspection that even has biblical references. The United States suffered severely from these problems during the 1970s, which is why FGIS was created. The opportunity to profit from manipulated inspection results exists as much today as any time in the past. It would be extremely shortsighted to abandon a system with the highest marks for integrity. Soybean farmers and U.S. agriculture cannot afford anything but the very best and most honest export inspection system possible.

Certainly, every effort must be made to keep inspection costs low through good management and cooperative arrangements with exporters. However, it is disingenuous of exporters to incessantly demand cutbacks to the point of undermining the system. The services provided by exporters will be provided so long as this country exports grain, and increased costs, whether they be for inspection or electricity or any other input, are ultimately passed back to farmers. This is a fact recognized by farmers as well as by everyone in the grain marketing chain.

Recognizing that farmers ultimately pay the costs of grain marketing (including grain inspection) in lower market prices at country elevators, ASA asks that FGIS be reauthorized, funded, and managed in a way that protects the integrity of this Nation's official inspection system.

STATEMENT OF THE NATIONAL GRAIN AND FEED ASSOCIATION, WASHINGTON, DC

The National Grain and Feed Association appreciates the opportunity to submit this statement concerning the future of the official grain inspection and weighing system. The future direction, structure and cost of the system is vitally important to our members and deserves careful consideration.

The National Grain and Feed Association has a long history of leadership in the Nation's grain inspection and weighing system. The need for uniform grades was one of the driving forces that led to the NGFA's creation in 1896. More recently, the NGFA played a major role in advising Congress during the transition of the inspection and weighing activities of the Federal Grain Inspection Service (FGIS) from appropriated funds to user fees.

Ours is the national nonprofit trade association of more than 1,100 grain, feed and processing firms comprising 5,000 facilities that store, handle, merchandise, mill, process and export more than two-thirds of all U.S. grains and oilseeds used in domestic and export markets. The NGFA is unique because it is the organization whose members represent a broad spectrum of commercial users of the official grain inspection and weighing system. Our broad membership includes exporters, terminal operators, country elevators, processing firms and feed mills. Our membership also consists of 40 affiliated State and regional grain and feed associations whose members include more than 10,000 grain, feed and processing facilities nationwide.

The NGFA also manages a system of widely used Trade Rules and Arbitration services that are important components in maintaining the efficiency of the commercial U.S. grain marketing system.

There have been several significant changes to the U.S. Grain Standards Act since its enactment in 1916. But seldom has there been the confluence of major issues concerning the future of the official grain inspection and weighing system as there is today.

Truly, the official grain inspection and weighing system stands at a major crossroads. Proposals to shift the Federal Grain Inspection Service's standardization activities to user fees would place further financial burdens on those already paying the vast majority of the agency's budget. The recent General Accounting Office study on the official inspection and weighing system has sounded the alarm bell on the future viability of the official system in the interior market. And there is serious apprehension in the grain industry over whether FGIS and its official designated and delegated agencies can continue to survive and provide the quality of official services required if current trends continue.

The NGFA believes that these developments make it incumbent upon Congress, the users of the official system who pay the vast majority of FGIS' budget, and other beneficiaries of the U.S. grain standards to undertake a serious reassessment

of the mission and structure of FGIS and the entire official inspection and weighing system. In the grain marketplace of the 1990's, what should FGIS' mission be and what can we afford? Are there better ways to control the costs and improve the structure and efficiency of the official system—both at export and in the interior market? Is the decline in the use of official services cause for concern by Government or the marketplace and, if so, what can be done to reverse it?

The NGFA has surveyed the members of its Grain and Feed Safety, Quality, Grades and Weights Committee to obtain their views on FGIS reauthorization and the current status of the official grain inspection and weighing system. Several of the findings demand attention:

- The industry considers the cost of the official system to be excessive.
- There is little industry support for funding most of what FGIS currently considers to be its standardization activities.
- There is a strong belief that the entire marketing chain—from producer to processor/end user to consumer—benefits from FGIS' standardization activities.
- There is a strong belief that the integrity of the official system must be maintained. There is a strong belief that the increase in the use of unofficial grades and in-house grades are considered a positive development.

These industry concerns also are reflected in the GAO's recent study, entitled "Grain Inspection: Industry Views on the Decline in Official Inspections and Inspection Costs." The GAO report provides a very useful review of the major issues surrounding the current state of the official inspection system. It confirms what our industry has known for some time: The use of the official system is declining because of its high costs, the consolidation within the industry, and the increasing acceptance of unofficial grades (either in-house grades or the use of unofficial agencies) by the market. As an aside, we were pleased to note that the report stated that neither industry nor FGIS believes that the integrity of the official system has been impaired because of the decline in the use of official services in the interior market.

These issues—including the shifting of standardization costs to user fees and FGIS reauthorization—are intertwined and inseparable. They should be considered as part of a total package, not treated separately. Obtaining well-reasoned, objective answers to these and other issues will require serious study by Congress and by all who use and benefit from the U.S. grain standards and the official inspection and weighing system. To provide sufficient time for this reanalysis, the NGFA strongly recommends that Congress reauthorize FGIS for only one year.

USER FEES FOR FGIS STANDARDIZATION ACTIVITIES

The Clinton administration has proposed shifting the \$7 million represented by FGIS' standardization activities from appropriated funds to user fees. That's not a new concept, having been proposed by the two preceding administrations. But it takes on added urgency this year given the need to control Federal spending. As the GAO indicated in its report, user fees already fund approximately 72 percent of FGIS' budget. But that only accounts for direct fees paid by users to FGIS. When one considers the additional user fees paid by the industry to FGIS delegated and designated official agencies, user fees actually fund approximately 84 percent of the total cost of maintaining the official inspection system. [See pie chart, page 73.]

The NGFA's board of directors has adopted a policy by which our association evaluates user fees for Government services. (See Appendix.) The NGFA believes that a fee increase of the magnitude proposed by the administration likely would cause an even more serious erosion in the use of the official system in the interior and further damage our ability to be competitive in export markets.

COVER STANDARDIZATION ACTIVITIES BY USER FEES?

Currently, FGIS' standardization activities consist of: 1) reviewing and updating the U.S. grain standards; 2) calibrating moisture, protein and other grain quality factors; 3) testing grain grading and weighing equipment; 4) conducting training and demonstrations projects for such "outside" groups as farmers and students; 5) collecting information on foreign complaints; 6) testing for pesticide residues; and 7) many other areas.

The rather far-flung nature of FGIS' current standardization activities raises a legitimate question about which activities should be supported by grain industry-paid user fees. It is the NGFA's view that the principal objective of standardization should be to provide consistent, reliable and up-to-date standards that facilitate the marketing of grain. Clearly, FGIS' current standardization activities go well beyond this objective. Therefore, we believe that before any serious consideration is given to

assessing increased user fees, there is a need to more narrowly define FGIS' standardization activities to encompass only the review and updating of grain standards and the maintenance of equipment calibrations determined to have market value.

For other activities now being pursued by the agency under the broad umbrella of its standardization activities, the NGFA believes FGIS should reassess their value and viability. If they merit continuation, FGIS should establish separate fees on direct beneficiaries to fully fund these services. For example, FGIS—as part of its standardization activities—should be charged with reviewing the specifications and performance of grain-testing equipment. Privately developed equipment should be submitted to FGIS for statistical performance evaluation and approval. And the agency, in turn, should evaluate the new equipment on the basis of established performance criteria. But rather than assessing user fees on the grain industry, the agency should pass the costs for conducting such equipment performance testing on to the commercial manufacturers who stand to benefit through sales of such equipment in the marketplace. If new equipment has potential commercial viability, private enterprise should—and will—incur the investment, development and testing costs associated with bringing such equipment to the marketplace.

This concept already is well established in other agencies of the Federal Government. For example, FDA makes no direct analysis of new drugs or chemicals developed for the market. Instead, it obtains and reviews the integrity and efficacy of industry-submitted data. We submit that FGIS should function in a similar manner, thereby saving considerable costs.

As another example, if FGIS believes that educational activities have value, the agency should also make those activities self-funding through separate user fees assessed on those who receive the service. This could be achieved through registration fees for grading schools or through some other means.

In summary, the NGFA believes that user fees should not be used as a mechanism for haphazardly shifting the cost of Government to the private sector, with little or no consideration of whether the service is really necessary, who the true beneficiary is, or whether Government efficiency can be improved to reduce total costs. Before implementing user fees, we believe a careful evaluation should be made to: 1) assess whether costs can be reduced; 2) measure total benefits and the distribution of benefits; and 3) consider ending programs, if appropriate.

STANDARDIZATION ACTIVITIES: WHO BENEFITS AND WHO SHOULD PAY

As noted previously, the NGFA believes that the principal objective of FGIS standardization should be to ensure an accurate, consistent system for objectively evaluating grains and oilseeds. Seen in this light, the primary impact of FGIS standardization as it applies to the fungible grain marketplace is to make it more cost efficient. When market efficiency is improved in a competitive market setting, gains largely are passed through to the final consumer (taxpayer) in the form of lower prices. (A competitive marketplace ensures that no single market participant has the market power to capture pure economic benefits and withhold them from the ultimate consumer.) Further, since the United States confronts a single price in international trade, U.S. farmers also reap benefits from FGIS' standardization activities since lower costs of handling and marketing grain mean that the derived farm gate price will be greater than it would be in a less efficient market.

Consumers benefit. Farmers benefit. But how much do grain handlers benefit? In all likelihood, less than either the consumer or the producer. As noted previously, a competitive market prevents an individual merchant from capturing much of the benefits of economic efficiency—since that efficiency is spread throughout the marketing system. In addition, it is unclear whether the grain merchant/handler really has interest in all activities associated with FGIS standardization activities. For example, the merchant that both buys *and* sells the commodity must be concerned about the *consistency* of the grading system—grades must be repeatable for both the buy and sell sides of a completed transaction. There is less focus on potential grading bias, as long as that bias consistently exists throughout the marketplace. In contrast, the producer (who wants to be paid on the basis of true value) and the end user (who wants to purchase on the basis of accurate valuations) receive dual benefits of standardization activities through a high level of *consistency* *and* a high degree of *accuracy*.

But determining the distribution of benefits from standardization is even more complicated. Consider the fact that 25 to 30 percent of U.S. corn never enters commercial market channels, but is fed to livestock or directed to industrial uses. Much of that corn probably is *never graded unofficially, much less officially*. Producers of those bushels certainly receive less benefit from a high degree of standardization

than the grower whose grain is moved to major markets and subjected—sometimes repeatedly—to grading.

From the processor's vantage point, grain standards ensure an efficient marketing system (and therefore the lowest possible delivered price), as well as greater reliability in the accuracy of the description of purchased grain. Further, many processors are increasing their use of special tests that are outside the scope of the grain standards (such as starch analysis, protein analysis, oil content, etc.), and therefore may rely less on official grading as the most accurate determinant of value.

Given the very broad distribution of the benefits from standardization, and the fact that consumers (and thus taxpayers) probably receive the greatest benefits in the form of lower food prices, we believe that the future costs of a more narrowly defined (and considerably less costly) FGIS standardization function should be financed through Government-appropriated funds. In this era of downsizing Government, we may find that the current array of FGIS standardization activities no longer can be justified by the cost.

However, if the Government determines that some level of new user fees must be imposed, we think the best approach—given the wide dispersion of benefits throughout the marketplace—would be some equitable distribution of the funding burden, shared by Government (representing general societal benefits and direct benefits to Government through the loan program), grain handlers and processors, and producers. (In this regard, we would advise against a producer check-off collected at the first point of sale. Through experience with other check-off programs, our industry has found that the business-related costs incurred in collecting such funds can easily exceed the value of funds collected.)

This type of cost-sharing among all beneficiaries should help ensure that FGIS provides the optimum level of standardization services. The danger of taxing only current direct users of the official system—who we have demonstrated receive only a small portion of the benefits—is that those FGIS standardization services that directly benefit producers, consumers or others will be discontinued.

The NGFA believes that whatever group of users is required to pay for standardization services, they also should be granted the authority to determine the amount of standardization activities (and costs) that are affordable.

In controlling user fee costs, the industry's recent experience with FGIS direct inspection costs and supervisory/administrative fees has been disappointing. For example, earlier this year we were told that FGIS "Government overhead" costs charged to the agency were being increased 20 percent, and the agency had no choice but to pay the increase. If Government continues to ask industry to pay user fees for Government services, it also must provide an adequate mechanism to control costs, possibly waiving civil service work rules and giving user fee-funded agencies the independence to negotiate price and service agreements with Government agencies. Automatic pass-through of costs from the Government to the users of official inspection and weighing services is totally unacceptable to the grain handling industry.

FGIS RELATIONS WITH DELEGATED STATES/DESIGNATED AGENCIES FOR INTERIOR MARKETS

FGIS is authorized under the U.S. Grain Standards Act to grant to a State or private agency an exclusive territory in which that entity is authorized to provide official inspection and weighing services. Two principal reasons have been cited by the agency for granting these exclusive territories: 1) a concern that official services be provided to all locations within a territory that might request it (which is a precondition for obtaining FGIS delegation or designation as an official agency); and 2) the concern that users of official services, if offered more than one service, might "shop" for grades more attractive to their business.

But the current FGIS policy of granting geographical franchises for inspection and weighing services has had several negative results:

—**Wide Variation in Fees:** For one, the GAO report referenced previously in this statement found wide variations in fees charged by official agencies in adjacent territories (e.g., truck inspection fees varied from 0.7 to 2.2 cents per bushel), despite the requirement that FGIS determine the "reasonableness" of fees by comparing fees assessed in adjacent areas for similar services. GAO's findings appear to indicate that fees charged by FGIS delegated and designated official agencies do not conform to the definition of "reasonable," as required by law.

In addition, with the exception of the new "commercial official" service, there is no latitude for individual users of official services in the interior market to negoti-

ate fees. Some interior users of official services also report that they receive poor or unresponsive service from their official agency.

—**Limited Competition:** GAO also reported that “* * * competition for charters has been limited.”¹ The report stated that designated agencies paid FGIS \$1.5 million in user fees and charged their customers an additional \$28 million (not counting travel and other miscellaneous charges) in fees for official services. These findings raise serious questions concerning the fee approval system and the method used to stimulate competition for providing official services in a specific geographic area.

—**Lack of Awareness About “Commercial Official” Alternative:** The GAO also found, somewhat surprisingly, that many industry members were unfamiliar with the new “commercial official” inspection program, which was designed specifically to provide FGIS delegated and designated agencies with greater flexibility in competing, on a price basis, with unofficial grades.

Although cost must be one factor in setting fees, the practice of Government franchises setting fees solely based on costs can result in inflated fees, a situation frequently encountered in setting rates for regulated monopolies. Introducing competition can provide a natural mechanism to provide a level of service expected by the customer at a reasonable price.

On a related matter, the NGFA questions whether “grade shopping” really would be a legitimate concern if FGIS is doing an adequate job of supervising the inspection and weighing results issued by its official agencies, a function already paid for by industry user fees. If official agencies truly were made accountable for inaccuracies of inspections, there would be an incentive to be accurate, regardless of who paid for the service. However, there is a lingering concern within the industry that, without proper supervision, “grade shopping” may undermine the credibility of the official system. On balance, when considering the potential benefits of optimum service at affordable prices, we believe we should work for a competitive system where the risks of “grade shopping” becoming a serious problem can be minimized consistent with the needs of the market.

We believe the time has come for FGIS to reevaluate the rationale for granting exclusive service agreements for territories in light of marketplace trends, and the guidelines under which official agencies must offer service. For example, if a system could be developed that would permit active competition among firms providing official services, FGIS review of agency fee structures would be unnecessary. And, as a general rule, competition is much preferable to price controls over agency fees.

There are other advantages of competition. Increased competition could enhance the responsiveness of agencies to those who obtain official services. Areas not located in close proximity to central markets could receive adequate service if there are sufficient applicants for providing official services. All of these issues need to be explored fully and frankly so that our official inspection system remains credible, service oriented and cost effective.

OFFICIAL INSPECTIONS AT EXPORT

Since its creation in 1976, FGIS has developed increasingly sophisticated monitoring and compliance mechanisms to oversee inspection and weighing at export elevators. We believe it is time for FGIS to maximize the use of that technology to reduce the significant cost incurred by U.S. exporters in paying for a multitude of FGIS personnel involved in performing on-site official inspection and weighing.

Further, consistent with our recommendation that FGIS explore ways to introduce competition into the domestic official system, the NGFA believes the benefits and costs of contracting with designated agencies to provide official services at export locations should be seriously evaluated. The feasibility of a competitive fee structure should be an integral part of this evaluation. When exploring this option, FGIS should determine whether there should be exclusive territories at export locations or whether official services at export points should be subject to continuous competition (as we suggested for interior official grades).

If it is found that it is feasible to allow designated or delegated agencies to perform official services at export points, FGIS should be required to develop a definition of export supervision that ensures affordability and provides adequate assurance of legal compliance. One possibility would be to assign one full-time FGIS employee on site at export facilities during all phases of loading.

¹ “Grain Inspection: Industry Views on the Decline in Official Inspections and Inspection Costs,” U.S. General Accounting Office, GAO/FRY-93-147, p. 41 (April 1993).

CONCLUSION

The NGFA believes that this is a watershed period for the official inspection and weighing system. The use of the official system is declining and costs are a problem. Users are raising basic questions about the structure and mission of the present system.

Clearly, it is time to evaluate all options carefully and systematically. Unfortunately, that process has only just begun. That is why the NGFA strongly recommends that Congress take the following actions:

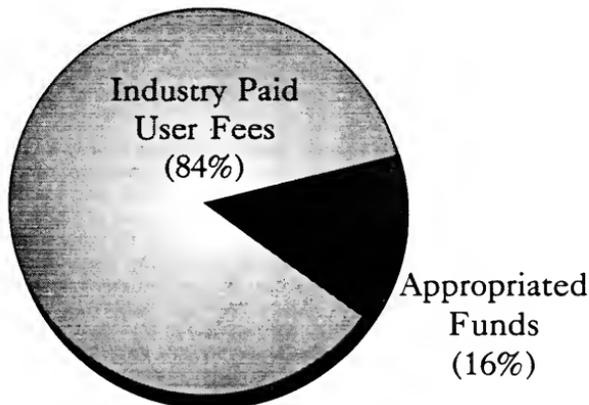
- Reauthorize FGIS for one year.** This will provide time for all interested parties to further evaluate structural changes and future directions that are in the best interest of the market. Congress then can conduct more substantive hearings on FGIS reauthorization in 1994, with the knowledge that the views being presented have been given full analysis. The future of the official inspection and weighing system is too important to do otherwise.
- Mandate that FGIS take the following actions:**
 1. **Eliminate all facets of standardization activities not necessary for the maintenance of accurate and consistent grades;**
 2. **Explore new ways to introduce a market-oriented approach for offering official services.** For example, the agency could open up selected interior official territories to competitive bidding for services on a one-year pilot program basis. The sole criteria for qualification should be whether the applicant agency and its personnel are qualified to inspect and weigh grain under the U.S. Grain Standards Act. New fee structures also could be explored that will reflect the actual cost of providing service to users. FGIS also should explore the option of allowing designated official agencies to perform official inspections at export locations, consistent with affordability, service and the maintenance of integrity of the official inspection program;
 3. **Implement cost-cutting actions within six months after reauthorization, including the closure of additional field offices where operating costs grossly exceed revenues.** If direct users in the region served by such field offices are willing to incur the additional costs, they should be given the opportunity. Other cost-reduction considerations should include close examination of overhead costs at FGIS' headquarters office in Washington and elsewhere; and
 4. **Eliminate the FGIS advisory committee.** Given the ongoing nature of the Grain Quality Workshops, which consist of representatives of producers, grain handlers, processors, end-users, exporters and academicians—as well as the participation of voluntary industry, producer and other organizations in FGIS rule-making activities—we believe the FGIS advisory committee has become duplicative. Its elimination would save the Government money and would save administrative FGIS staff time now spent in preparation for meetings.
- Eliminate the requirement that all grain standards be reviewed every five years.** In our view, the U.S. grain standards should be reviewed only when a clear market need exists.
- Provide limited appropriated funds for a much-reduced scope of standardization activities.** If FGIS adopts NGFA-recommended changes in its standardization activities, annual costs should be reduced from the current \$7 million to \$5 million or less. With cost savings generated from other recommended changes, as well as permitting competition in interior markets, there is potential to significantly reduce overall cost to the industry even if Congress subsequently decides to mandate that the industry pay a portion of remaining standardization costs. If that occurs, we reiterate that because of the wide distribution of benefits of standardization, it is wholly inappropriate to assess increased fees only on direct users of the grading system, even after necessary cuts are made.

The NGFA recognizes that its proposal for a one-year reauthorization of FGIS is unusual. But we believe it is the wisest and most appropriate course of action for Congress to take at this time. A one-year reauthorization will give FGIS an opportunity to use some new tools to get costs under control. It also will permit the users of official services the opportunity to evaluate changes in the system.

Ultimately, if this restructuring is unsuccessful in controlling the costs of official grain inspection and weighing, the industry and Government may have little choice but to shift even further in the direction of a self-regulated or privatized system as a means of controlling costs to stay competitive in world markets.

Who Supports the Official Inspection System?

(Source GAO Report)



Industry Paid User Fees

Direct Fees to FGIS:	\$19.2 million
Fees to Designated Agencies:	\$29.4 million
AMA Fees:	\$ 8.7 million
	<hr/>
	\$57.3 million
Appropriated Funds:	\$11.2 million
	<hr/>
	\$68.5 million



NGFA POLICY ON GOVERNMENT USER FEES

The Board of Directors of the National Grain and Feed Association has adopted the following policy regarding user fees for Government services:

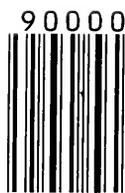
User fees: Where Government programs benefit a specific segment of industry or the public, user fees may be an acceptable revenue source. However, user fees should not be implemented as a means of shifting the cost of Government to the private sector, with no evaluation of whether continuation of such Government services are necessary or whether Government efficiency can be improved to reduce total costs. Before implementing user fees, a careful evaluation should be made to: 1) assess whether costs can be reduced; 2) measure total benefits and the distribution of benefits; and 3) consider ending programs if appropriate. When large increases are proposed, they should be phased in over a period of years to permit adjustment.

Any user fee imposed should not be excessive, only commensurate with the actual level of benefits realized. Excessive fees will force an underutilization of the service being provided and create distortions in the economy that serve to reduce overall economic efficiency and unfairly favor one industry over others. Therefore, the Government should avoid the temptations to impose fees on a particular business or consumer sector simply because that segment can be conveniently assessed (rather than assessing fees according to direct realized benefits). If the Government believes that a particular business sector is the only beneficiary of a Government program or service, the Government should first address the question of why Government should even be involved. To the extent that the Government can shift programs and services to entities in the private sector, there is a greater likelihood that a competitive marketplace will control costs and maintain operating efficiency that will benefit the entire economy.

ISBN 0-16-041374-5



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