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STATEMENT OF
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BEFORE THE
SENATE COMMITTEE ON AGRICULTURE AND FORESTRY
ON
THE RUSSIAN WHEAT SALES AND
AGRICULTURE'S ROLE IN EXPANDING U.S. WHEAT EXPORTS

Mr. Chairman and Members of the Committee:

I appreciate your invitation to present the findings from our examination. Massive sales of U.S. wheat to Russia last summer, at what turned out to be bargain prices, focused national attention on a number of complex and controversial issues and led to requests by this Committee and several Members of Congress for the General Accounting Office's examination.

We sent to interested Members of the Congress an interim staff report on November 3, 1972, covering certain aspects of the wheat sales to Russia. Last week we sent to Agriculture a draft report on its management of the wheat

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export subsidy program. A final report to the Congress will be issued after we assess and consider Agriculture's comments.

My remarks today will focus on

- Agriculture's management of the wheat export subsidy program, and
- whether Agriculture provided American farmers with current and meaningful foreign agricultural information so that they could adjust their operations and practices to world market conditions.

ROLE OF THE WHEAT EXPORT SUBSIDY PROGRAM

To understand the circumstances surrounding the sales of wheat to Russia, I will outline the role of the wheat export subsidy program in the sales. The program is designed to:

1. Insure U.S. wheats' competition in world markets.
2. Avoid disrupting world market prices.
3. Fullfill U.S. international obligations.
4. Aid price support programs by strengthening the domestic market price to producers.
5. Reduce the quantity of wheat taken into the Commodity Credit Corporation's (CCC) stocks under its price support program.
6. Promote the orderly liquidation of CCC stocks.

Export subsidy is discretionary with the Secretary of Agriculture as Director of the CCC. Wheat exports and

subsidy payments for fiscal years 1969 through the first quarter of 1973 are shown in enclosure I.

Mr. Chairman, I believe the most important element brought out in our examination is that Agriculture had not developed an effective system for providing or analyzing information upon which to make the judgments and take actions needed for efficient administration of the subsidy program. We are making several recommendations to Agriculture for correcting what we believe is a serious gap in its management process. I will discuss them later in the statement.

Concerning the background to the Russian sales, from about the time the Secretary of Agriculture visited Russia in April 1972 to the signing of a credit agreement early in July, officials of both countries discussed a variety of subjects and issues, including (1) most-favored-nation status for Russia, (2) repayment of Russia's World War II debt, (3) possible trade agreements, and (4) maritime matters.

The trade discussions centered around purchase of U.S. feedgrains and credit arrangements to accommodate such purchases. Negotiations were finalized in the United States with the July 8, 1972, agreement whereby the United States made credit available of \$750 million over a 3-year period for the purchase of U.S. grains (wheat, corn, barley, sorghum,

rye, and oats). Agriculture officials were aware that the Soviet negotiating team, which arrived late in June, included grain purchasing, financing, and shipping specialists, but stated that they were unaware of the Russians' simultaneous wheat negotiations with the U.S. grain trade.

We believe there were clear early signals from overseas and other sources concerning Russia's poor crop prospects and the dominant U.S. wheat supply situation. But, this information was not effectively used in Agriculture's decisionmaking.

The program, which was designed by Agriculture to assist U.S. exporters in competing with other suppliers under usual market conditions, was unable to cope with the disruptive nature of these purchases. The Russian Government entered a relatively stable market, and its huge, unanticipated orders distorted prevailing supply-demand conditions and drove wheat prices up sharply. Although Agriculture stated that these were commercial transactions and officially kept a hands-off attitude, these were not normal commercial transactions. Different ground rules appear appropriate for transactions involving purchases of substantial quantities of wheat by State procurement agencies.

In retrospect, assurance given to exporters by Agriculture that it would continue to provide subsidy on prevailing

export target prices was a crucial factor in determining the amount of Government subsidy paid. The target price was maintained in the face of increasing indications of U.S. market dominance in the available supply of wheat. Perhaps more significant was the assurance given to exporters that they could, in effect, commit the U.S. Government to make up the difference between this artificial target price and whatever prices domestic wheat might rise to without establishing a limit on quantities. The stage was thus set for the Russians to skillfully negotiate with individual exporters. The U.S. Government, not a participant in the negotiations, nevertheless subsidized the transactions much beyond what appeared necessary or desirable.

The Department of Agriculture, quite appropriately, points out that the United States stands to benefit substantially from wheat sales to Russia. These benefits include a positive impact on our balance of payments, the lessening of storage and inventory costs, reduced domestic subsidies, increased returns to a majority of farmers for their harvests, and the opening of new trade relationships. We estimate that balance-of-payments benefits will exceed \$700 million.

COLLECTING AND DISSEMINATING
FOREIGN AGRICULTURAL INFORMATION

Agriculture has fairly reliable data on general crop conditions and significant changes in worldwide supply and

demand. But, this information was not effectively used or disseminated. Farmers were not generally provided timely information with appropriate interpretive comments to assist them in arriving at sound marketing decisions.

Agriculture disseminates, through publications and press releases to the news media, only that information it considers reliable and supportable. Virtually all unclassified information is indexed, listed, and available to the public upon request. Recipients include numerous colleges, businesses, and agricultural groups but few individuals who might be farmers.

Agriculture also provides information daily to the news media, but its ability to keep farmers and farm groups fully informed has to be dictated by the information at its disposal. In the sales of wheat to Russia, for example, Agriculture officials stated they did not know the magnitude of sales made and did not attempt to find out, even though such information obviously was of great importance to wheat sellers. This coupled with an inaccurate assessment of Russian purchases, precluded Agriculture from realistically advising the public about wheat marketing prospects. Thus, Agriculture reports presented a distorted picture of market conditions.

Legislation directs Agriculture to acquire foreign agricultural information to assist "American farmers, processors, distributors and exporters to adjust their operations and practices to meet world conditions * * *." Agriculture has a conduit for informing the farm community of foreign agricultural developments through its Agricultural Marketing Division of the Federal Extension Service. But, because of limited staff, and emphasis on domestic matters, Service officials estimate that about 70 percent of U.S. farmers are not properly informed on foreign agriculture; those who are informed are usually the industry leaders.

The National Farmers Organization, a group that negotiates grain contracts for its members, stated last September that: "We, and others like us can operate efficiently only if we are provided full, accurate information on policy and day to day operations in the Department that relate to grain programs." Other farm groups and members of the Congress expressed similar sentiments concerning the need for more effectively providing the data that farmers and farm groups need to direct their marketing activities.

Agriculture has not determined the specific intelligence needs of the agricultural sector. We believe the Secretary

of Agriculture needs to consult with representatives of interested groups, including farmers, processors, distributors and exporters, and identify the information needs of each group.

This is a necessary first step in developing a more responsive information system that will provide farmers and other interested parties with current information on trade prospects.

IMPACT OF RUSSIAN SALES

Perhaps the most hectic period in U.S. wheat trading history occurred in the summer of 1972, as Agriculture sought to maintain its export subsidy program despite escalating domestic prices and consequent heavy subsidy burdens. The credit agreement with Russia and the subsequent disclosure of large wheat sales by private exporters seriously tested the efficacy of Agriculture's wheat export program.

These massive sales raised domestic wheat prices from about \$1.68 a bushel in July to \$2.49 a bushel in September. With almost every increase, Agriculture raised the subsidy to fill the gap between domestic prices and the presumed export market price. In September, Agriculture terminated its subsidy and let world wheat prices seek their own levels. Agriculture's estimates of 1972 and 1973 subsidy payments illustrate the impact of the Russian sales. The estimated

subsidy of \$67 million, based on exporting 650 million bushels of wheat, mushroomed to \$300 million on exports of 1.1 billion bushels.

The Russian sales magnified imperfections in the wheat export subsidy program. From November 1971, Agriculture neither required nor received information from the grain export trade on contracted sales because "it had no commercial intelligence value." The principal information it had relative to probable U.S. exports was the registrations for export subsidy, but exporters often delay registering sales or register without sales, so this information could hardly be considered timely or accurate.

The Russians negotiated purchases of about 440 million bushels of wheat with private U.S. grain exporters during 5 weeks in July and August 1972 for deliveries through August 1973 at fixed prices at or slightly below the \$1.63 to \$1.65 target price range. Exporters were able to contract for these large quantities at these prices because Agriculture officials assured them that the subsidy program would continue at prevailing export target prices.

It is difficult to reconcile these assurances with Agriculture's knowledge of the market dominance of U.S. wheat and lack of knowledge of the quantities involved in the sales to Russia. As the domestic wheat price moved sharply higher,

so did Agriculture's subsidy support. This culminated in a special subsidy rate of 47 cents a bushel from August 25 to September 1, 1972, when approximately 282 million bushels valued at about \$128 million were registered for subsidy. These special registrations for six major exporters, together with their regular subsidy registrations, are shown in enclosure II. See enclosure III for export target and subsidy rates from July 3 to September 25, 1972.

Although the special subsidy was intended to equalize sales and purchase prices for exporters who had sold to the Russians at low prices, all export sales were eligible. Agriculture had no information on other higher sales made by the exporters. Sales were made at prices higher than the \$1.63 to \$1.65 target price, and, by delaying their registrations, exporters took advantage of the increased subsidy rates.

While Agriculture was attempting to make up the difference between the \$1.63 target price and the going domestic price of about \$2.10, the offered sales prices in Europe during the week were substantially higher. Even at the higher prices, Europeans made advance purchase of large quantities of U.S. wheat through April 1973 needs.

MANAGEMENT IMPROVEMENTS NEEDED

The key determinant in establishing daily wheat subsidy rates is the export target price. The difference between this target price and the prevailing domestic price becomes the basic subsidy rate for exporting a given type and grade of wheat. The export target price for Hard Red Winter wheat, the principal type of wheat sold to the Russians, was maintained at \$1.63 to \$1.65 a bushel from around October 1971 through mid-August 1972.

Dominant U.S. supply position

As early as January 1972, the U.S. Embassy in The Netherlands commented that U.S. wheat, both Hard Winter and Spring, dominated the market because of its competitive pricing and because of shortages experienced by other supplier countries. The U.S. Embassy in The Netherlands reported that buyers were unable to obtain wheat from Australia and Russia, and the Australian Wheat Board told prospective buyers that supplies might not be sufficient to satisfy traditional customers.

The first visible signs of Russia's wheat purchasing occurred in March 1972, when Canada sold it about 3.5 million tons (about 130 million bushels) with an option to buy 1.47 million tons of wheat and flour to be delivered from

July 1972 to May 1973. Following this sale, the Canadian Wheat Board reportedly withdrew from the market for the remainder of the crop year (August 1972).

A Foreign Agricultural Service study in April 1972, assessing the possible competition in supplying grains to Russia, observed that competing countries' stocks for exports were low, committed, or lacked the physical facilities for movement. The report commented:

In the short-run, therefore, if the USSR were to enter the world market looking for a large tonnage of grains in addition to the wheat which it has already purchased from Canada, it would have to be content with relatively small quantities from several different suppliers, unless it were to buy from the United States.

Export Marketing Service officials told us that they recognized in the spring of 1972 that the world wheat picture was changing and that some increase in export prices might be possible. However, the export target price was not changed because:

- World prices at \$1.63 to \$1.65 were not so high as to bring about excessive production from competing exporting countries.
- Canada had made extensive future delivery commitments at low prices, many of which provided the buyer an option to take additional quantities at the same price.
- The United States had large wheat stocks on hand and needed to increase exports.

--Agriculture wanted to be fair to traditional U.S. customers who had come to depend on this price level.

--It would have been illogical to allow wheat prices to rise before idle acreage was brought into production.

We could find no analyses of the effects a change in its pricing policy have had on the various reasons Agriculture offered for maintaining it. The representations seemed to reflect the intuitive judgment of its officials.

Speculative subsidy registrations

A subsidy registration contract exists when wheat is offered for export and accepted by CCC. Exporters collect on subsidy registrations upon submitting documents that shipments have been made. An October 1967 change in the program's regulations allowed exporters to apply shipments to any open subsidy registration and to register for subsidy at any time, whether a sale had been made or not. Exporters choosing to register before or after making sales could gain or lose on the subsidy, depending on whether it went up or down.

The speculative aspects of the subsidy registration system are illustrated by five examples noted where exporters delayed registering for up to 4 weeks after making sales. In these examples CCC will pay exporters subsidies totaling about \$604,493, whereas had the exporters registered on the

sales dates the subsidies would have totaled \$286,188, or \$318,305 less.

Several cases involved waivers of subsidy entitlement from one company to another. The ultimate export is bought at a net price (basically domestic price less subsidy) and rights to subsidy are waived to the seller. In some cases the company making the actual export lost on the transaction because it was unable to buy low enough to satisfy sales commitments, while the company selling it obtained large subsidy payments for simply selling wheat domestically.

Agriculture rationalizes this practice on the basis that, although the subsidy recipient does not make the actual export, he causes an export to be made and is entitled to payment. We question the need for a further speculative element in wheat exports, but, more important, we believe total U.S. exports could be adversely affected. In some cases, the company waiving the subsidy already has an export sales commitment which must be honored. By accepting the domestic sales of the subsidy contractor, Agriculture relieves the contractor of his obligation to export and substitutes in its place an export which would have been made regardless of the subsidy. To the extent that this situation prevails, that much less wheat is exported.

Carrying-charge increment

CCC pays exporters a carrying-charge increment to cover the estimated costs of owning wheat for future delivery. Ownership of wheat is understood to cover insurance, interest, storage, and other costs which are passed on to the buyer.

The increment was designed to enable U.S. exporters to compete with Canadian and Australian Wheat Boards, which bear the carrying charges for future delivery of wheat. Payments are made to exporters of all classes of wheat exported on or after the 61st day following the registration for subsidy, for a maximum of 180 days.

To collect the carrying-charge increment, exporters submit evidence of shipment and certification of sale showing the sales contract date, amount, buyer, and shipping date. Records showed that sales contracts cited as supports for payments frequently called for shipments within a few days. The registrations such shipments were applied to, however, were sometimes dated up to 7 months earlier, resulting in significant payments.

Exporters view the carrying-charge increment as a cushion against possible losses or as additional profits. Two exporters estimated that they realized additional revenues of about 5 cents for each bushel exported. This compares with

net profit in the trade of about 1.5 cents a bushel. In a cursory review of 1972 files, we found 28 instances totaling \$360,000 where the sales contracts cited as support for payment called for shipment within a few days after the date of sale.

Other subsidies

CCC pays exporters a rail subsidy for Hard Red Spring and Durum wheat to compensate for the additional cost of shipping by rail when the St. Lawrence Seaway and Upper Mississippi River are closed to water transportation because of winter ice conditions.

In addition to these subsidies, wheat exporters are eligible for benefits under the (1) CCC Export Credit Sales Program, (2) Barter Program, and (3) Title I, Public Law 480 sales for long-term credit to foreign governments. U.S. wheat exports, therefore, are subsidized, under certain circumstances, up to 25 to 30 percent of the sales prices.

Exporters' profits on Russian sales

Grain company records do not segregate Russian sales from other sales. In an attempt to assess their profits on the sales to Russia, five of the six exporters provided us statements reflecting their approximation of profit or loss

on these sales. None of the statements indicate that excessive profits accrued.

Because of the complexities involved in grain merchandise accounting, the difficulties in deriving a meaningful statement on the profitability of selected sales, and the fact that our review has not been completed, we are not in a position to express an opinion on the validity of exporters' representations at this time.

IMPORTANCE OF PROGRAM EVALUATION

Mr. Chairman, I was pleased with your January 17, 1973, remarks to this Committee underscoring the importance of program evaluation. You said that:

The key word of our committee this year * * * will be increased emphasis on oversight, using the most sophisticated cost-effectiveness and system analysis techniques to evaluate the worth of existing programs, and the way they are being administered by the Executive Branch. The Committee Staff has already laid the groundwork for this systematic program review with the GAO and the Congressional Research Staff * * *.

I have continuously stressed program evaluation as fundamental to effective administration and have urged the Congress to include appropriate language in legislation

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covering the various programs. The accountable agencies should be responsible for evaluation and I have instructed our staff to give particular attention to this need and to include in our advice to the Congress our appraisal of how well the agencies are performing their evaluations.

The weaknesses we observed in the wheat export subsidy program are largely attributable to Agriculture's failure to develop a management evaluation system to ascertain whether subsidies involved in wheat exports were achieving program objectives effectively and economically.

Attempts to evaluate the program have been made only during crises, such as after the sales to Russia, and then only on a limited basis. Officials claimed that the complexity of the program precluded effective examination. We recognize the complexities involved. Nevertheless, the substantial expenditures of Government funds to meet wheat export objectives compels Agriculture to assess program results. In its absence effective management actions are impaired.

Need for management information

Vital information on the operations of the subsidy program was generally unavailable. Agriculture had not deemed it necessary to develop information basic to program management. When data was available, meaningful summaries

could be obtained only by manually reviewing voluminous files. This data void is crucial because, without key information, Agriculture is unable to make management decisions necessary to effectively and efficiently administer the subsidy program. Some important management information voids are discussed below.

Basis for subsidy calculations

The estimated U.S. port price and the prices offered for U.S. and competing wheats on world markets are basic to developing subsidy rates. Domestic buyers and sellers are contacted daily to develop a single price which reflects the price for wheat delivered to designated U.S. ports.

We were unable to ascertain the rationale and judgments exercised and the relative weights given to the variety of factors involved in the calculation of subsidy. We observed this same lack of documentation in our July 1967 report "Review of Certain Aspects of the Wheat Export Program Conducted by the Commodity Credit Corporation (B-160340)."

Lack of information on subsidy payments

Agriculture does not require information from exporters on purchase and sale prices of export transactions, nor does it ascertain that subsidy payments are reasonable and result in additional wheat exports.

Other important data, obtainable only by detailed examination of voluminous files, included

- subsidies paid to individual export companies;
- subsidy payments by type, i.e., basic, carrying-charge increment, and rail;
- penalties assessed for nonperformance, by company, value, reason, and number involved; and
- administrative decisions absolving exporters from penalties for nonexport by number and type involved.

* * * * *

We are exploring with Agriculture several proposals for improving management of the wheat export subsidy program and for developing a more responsive system for collecting and analyzing foreign agriculture information.

With respect to Agriculture's role in wheat exports, we believe the Secretary of Agriculture should:

- Review the entire program and determine the need for subsidies and, if needed, how they can be used more effectively and efficiently in world market competition.
- Develop a coordinated system for negotiating the sale of wheat to nonmarket economies (such as those of Communist countries) and other Government-directed procurements.

We believe that a mechanism can be devised within the system of using private capital for marketing agricultural products while recognizing that foreign-government-directed procurements exceed normal supply-demand considerations.

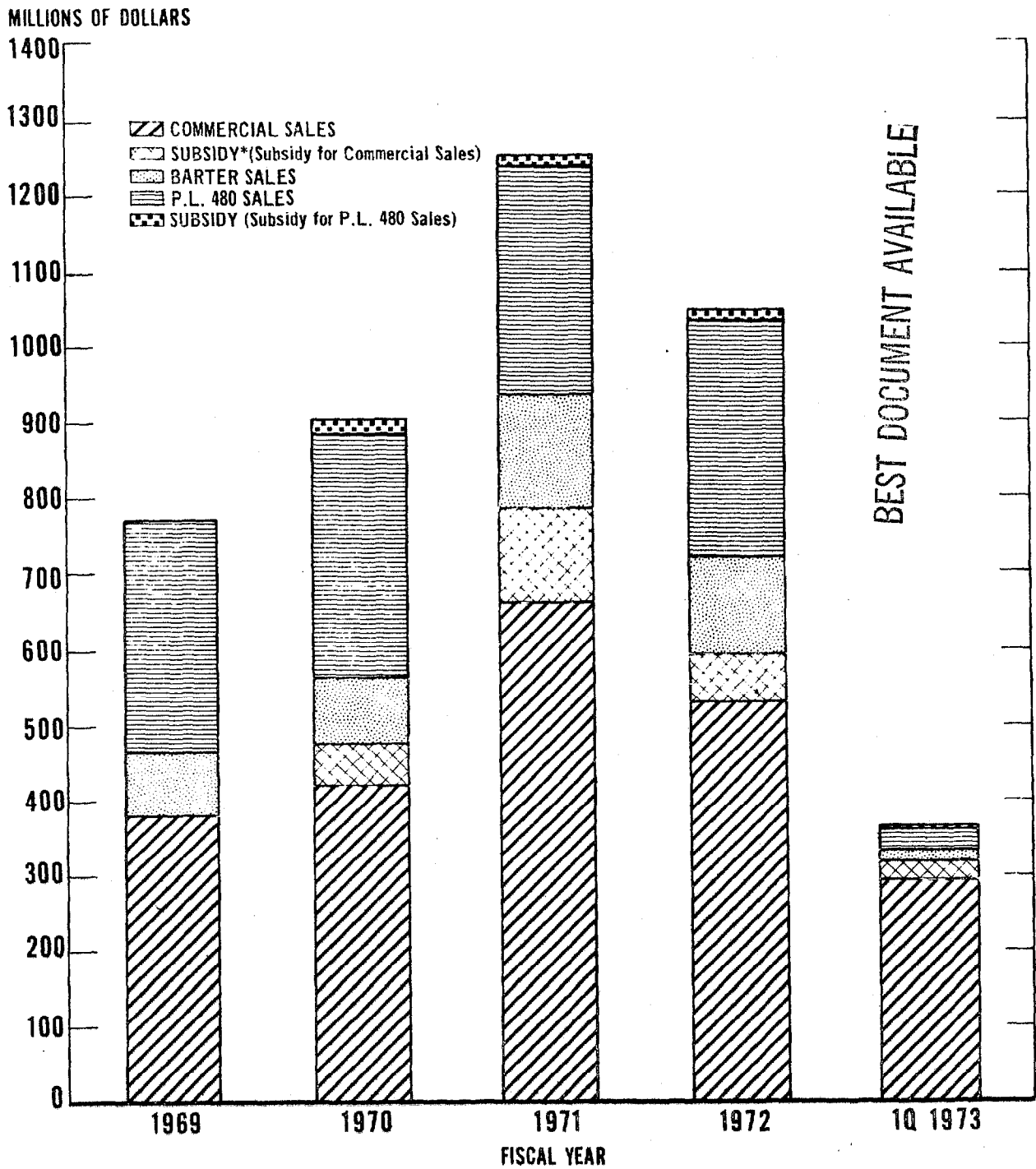
In anticipation of the possible renewal of wheat export subsidy payments, the Secretary of Agriculture should establish a system for:

- Providing for periodic evaluations of program effectiveness and efficiency, including periodic checks on end-users of wheat and countries of ultimate destination.
- Documenting the basis and rationale used in establishing the daily subsidies.
- Directing that timely reports on subsidy recipients and administrative decisions on penalty foregoings are prepared.
- Directing that sales and cost data on wheat transactions be obtained and used in establishing subsidy levels.
- Revising the basis for computing entitlement to the carrying-charge increment.

Several of the major grain companies involved in the sales to Russia have offered to discuss with us their views of the operation of the subsidy program, but, as yet, we have not had the opportunity to meet with them. In the process of refining and firming up our recommendations to Agriculture, my staff plans to take advantage of their offer.

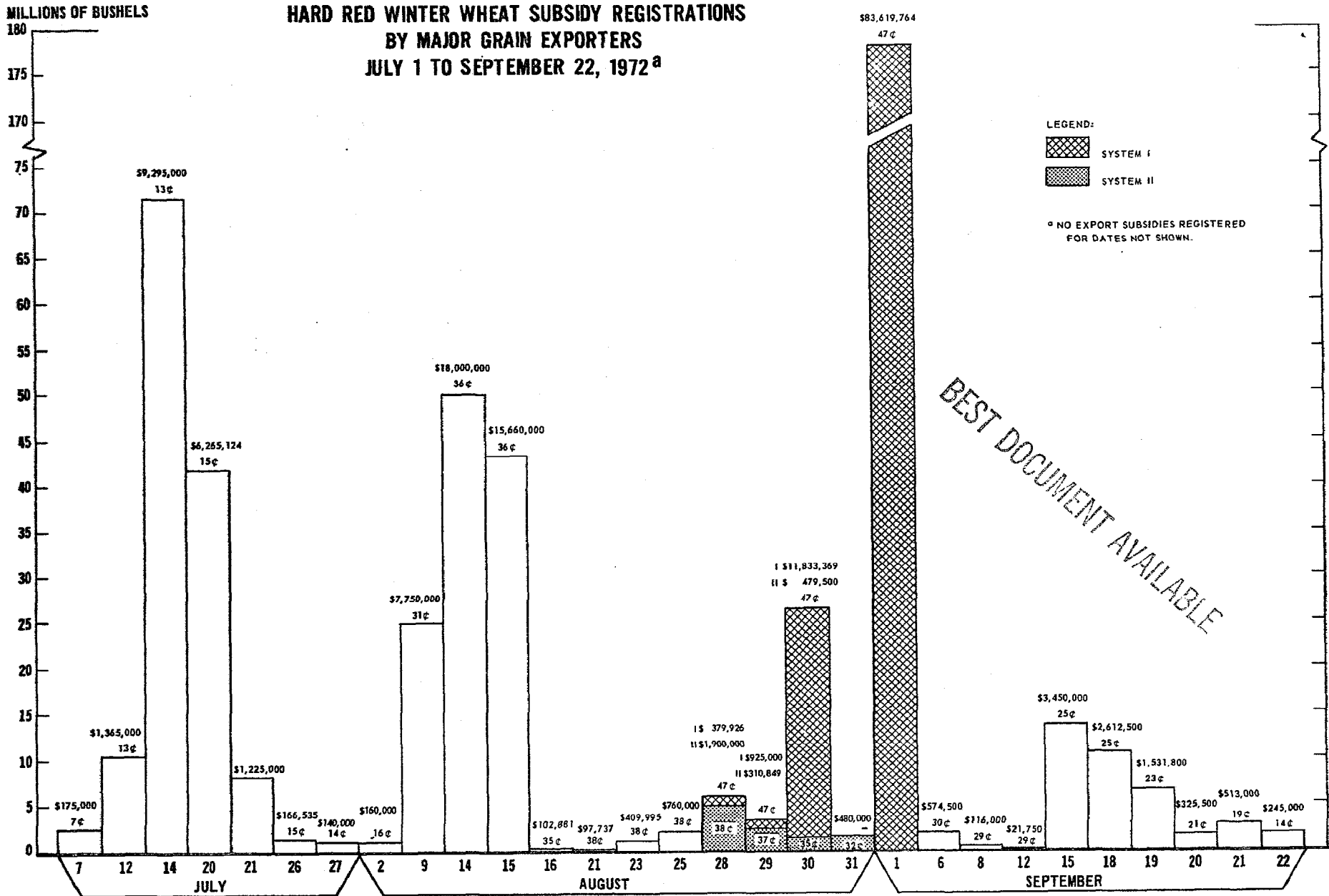
This concludes my testimony. I shall be pleased to try and answer your questions.

WHEAT EXPORTS AND SUBSIDY PAYMENTS—COMMERCIAL AND P.L. 480 SALES, FISCAL YEARS 1969 TO 1972 AND FIRST QUARTER 1973



*Payments have been reduced by proceeds of export marketing certificates
 SOURCE: Prepared by GAO from information provided by Department of Agriculture

HARD RED WINTER WHEAT SUBSIDY REGISTRATIONS BY MAJOR GRAIN EXPORTERS JULY 1 TO SEPTEMBER 22, 1972^a



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UNITED STATES EXPORT SUBSIDY RATES
AND RELATED EXPORT PRICES FOR HARD RED WINTER WHEAT
FOR THE PERIOD JULY 1 TO SEPTEMBER 25, 1972 (note a)

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<u>Date</u>	<u>Delivered shipboard at U.S. port</u>	<u>Export subsidy rate (note b)</u>	<u>Export target price</u>
—————(per bushel)—————			
July 3	\$1.68-1/4	\$.05	\$1.63-1/4
5	1.69	.06	1.63
6	1.71-1/8	.07	1.64-1/8
7	1.69-7/8	.07	1.62-7/8
10	1.71-7/8	.09	1.62-7/8
11	1.76-1/4	.13	1.63-1/4
12	1.76-1/2	.13	1.63-1/2
13	1.76-1/2	.13	1.63-1/2
14	1.73-1/4	.10	1.63-1/4
17	1.74-1/4	.11	1.63-1/4
18	1.76-7/8	.13	1.63-7/8
19	1.79-1/4	.15	1.64-1/4
20	1.77-5/8	.14	1.63-5/8
21	1.76-1/4	.13	1.63-1/4
24	1.78-3/4	.14	1.64-3/4
25	1.79-1/8	.15	1.64-1/8
26	1.77-7/8	.14	1.63-7/8
27	1.76-5/8	.13	1.63-5/8
28	1.78	.14	1.64
31	1.79-3/4	.16	1.63-3/4
Aug. 1	1.80-1/2	.16	1.64-1/2
2	1.80-3/4	.17	1.63-3/4
3	1.88	.21	1.67
4	1.95	.31	1.64
7	2.05	.31	1.74
8	2.04	.31	1.73
9	1.96-1/4	.31	1.65-1/4
10	2.02	.36	1.66
11	2.04-3/4	.36	1.68-3/4
14	2.05	.36	1.69
15	2.02-3/4	.35	1.67-3/4
16	2.04	.36	1.68
17	2.08	.38	1.70
18	2.10-1/4	.38	1.72-1/4
21	2.10-1/2	.38	1.72-1/2
22	2.11-3/4	.38	1.73-3/4
23	2.14-1/4	.38	1.76-1/4
24	2.12	.38	1.74

Date	Delivered shipboard at U.S. port	Export subsidy rate (note b)		Export target price	
		I ^c	II	I ^c	II
(per bushel)					
Aug. 25	2.09-3/4	\$.47	.38	\$1.62-3/4	1.71-3/4
28	2.10-1/4	.47	.37	1.63-1/4	1.73-1/4
29	2.13-1/4	.47	.35	1.66-1/4	1.78-1/4
30	2.14-1/4	.47	.32	1.67-1/4	1.82-1/4
31	2.12	.47	.30	1.65	1.82
Sept. 1	2.17-1/4		.30		1.87-1/4
5	2.18-1/2		.30		1.88-1/2
6	2.17-1/4		.30		1.87-1/4
7	2.17-1/8		.29		1.88-1/8
8	2.18-3/8		.30		1.88-3/8
11	2.21		.29		1.92
12	2.27		.28		1.99
13	2.25-1/2		.26		1.99-1/2
14	2.29-3/4		.25		2.04-3/4
15	2.38-1/8		.25		2.13-1/8
18	2.49-1/8		.23		2.26-1/8
19	2.46-1/2		.21		2.25-1/2
20	2.40-1/4		.19		2.21-1/4
21	2.39-3/4		.14		2.25-3/4
22	2.43-5/8		.00		2.43-5/8
25	2.39-1/2		.00		2.39-1/2

^aNo. 2 Hard Red Winter, Ordinary Protein, f.o.b. Gulf-East Ports.

^bRate announced effective 3.31 p.m. that day applicable through 3:30 p.m. the following day.

^cOn August 25, 1972, Agriculture announced a two-tier system which provided a special subsidy rate of .47 cent a bushel through September 1 for contracts entered into prior to August 24, and a subsidy in later sales at new rates which did not maintain the \$1.63 to \$1.65 base.

Source: Wheat and Wheat Flour Export Programs Payment Rate Announcements and wheat market information and subsidy work sheets, Export Marketing Service, Department of Agriculture.