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THE EXPORT ENHANCEMENT PROGRAM,
U.S. FOREIGN AGRICULTURAL MARKET
DEVELOPMENT COOPERATOR PROGRAM,
LONG TERM BILATERAL GRAIN AGREEMENTS
AND COUNTERTRADE,
ALTERNATIVE AGRICULTURAL TRADE
LEGISLATION PROPOSALS

STATEMENT OF
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BEFORE THE
SUBCOMMITTEE ON DOMESTIC AND FOREIGN
MARKETING AND PRODUCT PROMOTION
COMMITTEE ON AGRICULTURE,
NUTRITION, AND FORESTRY
UNITED STATES SENATE



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Mr. Chairman and Members of the Subcommittee

We are pleased to be here to discuss with you our recent work in the agricultural trade area. My statement today will address our work on the Export Enhancement Program (EEP), the Foreign Market Development Cooperator Program, and bilateral long-term grain agreements and countertrade. Each of these export programs and activities are included in many of the agricultural trade legislation proposals being reviewed by this Subcommittee and the Congress. I will also focus on other major characteristics of these proposals.

EXPORT ENHANCEMENT PROGRAM

We have reviewed the EEP at the requests of Representative George Brown, Chairman, Subcommittee on Department Operations, Research and Foreign Agriculture, House Agriculture Subcommittee Senator Tom Harkin, Chairman, Subcommittee on Nutrition and Investigations, Senate Committee on Agriculture, Nutrition, and Forestry; and Senator Charles E. Grassley.

The EEP was originally established in May 1985 by the administration, following extensive lobbying by an informal coalition of agricultural trade organizations. It was modified in December of 1985 by the Food Security Act of 1985, and again by the Food Security Improvements Act of 1986. The Secretary of Agriculture is required to dispose of a minimum of \$1 billion and a maximum of \$1.5 billion in surplus agricultural commodities owned by the Commodity Credit Corporation. This amount is to be

made available over a 3-year period ending in September 1988 as a bonus to U.S. exporters to expand sales of specified U.S. agricultural commodities in targeted markets. In practice, this bonus is a subsidy in kind which enables exporters to lower the price of their commodities to be competitive with subsidized foreign agricultural exports.

Many supporters of a subsidy program saw the EEP as a means of increasing U.S. exports, regaining lost U.S. market share, and disposing of the burgeoning surplus of U.S. wheat and other agricultural commodities. It was also viewed as a means of persuading the European Community to negotiate away its own export restitution program. The EEP was viewed by some as a bridge--a means of making U.S. prices more competitive during the period between the time of its establishment and the lowering of loan rates eventually mandated by the Food Security Act of 1985.

According to Agriculture, the EEP has been aimed at the European Community because it "directly" subsidizes exports. While Agriculture did consider targeting export markets of competitors that "indirectly" subsidize their exports--through low domestic transportation rates, for example--such proposals have not been approved. It is important to note, however, that International Wheat Council data show that while the U.S. share of the world wheat/wheat flour market, the primary focus of the program in practice, dropped from 44.8 percent to 29.0 percent from the 1981 to the 1986 crop year, the European Community's share increased only 3.8 percent (from 13.5 to 17.3 percent).

Although Argentina, Australia, and Canada increased their market shares during this period, a deliberate effort has been made to protect the traditional markets of these "non-subsidizing" competitors.

Activity under the program

As of March 6, 1987, 64 initiatives had been announced covering 40 countries and 12 commodities--wheat, wheat flour, rice, poultry, barley malt, semolina, eggs, dairy cattle, poultry feed, barley, and vegetable oil. EEP sales totaled about 9.1 mmt of wheat, 1.4 mmt of flour (grain equivalent), 2.8 mmt of barley and lesser quantities of rice, poultry, barley malt, semolina, and dairy cattle. The sales value for these commodities totals \$1.3 billion. As of March 9, the total market value of bonuses awarded was about \$600 million.

While in fiscal year 1986, EEP sales represented only 3 percent of the value of total U.S. agricultural exports, EEP grain sales represented 12 percent of the total volume of U.S. grain exports, and about 25 percent of the total volume of U.S. wheat and wheat flour exports. For the first 3 months of fiscal year 1987, EEP sales represented 36 percent of U.S. wheat and wheat flour exports.

Subsequent to the completion of our audit work in December 1986, the EEP has been expanded significantly, with wheat initiatives made to such countries as China, Iraq, Nigeria, and Poland. This broadening of the program will most likely result in Agriculture being able to dispose of \$1 billion, and perhaps

even \$1.5 billion in commodities using market value. In addition, the expansion, due largely to continuing congressional and farm sector pressure in the light of dissatisfaction with U.S. agricultural export performance, has meant targeting markets where non-subsidizing competitors have had significant shares.

According to a letter from the U.S. Trade Representative dated January 30, 1987, the European Community has been, and continues to be, the principal target of the EEP. Agriculture officials maintain that the criteria for targeting countries under the program have not changed. Some observers indicate that the broadening of the program has resulted from decreased opposition by State, Defense, and Treasury to certain countries being targeted as recipients.

EEP and the Soviet Union

A controversial aspect of the EEP had been the administration's decision to exclude the Soviet Union from the EEP for foreign policy reasons, despite the fact that the European Community's share of the Soviet wheat market rose from 5 to 22 percent from the 1981 to the 1985 crop year.¹ While Agriculture claimed that the Soviet Union was excluded because non-subsidizing competitors had a significant share of the market (about 48 percent for the year ending June 30, 1985), the same non-subsidizers had equal or greater shares of other markets targeted under the EEP.

¹Crop year is defined as the 12-month period ending September 30.

On August 1, 1986, the administration announced that the Soviet Union was eligible to purchase 4 million metric tons (mmt) of wheat under the EEP, by far the largest initiative under the program. Agriculture officials stated that the initiative was designed to remove the Soviet excuse that price considerations prevented their fulfilling, for the second year in a row, a requirement of the Long Term Agreement with the United States that they purchase a minimum 4 mmt of wheat in each agreement year.

The August 1986 initiative to the Soviet Union expired September 30 with no sales made. Agriculture officials cited recent changes in Soviet contract terms as a major impediment to U.S. wheat sales under the EEP, but Soviet trade officials told us that U.S. prices still exceeded the "world price" despite the EEP initiative.

It should be noted that exports of U.S. wheat to the Soviet Union decreased dramatically from the 1985 to the 1986 crop year. There have been varying interpretations as to why the Soviets purchased only 0.15 mmt of wheat from the United States during the 1986 crop year and why they did not live up to the minimum purchase requirement of the Long Term Agreement with the United States for the agreement year ending September 30, 1985. Some grain trade representatives claimed that the Soviets did not do so because they believed they were discriminated against since they were ineligible for the cheaper wheat available through the EEP. Agriculture officials, however, believe that the Soviets

did not buy the required amount because of lower prices elsewhere and that, even if the EEP did not exist, they would have bought elsewhere for price reasons. Soviet trade representatives, in fact, told us that they had stopped purchasing wheat from the United States in late 1984 because of the higher-than-market U.S. prices. They added that concerns over grain quality, reduced hard currency, and an internal reorganization in their bureaucracy also caused them to curtail U.S. wheat imports.

Impact on U.S. Exports

An exact measure of how much the EEP has increased U.S. exports of wheat and wheat flour worldwide, or even just to targeted markets, is difficult to determine because other factors influence the competitiveness of U.S. agricultural exports. One factor is the declining value of the dollar and another is the lower loan rates following passage of the Food Security Act of 1985. Both have been expected to increase the competitiveness of U.S. agricultural products and result in higher U.S. exports. Furthermore, given the multiple independent variables influencing trade in the agricultural commodities involved, it is difficult to develop a methodology to assess additionality.

During the 1986 crop year, total world exports of wheat and wheat flour amounted to 86.6 mmt according to International Wheat Council data. This was a significant decrease from the 104 mmt for the 1985 crop year or the 99 mmt average for the last 5 crop years. The decrease of 17.4 mmt was about the same as the decrease in exports to the Soviet Union alone.

U.S. exports of wheat and wheat flour worldwide decreased from 38.2 mmt for the 1985 crop year to 25.1 mmt for 1986, 75 percent of the decrease in total world exports. The U.S. share of world wheat and wheat flour exports decreased from 36.7 to 29.0 percent. The U.S. share of exports to the Soviet Union decreased even more dramatically, from 22 percent to only 1 percent, during that same period (from 6.08 mmt to 0.15 mmt).

On the plus side, U.S. exports of wheat and wheat flour increased to certain markets targeted under the EEP during the 1986 crop year. The largest increase, according to Agriculture statistics, was for wheat to Algeria, but there were also increases in wheat exports to Egypt, Turkey, Zaire, Jordan, and Yugoslavia and in wheat flour exports to Egypt, Yemen, the Philippines, Zaire, and Iraq. It should be noted that for many of the countries targeted under the EEP, the initiatives were announced late in the crop year and sales were not made until later. Consequently, there is a lag in the data and some increased exports will not be recorded until the following year.

U.S. exports of wheat to markets not targeted under the EEP during the 1986 crop year decreased significantly, with dramatic decreases occurring for the Soviet Union, Brazil, and China. Lower demand resulting from increased production and/or limited availability of foreign currency was responsible for these countries' decreased imports. Many specialists in the grain trade, however, believe that the decreased U.S. share of exports to these countries was due to price and quality factors.

Because the EEP has been expanded significantly in recent months, not only for wheat but for other commodities as well, and there is a lag time before any impact on exports may be seen, 1987 will better test whether the EEP has been effective in increasing U.S. exports. Nonetheless, the same analytical limitations outlined above will still be factors.

Impact on EC

Although European Community officials openly criticized the EEP as an illegal subsidy program because it was targeted and, in their opinion, undercut world prices, the initial response of the Community to the EEP was a wait-and-see attitude. Later, however, the Community made a determined effort to protect what it considered its markets by providing increased and country-specific restitution (subsidy) payments for sales to countries targeted under the EEP.

European grain traders told us that the EEP had reduced European Community sales in the Mediterranean region. International Wheat Council data support this and reflect especially large decreases in Community wheat sales to Algeria and wheat flour sales to Egypt from the 1985 to 1986 crop year. The decrease in European Community worldwide wheat and wheat flour exports--from 17.1 mmt for the 1985 crop year to 15.0 mmt for 1986--occurred in the context of the overall decrease in world exports of 17 percent. The 1987 crop year will better test how much of the decrease in European Community exports was due to the EEP.

The ultimate impact of the EEP depends on how serious and sustained a commitment it represents. The United States did not renew the one-year U.S.-Egyptian Wheat Flour Agreement of 1983 under which it sold heavily subsidized flour to Egypt. Some European as well as U.S. government and private sector officials have contended that this demonstrated U.S. unwillingness to seriously challenge European Community agricultural export subsidies. U.S. policy has been criticized by the U.S. agricultural community as inconsistent and lacking in follow-up commitment.

Impact on other competitors

It appears that Argentina, Australia, and Canada have all been adversely affected by the EEP. These countries would be hurt if the effect of the EEP were to either lower the volume of their exports or the prices they receive. The administration repeatedly assured government officials of all three countries that the program would be implemented in a way that would maintain the traditional commercial trade volume of non-subsidizing competitors and obtained assurances from importing countries when applicable. Despite these assurances, the non-subsidizers became increasingly concerned with the broadening of the program and its overall related price impact. Their concerns became most vocal when the Soviet Union was targeted under the program in August 1986.

There is little evidence that EEP sales directly displaced the sales of Argentina, Australia, or Canada for the 1986 crop

year. However, since the EEP did not begin selling in a major way until well into the 1986 crop year, any direct loss of market share would not become evident until the 1987 crop year. In any case, the EEP is viewed by many as having had a price depressing effect, in which case not only the Community, but all exporters, would have been adversely affected.

Budget Neutrality and EEP Cost

Although the EEP was designed to be budget neutral, that is, it would not increase government outlays, we found examples in which individual EEP sales will likely result in higher government outlays. A few sales have released CCC commodities onto the domestic market which were greater than the commodities (or their equivalents) that were actually exported. For example, bonuses for EEP poultry sales released soybeans and corn on the domestic market which had a value greater than that of the soybeans and corn used in raising the exported chickens. As a result, in such circumstances, the government is likely to end up buying back at the loan rate an amount equal to the extra corn and soybeans originally given away as a bonus.

For poultry and dairy cattle, even if net additionality (the amount of new exports that result from the EEP) is 100 percent, unexported bonus commodities will be placed on the U.S. domestic market and will likely increase CCC expenditures. For other commodities, there will be additional budgetary expenses if more bonus commodities are released from CCC stocks than U.S. exports increase. While net additionality cannot at this point be

measured, the EEP flour, barley, and barley malt sales are also likely to be budgetarily expensive.

Agriculture's view is that it is acceptable for specific EEP sales to violate the budget neutrality condition as long as the program as a whole does not. However, in the case outlined above, while poultry and dairy farmers may benefit, releasing feedgrains onto already surplus domestic markets is detrimental to those markets. The Food Security Act of 1985 directs Agriculture to attempt to make 15 percent of the EEP-subsidized sales in poultry, meat, and meat products. Sales of these commodities have involved large bonuses. Consequently, Agriculture faces potentially conflicting goals in meeting the 15 percent animal product export goal while minimizing the adverse budgetary impacts and disruptions of commodity markets that would follow from large-scale EEP exports of these products.

Export Enhancement Program Conclusions

Exports of wheat and wheat flour have increased for several markets targeted under the EEP during the last year, but these have been offset by decreased exports to other markets, especially the Soviet Union. Increases in exports to the targeted markets probably can be attributed largely to the fact that the EEP, coupled with sufficient export credit guarantees, was available. It is clear that the targeted importing countries have been beneficiaries under the EEP as they have received wheat and other agricultural commodities at lower prices.

The design of the EEP restricted its effectiveness in substantially increasing U.S. exports. The program was targeted against the European Community, not against all U.S. competitors and, consequently, the number of markets that could be targeted was limited. Efforts were made not to harm the countries identified as non-subsidizers even though these countries had increased their shares of particular markets at least as much as the European Community. Furthermore, the Soviet Union, the largest importer of wheat and a market in which the European Community had significantly increased its share, was not made eligible for foreign policy reasons until August 1986, and then for only 2 months instead of the usual one year and with bonus amounts prescribed at relatively low levels.

Although the EEP in its restricted form appears to have increased selected U.S. agricultural exports in many targeted countries, there is little reason to believe that once the EEP expires, these gains in U.S. agricultural exports will be sustained in targeted markets without fundamental changes in the market. Although the decline in the value of the dollar and lower loan rates may make the price of U.S. wheat more competitive in the international market place, it is extremely doubtful that U.S. wheat flour, poultry, or dairy cattle, for example, could be exported at competitive prices once the subsidy program expires without major changes in the European Community's subsidy policies.

We believe that the EEP, combined with the dollar's decline and lower loan rates, has increased the financial cost of the European Community's Common Agricultural Policy, particularly through increased subsidy payments, and has contributed to realizing agreement to include agricultural subsidies in the new round of multilateral trade negotiations under the General Agreement on Tariffs and Trade.

The current subsidy war between the United States and the European Community is a major factor in unsettling the world market. Broadening the EEP to other markets by making it an across-the-board program would eliminate charges of discrimination by traditional buyers and would increase competition and pressure on the European Community, but it would further antagonize non-subsidizing exporters who already are critical of the targeted program for undermining the world price structure. Furthermore, making the EEP an across-the-board program raises the question as to whether the \$1.5 billion in CCC stocks authorized in legislation would be sufficient.

The world agricultural market is experiencing a major change, as reflected in the tremendous over production and surpluses of major crops throughout the world. U.S. and European Community pricing policies, accelerated adoption of improved technology, and increased emphasis on agricultural self-sufficiency in developing countries, have increased agricultural production worldwide. Countries which were once net agricultural importers have become net exporters. Additionally, developing

countries faced with widespread economic problems are importing less food and feed grains. These changes in the world market require major modifications in agricultural policies and programs of traditional agricultural producers and exporters, such as the United States and the European Community. While the need for major changes in the farm policies and programs of these countries is great, little change has yet taken place as their governments continue to try to adjust programs suited to a different era. The EEP is in essence a bridge program at best. The program as implemented deals with the symptoms, not the fundamental causes, of the problems facing U.S. agriculture. Although the EEP may have some effect in encouraging the Community to negotiate, it does not increase world demand for exports in a period of overproduction and surpluses. More fundamental changes are needed to restore equilibrium.

FOREIGN MARKET DEVELOPMENT COOPERATOR PROGRAM

The Agriculture Trade Development and Assistance Act of 1954 (Public Law 480), as amended, and the Agriculture and Food Act of 1981 (Public Law 97-98), as amended, authorized market development activities and the use of federal funds to develop, maintain or expand foreign markets for U.S. agricultural commodities. FAS administratively determined that this should be accomplished through private, non-profit agricultural organizations, known as cooperators, who should be required to share jointly in the financial expense of the market development

programs. Cooperator programs usually fall into three categories: trade servicing, technical assistance, and consumer promotion. Activities and programs are geared to increasing consumer and commercial uses of U.S. agricultural products and developing long-term markets rather than achieving immediate sales of agricultural products.

In fiscal year 1986, cooperators expended \$39.7 million of FAS funds on the market development program. Cooperators reported contributions of \$35.9 million and credited foreign third party interests with contributing \$38.8 million. Cooperators conducted approximately 5,500 individual market development activities in 132 countries.

FAS has stated that the market development program has played an important role in increasing U.S. agricultural exports from \$3 billion in its inception in 1955 to approximately \$26 billion in fiscal year 1986.

The Congress established a broad goal for market development programs -- develop and expand foreign markets for U.S. agricultural commodities -- and provided general program direction to FAS. The Congress also gave FAS broad discretion in establishing program and financial parameters. Consequently, cooperators implement numerous and varied market development activities.

FAS continues to fund the cooperators' programs without critically assessing what results are achieved or how well. FAS planning and evaluation methodologies, including base evaluations

and annual program evaluations, are insufficient to fully determine which market development activities are effective and which need to be refined or terminated.

FAS guidelines encourage the cooperators to contribute annual amounts equal to or greater than the FAS funds authorized by the project agreement but do not require cooperators to contribute. The FAS guidelines define contributions based on their source (who provides the contribution) rather than on the type of contribution (cash or goods and services). Thus, cooperator cash contributions, as defined by FAS, consist of some cash but primarily of goods and services rendered through U.S. headquarters offices in support of marketing activities. These cash and goods and services contributions represent the cooperator's match of FAS funds awarded in project agreements. FAS funds the major share of the direct costs of the cooperators' overseas market development programs; cooperators pay for some overseas expenses, for example, salaries of personnel conducting the activities. FAS also pays for most of the cooperators' indirect overseas expense, such as rent and utilities. Furthermore, FAS has no assurance that cooperator contributions adhere to FAS guidelines that they be in addition to activities the cooperators would have conducted without the FAS funded market development programs and that they relate to an FAS-approved activity.

Market Development Conclusions

Public Law 480 and amendments to this law emphasized the importance of developing and expanding foreign agricultural markets. The legislative history contains no indication as to how this goal was to be achieved. FAS made administrative and financial determinations as to program implementation but put few restrictions on the total funding a cooperator can receive for a specific program, how long a cooperator can receive funding for that program, or what constitutes a successful program.

FAS planning and evaluation strategies, including the benefit-cost ratios calculated by cooperators and intended by FAS to help measure program effectiveness, use overly optimistic assumptions about the market situation. FAS has conducted just 19 annual evaluations, a small number considering that it funds over 1,200 country programs each year. Further, some annual evaluations misstate the results and exaggerate the outcome of the program.

We analyzed the market development plans, end-of-year reports, and income statements of various cooperators and found that, for the most part, cooperator contributions to the programs are primarily goods and services contributions rather than cash contributions as the FAS title "cash contribution" would indicate. Cooperators state that these goods and services contributions represent cash expenditures in support of approved marketing activities. FAS officials said that they do not scrutinize cooperator contributions carefully and have little

assurance that they are accurately reported. Thus, we believe that the FAS data indicating that there is about a one-third sharing of program costs among FAS, cooperators, and foreign third parties, conveys the impression that cooperators are financing the program more fully than actually occurs. FAS is paying the majority of the direct and overseas costs of the program and assuming all the financing risk.

Market Development Recommendations

We recommend that the Secretary of Agriculture direct the Administrator of FAS to take the following actions.

- Clarify cooperator program goals and establish standards or limits on total funding levels per program and timeframes for individual program funding.
- Revise FAS guidelines to require the inclusion of measurable goals in cooperator market development plans and/or activities to facilitate effectiveness evaluations and track activity results.
- Revise FAS guidelines to define program contributions in terms of source, rather than in terms of cash and goods and services.
- Furthermore, we recommend that the Secretary of Agriculture, consider, and report to the Congress, the possibility of redirecting some USDA resources to FAS' Compliance Review Staff to allow more complete review of cooperator compliance with FAS guidelines.

ALTERNATIVE GRAIN TRADING PRACTICES:

LONG-TERM BILATERAL GRAIN AGREEMENTS AND COUNTERTRADE

Our review is in response to increased congressional interest in pursuing alternative grain trading practices as a means of increasing U.S. grain exports. During the 99th session of Congress, members urged the administration to explore the possibility of expanding bilateral grain agreements and bartering U.S. grain abroad. The Food Security Act of 1985 provides for a pilot barter program and specifically requires that the U.S. Department of Agriculture carry out at least two projects with nations experiencing food and currency reserve shortages during fiscal years 1986 and 1987. Furthermore, numerous agricultural trade bills were introduced during the 99th Congress, many of which included some requirement for the U.S. government to pursue alternative agricultural trading approaches. Interest in such practices continues to grow in the current Congress.

Long-term bilateral grain agreements are used most extensively in countries where the government is directly involved in agricultural production and marketing. Three of our four principal grain competitors -- Argentina, Australia and Canada -- have government owned enterprises that play a major role in their grain trade. They have used long-term bilateral agreements more extensively than the United States in attempts to both maintain and expand their market shares. Our findings indicate that in the 1980's, the minimum purchase volumes specified in foreign bilateral agreements represent a little over

20 percent of wheat and coarse grain traded on the world market. Since 1983, minimum wheat and coarse grain export volumes listed under such agreements accounted for, on average, 40 percent of their total grain exports compared to a 14 percent average for minimum wheat and corn exports specified under U.S. bilateral grain agreements.

Many U.S. and foreign officials acknowledge that long-term bilateral grain agreements have declined in importance as a result of a buyer's market in world grain trade over the last few years. Despite a slight decrease since 1985, due in large part to the oversupply of grain in the world market, the use of long-term bilateral grain agreements by major U.S. competitors remains an important aspect of international grain trade.

Historically, the United States has opposed long-term agreements on the grounds that they run counter to free trade policies and represent a significant non-competitive trade practice. Nonetheless, the United States has entered into such agreements with the Soviet Union and China to provide grain over extended periods through the private sector at prevailing market prices. These exceptions were made to (1) establish a mechanism for close communication on agricultural trade with these countries; (2) minimize the occurrence of large unexpected, erratic, and disruptive sales; (3) stabilize U.S. domestic prices; and (4) develop an expanding agricultural export market.

From 1976 to 1981, minimum grain quantities specified under these long-term bilateral grain agreements represented less than

10 percent of total U.S. grain exports. Since 1981, the minimum amounts have represented significantly larger percentages of total U.S. grain exports; however, this has occurred during a period of overall decline in U.S. grain exports. If actual sales occurring under the agreements are examined instead of agreement minimums, the bilateral grain exports under these agreements reach 19 percent of total grain exports. This is due largely to Soviet grain purchases that in some agreement years far exceeded total quantity minimums.

Our analysis shows that some foreign competitors have used countertrade to export grain, primarily to developing countries and the Soviet bloc. Among the documented countertrade cases involving grain transfers on which we found information, only one out of the 21 involved the United States. As of January 1987, the United States has not initiated any pilot barter projects as required by the Food Security Act of 1985. Agriculture officials informed us that compliance has been hampered by the requirement that the barter be initiated with a less developed country which has limited foreign exchange and which also has a strategic mineral we need in our stockpile. Meetings among officials from Agriculture, the General Services Administration, and the Department of Energy have not been successful in producing agreement on a means for complying with the provisions of the law.

In short, other countries have used both bilateral agreements and various forms of countertrade as agricultural

trading tools in the midst of increasingly competitive world market conditions, large foreign debt, and hard currency shortages faced by the less developed countries. Recent trends indicate that world agriculture trade will witness continued usage of both bilateral agreements and countertrade as alternative means to stimulate exports.

U.S.-Soviet grain agreements

The first U.S.-Soviet bilateral grain agreement was in effect from October 1, 1976 to September 30, 1981. Under this agreement, the Soviets would purchase annually at least 6 mmt of U.S. wheat and corn in approximately equal proportions, at market price, for a 5 year period. Moreover, the Soviets could purchase an additional 2 mmt of grain without consulting the U.S. government unless U.S. carry over and forward grain estimates were less than 225 mmt. The agreement stipulated that sales were to be made from U.S. private commercial sources at the market price prevailing at the time of the purchase. Consultations to discuss the implementation of the agreement were required every 6 months and whenever either party wished to buy or sell over the 8 mmt, agreement maximum. The Soviets were also required to space their grain purchases as evenly as possible throughout each year; moreover, all grain purchased from the United States was to be used only for domestic consumption. This first agreement was extended twice beyond the lapse date of September 1981; each time for an additional year covering the period from October 1981 to September 1983.

The Soviet purchases exceeded the 6 mmt minimum specified in the 1976 agreement and, in several of the years actually totaled two or three times the minimum. In those years, U.S. grain exports to the Soviets represented a significant percentage of total U.S. grain exports; however, the minimum agreement amounts themselves represented less than 10 percent of total annual U.S. exports.

Soviet purchases of U.S. grain were adversely affected between January 1980 and March 1981 by the U.S. grain embargo imposed by President Carter in response to the Soviet invasion of Afghanistan. During this period, total Soviet grain purchases were limited to 8 mmt, the maximum quantity specified in the 1976 agreement. The embargo effectively stopped the export of 17 mmt of U.S. grain which the Soviets had planned to purchase prior to the embargo announcement. The Soviets, facing a poor harvest, immediately sought alternative wheat and corn suppliers. Other major grain producers--Canada, Australia, Argentina, and the EC--expanded their own production and gained in the Soviet grain market during this period. As a result, the embargo affected the United States' reputation as a reliable grain supplier and contributed to the loss of Soviet grain market share to major competitors. Despite the current administration's termination of the embargo in April 1981, the United States has not been successful in regaining its lost Soviet wheat market shares. The U.S. share of Soviet wheat imports was 65.5 percent in 1978/79; the highest share since the embargo termination was 31.5 percent

in 1981/82. U.S. wheat market shares have dropped consistently since 1983/84 to 1.3 percent in 1985/86. The U.S. share of Soviet coarse grain imports was 83.3 percent in 1978/79; this has averaged 55 percent since 1983.

The second five-year grain agreement with the Soviets was initiated in 1983 and contained many of the same conditions as the previous 1976 agreement concerning the spacing of purchases, re-export restrictions, semiannual consultations, and purchase prices. New features included (1) a 9 mmt annual purchase quantity of wheat and corn, with minimum quantities of wheat and corn at 4 mmt each, (2) the ability of the Soviets to substitute soybeans and/or soybean meal in the ratio of 1 ton of soybeans for 2 tons of grain, and (3) the ability of the Soviets to purchase annually an additional 3 mmt of grain without prior consultations. In July 1986, the Soviets stated their intent to add new grain quality provisions to all grain purchase contracts; these provisions would allow them to reject shiploads of grain or withhold up to 5 percent of the total payment if Soviet officials determine grain imports to be of an unacceptable quality.

In 1983/84, under the second agreement, Soviet purchases significantly exceeded the minimum quantities. In 1984/85, total grain purchases were twice the minimum quantity; however, this was due to unusually large corn purchases as wheat purchases actually fell below the required 4 mmt portion. In 1985/86, the Soviets did not adhere to either the required total grain purchase amount or the minimum wheat portion. With the large

overall Soviet purchases during 1983/84 and 1984/85, grain exports under this bilateral agreement represented a sizable percentage of total U.S. grain exports.

Since 1984, the Soviets have been reluctant to buy minimum quantities of U.S. wheat under the 1983 agreement due to large variances between the U.S. and world market prices. The Soviets have been successful in buying wheat on the world market from foreign competitors at prices well below those offered by U.S. suppliers. Since the agreement merely stipulates that sales are to be made at "prevailing market prices," the Soviets have interpreted this phrase to mean world market prices, while the U.S. position is that the wording refers to U.S. domestic prices.

U.S.-China grain agreement

The 4-year U.S.-China grain agreement beginning in January 1981 required annual grain purchases between 6 and 8 mmt of wheat and corn, with corn representing 15 to 20 percent of total sales. The PRC could purchase 1 mmt over the maximum of 8 mmt without prior notice, but any purchases over 9 mmt required advance notification. Transactions were to be made at prevailing market prices in accordance with commercial terms. In addition, the agreement contained an escape clause that released the United States from selling the minimum quantities by virtue of "exceptional circumstances." However, the reductions were to be proportional to U.S. grain exports to all other customers and to grain purchased from other foreign suppliers by the PRC.

U.S. grain exports to the PRC under the agreement were above maximum levels during the first two years of the agreement. However, these sales dwindled significantly during the final 2 years to less than half prior year purchases and well under total minimum quantities.² It is generally believed that unexpected increases in Chinese grain production and problems between the United States and China over textile imports resulted in the Chinese not buying large quantities of grain under the agreement and ultimately not renewing it. More recently, Chinese concerns over the price and quality of U.S. grain have resulted in reduced purchases.

Summary of U.S. experience

Until 1981, minimum grain export quantities required under long-term bilateral grain agreements represented under 10 percent of total U.S. grain exports. After 1981, the minimum amounts represented significantly larger portions of U.S. total grain exports, but this was occurring during a period of declining U.S. grain exports. In years when Soviet purchases far exceeded total quantity minimums (1977/78, 1978/79, 1981/82, 1983/84, and 1984/85), the bilateral grain sales represented significant percentages of overall U.S. grain exports.³

²Only in 1982 did the PRC meet both the total grain purchase minimum (6 to 8 mmt) and the provision that of this total amount, 15 to 20 percent would be corn (0.9 mmt to 1.2 mmt).

³Even though overall Soviet grain purchases exceeded the total minimum quantities specified in the agreements for these years, required minimum quantity purchases of wheat were not met for some years.

During 1983 to 1986, minimum grain export quantities specified under long-term bilateral grain agreements of major foreign grain exporters (Australia, Argentina, and Canada) represented, on average, approximately 40 percent of their total grain exports. In comparison, for the same timeframe, minimum grain export quantities specified under U.S. agreements represented only 14 percent of total U.S. grain exports. In short, minimum purchase quantities under the three U.S. long-term bilateral grain agreements represent a much smaller proportion of its total grain exports than those in agreements of major foreign exporters.⁴

U.S. experiences in countertrade

The United States officially opposes government-mandated countertrade because it is contrary to current U.S. trade policy and support for the multilateral trading system. Nevertheless, Congress recently has supported the use of voluntary barter/countertrade for expanding the U.S. share of the international grain market. As stated in the Food Security Act of 1985, barter is considered an effective secondary method of reducing excess supplies of agricultural commodities and adding

⁴It is difficult for GAO to obtain data on actual grain sales made under the long-term bilateral grain agreements of foreign competitors. However, attempts are continuing and, where obtainable, will be included in a forthcoming GAO report on foreign use of long-term agreements.

needed strategic and critical materials to the National Defense Stockpile.

The U.S. government has in fact used countertrade to dispose of surplus agricultural commodities through the barter program of 1950-73, and the United States-Jamaica barter agreements of 1982 and 1983. In addition, the U.S. government does not oppose the use of countertrade by the private sector, unless such use could have a negative impact on national security. In fact, the government provides advisory services and market information to prospective U.S. exporters who want to use countertrade.

The Barter Program of 1950-73

The Barter Program of 1950-73 authorized the Secretary of Agriculture to reduce inventories of surplus agricultural commodities owned by the Commodity Credit Corporation (CCC) through barter agreements to obtain strategic and critical materials for the National Defense Stockpile or to obtain foreign-produced supplies and services for U.S. agencies operating abroad. According to the USDA, "barter is a CCC program that utilizes exports of U.S. agricultural commodities to generate funds for acquisition of goods and services overseas to meet requirements of U.S. government agencies and to procure strategic materials for stockpiling."

From 1950 to 1954, very little happened in the barter program. From 1954 to 1962, it was used to exchange CCC-owned agricultural commodities for strategic materials. By 1962, stockpile goals were decreased, and the program shifted to the

barter of agricultural commodities for (1) foreign-produced supplies and services for overseas military installations and (2) projects of the Agency for International Development (AID). The program was suspended in 1973 when CCC stocks were largely depleted, stockpile goals changed, and the strong foreign commercial export market no longer justified the need for a barter program.

The three objectives of the program were (1) disposal of surplus U.S. agricultural commodities, (2) acquisition of strategic material for the National Defense Stockpile, and (3) acquisition of goods and services "offshore" that were needed by U.S. development programs or for military purposes. The value of the agricultural commodities exported from 1950 to 1973, based on export market value, was \$6.65 billion. Despite these successes, there were problems with the program. Negotiations were complex and time-consuming. In addition, there were concerns that commodities were resold, thus displacing cash sales, and that the program, in essence, was providing subsidies to exports.

U.S.-Jamaica Barter Agreements

On February 25, 1982, the United States signed two barter agreements with the Bauxite and Alumina Trading Company, Ltd (BATCO), of Jamaica. The first agreement, signed by the CCC and BATCO, was for the exchange of 400,000 tons of Jamaican bauxite for 7,238 metric tons of nonfat dry milk and 1,905 metric tons of anhydrous milk fat (oil). The total value of the agricultural commodities was estimated at \$13 million. The second agreement,

signed by the General Services Administration (GSA) and BATCO, was for the exchange of 1.2 million tons of Jamaican bauxite for cash and excess stockpile materials (tin and tungsten).

According to a CCC official, the agreements were a success in a number of respects. First, the U.S. stockpile inventory for bauxite was below the desired level. Second, Agriculture was able to barter dairy products that it would not have been able to sell otherwise. Third, it promoted regional foreign policy goals.

There were a number of problems with the agreements, however. First, a considerable amount of time was spent finding a material or commodity at acceptable prices to which Jamaica would agree. Second, determination of the value of the bauxite was problematic. Third, there was a lack of competitive market conditions in the negotiations; since Jamaica knew that President Reagan had announced the exchange, it "struck a hard bargain" during negotiations.

On November 17, 1983, a third agreement was signed with BATCO exchanging dairy products for 1 million tons of bauxite for the National Defense Stockpile. The total value of all the agreements with Jamaica was \$47 million.

Administration Task Forces

The current administration has formed at least two groups to debate the issue of countertrade, the Inter-Agency Working Group of the Trade Policy Review Group (chaired by the U.S. Trade Representative) and the Working Group on Barter (chaired by

Agriculture). This latter group is the administration's most recent response to the barter issue.

The Inter-Agency Working Group reviewed countertrade and barter in 1983 to create a government consensus and policy on the matter. The group concluded that the U.S. government generally views countertrade as contrary to an open, free trading system. However, as a matter of policy, it will not oppose U.S. companies' participation in countertrade arrangements unless such action could have a negative impact on national security. Thus the U.S. government will provide advisory and market intelligence services to U.S. businesses, including information on the application of U.S. trade laws to countertrade goods; continue to review financing for projects containing countertrade on a case-by-case basis, taking account of the distortions caused by these practices; continue to oppose government-mandated countertrade and will raise these concerns with the relevant governments; participate in reviews of countertrade in the International Monetary Fund, the Organization for Economic Cooperation and Development, and the General Agreement of Tariffs and Trade; and exercise caution in the use of barter authority, reserving it for those situations which offer advantages not offered by conventional market operations.

The Working Group on Barter (WGOB) established in January 1984 by an executive order, was charged with determining whether a particular countertrade proposal was in the best interest of the country. According to an official statement on the WGOB,

"the barter review process will assure that barter proposals will receive attention at not only the requisite departments/agencies, but at the highest levels of government."

According to a USDA official, the working group has considered two countertrade proposals: (1) a Mexican proposal to exchange fluorspar for CCC dry milk, and (2) a Department of Defense (DOD) proposal to exchange U.S. scrap metal for materials needed for the National Defense Stockpile. In both cases, the proposals were rejected, although DOD actually withdrew its proposal due to the time-consuming review process. At present, the WGOB has disbanded in accordance with a National Security Council directive calling for the disbandment of all groups conducting work related to the National Defense Stockpile.

Pilot Barter Provision

Section 1129 of the Food Security Act of 1985 provides for a pilot barter program to be carried out during fiscal years 1986 and 1987. The program, to be carried out with at least two nations which have food and currency reserve shortages, calls for the barter of surplus CCC commodities for strategic or other materials that the United States does not produce domestically in amounts sufficient for its requirements and for which national stockpile reserves or goals established by law are unmet. Normal commercial trade channels must be used and commercial marketings must not be disrupted.

Section 1167 of the Food Security Act of 1985 amends the CCC Charter Act to provide that if the strategic petroleum reserve

falls below prescribed levels, and upon request from the Secretary of Energy, the CCC must, to the maximum extent practicable and with approval from the Secretary, make available CCC commodities worth at least 300 million to barter for petroleum products (including crude oil). This section also requires the Secretary of Agriculture to provide technical assistance relating to bartering of agricultural commodities and products to U.S. exporters who request such assistance.

As reported to Congress on January 2, 1987, by the Secretary of Agriculture, no agreements have been concluded for the pilot barter program. Agriculture stated in its report that it intends to continue with efforts to initiate substantive discussions with several countries having food and currency reserve shortages which offer potential for obtaining strategic minerals.

In more recent discussions with Agriculture officials, they reiterated that the Department could not report any progress on barter initiatives; however, they emphasized their commitment to complete the projects. Complications regarding division of program authority, agency coordination, and reimbursement between federal agencies involved in potential barter transactions have contributed to the lack of action. Additionally, there have been problems in identifying the appropriate combination of eligible countries and acceptable commodities. Agriculture officials reported that they had met on several occasions with Energy and GSA representatives without successfully reaching agreement on a means for carrying out the provisions of the law.

ALTERNATIVE AGRICULTURAL TRADE

LEGISLATION PROPOSALS

Before addressing alternative agricultural trade legislation proposals, we would like briefly to focus on selected trade provisions of the Food Security Act of 1985.

The Food Security Act of 1985 was signed into law on December 23, 1985. Its extensive trade title contains a number of provisions designed to counter foreign subsidized sales, develop new markets, and provide food assistance to developing countries. It includes reauthorizing such long-standing export assistance programs as Public Law 480 (Food for Peace) and establishing new efforts such as the Targeted Export Assistance program. It also provides continued support for several export assistance programs such as short-term export credit guarantees (GSM-102) and the Export Enhancement Program. In addition, the law mandates an intermediate credit guarantee program, a new export assistance program to promote the export of meat and dairy animals, and a pilot barter program. Within Agriculture, the Foreign Agricultural Service (FAS) has the lead role in developing and executing the programs and initiatives outlined by Congress in the trade title.

The Food Security Act of 1985 authorized the lowering of loan rates and the establishment of marketing loan programs. Both of these initiatives are designed to enhance the competitiveness of U.S. agricultural commodities overseas. Although the Secretary has used his discretionary authority to

establish marketing loan programs for rice and cotton, he has resisted inclusion of wheat, corn, and soybeans principally because of budgetary implications. The Secretary was also provided in the Act with considerable discretionary authority in implementing the Export Enhancement Program.

The Secretary of Agriculture, it should be noted, has considerable latitude under other existing authority to initiate many export promotion and market development activities under the proposed legislation we are discussing today. For example, the Secretary has broad discretionary authority in the management of the Foreign Agricultural Service's foreign market development activities.

In addition, the administration has the authority, under existing trade law, to respond to unfair trade practices of foreign governments. The administration launched a more activist effort at resolving Section 301 cases in October 1985. This effort is aimed at combating unjustifiable and unreasonable import restrictions by foreign countries, particularly agricultural related restrictions of the European Community.

It should be noted that agriculture is a major issue in the current Uruguay round of multilateral negotiations at which the United States is seeking improved market access; commitments to freeze the present level of export subsidies and eventually to phase them out; and minimization of the adverse effects that sanitary and phytosanitary barriers can have on trade. Our 1985

report on issues to be addressed by the United States in the GATT provides a detailed analysis of agricultural trade problems.⁵

In the administration's proposed trade bill (Trade Competitiveness Act of 1987), there was no title for agricultural trade. However, the titles that deal with trade matters as a generic issue can be applied to agriculture. According to administration officials, adequate authority existed under the Food Security Act of 1985 and other laws to sufficiently represent agricultural trade interests.

We would now like to address the first of several major proposed alternatives. Title VII of S. 490 (Senate Omnibus Trade Bill) and S. 512 (Agricultural Competitiveness and Trade Act of 1987) are identical. Title VII provides a framework for improved management of export promotion and foreign market development activities. More emphasis on market development, coordination of existing and newly established programs and activities, better program evaluation, greater flexibility in the use of agricultural attaches, more emphasis on new markets and value-added commodities, an expanded effort to respond to product quality problems, and an establishment of a broad-based publicly accessible export market development advisory committee appear to be a positive response to increasing foreign competition. Proposed funding increases for trade shows and exhibitions, for general management support of export programs, and for additional

⁵Current Issues in U.S. Participation in the Multilateral Trading System, (GAO/NSIAD-85-118), September 23, 1985.

personnel seem appropriate, if after close analysis of existing resources, it is found that such resources, even through budgetary shifts and reprogramming, are inadequate. It is clear that the many new export programs of the 1985 Food Security Act have challenged the adequacy of existing FAS resources.

We also believe the general negotiating objectives of the title--to eliminate trade barriers, clarify GATT rules for agricultural trade, and address export subsidies--are consistent with our current trade policy objectives and are responsive to the major agricultural trade problems identified earlier in our statement. We would like to underscore the importance of reciprocal reductions in agricultural subsidies in any multilateral negotiations.

The proposed use, in Title VII, of CCC commodities by cooperators for demonstration projects raises some questions. There are limitations to the use of these commodities and it is unclear how many cooperators could participate in such projects.

Title VI of H.R. 3, the omnibus House trade bill, calls for an extensive reorganization of the U.S. agricultural trade apparatus in the executive branch. Many of its proposed changes are consistent with the July 1986 report of the National Commission on Agricultural Trade and Export Policy. Some of the more significant changes incorporated into this bill include:

- designation of the Department of Agriculture as the lead U.S. agricultural trade agency;
- reorganization of the Department of Agriculture by providing

for Presidentially appointed positions of Undersecretary of Agriculture for Trade and International Affairs, Under Secretary of Agriculture for Commodity Programs and up to two additional assistant secretaries to assist the two new Under Secretaries;

- transfer of the International Economics Division of the Economic Research Service (ERS), and the World Agricultural Outlook Board, to the Foreign Agricultural Service, and the establishment of a Commodity Division to promote value-added agricultural products not covered by cooperator agreements and help develop cooperator organizations;
- establishment of a General Sales Manager's Office under the Under Secretary for Trade which would be responsible for all program development, and management of agricultural trade officers overseas;
- establishment of an office to monitor trade practices under the Under Secretary for Trade to study trade practices of other nations and promote U.S. exports;
- establishment of an office to provide assistance to victims of unfair trade practices;
- establishment of an Office of Agricultural Trade Policy, Planning and Evaluation under the Under Secretary for Trade to develop long-term agricultural trade strategy reports;
- use of food aid and related economic assistance programs to develop U.S. markets;
- development of an annual report on the extent food aid and

agricultural assistance served market development objectives;

- establishment of an office of Food Aid Policy under the direction of the General Sales Manager;
- making available to cooperator organizations commodities owned by the CCC to expand markets for U.S. products;
- expansion of the Export Enhancement Program to give priority to all interested foreign purchasers who traditionally purchase U.S. agricultural commodities; or those who begin or continue to purchase quantities equal to or greater than the level of purchases of previous years, and provide every 30 days to appropriate committees, a current list of countries and products and a justification for their participation; and
- asking the Secretary of Agriculture to expedite the barter provisions of 1985 Food Security Act.

In summary, the agriculture title of the House trade bill significantly restructures and reorients the U.S. agricultural bureaucracy in an effort to improve U.S. competitiveness abroad. Such a major reorganization should be undertaken only after a thorough impact analysis that clearly addresses the costs and the benefits of such a major change. Because of its comprehensive nature, many agencies, interest groups, and U.S. policies will be affected, raising serious questions about the practicality and desirability of such an ambitious legislative proposal.

Another alternative legislative proposal advanced in the Senate is S.310, the Agricultural Export Enhancement Act of 1987. Similar to H.R.3, S.310 would broaden the spectrum of countries eligible under the Export Enhancement Program. However, S.310 provides a detailed and complex methodology for determining which countries would be eligible, and how bonus commodities would be allocated. Both H.R.3 and S.310 raise questions concerning the cost of an expanded export bonus program and its impact on the U.S. and world market, U.S. trade relations with other countries, and U.S. negotiations in the current round of multilateral trade discussions.

In summary, two of the three legislative proposals modify the Export Enhancement Program. Neither one proposes increasing the value of bonus commodities to be used annually. Targeting criteria would be substantially broadened as compared to the existing program. With the recent expansion in EEP activity, it is probable that the maximum allocation of \$1.5 billion in CCC commodities over 3 years will be used. If a broadening of criteria were adopted, the existing authorization would most likely be inadequate. Furthermore, an increase in commodities released by the CCC could also cause budgetary outlays.

Mr. Chairman, let me close by reiterating that the Food Security Act of 1985 and the existing trade legislation provide considerable discretionary authority for the Administration to develop a more assertive agricultural trade policy and programs

if it wishes. On the other hand, if it does not exercise that authority, specific legislation could require it.

Mr. Chairman, this concludes my statement. I'll be happy to answer any questions you may have.