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Briefing Report to Congressional Requesters

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INTERNATIONAL TRADE

Implementation of the Agricultural Export Enhancement Program

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National Security and
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March 17, 1987

The Honorable Charles E. Grassley
United States Senate

The Honorable Tom Harkin
Chairman, Subcommittee on Nutrition
and Investigations
Committee on Agriculture, Nutrition,
and Forestry
United States Senate

The Honorable George E. Brown, Jr.
Chairman, Subcommittee on
Department Operations, Research,
and Foreign Agriculture
Committee on Agriculture
House of Representatives

As you requested, we assessed the implementation of the Export Enhancement Program (EEP) and its effectiveness in increasing U.S. agricultural exports and encouraging U.S. trading partners to begin serious negotiations on agricultural trade problems. We provided interim assessments of the program in testimony before the House Subcommittee in October 1985 and in April and September 1986. This briefing report covers the first full year of operation of the EEP

Background

In the face of decreasing U.S. exports, agricultural trade organizations lobbied extensively for an across-the-board export subsidy program early in 1985; however, in May the Secretary of Agriculture announced the establishment of the targeted Export Enhancement Program. Under the EEP, the Commodity Credit Corporation was to make available up to $2-billion worth of surplus agricultural commodities over a 3-year period as bonuses to U.S. exporters to expand sales of specific U.S. agricultural commodities in specific markets. In practice, the bonuses were subsidies-in-kind to enable exporters to lower the prices of their commodities to be competitive with subsidized foreign agricultural exports. The prices of many U.S. agricultural commodities, e.g., wheat, had become significantly higher than those of foreign commodities and were no longer competitive in the international marketplace.

The United States had discontinued a long-standing agricultural export subsidy program in 1973. The new program was not established without some misgivings on the part of the administration which, like previous administrations, considered subsidies, in general, to be unfair trade practices. The Secretary of Agriculture emphasized that the Department remained fully committed to market-oriented international trade policies. The deteriorating U.S. position in the world marketplace for agricultural products, however, provided impetus for the EEP.

Department of Agriculture figures showed that U.S. agricultural exports declined substantially from the 1981 record level of 162 million tons valued at $44 billion. At the time the EEP was announced, the U.S. government was projecting that 1985 exports would fall to 137 million tons valued at $33.5 billion and that the United States would supply less than 45 percent of the world's grain import needs in 1985 compared with 60 percent in 1980.

Design of the EEP

According to guidelines established by the cabinet-level Economic Policy Council, each initiative under the EEP was to meet several criteria, the most important of which were additionality and targeting, which were defined as follows.

- Additionality—sales were to increase U.S. agricultural exports above those that would have occurred in the absence of the program.
- Targeting—sales were to be targeted at specific market opportunities, especially those to challenge competitors that were subsidizing their exports.

Almost immediately after the EEP was announced, there was dissatisfaction with it. Groups who had lobbied for the subsidy program would have preferred an across-the-board program to the targeted EEP Once the initiatives began to be announced—wheat to Algeria in June, wheat flour and wheat to Egypt in July, and wheat flour to Yemen in August--critics became impatient with the slow implementation of the EEP. Furthermore, the fact that the program was both targeted and discretionary led critics to question how much of the $2 billion available for the program over the 3-year period would actually be used.

Subsequent to the establishment of the EEP, debate on the 1985 farm bill included discussion of a modified subsidy program. In the final version of the Food Security Act of 1985, one of several provisions to expand trade in agricultural products called for a mandatory export subsidy program. The Secretary of Agriculture was directed to use $2 billion worth of commodities for the program over the 3 years beginning October 1, 1985, to counter unfair foreign trade practices and to make U.S. agricultural products more competitive generally. Although he signed the legislation, the President objected to the mandatory program, which he believed threatened to precipitate an agricultural commodity trade war with U.S. allies. He further noted that fulfilling the $2-billion goal might be impossible without subsidizing exports in a manner which would be contrary to U.S. national security interests. Subsequently, in March 1986, Congress passed the Food Security Improvements Act of 1986 which, while keeping the subsidy program mandatory, stipulated that the value of the commodities to be used during the 3-year period was to be not less than $1 billion nor more than $1.5 billion.

According to Agriculture, the EEP was aimed at the European Community because its policies "directly" subsidized exports. While Agriculture did consider targeting export markets of competitors that "indirectly" subsidized— through low domestic transportation rates, for example— such proposals were not 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[1], 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 was made to protect the traditional markets of these "non-subsidizing" competitors.

A controversial aspect of the targeting was 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 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 wheat markets targeted under the EEP, including Egypt, Jordan, Sri Lanka, and Yemen

However, 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.

[1]For wheat and wheat flour, the crop year is defined as the 12-month period ending June 30

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.

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, vegetable oil, and sorghum. 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 totaled about $1.3 billion.

Total sales made under the 64 initiatives will result in the disposal of $868 million in bonus commodities at their book value, i.e., the government's acquisition cost. The total market value, which represents the commodities' estimated value on the current market, was only $603 million, or about 69 percent of the book value. In a period of declining prices, using book value to tally total bonus awards allows Agriculture to make fewer sales and dispose of a smaller volume of commodities to meet its $1-billion mandate.

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 the book value method. 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 Department officials to certain countries being targeted as recipients.

EEP's Impact on U.S. Wheat and Wheat Flour Exports

Through September 30, 1986, about half of the EEP initiatives and most of the sales involved either wheat or wheat flour. It was not until the last several months of fiscal year 1986 that other commodities began to be targeted to any extent. Although a number of barley initiatives and sales occurred during these last months, our analysis of the impact of the EEP in increasing exports was limited primarily to wheat and wheat flour.

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 of wheat and wheat flour 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 even 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.

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. The 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.

Targeting the Soviet Union

The Soviet Union is a special case. 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 problems with U.S. grain quality were also a factor.

The August 1, 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, but Soviet trade officials told us that the U.S. price still exceeded the "world price" despite the EEP initiative. 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.

EEP as Inducement to Negotiations on Export Subsidies

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 the 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. While the 1983 Agreement resulted in several French flour mills being closed and the overall restructuring of the French flour industry, the gain in the U.S. share of the Egyptian wheat flour market proved to be temporary. Some observers believe that if the United States were to terminate the EEP before the successful conclusion of international negotiations, this would be viewed as yet another indication of its lack of political will to retaliate against unfair trading practices. Hence, they believe that abandoning such a program could adversely affect progress toward meaningful agricultural trade negotiations.

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. Although agricultural trade was placed on the agenda for the new "Uruguay Round" of negotiations, it does not yet appear that U.S. negotiators have won a formal mandate for "fast-track" agricultural talks, i.e., negotiations which are undertaken with the goal of reaching agreement in less than 2 years.

The inclusion of agricultural issues on the agenda does not require any specific action during the negotiations, such as rolling back or even freezing existing agricultural export subsidies. The Under Secretary of Agriculture for International Affairs and Commodity Programs told us that the agreement did not preclude continuation of the EEP and that the program, in fact, should continue to put further pressure on the European Community to negotiate agricultural subsidy issues. He acknowledged that the conflict between the United States and the European Community on agricultural export subsidies might intensify in the future. During the first 3 months of fiscal year 1987, the subsidy "war" between the United States and the Community has, in fact, intensified, as evidenced by increases in U.S. export bonuses and Community subsidy payments.

Adverse Impact on Non-Subsidizing Competitors

According to administration officials, the EEP has been designed to avoid competing directly with sales made by non-subsidizing competitors. For wheat and wheat flour, this has been interpreted by the administration to mean Argentina, Australia, and Canada. Although many countries, including the United States, subsidize the production and/or export of their agricultural commodities in various and sometimes indirect ways, the EEP has in practice been targeted specifically at the European Community because it directly subsidizes exports of wheat and other agricultural products

In retrospect, 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.

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 marketplace, 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 has increased the financial cost of the European Community's Common Agricultural Policy, specifically through increased subsidy payments. It has thereby 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 overproduction and surpluses of major crops throughout the world. U.S. and European Community pricing policies, accelerated improvements in 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 feedgrains. 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.

Views of Agency Officials

Due to the requesters' needs, sufficient time was not available to obtain official comments on this briefing report from the Department of Agriculture. It was reviewed by program-level officials, and the Assistant Administrator for Commodity and Marketing Programs, FAS, told us that overall it fairly represented the facts. He noted several areas of concern, however, and suggested some changes which we considered and incorporated as appropriate.

As arranged with the Chairman, Subcommittee on Department Operations, Research, and Foreign Agriculture, House Committee on Agriculture, unless the Chairman plans to publicly announce its contents earlier, we do not plan to distribute this briefing report until 30 days from its issue date. At that time, we will send copies to the Secretaries of Agriculture, Commerce, State, and Treasury; Director of the Office of Management and Budget; U.S. Trade Representative; and Chairman of the Council of Economic Advisors. Copies will also be made available to other interested parties upon request.

If there are any questions, please contact me on (202) 275-4812.

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Contents

Tables

Figures

Abbreviations

ASCS	Agricultural Stabilization and Conservation Service
CAP	Common Agricultural Policy
CCC	Commodity Credit Corporation
EEP	Export Enhancement Program
FAS	Foreign Agricultural Service
GATT	General Agreement on Tariffs and Trade
IWC	International Wheat Council
mmt	million metric tons
OMB	Office of Management and Budget
PIK	payment-in-kind

Background

Prior to the announcement of the Export Enhancement Program (EEP), Agriculture had not seriously addressed agricultural export subsidies as a realistic policy option. According to the Under Secretary of Agriculture for International Affairs and Commodity Programs, since the wheat export subsidy program was terminated in 1973 following the grain sales to the Soviet Union the previous year, Agriculture had opposed export subsidies in principle. Furthermore, the present administration, like previous ones, had been opposed to all subsidies as unfair trade practices contrary to the principles of free trade that the administration espoused.

The $2 billion EEP, established in May 1985, resulted from efforts by the Senate leadership, and the Director of the Office of Management and Budget (OMB). Farm interests had lobbied for an across-the-board program, not a targeted subsidy-in-kind program. However, according to an Agriculture press release dated May 15, 1985, the EEP would offer government-owned commodities as bonuses to U.S. exporters to expand sales of U.S agricultural products in targeted markets. According to the Under Secretary, a targeted approach was considered to be in the best interests of the United States. A trade war was not wanted; rather, it was hoped that differences over agricultural subsidies could be resolved through negotiations. The Under Secretary noted that not all U.S. competitors used unfair practices and that targeting would make it easier to focus on those countries that did so.

Development of the EEP Criteria

On May 31, 1985, Agriculture announced the four criteria by which the EEP was to operate.

1. Additionality: sales were to increase U.S. agricultural exports above those that would have occurred in the absence of the program.

2. Targeting: sales were to be targeted at specific market opportunities, especially those to challenge competitors which were subsidizing their exports.

3. Cost effectiveness: sales were to result in a net plus to the overall economy.

4. Budget neutrality: sales were not to increase budget outlays above those that would have accrued in the absence of the program.

The Cabinet-level interagency Economic Policy Council (consisting of representatives of the Departments of Agriculture, Commerce, State and Treasury; OMB; Office of the U.S. Trade Representative; and Council of Economic Advisors) which had discussed the four criteria at a May 23 meeting, agreed at that time that no transactions involving direct sales to the Soviet Union or its allies were to be included under the EEP. In addition, EEP sales were not to compete directly with sales made by major debtor nations, including but not limited to Brazil, Argentina, and Mexico. Australia and Canada were not identified in the minutes of the May 1985 discussions but, in practice, the targeting approach was to be implemented to avoid competing directly with sales made by those countries.

Discontent With Initial Program

Almost immediately after the EEP was announced, there was dissatisfaction with the design of the program and the way it was being implemented. Groups who had lobbied for the program would have preferred an across-the-board subsidy program available for exports to all markets, not just those targeted by Agriculture. Once the initiatives began to be announced—wheat to Algeria in June, wheat flour and wheat to Egypt in July, and wheat flour to Yemen in August—the supporters of an across-the-board subsidy program became impatient with the slow implementation of the EEP. Furthermore, the fact that the EEP was both targeted and discretionary led these groups to question how much of the $2 billion available for it over the 3-year period would actually be used. The first EEP sale was not made until September. Discontent with the EEP became more widespread and demands were made for major changes in the program.

Export Enhancement Advisory Group

The establishment of the Agricultural Export Enhancement Advisory Group was proposed by Agriculture in a July 22, 1985, notice in the Federal Register to provide advice on the establishment and administration of the EEP. Since its establishment, the group, consisting of eight members representing farmers and the export trade, has met only twice, on August 14 and October 9, 1985. The Under Secretary of Agriculture for International Affairs and Commodity Programs presided at both meetings, and a number of key EEP officials from Agriculture were also present.

At the August meeting, several members mentioned the targeting aspect of the EEP as the biggest issue; there was concern that it should not result in a "net deficit of business." One member told us in July 1985 that the United States would alienate its good customers with the targeted approach—the Soviet Union, People's Republic of China, Japan, and South Korea would consider the program discriminatory. The Soviet Union, we were told, indicated that it would walk away from the U.S.-Soviet Long Term Agreement and would not buy the required minimum 4 million tons of wheat; it could claim that the U.S. government had reneged on the agreement by not providing goods at prevailing market prices. The Under Secretary noted in August that the administration was empowered to make the program across-the-board, but he did not believe that its policy would change on this issue

At the October 9 meeting, the Under Secretary reiterated that the principal reason for establishing a targeted program related to U.S. trade policy, which opposed export subsidies rather than encouraged them. He noted that this principle had been reaffirmed at the highest levels of the administration the previous week.

Expectations for the EEP

Perhaps the primary reason for the discontent with the EEP was that many proponents of a subsidy program had unrealistically high expectations as to what such a program was to achieve. These expectations included not only increasing U.S. agricultural exports and bringing the European Community to the negotiating table but also disposing of increasingly high government stocks of basic agricultural commodities and aiding the many farmers who were in poor financial straits. It soon became clear that the EEP was not going to meet many of these expectations. However, the Under Secretary told us in August 1985 that he would view the program as successful if it resulted in bringing the Europeans to the negotiating table on agricultural trade issues.

Grain trade officials and academic experts, as well as the Under Secretary, saw the need for Congress to lower price support levels to make U.S. prices for agricultural commodities competitive in the world marketplace. They looked at the subsidy program as a stopgap measure because lower price support levels, if enacted, would not become effective until June or September of the following year and something was needed in the interim to increase exports and decrease stocks of government-owned commodities. Unlike the Under Secretary, many individuals indicated that the program needed to be across-the-board; they also would have preferred that the $2 billion in commodities be disposed of in an expeditious way.

In conclusion, the EEP as implemented was perceived by the Under Secretary as a program dealing with the symptoms, not the root causes, facing U.S. agriculture. He also saw the program as but one of several means of pressuring the European Community to negotiate agricultural trade issues. While many agriculture experts would agree that the primary reason for the decrease in U.S. agricultural exports was the high U.S. prices, too often the changing structure of the world agricultural market, especially overproduction of basic commodities, has not been given sufficient attention.

Food Security Act of 1985

Discontent with the existing EEP, especially its targeted aspect, led to congressional support for a more aggressive agricultural export subsidy program. Debate on the farm bill included discussion of a modified subsidy program. In the final version of the Food Security Act of 1985, one of several provisions to expand trade in agricultural products called for an export subsidy program. The Secretary of Agriculture was directed to use $2-billion worth of commodities for the program over the 3 years beginning October 1, 1985, to make U.S. commodities more competitive. This program differed from the EEP as established in May 1985 primarily because it was mandatory, rather than discretionary. Furthermore, whereas the EEP had called for targeting markets where competitors were subsidizing their exports, the new law called for a broadened program. The EEP was to be used to counter or offset the adverse effects of subsidies or other unfair trade practices of foreign competitors, the adverse effects of U.S. agricultural price support levels, and fluctuations in the exchange rate of the U.S. dollar against other major currencies.

In signing the Act into law on December 23, 1985, the President noted that while the legislation contained some needed reforms, it also contained several highly objectionable features which had to be changed. One of these was the mandatory 3-year export subsidy program involving $2-billion worth of commodities. The President said that a program of this size and nature could precipitate an agricultural commodity trade war with U.S. allies and might be impossible to fulfill without subsidizing exports in a manner which would be contrary to U.S. national security interests.

As a result of the December farm legislation, the Economic Policy Council met in early 1986 to discuss several options presented by Agriculture. These included continuing the current program, expanding it by targeting other unfair export practices, and implementing an across-the-board program for designated bulk commodities while continuing selective targeting for other commodities. The Council, having been told by Agriculture that the law could be complied with only by adopting the third option, considered options for changing the legislation, including amendments to make the program discretionary and stretching it from 3 to 5 years. Ultimately, however, Congress passed the Food Security Improvements Act of 1986 which, while keeping the program mandatory, stipulated that the value of the commodities to be disposed of during the 3-year period was to be not less than $1 billion nor more than $1.5 billion. This compromise appeared to allow Agriculture to continue with its targeted program, although it was recognized that it would still be very difficult to dispose of approximately $333 million in commodities each year.

Although it appeared in April 1986 as though Agriculture might be able to dispose of about $300 million in commodities the first year, there were still complaints about the discriminatory nature of the program, especially with respect to the Soviet Union, the largest traditional customer of the United States for wheat. As it became more likely that the Congress was going to enact legislation expanding the program, the Secretary of Agriculture on August 1 announced that the Soviet Union was eligible to purchase almost 4 million metric tons of wheat under the EEP. Agriculture officials noted that the initiative was designed to remove the Soviet excuse of price considerations for not fulfilling the minimum purchase requirements of the Long Term Agreement with the United States a second year in a row.

Implementation of the EEP

When the EEP was designed, the administration established broad program criteria, including targeting and maintaining budget neutrality. However, specific operational guidelines for implementing these criteria were generally not developed and this has led to seemingly inconsistent applications. Such inconsistencies have been noted especially in decisions to target or to exclude countries from the EEP. In contrast, other EEP procedures specifically directing the program operations, such as bidding and bonus acquisition regulations, have been more explicit and have generally been considered satisfactory by participating exporters.

Focus on the European Community Limits EEP Scope

From the inception of the EEP, the Cabinet-level Economic Policy Council decided not to implement an across-the-board subsidy program, but instead it determined that proposals would be targeted on specific market opportunities, especially those that challenge competitors that subsidize exports. The Council neither specifically mentioned the European Community as the primary focus of the EEP nor did the criteria necessarily exclude the targeting of markets of other subsidizers. In practice, however, the administration has implemented the EEP so as to have the greatest impact on the European Community while simultaneously protecting the markets of competitors not considered direct subsidizers, namely, Australia, Argentina, and Canada in the case of wheat. While the Foreign Agricultural Service (FAS) did consider targeting the export markets of competitors that "indirectly" subsidize through such mechanisms as low domestic transportation rates, these proposals were not approved.

It is important to note that these other competitors have increased their shares of the wheat/wheat flour export market. International Wheat Council data show that from the 1981 to the 1986 crop year, the U.S. share of the world wheat/wheat flour market dropped from 44.8 to 29.0 percent. In contrast, the Community's share increased only 3.8 percent—from 13.5 to 17.3 percent. Argentina, Australia, and Canada also increased their market shares during this period by 2.9 percent, 6.9 percent, and 1 6 percent, respectively. Although the EEP was directed at the Community, in some targeted countries in which the U.S. share had declined, the loss in share was not to the Community alone. In fact, from the 1983 to the 1985 crop year, other competitors increased their wheat exports in 25 percent of the countries targeted for wheat under the EEP.

Assurances Attempt to Protect Other Competitors

The administration has made a deliberate effort to protect the traditional markets of non-subsidizers by obtaining assurances from EEP recipients that they would continue to import from non-subsidizers. There are no interagency guidelines for determining when assurances should be required; rather, it is simply determined if the non-subsidizer has a "significant" presence in the targeted country and warrants an assurance.

According to FAS, assurances covering wheat and barley sales have been provided in 10 of the 22 initiatives announced as of September 30, 1986, for those two commodities. FAS told us in January 1987 that it had received no indications from recipient countries that they were unable to meet the terms of the assurances. However, few of the initiatives had been in effect for a full year, and FAS had not conducted a review to verify compliance with the terms of the assurances.

Targeting of European Community Markets

Although other countries have also increased their share of the world wheat market, the European Community clearly remains a strong U.S. competitor. As of September 30, 1986, Agriculture had announced EEP wheat initiatives in 16 countries; in 10 of these countries,[1] the Community provided at least 15 percent of the wheat imports during the 1985 crop year (ending June 30, 1985). In the remaining 6 countries,[2] the Community's share was negligible in the 1985 crop year but was expected to increase during the following year if the EEP were not made available to these countries. For example, this was the rationale for targeting the Philippines which had previously bought only U.S. wheat. According to FAS, recent changes in the Philippines' import practices were likely to result in substantial purchases of European wheat and flour. To prevent the Community from entering a U.S. market, the administration targeted the Philippines under the EEP. One can only speculate as to the extent to which the Philippines or other countries would have purchased wheat in the absence of the EEP.

Foreign Policy Concerns Further Restrict EEP

Perhaps the most controversial aspect of the targeting was the administration's initial decision to exclude the Soviet Union from the EEP, despite the fact that the European Community's share of the Soviet wheat market rose from 5 to 22 percent from crop year 1981 to crop

[1] Algeria, Benin, Canary Islands, Morocco, Senegal, Sri Lanka, Syria, Tunisia, Soviet Union, and Zaire

[2] Egypt, Jordan, Philippines, Turkey, Yemen, and Yugoslavia

year 1985. Agriculture claimed the Soviet Union was excluded because the non-subsidizing competitors had about a 48-percent share of the market in crop year 1985. Non-subsidizers, however, had equal or greater shares of other markets targeted under the EEP, such as Egypt, Iraq, Jordan, and Sri Lanka. Clearly, the Soviet Union had been excluded until August 1, 1986, for foreign policy reasons.

The Community also had a substantial share of other markets which were not targeted under the EEP. In the 1985 crop year, for example, the Community provided 95 percent of Angola's wheat/flour imports, 90 percent of Libya's flour imports, and 60 percent of Poland's wheat imports. Neither Angola nor Libya have been targeted, however, and Poland was not targeted for wheat until January 1987.

Potential for Other Commodities May Be Limited

The majority of the early EEP initiatives were for wheat or wheat flour Since April 1986, however, Agriculture has greatly expanded the types of eligible commodities, including vegetable oil, eggs, dairy cattle, poultry feed, and barley. In many of the targeted markets, the European Community is the only other major exporter, thereby giving the United States an excellent opportunity to directly displace Community sales.

Other competitors do have a significant share of the barley market. However, within the last 2 years, the Community has increased its market share for barley from 25 to 43 percent. Through aggressive export subsidies, its barley exports increased from 3 8 million metric tons (mmt) for the 1984 crop year ending September 30, 1984 to 8.0 mmt tons for the 1985 crop year and 7.5 mmt for the 1986 crop year. Restitution payments jumped from $27.55 dollars per metric ton in December 1984 to $135.75 in October 1986. In contrast, U.S. barley exports declined from 2.1 mmt to 1.2 mmt from the 1984 to the 1985 crop year. As a result, Agriculture has made an effort to target the Community's barley market and as of September 30, 1986, had announced 6 barley initiatives totaling 2.16 mmt.

The United States is entering new markets in the majority of the non-wheat initiatives, such as flour, poultry, barley, eggs, and dairy cattle. Although these initiatives offer the potential to tap new markets, the high bonuses, compared with those for wheat, make them costly and unlikely to remain competitive beyond the expiration of the EEP. Officials acknowledge that U.S. long-term competitiveness for these commodities depends on eliminating Community export subsidies

The European Community also exports a large volume of processed commodities, including butter, honey, and milk. According to FAS, processed commodities have not been targeted due to their high degree of variability (i.e., color, taste, and consistency), irregular demand, impracticability of protecting non-subsidizers, and the very high bonuses that such commodities would require.

EEP Operating and Pricing Procedures

Before a country can be targeted under the EEP, the proposal must be approved through an interagency review group, consisting of representatives of the Departments of Agriculture, Commerce, State, and Treasury; the Council of Economic Advisors; OMB; and the Office of the U.S Trade Representative. Proposals generally originate within FAS but may also be submitted from the private sector for consideration. In a few cases, countries have requested that Agriculture consider targeting them for EEP commodities.

According to the original EEP guidelines, each proposal must be commodity and country specific and Agriculture develops a detailed analysis of the initiative's potential effect on non-subsidizers, costs and benefits, and domestic market impact. After a proposal is approved, U.S. officials notify the targeted country and explain the EEP guidelines and procedures. Generally, countries are not informed of the proposed initiative before it has received interagency approval

After the administration decides to target a country for a particular commodity, Agriculture announces the initiative and provides the detailed provisions under which exporters may qualify to obtain bonus commodities. Each interested exporter must furnish evidence of previous export experience in that particular commodity and of financial responsibility or satisfactory performance under other U.S. government programs. Exporters may then negotiate commercial sales of the eligible commodity in response to tenders issued by the buying country and submit their offers to Agriculture for approval. Agriculture also requires a large performance security bond for each offer that the exporter submits.

Through the EEP, Agriculture attempts to facilitate U.S. commercial sales at prices competitive with those of the European Community. For most commodities, Agriculture calculates a minimum sales price and a maximum bonus amount based upon the price differential between the United States and the Community. These calculations are completed before Agriculture reviews the offers. Because Agriculture considers the information to be market-sensitive, neither the price estimates nor the methodology is released publicly.

After a country tenders for a specific commodity, U.S. exporters negotiate a selling price with the country or its authorized importers and then submit this price along with their bonus request to Agriculture for approval. Sales contracts are conditional upon Agriculture's approval, but Agriculture does not get involved with the actual price negotiations. Bids falling below the minimum sales price are rejected to prevent the program from being classified as concessional and to guard against significantly undercutting world prices. Likewise, bonuses exceeding the maximum amount that Agriculture believes necessary to compensate the exporter for the lower sale price are rejected and exporters may resubmit revised offers. Offers which fall within the minimum price/ maximum bonus range are then ranked daily according to the lowest bonus value and sales are approved until the tender request is filled. FAS officials and exporters noted that unrealistically low offers are sometimes submitted because a buyer is deliberately trying to manipulate the price.

Procedures Vary for Soviet Initiative

On August 1, 1986, the administration announced that the Soviet Union was eligible to purchase 4 MMT of wheat under the EEP. The initiative was to expire on September 30—approximately 60 days later. Agriculture officials noted that the Soviet initiative was designed to remove the Soviets' excuse that price considerations prevented their fulfilling the Long Term Agreement with the United States. As a result, different procedures were devised to handle the Soviet sale.

According to Agriculture, the standard price review procedures would have been too cumbersome, considering the large quantity of wheat and the relatively short timeframe involved. Rather than establishing a confidential minimum sales price and maximum bonus amount for each potential sale, Agriculture announced a fixed, weekly bonus which would apply to any sales made that week. U.S. exporters were free to negotiate a sales price with the Soviets which would not require Agriculture review and approval.

The bonus was initially set at $13 per metric ton but later increased to $15. Unlike the other wheat initiatives, the bonus amount was not based on the European Community-U.S. price differential, but reflected the price differential between the United States and other major wheat exporters. Bonus amounts for previous EEP wheat sales were generally between $20 and $25 per metric ton.

Several weeks after the Soviet initiative was announced, Agriculture deviated somewhat from its standard method for reviewing the minimum price and maximum bonus amounts, apparently reluctant to allow the bonus for other EEP initiatives for hard red winter wheat (the type of U.S. wheat the Soviets buy) to exceed the fixed Soviet bonus. However, no clear policy directive to this effect was announced and we have received conflicting information from high-level Agriculture officials about this. We were told that wheat bonus awards would be considered cautiously until the Soviet initiative expired on September 30.

Price Information Is Inexact

We reviewed FAS methodology for determining the minimum sales price and maximum bonus awards for wheat, flour, poultry, and barley but did not attempt to verify the actual price data used in these calculations. FAS has attempted to collect price information, but Department officials have acknowledged that it is often difficult to obtain and verify, especially for commodities which lack a futures market and frequent export activity. Thus, the price-setting process involves considerable judgement. For example, other than EEP sales, U.S. barley exports accounted for only 3 percent of the worldwide exports during the 1986 crop year. This low export volume means little information is available for estimating barley export prices. FAS must therefore construct an estimated export price by using a domestic cash price and adding transportation costs to the point of export. A daily domestic cash price may reflect an "offered" rather than actual sales price for that particular day if no sales were made. Moreover, transportation costs vary among regions and depend upon size of shipments and supply and demand.

The data collection efforts and methodology for price-setting vary for each commodity, partially due to the nature of the market and the availability of information. However, FAS collects both domestic and European price information and considers factors such as quality, packaging, processing, and transportation rates in determining appropriate prices for all EEP sales. FAS obtains some domestic price information from several branches within the Department, including the Agricultural Marketing Service and the Agriculture Stabilization and Conservation Service (ASCS). European price information for wheat and barley is collected by the Agricultural Counselor's Office at the Hague and reported daily to FAS. This report contains such information as sales made, tenders announced, the European Community's export restitution activity, and general information on freight rates, stock levels, and quality complaints. In addition, FAS has contracted with a private broker to obtain grain price information.

Some methodologies for determining minimum sales prices and maximum bonus amounts have been revised during the course of the EEP. However, FAS frequently lacked written guidelines and documentation on how some determinations were made. For example, early in the program we obtained conflicting statements on how wheat bonuses were set, and FAS had no guidelines to clarify the situation. In other cases, different methods for determining the maximum bonus were applied, but such information was not generally recorded in the files. Commodity prices, freight rates, and quality premiums were sometimes adjusted from one day to the next without clear documentation.

Although we believe the methodology for determining wheat, flour, and barley prices is reasonable, it appears that FAS has occasionally misjudged price or bonus amounts. This has occurred, for example, in the flour sales. The United States does not generally export flour commercially, therefore a true export price is not readily available. Although ASCS provides a daily price quote for a standard quality flour, these quotes are often inflated, as we noted in a prior report.[3] FAS officials also acknowledged this problem and have therefore devised their own method of setting flour prices. Although direct comparisons between the FAS and ASCS flour prices are difficult due to differences in delivery periods and qualifications, we did review sales which had similar specifications. In some cases the FAS estimate was approximately the same price, or even higher, than the ASCS "inflated" price. If the estimated U.S. price is high, the differential between the U.S. and European price increases, thereby driving up the maximum allowable bonus. For example, in one case the maximum bonus was approximately $28 per metric ton higher than the highest bonus requested by an exporter. If exporters had requested the maximum bonus amount allowed, the Commodity Credit Corporation (CCC) would have had to provide an additional $2 million in bonus commodities for that particular sale. In most cases we reviewed, competition among exporters tended to keep the bonus requests lower than the FAS maximum amount.

We also reviewed FAS methodology for estimating poultry prices. Several Agriculture officials noted that obtaining data on poultry prices is very

[3] Opportunities For Greater Cost Effectiveness In Public Law 480, Title I Food Purchases, (GAO/NSIAD-84-69) Apr 19, 1984

difficult. We do not disagree, but we believe that the methodology chosen by FAS does not accurately assess current market prices and tends to overestimate the bonus amount needed. FAS uses price and cost estimates which give the benefit of the doubt to the exporter so that the allowable bonus covers worst case costs which are higher than typical costs. Because competition for EEP poultry sales has been limited, the potential exists for these sales to result in very high bonus awards.

Prices Have Been Undercut

FAS claims that EEP prices meet competition without undercutting world prices. The European Community has alleged otherwise. However, it has presented only minimal evidence of this. We examined one EEP sale to Algeria for which several Community exporters claimed the U.S. price undercut the Community wheat price by $24. According to FAS, the maximum estimated differential between the Community and the U.S. price was less than $5. Again, since pricing is inexact, varying estimates of Community price, U.S. price, or freight rates can affect the differential by several dollars. In the sale to Algeria, it appears that the FAS-estimated price may have been lower than necessary, but it is difficult to determine if this was due solely to poor price information.

In contrast, shortly after the EEP was implemented, FAS rejected U.S. exporters' offers to sell wheat to Algeria because it believed the prices submitted were too low. No U.S. sales were made at that time. One week later, the European Community sold 200,000 metric tons of wheat to Algeria.

It is difficult to determine whether the Community or the United States has been responsible for undercutting prices in particular cases, and both sides have accused the other of this practice. But clearly the EEP has had an impact on lowering commodity prices in certain targeted countries. For example, Egypt tendered for flour in late May 1986. One Community flour miller estimated that flour prices were approximately $170 per metric ton at this time. When FAS received the initial flour bids, ranging from $148 to $150 per metric ton, it rejected them for being too low. Shortly thereafter, FAS received information that the Community flour price had dropped to $147.50 per metric ton, thereby allowing FAS to establish a new minimum price. After FAS adjusted the minimum price accordingly, a U.S. sale was made on June 3 for $145 per metric ton. Both the United States and the Community claim that they did not initiate the price cuts but only responded to the other's action. As a result, flour prices dropped significantly within a few weeks.

Acquisition of CCC Stocks

As noted previously, exporters generally submit a sales price and a bonus request to FAS for approval, and the dollar value of the bonus is set at the time FAS approves the sales contract. However, successful bidders cannot actually receive their bonus awards until the EEP commodities have been exported. After Agriculture receives proof of export, the exporter may obtain bonus commodities up to the dollar value of the bonus award. The bonus commodities are priced at their current market value. Agriculture periodically issues catalogs listing quantity, quality, and location of available commodities from which exporters select their bonuses.

The procedures for acquiring bonus commodities have changed somewhat over the course of the program. Initially, exporters were required to select and reserve their commodities from the catalog within 30 days after FAS approved the sales contract. The quantity the exporter would later receive upon proof of export was therefore set when catalog selection was made. Often, the actual export occurs several months after the sales contract has been signed. For example, an exporter may have selected bonus commodities at a February market price but would not receive them until June, when the price would most likely be different. However, the number of bushels received remained constant. According to Agriculture, the 30-day period was established in order to value bonus commodities as close to the sales date as possible and to avoid any possible market manipulations or unfair market advantages by exporters. In addition, when the EEP began, each announcement specified the particular commodity that was to be provided as the bonus Wheat was the predominant bonus commodity to be provided through CCC stocks.

In June 1986, Agriculture began implementing new procedures under which the exporter must apply for a generic certificate equal to the dollar value of the bonus award within 30 days of export and should receive it within 10 days. The certificate is valid for 6 months and can be redeemed for any available CCC commodity at its current market value or sold for cash. The change in the system was made so that the EEP procedures would be similar to those of the domestic Payment-In-Kind (PIK) program which also uses generic certificates Exporters and Agriculture officials stated that similar generic certificates issued under the domestic PIK program sell for 102 to 110 percent of their face value. FAS officials have received unconfirmed reports that the certificates have been sold for as much as 130 percent of their face value

The exporters we contacted preferred the new generic certificate system over the old bonus selection process, because it allows them to choose a bonus from a greater variety of commodities. Also, because the exporters can resell the certificates, they are more liquid and hence more valuable than specific commodity awards.

At the time of our review, Agriculture had processed requests for bonuses on about 240 contracts. We examined 56 of these contracts and found that exporters generally had complied with the announcement and contract provisions and that Agriculture had accurately computed the bonus quantities. The CCC catalog prices we reviewed were in line with other published market prices. Generally, exporters believed that the CCC catalog prices fairly reflected market value, although they noted that each exporter may value certain commodities differently.

EEP May Not Be Budget Neutral

The EEP is designed to be budget neutral—that is, it should not increase government outlays. Government outlays can increase if an EEP sale results in more of a commodity being released from CCC stocks than is removed from the U.S. market by the increased exports. Any such extra commodities that are covered by price support programs will displace sales of newly harvested commodities, causing farmers to forfeit commodities in lieu of paying off their price support loans. The government will thus end up buying back at the loan rate sufficient new crop production to remove the excess bonus commodities from the market.

Whether a sale violates the budget neutrality condition depends on its "net additionality"—the amount of new exports that result from the EEP. The net or final additionality of an EEP-subsidized sale may be less than the full amount of the sale if (1) it displaces commercial U.S. sales to the recipient country or (2) the displaced competing exporter, e.g., the European Community, uses the commodity that would have been sold to displace U.S. sales in a third country. Net additionality is difficult to estimate accurately, and we do not have estimates that we view as reliable. Nevertheless, some analysts, including those at the Congressional Budget Office, expect net additionality to be sufficiently small so that the budgetary costs will be large. We identified some cases in which individual EEP sales will clearly result in higher government outlays.

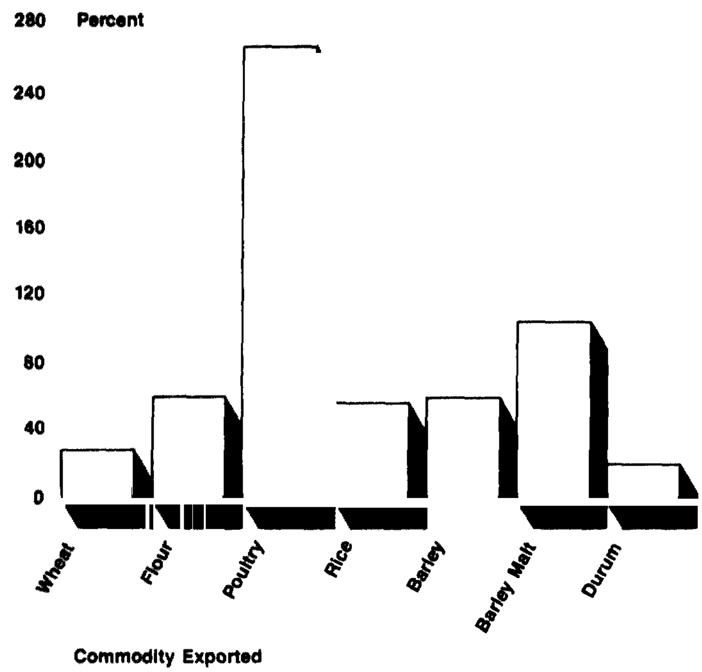
A few specific EEP-funded sales have released CCC commodities onto the domestic market which were greater than the commodity (or its equivalent) that was actually exported. For example, bonuses for EEP poultry exports released more soybeans and corn on the domestic market than were used in raising the exported chickens. 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 "free." For all poultry sales together, we estimated in our September 30 testimony that the value of the bonus was 266 percent of the value of the feed contained in the poultry exported. The cost of repurchasing the unexported corn and soybeans could have been as much as $23 million.

Dairy cattle also require very large subsidies, but they are a special case. Agriculture wants to export cattle to operate the dairy termination program with minimum disruption to domestic beef producers. Bonuses for the dairy cattle sales to date have totaled $8.6 million in the form of generic certificates. The 6,150 heifers consumed only about $0.6-million worth of U.S. corn before being exported. If the certificates are redeemed for corn, an amount equal to 93 percent of the bonus could be repurchased by CCC, incurring an $8.0 million additional budgetary outlay.

For poultry and dairy cattle, even if additionality is 100 percent—the most favorable case—unexported bonus commodities will be placed on the U.S. domestic market and will likely increase CCC expenditures. The flour, barley, and barley malt sales are also likely to be budgetarily expensive and of little aid to U.S. farmers.

Figure II.1 shows the bonus as a percentage of the EEP sale. Dairy cattle are not included since generic certificates were used, but if they were redeemed for corn at current prices, the bar would extend well off the page since the bonus was up to 15 times the amount of corn consumed in raising the exported cattle. For wheat flour, barley, and rice, the bonus was roughly 60 percent of the amount exported. If net additionality for these commodities was less than this percentage, the EEP program would likely result in budgetary outlays.

Figure II.1: EEP Bonus as Percentage of Exports



Note Amount of estimated bonus as a percent of amount of commodity exported, except for poultry where calculations are made in value terms One barley sale using generic certificates is not included

Source Agriculture EEP Summary Status Sheet, Sept 19, 1986, and GAO calculations

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. In a few of the proposals submitted to the interagency review group, Agriculture included explicit warnings that the bonus commodities released would be "over and above that necessary to produce the poultry" or that "wheat flour proposals which assume about a third overall additionality may have a negative impact on the CCC budget."

For the poultry and dairy cattle sales outlined above, poultry and dairy farmers may benefit but 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. To date, 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.

It should be noted that, subsequent to our September testimony, Agriculture decided to restrict future bonuses on dairy cattle sales. The ratio of the bonus amount to sales amount for dairy cattle sales was to be no greater than that ratio for wheat sales. We calculate the ratio for wheat sales as 25 percent in figure II.1.

Exporter Participation and Comments

As of December 4, 1986, 35 companies had been awarded contracts for commodities under the EEP. Cargill received 24 percent of the allotted bonuses, followed by Continental Grain with 11 percent, and Louis Dreyfus with 10 percent.

We spoke to five wheat/flour exporters regarding their views of the program's operation. These exporters, who had received 49 percent of the EEP bonus awards as of December 4, 1986, were generally satisfied with the EEP's operational procedures; they did express some concern regarding penalties imposed by FAS for shipping delays. According to EEP procedures, an exporter's bonus award may be subject to reexamination if the exporter fails to export the commodity by the date specified in the sales contract. Exporters have claimed that some delays are beyond their control and have appealed the penalty decisions. An FAS official stated that some penalties have been reduced accordingly, but none have been completely waived.

Use of Export Credit Guarantees

FAS has provided short-term export credit guarantees with some of the EEP initiatives. The credit program, known as GSM-102, allows countries to purchase U.S. commodities when credit guarantees are necessary to secure private financing. As of December 4, 1986, such credit guarantees had been made available in 14 of the 52 initiatives, 11 of which are for wheat and wheat flour. FAS officials noted that most countries which have GSM-102 available have used it for EEP purchases. FAS and exporters further noted that the credit guarantee has been extremely important in the EEP and that some EEP sales could not be made without it. To facilitate some sales, countries have received GSM-102 authorization shortly after being targeted under the EEP. For example, Senegal was targeted for wheat in July 1986 and credit was made available in August. On the other hand, an FAS official stated that Syria was not given GSM-102 and was therefore unable to purchase EEP wheat. (Due to export controls imposed on Syria by the President, the Syrian initiative was canceled in November 1986.)

Limited Impact on Wheat and Wheat Flour Exports

Through September 30, 1986, about half of the EEP initiatives and most of the sales involved either wheat or wheat flour. Not until April 1986 were other commodities targeted to any extent. Although there was a number of barley initiatives and sales during the last several months of fiscal year 1986, our analysis of the impact of the EEP in increasing exports was limited to wheat and wheat flour.

An exact measure of how much the EEP has increased U.S. exports of wheat and wheat flour worldwide or even to targeted markets is very difficult to determine because the declining value of the dollar and the lower loan rates following passage of the Food Security Act of 1985 also influence the competitiveness of U.S. agricultural exports. Both factors have been expected to increase the competitiveness of U S. agricultural products and result in higher U.S. exports. Notwithstanding these measurement difficulties, we attempted to assess the extent to which the EEP increased U.S exports.

During the 1986 crop year ending June 30, 1986, total world exports of wheat and wheat flour amounted to 86.6 mmt according to data of the International Wheat Council (IWC). As shown in table III. 1, this was a significant decrease from the 104 mmt of wheat exports for the 1985 crop year or the 99 mmt average wheat exports for the last 5 crop years.

Table III.1: World Trade in Wheat and Wheat Flour (July/June)

Figures in mmt

Exporter	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86
Argentina	3 9	4 3	7 5	9 6	8 0	6 1
Australia	11 1	11 4	8 5	11.6	15 1	16 2
Canada	17 0	17 8	21 1	21 2	19 1	17 1
European Community	12 7	14 0	14 1	14 9	17 1	15 0
United States	42 1	49 3	39 3	38.3	38 2	25 1
Subtotal	86 8	86 8	90 5	95.6	97 5	79 5
Other	7 2	4 0	5 5	4.7	6 5	7 1
Total	**94.0**	**100.7**	**96.1**	**100.3**	**104.0**	**86.6**

The decrease of 17.4 mmt in world wheat and wheat flour exports is about the same as the decrease in such exports to the Soviet Union alone Exports to the Soviet Union dropped from 28.1 mmt for the 1985 crop year to only 11.7 mmt for the 1986 crop year, a decrease of 16.4 mmt.

U.S. exports of wheat and wheat flour worldwide decreased from 38.2 mmt for the 1985 crop year to 25.1 mmt for the 1986 crop year, i.e., 75 percent of the 17.4 mmt decrease in total world exports. The U.S. share of world exports decreased from 36.7 to 29.0 percent. U.S. exports to the Soviet Union decreased even more dramatically, from 6.08 mmt for the 1985 crop year to only 0.15 mmt for the 1986 crop year, with the U.S. share decreasing from 22 percent to only 1 percent.

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. Table III.2 shows wheat exports for the 1985 and 1986 crop years to countries targeted under the EEP. The largest increase, according to Agriculture statistics, was for Algeria, but there were also increases in exports to Egypt, Turkey, Zaire, Jordan, and Yugoslavia. Although there were net decreases in wheat exports to some of the other countries targeted under the EEP, exports to these countries would likely have been even lower without the EEP. 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 even later. Consequently, there is a lag in the data and some increased exports will not be recorded until the following year.

Table III.2: U.S. Wheat Exports to Countries Targeted Under the EEP Through June 30, 1986

Figures in metric tons

Country	Date of initiative	Exports year ending 6/30/85	Exports year ending 6/30/86	Amount of change
Algeria	June 4, 1985 Apr 10, 1986	653,000	1,405,000	752,000
Egypt	July 26, 1985 Oct 30, 1985 June 24, 1986	1,420,000	1,630,000	210,000
Yemen	Sep 6, 1985	119,000	16,000	(103,000)
Morocco	Sep 30, 1985	1,376,000	1,011,000	(365,000)
Turkey	Oct 16, 1985 May 8, 1986	528,000	550,000	22,000
Zaire	Dec 27, 1985 May 15, 1986	109,000	122,000	13,000
Tunisia	Mar 18, 1986	589,000	61,000	(528,000)
Jordan	Mar 19, 1986 June 20, 1986	186,000	287,000	101,000
Benin	Apr 7, 1986	No exports specified		
Syria	Apr 8, 1986	120,000	0	(120,000)
Yugoslavia	Apr 10, 1986 June 24, 1986	0	41,000	41,000
Sri Lanka	May 16, 1986	226,000	201,000	(25,000)

Also on the plus side, U.S. wheat flour exports increased to all countries targeted for wheat flour, except Algeria.

Table III.3: U.S. Wheat Flour Exports to Countries Targeted Under the EEP Through June 30, 1986

Figures in metric tons

Country	Date of initiative	Exports year ending 6/30/85	Exports year ending 6/30/86	Amount of change
Egypt	July 2, 1985	603,000	652,000	49,000
Yemen	Aug 20, 1985 Apr 14, 1986	6,000	46,000	40,000
Philippines	Nov 15, 1985	6,000	76,000	70,000
Zaire	Nov 18, 1985 May 15, 1986	9,000	29,000	20,000
Iraq	Dec 9, 1985	0	54,000	54,000
Algeria	Feb 25, 1986	No exports specified		

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. Table III. 4 shows those countries not targeted under the EEP where U.S. wheat exports decreased by more than 100,000 metric tons from the 1985 to the 1986 crop year.

Table III.4: U.S. Wheat Exports to Countries Not Targeted Under the EEP Through June 30, 1986

Figures in metric tons

Country	Exports year ending 6/30/85	Exports year ending 6/30/86	Amount of decrease
Soviet Union	6,076,000	153,000	5,923,000
Brazil	3,070,000	735,000	2,335,000
China	2,440,000	541,000	1,899,000
Nigeria	1,632,000	731,000	901,000
Bangladesh	1,189,000	433,000	756,000
Iraq	852,000	397,000	455,000
Korea	2,107,000	1,760,000	347,000
Indonesia	577,000	255,000	322,000
Peru	458,000	189,000	269,000
Chile	652,000	462,000	190,000
Israel	597,000	443,000	154,000

It is generally believed that the decreases in U.S. wheat exports to these countries were due to price, quality, and lower demand resulting from increased production and/or limited availability of foreign currency. The decreases in U.S. exports to some countries, including the Soviet

Union, Brazil, and China, occurred in the context of their reduced imports overall. It should be noted that, although the European Community also saw a decrease in its wheat exports to the Soviet Union (from 6.1 to 4.3 mmt), its <u>share</u> of Soviet wheat imports increased from 22 to 37 percent. As the Community saw its exports displaced by the United States in countries targeted under the EEP, it became all the more important to maintain its volume of exports to the Soviet Union.

While other major exporters also saw the volume of their wheat exports to the Soviet Union decrease from the 1985 to the 1986 crop year, it is clear that the United States bore the brunt of the large decrease in Soviet wheat exports. According to IWC data, Soviet wheat and wheat flour purchasing patterns during the last 6 years were as shown in table III.5.

Table III.5: Market Share of Major Exporters of Wheat to the Soviet Union (July/June)

	1980-81		1981-82		1982-83		1983-84		1984-85		1985-86	
	(%)	mmt	(%)	mmt	(%)	mmt	(%)	mmt	(%)	mmt	(%)	mmt
Argentina	(19)	2 9	(16)	3 1	(21)	4 2	(17)	3 6	(14)	4 0	(6)	0 7
Australia	(17)	2 5	(12)	2 3	(5)	1 0	(7)	1 5	(7)	2 0	(24)	2 8
Canada	(30)	4 5	(25)	4 8	(34)	6 9	(28)	5 8	(27)	7 6	(28)	3 3
European Community	(5)	0 7	(9)	1 7	(17)	3 4	(21)	4 3	(22)	6 1	(37)	4 3
United States	(20)	3 0	(35)	6 9	(15)	3 0	(21)	4 3	(22)	6 1	(1)	0 2
Other	(9)	1 3	(4)	0 8	(8)	1 6	(5)	1 1	(8)	2.3	(4)	0 4
Tota		**14.9**		**19.6**		**20.1**		**20.6**		**28.1**		**11.7**

In summary, it appears that the impact of the EEP in increasing U.S. exports has been limited. Although exports to certain targeted markets have increased, the U.S. share of wheat exports to other countries, most notably the Soviet Union, has fallen off considerably.

Increased Likelihood of Successful Negotiations With European Community

One of the two stated objectives of the EEP was to encourage U.S. trading partners to begin serious negotiations on agricultural trade problems. The program was, in fact, aimed at the European Community, which directly subsidizes its agricultural exports; through such subsidization, the Community has been able to increase its market share while the U.S. market share has decreased. The Community's use of subsidies has allowed it to become the world's leading exporter of such commodities as wheat flour, sugar, beef, dairy products, and poultry.

The Community reaction to the EEP has been based in large measure on its long-term agricultural policies which support many small farmers. In 1980, the average farm size in the Community was 16 hectares compared with 160 hectares in the United States. Although the number of people employed in farming in the Community declined from 23.6 million in 1950 to 8.7 million in 1980, the decline has slowed in recent years.

When the Treaty of Rome established the European Economic Community in 1957, it set out the objectives of the Common Agricultural Policy (CAP). These included ensuring a fair standard of living for the agricultural community in particular by increasing the individual earnings of persons engaged in agriculture. CAP expenditures were $23 billion in 1985 and were expected to increase to $28 billion in 1986. They represent about two thirds of the Community's budget.

The key CAP mechanism to maintain farmers' income is price supports. Although differences exist among commodities, three basic strategies are used to maintain prices. First, levies and duties on imported commodities are high enough to ensure that they cannot be sold at a price less than the Community support level. Second, intervention buying is used to withdraw excess supplies from the market and strengthen prices. Third, to reduce surpluses, the Community grants export subsidies, known as export restitutions.

Community expenditures on agricultural export subsidies amounted to about $5.3 billion in 1985. Export subsidies have typically accounted for about 35 percent of the CAP annual budget.

Community Reaction to the EEP

The European Community's initial response to the Export Enhancement Program was a wait-and-see attitude, but it later made a determined effort to protect what it considered its markets by providing increased and country-specific restitutions. Also, Community officials criticized the EEP as an illegal subsidy program because it was targeted and, in its opinion, undercut world prices.

Community reaction at the announcement of the EEP in May 1985 was muted. However, on September 19, 1985, after the European Community Commissioner for Agriculture noted that EEP's first sale of 500,000 tons of wheat to Egypt was "at a much lower price than the usual practice," the restitutions for wheat to Algeria, Egypt, Morocco, Syria, and Tunisia were raised from about \$33 to \$44. A sale of 200,000 tons of French wheat to Algeria was made that same day. A week later, the Community raised for one day the export restitution for Algeria from about \$44 to \$63. This had the desired effect, as the Community sold 277,800 tons of wheat to Algeria the day the restitution was announced. The next day the Commission canceled the special restitution. In December 1986, a U.S. agricultural representative to the Community told us that it was making increased use of these special restitutions to counter the EEP.

The European Community's practice of competing in the marketplace with increased and special restitutions has continued throughout the program. In June 1986, the Community raised restitution amounts for barley exports to selected countries in the Middle East, leading to its sales of 210,000 tons of barley to Saudi Arabia, Algeria, Israel, and Jordan—all countries recently targeted for barley under the EEP. At the same time, restitution amounts were increased for Yugoslavia, Egypt, and other nearby destinations. Community officials told us that the export restitutions were increased to compete with the EEP.

Impact of EEP on Community Exports

According to IWC data, Community wheat and wheat flour exports to Middle East and North African markets which had been targeted under the EEP declined from the 1985 to the 1986 crop year, as shown in table IV.1.

Table IV.1: Community Wheat and Wheat Flour Exports to Countries Targeted Under the EEP Through June 30, 1986

Figures in metric tons

Country	Date of initiative	Exports year ending 6/30/85	6/30/86	Amount of change
Wheat:				
Algeria	June 4, 1985 Apr. 10, 1986	1,125,000	466,000	(659,000)
Egypt	July 26, 1985 Oct. 30, 1985 June 24, 1986	1,000	52,000	51,000
Yemen	Sep 6, 1985	0	0	0
Morocco	Sep 30, 1985	910,000	743,000	(167,000)
Turkey	Oct. 16, 1985 May 8, 1986	40,000	106,000	66,000
Tunisia	Mar 18, 1986	238,000	527,000	289 000
Jordan	Mar 19, 1986 June 20, 1986	3,000	12,000	9,000
Syria	Apr 8, 1986	519,000	342,000	(177,000)
Wheat flour:				
Egypt	July 2, 1985	1,636,000	1,284,000	(352,000)
Yemen	Aug 20, 1985 Apr 14, 1986	241,000	146,000	(95,000)
Iraq	Dec. 9, 1985	252,000	155,000	(97,000)
Algeria	Feb. 25, 1986	3,000	94,000	91,000

Source: International Wheat Council

European grain traders told us in April and May of 1986 that the EEP had reduced Community sales in the Mediterranean region. Some added, however, that the EEP would not recapture or increase sales in the long run. In April 1986, a report of the European Community Associations of Grain and Feed Traders noted a 1.4- million ton decline in the Community's soft wheat exports from the year ending March 20, 1985, to the following year. The report explained the decline as due to late buying by the Soviets, marked fluctuations of the dollar, and problems with competition in world markets. More specifically, the world competition was attributed to the EEP which, according to the report, caused the Community to lose "several potential export markets, in particular in the Mediterranean." The report went on to state that partly as a consequence of the sales decline in the Mediterranean, the Soviet Union had become one of the Community's most important customers.

European Community wheat and wheat flour exports decreased from 17.1 mmt for the 1985 crop year to 15.0 mmt for the 1986 crop year, according to IWC data. Total world exports, however, decreased from 104 mmt to 86.6 mmt during that period. It is not clear how much of the decrease in Community exports was due to the EEP. The 1987 crop year will be a better test than the previous year, since the EEP did not begin selling in a major way until well into the 1986 crop year.

EEP as an Inducement to Negotiations

European Community officials, permanent delegation officials to the Community from member nations, and trade and trade association officials have spoken of the Community's willingness, and even commitment, to match EEP in the marketplace. They generally indicated that the EEP has had a less significant financial impact on the Community than has the recent dollar decline or the loan rate decreases. It was noted that the Community's response of competing directly with the EEP through increased and country-specific restitutions or sales through intervention stocks is based on a long history of supporting a relatively large population of small farmers despite the surpluses that such policies have created.

Community officials argue that the EEP's aggressive, targeted nature has underscored the seriousness of the disagreement between the United States and the European Community with respect to subsidies. They contend that the EEP is not necessary, i.e., the decline in the value of the dollar and the new market loan rates have created more financial pressure without the antagonism generated by the EEP. Permanent delegation officials to the Community from France and the United Kingdom had a slightly different interpretation of the EEP's impact; they said that it had brought the United States and the Community closer to negotiations than they were a year ago but that the ill feeling created by the EEP would strengthen the Community's resolve to extract significant concessions from the United States for any concessions they accepted.

The permanent French representative to the Community told us that if the U.S. goal is to trade the EEP for export restitution, then the success of negotiations is not likely; all forms of agricultural subsidies, including U.S. deficiency payments, will need to be discussed. He reasoned that the reference to agriculture made in the May 1985 Tokyo economic summit communique, the first time agricultural trade had been discussed in a formal summit communique, reflected an important agreement among the signatories on the need to deal with the world agricultural situation. More specifically, the high costs of the farm programs of both the United States and the Community make negotiations in their mutual interests.

Although the EEP alone will not bring about successful negotiations, in combination with the other factors it should increase their likelihood. It is clear that the Community recognizes the overproduction problem and its cause and high cost. Overall, however, our discussions with Community, U.S., and foreign government and trade officials make clear that agricultural reform in the Community will be a long-term process.

In October 1985, after the United States announced its intent to file a complaint under the Subsidies Code of the General Agreement on Tariffs and Trade (GATT) against the European Community over its export restitution system, the Community announced its intention to file a counter-complaint on the EEP. In the announcement, the Community claimed that its subsidies had not undercut prices but the EEP had. Community officials noted that subsidies for agricultural exports are not illegal under the GATT and gave that as a partial explanation of the initially restrained reaction of the Community to the EEP. However, the Community's legal objections arise from the specific operation of the EEP, namely, that it is targeted and, according to the Community's claims, undercuts world prices. Because the program is targeted, it is aimed at capturing market shares and the Community considers this illegal under the GATT code. Also, subsidies are not supposed to undercut world prices; EEP prices, the Community claimed, were in some cases \$20 to \$25 below those necessary to make a sale. The U.S. Agricultural Counselor to the Community has said that any arguments against the EEP could also be used against the Community's restitution program. He added that the United States has never accepted as legal the Community's system of variable levies and duties and export subsidies but has never legally challenged it.

In March 1986, U.S. and Community representatives held informal consultations on their wheat trade dispute. The U.S. position was that in recent years it had taken steps to control production and the 1985 Food Security Act continued those efforts; the Community, by contrast, through its export restitution system had guaranteed farmers a market outlet and as a result had shifted over time from being a net grain importer to a net exporter. The Community countered by stating that pending agricultural reform measures, as outlined in an official document known as the "Green Paper," will have the effect of discouraging production; futhermore, export restitution levels have not undercut world prices but the EEP prices had. Community representatives took exception to the base year the United States chose for demonstrating the swing in Community grain production. U.S. officials questioned whether more than a minimal amount of crop area would be removed from production should the Common Agricultural Policy reform proposals be approved. As of January 1987, neither the United States nor the Community had taken formal action on the complaints and neither is likely to do so in light of agricultural trade issues being discussed in the current round of multilateral trade negotiations.

The ultimate impact of the EEP also 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 the United States sold heavily subsidized flour to Egypt European and U.S. officials have contended that this demonstrated U.S. unwillingness to seriously challenge Community agricultural export subsidies. The U.S. approach has been criticized by U.S. agricultural interests as inconsistent and lacking in follow-up commitment The 1983 Agreement resulted in several French flour mills being closed and the overall restructuring of the French flour industry. However, the gain in the U.S. share of the Egyptian wheat flour market proved to be temporary. Some observers believe that if the United States were to terminate the EEP, this would be viewed as yet another indication of the lack of U.S. political will to retaliate against unfair trading practices. Hence, they believe that abandoning such a program could adversely affect progress toward meaningful agricultural trade negotiations.

The recently completed GATT ministerial resulted in an agreement to launch the new "Uruguay round" of multilateral trade negotiations. Although agricultural trade was placed on the agenda, it does not yet appear that U.S. negotiators have won a formal mandate for "fast-track" agricultural talks, i.e., negotiations which are undertaken with the goal of reaching agreement in less than 2 years Although the accord contained a provision allowing for a speedup if the negotiators agree, there was no agreement in terms of rolling back or even freezing existing agricultural export subsidies. The Under Secretary of Agriculture for International Affairs and Commodity Programs told us that the agreement did not preclude continuation of the EEP and that the program, in fact, should continue to put further pressure on the Community to negotiate agricultural subsidy issues. He acknowledged that the conflict between the United States and the Community on agricultural export subsidies might intensify in the future. During the first 3 months of fiscal year 1987, the subsidy "war" between the United States and the Community has in fact intensified, as evidenced by increases in U.S. export bonuses and Community subsidy payments.

Adverse Impact on Non-Subsidizing Competitors

Many countries, including the United States, subsidize the production and/or export of their agricultural commodities in various ways. Nonetheless, the EEP in practice was targeted specifically at the European Community, which directly subsidizes its agricultural exports on an ongoing basis. Although it was for foreign policy reasons that the administration did not target the Soviet Union under the EEP until August 1986, the official reason given was that Argentina, Australia, and Canada were significant suppliers to that country and the United States did not wish to displace their exports.

Interestingly, after the program had been in effect for more than a year and farm interests were not satisfied with progress in increasing U.S. agricultural exports, the administration announced that the Soviet Union would be eligible to purchase almost 4 million metric tons of wheat under the EEP; the Presidential decision was made as an attempt to preclude congressional passage of legislation broadening the program. Officials of both the State and Defense Departments were adamantly opposed to opening the program up to the Soviets. Argentina, Australia, and Canada vigorously opposed the broadening of the program. Agriculture noted that non-subsidizing competitors should not be upset since the United States already had the Long Term Agreement with the Soviet Union which called for the Soviets buying at least 4 mmt of wheat per year.

In retrospect it appears that, although efforts were taken not to harm Argentina, Australia, or Canada, all may have been adversely affected as a result of the existence of the EEP. These countries would be hurt if the effect of the EEP was to lower either the volume of their exports or the prices they receive. The administration assured government officials of all three countries that the EEP would be implemented in a way so that they would be able to maintain their market shares in all those countries targeted under the program. These assurances were given repeatedly. And in fact, before announcing 10 of the 22 wheat and barley initiatives, U.S. officials obtained assurances from officials of the prospective importing governments that they would continue to import from non-subsidizing competitors in amounts at least as high as the highest levels in recent years. While the three countries were generally reassured during the early months the EEP was in operation, over time they became increasingly concerned with the broadening of the program and its overall related price impact. Their concerns became most vocal when the administration announced the Soviet initiative in August 1986.

Although EEP sales may have had a price-depressing effect on the exports of Argentina, Australia, and Canada, we found little evidence of EEP sales directly displacing the wheat sales of these three countries during the 1986 crop year. Table V.1 shows their wheat exports to markets targeted under the EEP. According to IWC data, Argentina's wheat exports decreased for Turkey and Jordan but increased for Zaire, Syria, and Sri Lanka. Moreover, while overall Argentine wheat and wheat flour exports decreased from 8.0 mmt in the 1985 crop year to 6.1 mmt in 1986, we were told that this was due in large part to decreased production resulting especially from flooding. Australia's wheat exports increased for Egypt, Yemen, Turkey, the Philippines, Jordan, and Sri Lanka. There were no decreases. Finally, Canada's wheat exports increased slightly for Algeria, Egypt, the Philippines, and Sri Lanka but decreased for Yemen by 0.1 mmt and for Syria by 0.5 mmt. It should be noted, however, that total Syrian imports decreased from 1.2 mmt to 0.6 mmt during this period and that the United States did not actually make any sales to Syria under the EEP initiative, which was cancelled in November 1986.

Table V.1: Argentine, Australian, and Canadian Wheat Exports to Countries Targeted Under EEP Through June 30, 1986

Figures in metric tons

Targeted country	Exporting country	Exports year ending 6/30/85	Exports year ending 6/30/86	Amount of change
Algeria	Argentina	(a)	(a)	(b)
	Australia	(a)	(a)	(b)
	Canada	472,000	487,000	15,000
Egypt	Argentina	(a)	(a)	(b)
	Australia	2,208,000	2,363,000	155,000
	Canada	444,000	469,000	25,000
Yemen	Argentina	(a)	(a)	(b)
	Australia	349,000	481,000	132,000
	Canada	108,000	(a)	108,000
Morocco	Argentina	(a)	(a)	(b)
	Australia	(a)	(a)	(b)
	Canada	(a)	(a)	(b)
Turkey	Argentina	324,000	249,000	(75,000)
	Australia	(a)	53,000	53,000
	Canada	(a)	(a)	(b)
Zaire	Argentina	(a)	11,000	11,000
	Australia	(a)	(a)	(b)
	Canada	(a)	(a)	(b)
Philippines	Argentina	(a)	(a)	(b)
	Australia	(a)	46,000	46,000
	Canada	(a)	21,000	21,000
Tunisia	Argentina	(a)	(a)	(b)
	Australia	(a)	(a)	(b)
	Canada	(a)	(a)	(b)
Jordan	Argentina	82,000	(a)	(82,000)
	Australia	92,000	110,000	18,000
	Canada	(a)	(a)	(b)
Benin	Argentina	(a)	(a)	(b)
	Australia	(a)	(a)	(b)
	Canada	(a)	(a)	(b)
Syria	Argentina	(a)	291,000	291,000
	Australia	(a)	(a)	(b)
	Canada	495,000	(a)	(495,000)
Yugoslavia	Argentina	(a)	(a)	(b)
	Australia	(a)	(a)	(b)
	Canada	(a)	(a)	(b)
Sri Lanka	Argentina	(a)	52,000	52,000
	Australia	152,000	221,000	69,000
	Canada	100,000	108,000	8,000

[a]Less than 500 mt according to IWC data

[b]Not applicable

With respect to wheat flour exports by Argentina, Australia, and Canada to markets targeted under the EEP, there was an increase of 3,000 metric tons of wheat flour by Australia to the Philippines from the 1985 to the 1986 crop year. During that same period, there was no change in Canada's exports of wheat flour to Yemen and a decrease of 6,000 metric tons to Egypt.

In conclusion, there is little evidence that the EEP was responsible for Argentina, Australia, or Canada losing market shares in crop year 1986. However, since the EEP did not begin selling in a major way until well into the 1986 crop year, lost market shares may not become evident until the 1987 crop year. In any case, the EEP is viewed by many as having had a price-depressing effect—both as initiatives were announced and as sales were made—which has adversely affected all exporters. In August 1986, the Prime Minister of Australia stated that "already the EEP will cost Australian farmers $360 million next year." He indicated that it was unlikely the United States would gain any significant market share, since the Community's subsidy mechanisms would match the U S. price as a matter of course. Non-subsidizers would have no option but to follow the price down.

A Canadian official noted that the price impact of the targeted program was much the same as that of an across-the-board program; it could not be confined to the targeted country Canadian officials noted that the EEP was not creating more demand but was lowering world prices. Since Canada exported approximately 80 percent of its wheat and the European Community about 20 percent, Canada was being hurt more than the Community. One example of the EEP lowering prices was the announcement of the barley initiative to Saudi Arabia. As a result of the announcement of this initiative, the trading value went down about $10 (from $72 to $62). One Canadian official noted that the EEP was creating realignments in world wheat trade, a view similar to those of some U.S. grain trade officials. He noted that the EEP was forcing traditional buyers to go to other markets

The officials of non-subsidizing competitor governments viewed the EEP as a departure from U.S. trade policy generally, or at least the stated U S. policy of free and open trade and opposition to export subsidies Australian and Canadian officials noted that although the United States has always had internal production subsidies, the EEP was the first program since the early 1970's under which the United States had provided direct export subsidies.

There was general consensus among the officials of all three countries that the EEP was not unlike the European Community's restitution program, especially in its effect of lowering world prices. One Australian official opined that with the EEP, the United States had legitimized the

Community restitution program. Officials of all three countries generally indicated that they shared the U.S. goal of bringing the Community to the negotiating table for agricultural trade issues; they also had suffered from the Community's restitution program which resulted in the Community becoming a major net exporter instead of importer of grain However, these officials generally stated their disapproval of the EEP as a suitable method for encouraging the Community to moderate its restitution program, with some alluding to a trade war between the United States and the Community from which all exporting nations would suffer.

It should be noted that Argentina, Australia, and Canada were 3 of 14 countries whose ministers and representatives met in Cairns, Australia, in August 1986 to consider the world agricultural crisis. Calling themselves "fair traders in agriculture," the group called for the removal of market access barriers, substantial reductions of agricultural subsidies, and the elimination of subsidies affecting agricultural trade. It should be noted that this group was influential in having agricultural trade placed on the agenda of the new "Uruguay Round" of multilateral trade negotiations.

Objectives, Scope, and Methodology

Our review of the EEP is the result of three separate requests from the Congress. In a June 4, 1985 letter, the Chairman of the Subcommittee on Administrative Practice and Procedure, Senate Committee on the Judiciary, asked us to analyze the newly announced program in the light of abuses that had occurred in export subsidy programs during the late 1960's and early 1970's. In a July 9, 1985 letter, Senator Tom Harkin asked us to determine whether the program was operable and, if so, whether Agriculture could manage it correctly and efficiently. In a September 30, 1985 letter, the Chairman of the Subcommittee on Department Operations, Research, and Foreign Agriculture, House Committee on Agriculture, asked us to review the operation of the program, considering the limited amount of activity to date.

The two primary objectives of our review were to assess the management of the EEP and its effectiveness in achieving its stated objectives—namely, to increase U.S. exports and to encourage the European Community to begin serious negotiations on agricultural trade problems. In addition, we sought to assess the impact of the EEP not only on the European Community but also on other major U.S. competitors. The impact of the EEP on such countries as Argentina, Australia, and Canada is significant in that the EEP was designed to do minimal harm to these countries, which were considered to be "non-subsidizing" competitors. We also assessed the design of the program as originally conceived and as changed because of the Food Security Act of 1985 and amendments to that Act.

To assess the design of the program, we interviewed representatives and reviewed documents of the various agencies on the Economic Policy Council (the Departments of Agriculture, State, and Treasury; Office of the U.S. Trade Representative; Office of Management and Budget; and Council of Economic Advisors). We met with representatives of the various groups who had lobbied for the export subsidy program and with members of the Agricultural Export Enhancement Advisory Group and also reviewed the transcripts of its August 1985 meeting and minutes of its October 1985 meeting.

To assess the management of the program, we interviewed program officials and reviewed pertinent documents at Agriculture and at other agencies participating in the interagency working group discussions concerning countries and commodities to be targeted. At Agriculture we analyzed the process for determining exporters to receive the bonus commodities. We assessed the methods by which minimum sales prices and maximum bonus amounts were determined and those by which exporters were provided with the bonus commodities by the Agricultural Stabilization and Conservation Service. Finally, we interviewed U.S. exporters who have participated in the program and officials of foreign governments and buying agencies in countries targeted under the program.

To assess the effectiveness of the program in increasing U.S. exports and encouraging the European Community to begin negotiations of agricultural trade problems, we interviewed officials of the U.S. government agencies noted above, U.S. grain exporters, officials of foreign governments (including competitors, targeted countries, and traditional customers not targeted under the program), and of the Organization of Economic Cooperation and Development and General Agreement on Tariffs and Trade. We reviewed export activity of the United States and its competitors since the inception of the program and assessed the extent to which the costs of the European Community subsidy program increased due to the EEP and other factors. From the inception of the EEP in June 1985 through September 30, 1986, about half of the initiatives and most of the sales involved either wheat or wheat flour, so our analysis of the impact of the EEP in increasing exports was limited to wheat and wheat flour. We relied primarily on data from the International Wheat Council as well as the Department of Agriculture.

To assess the impact of the EEP on non-subsidizing competitors, we interviewed officials of the Argentine, Australian, and Canadian governments and reviewed documents provided by them. We also met with U.S. government officials, primarily from the Departments of Agriculture and State and the Office of the U.S. Trade Representative.

Our work was performed in accordance with generally accepted government auditing standards.

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