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Status Report on GAO's Reviews of the Targeted Export Assistance Program, the Export Enhancement Program, and the GSM-102/103 Export Credit Guarantee Programs

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Before the
Committee on Agriculture, Nutrition, and Forestry
United States Senate

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Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss with you the status of our ongoing work on several programs administered by the Department of Agriculture's Foreign Agricultural Service (FAS): (1) the Targeted Export Assistance Program, (2) the Export Enhancement Program, and (3) the GSM-102/103 Export Credit Guarantee Programs. All of these programs have been part of the effort to increase U.S. agricultural exports. In the course of our work, we have identified program management problems which need to be addressed. The new leadership at the U.S. Department of Agriculture is taking a constructive approach to the management problems GAO identified and is in the process of taking responsive action. For example, it has developed proposed regulations for the Targeted Export Assistance Program and the Export Enhancement Program to make them more structured and open. It is also reviewing a proposed FAS reorganization to improve management of FAS operations. Despite these actions, problems still exist. I would now like to discuss in more detail the three above cited export programs.

THE TARGETED EXPORT ASSISTANCE PROGRAM

As requested by Congressman Schumer, we are reviewing the extent to which FAS has implemented the recommendations made in our May 1988 report on the Targeted Export Assistance (TEA) Program.

Since that time, FAS has taken steps to address some of our concerns, such as formalizing its application procedures, developing evaluation guidelines, and requiring that evaluation planning be incorporated in the activity plans. It also established an evaluation branch and charged it with responsibility for clarifying evaluation requirements and working with the commodity divisions in tracking evaluation results. In addition, FAS has drafted proposed regulations for the TEA program which are currently under OMB review.

Our current review has shown, however, that FAS still does not have an adequate system of internal controls to effectively manage this program. Guidelines for the program are not clearly understood by participants and several have expressed confusion, particularly in such areas as contracting out, authorized expenditures, contributions, and evaluation requirements. Minimal documentation exists on major program decisions, leaving FAS vulnerable to questions of accountability and fairness. There is little coordination of funding and activities between the Targeted Export Assistance and Cooperator Foreign Market Development programs, even though approximately half of the TEA participants also participate in the Cooperator program.

FAS exercises minimal oversight of the program. To date, the new evaluation section has done little to track and analyze evaluation results, and is not planning to evaluate the success of

TEA overall. Under the proposed reorganization, a new and expanded Office of Planning and Evaluation would be established.

Based on our work to date, we believe that there may be an opportunity for FAS to better utilize its resources and to improve the management of its market development programs. By combining the TEA and Cooperator programs, FAS would be in a better position to more effectively manage its programs and make more efficient use of its management resources. This is an issue we are currently pursuing.

THE EXPORT ENHANCEMENT PROGRAM

Our review of the Export Enhancement Program (EEP) is being conducted at the request of the Chairman, House Committee on Agriculture; Congressman Conte, the Ranking Minority member of the House Committee on Appropriations; and Congressman Schumer. It covers three major areas--EEP program activity, external effects, and administration.

On February 12, 1990, we issued a fact sheet which provides information on how the EEP operates and on the nature and extent of the program from its inception. This fact sheet includes data on the sales value of commodities sold and delivered under the program, benefits to U.S. exporters in the form of bonuses associated with these sales, countries importing commodities under the program; and exporters participating in the program. In addition, on February 7, 1990 we issued a letter report to the FAS Administrator on apparent program bonus overpayments. We are now in the process of finalizing a report on the changing role of the EEP, its effect on world agricultural trade, and the need for program operation and management improvements.

The EEP has contributed to increased U.S. agricultural exports, particularly wheat, in many countries, including the Soviet Union, China, and those in the Middle East. The extent of its contributions, however, is difficult if not impossible to quantify because of the many factors that influence exports.

Although in its early years the EEP increased the cost of subsidies for the European Community (EC), it has neither deterred the EC from using subsidies nor hurt its share of the world market. Nevertheless, we believe that the EEP has been instrumental in bringing the EC to the negotiating table, and should continue to be available as a U.S. trade policy tool until agreements are reached on agricultural subsidies.

The effects of EEP are being felt by other U.S. competitors, specifically Australia, Argentina, and Canada. While EEP was designed to challenge subsidizing competitor nations, particularly the European Community, the abovementioned countries have been adversely affected both in terms of lower prices for their commodities and in reduced market shares.

Administration of the EEP is a complex and cumbersome process. In response to issues we raised during recent House hearings and those addressed in the Department of Agriculture's Inspector General's report on the EEP (Audit Report No. 07099-18-Hy), FAS has been working to improve the program. For example, criteria for determining the overall program level and for selecting commodities and countries to target for EEP sales have been revised and were published in the Federal Register on November 27, 1989. In addition, FAS recently drafted proposed regulations dealing with EEP operations and is preparing written policies and guidelines to address some of the following problems:

-- EEP proposals have been processed through three separate divisions in FAS and filed in a variety of ways. FAS does not have a central point where proposal progress is documented and controlled from submittal to approval or rejection. A centralized tracking system would allow FAS to provide a full history and current status of any proposal when an inquiry is made.

-- Price and bonus calculations are not adequately documented; it is currently difficult to determine from available records whether bonus payments have been excessive.

-- FAS has established qualification requirements for exporters wishing to participate in EEP. However, FAS is not routinely verifying certain information provided by the exporters.

-- FAS has lacked the internal controls necessary to ensure that exporters do not get bonuses for shipments in excess of the amount stated in the contract agreement.

On February 6, 1990, the FAS Administrator testified before your Subcommittee on Domestic and Foreign Marketing and Product Promotion. His testimony highlighted recent program changes which address issues raised by GAO and the OIG. We intend to review these changes and the proposed regulations to evaluate the need for additional improvements.

The EEP remains an important trade policy tool because unilaterally abandoning it would weaken the U.S. negotiating position with the EC. In today's tighter wheat market, the EEP is appropriately being used more selectively. However, in light of continuing EC export subsidies, it is important to fund EEP at levels adequate to maintain the program's credibility as a trade policy tool. If market conditions change, the EEP could again be used aggressively, potentially increasing the cost of the EC's subsidy program and applying pressure on others to negotiate.

GSM-102/103 EXPORT CREDIT GUARANTEE PROGRAMS

Our current review of the GSM-102/103 Export Credit Guarantee Programs was requested by the Chairman, Subcommittee on Tobacco and Peanuts, House Committee on Agriculture. On numerous occasions during the past two years, we have reported on the Commodity Credit Corporation's (CCC) Export Credit Guarantee Programs, referred to as GSM-102 and GSM-103. Each time we discussed the need for improved program management. Today I am pleased to say that FAS officials have taken some action on our concerns. However, we believe more needs to be done.

FAS officials are now more accurately accounting for outstanding guarantees, and they are reviewing participants compliance with program regulations. Other ways to improve the management of the program could include physically verifying that only U.S. agricultural products are being exported, taking suspension or debarment actions against participants violating program regulations, better defining commodities that are eligible for program coverage, and improving the timely handling of revisions to GSM documents when requested by program participants.

When we testified on the GSM programs last November, before House Agriculture Subcommittees, we noted that a major participating financial institution was embroiled in controversy over its unauthorized loans to Iraq. Repayment of many of the unauthorized loans is guaranteed by CCC under the GSM programs. In light of the circumstances surrounding the controversy, we believe that FAS may want to examine the loan exposure of individual financial institutions participating in the programs and assess the potential impact on CCC's guarantee liability. In response to a request by the Subcommittee on Criminal Justice, House Committee on the Judiciary, we will be reviewing this issue.

In your letter you specifically asked us to comment on the issue of a loan loss reserve for the CCC. As we have reported in recent years, our opinion on the financial statements of CCC is qualified because CCC has not established in its financial statements an allowance for the uncollectible portion of outstanding loans to countries experiencing financial difficulties. We estimate that cumulative losses on such loans as of September 30, 1988, range from $5.6 billion to $8.8 billion on loans outstanding of $16 billion. Also, we estimate additional cumulative losses of $2.3 billion to $3.5 billion on guarantees of outstanding loans to foreign countries amounting to $6 billion. Our understanding is that CCC is considering including an allowance for these losses in its fiscal year 1989 financial statements. In addition, the Department of Agriculture is considering recognizing the loss in its consolidated annual report for 1988 due out this spring.

The situation of the CCC with respect to loans and loan guarantees to foreign countries is analogous to the situation of the U.S. Export-Import Bank which makes direct loans and provides loan guarantees to foreign purchasers of U.S. exports. For a number of years GAO issued adverse opinions on the financial statements of the Export-Import Bank because the bank had not created a loan loss reserve. Last month the Export-Import Bank corrected this problem when it established a $4.8 billion reserve to cover possible losses on 40 percent of its outstanding loans and loan guarantees.

Mr. Chairman, this concludes my statement. More detailed information on the three programs is contained in the attached appendices. I will be happy to answer any questions you may have.

THE TARGETED EXPORT ASSISTANCE PROGRAM

Our review of the TEA program, requested by Congressman Schumer, examines the extent to which FAS has implemented the recommendations made in our May 1988[1] report. The TEA program was mandated by the Food Security Act of 1985 to counter or offset the adverse effects of foreign competitors' unfair trade practices and thereby increase U.S. agricultural exports. Since the legislation did not specify how this program should be carried out, the Foreign Agricultural Service (FAS) decided to establish a market development assistance program similar to that of the Cooperator Market Development Program, for commodities and products adversely affected by unfair trade practices.

This program is now in its fifth and final year of funding. In each year of the program, the total authorized amount was allocated. For fiscal years 1986 through 1988, the annual allocations amounted to $110 million, and for 1989 and 1990, they amounted to $200 million. Approximately 46 not-for-profit agricultural organizations have participated in each year of the program and more than 200 for-profit private firms have received benefits under the program each year.

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[1]Review of Targeted Export Assistance Program (GAO/NSIAD-88-183).

Over 50 percent of TEA funds for fiscal year 1989 were spent in Asian markets, with promotions in Japan alone accounting for 35 percent of TEA funds. European countries were the next largest targeted markets, with promotions in the United Kingdom accounting for over 12 percent of TEA funds. In each year of the program, the top 15 commodity organizations, ranked by amount of TEA funds received, accounted for over 60 percent of TEA funds. For fiscal year 1989, the branded portion of the TEA program, in which activities are aimed at establishing consumer loyalty to a particular brand, accounted for approximately 35 percent of the TEA allocation. The generic portion of the program, in which activities are designed to increase the total market for that commodity with no particular brand being promoted, accounted for the remainder.

TEA Program Administration Lacks Sufficient Management Control and Accountability

In our May 1988 report on TEA, we made several recommendations relating to management control and accountability. In the follow-up review which we are now concluding, we examined the extent to which FAS has implemented our recommendations. FAS has made some improvements in program administration; however, we remain concerned that FAS does not yet have an adequate system of internal controls and is not exercising sufficient oversight of the program.

Inadequate documentation

FAS has not been sufficiently documenting program decisions. As we noted in the May 1988 report, FAS was not documenting the funding allocation decision process to clearly show how the funding criteria were applied and prioritized and the basis for those decisions.

Our current review indicates that FAS continues to make major funding decisions based on limited written information and relies on its marketing specialists to verbally explain the suitability of the applicants, the rationale for the recommended funding amounts, and other major program decisions. The marketing specialists are primarily responsible for reviewing the applications to the TEA program and writing summaries on each application. These summaries, which average four pages in length, include a brief discussion of what the applicant proposes to do with the requested funding amount. These summaries are then forwarded, with a recommendation from the Assistant Administrator for Commodity and Marketing Programs, through the Administrator, FAS, to the Undersecretary for International Affairs and Commodity Programs for final approval. We have been told by FAS officials that these summaries are the main source of documentation for their TEA allocation decisions.

A review of all TEA summaries for funding for fiscal years 1989 and 1990 provides little insight on how FAS applies and prioritizes the criteria. We recognize that the decisions are based not only on the application criteria but also on such factors as balancing the needs of all commodity division requests. FAS officials told us that they do not have time to fully document program decisions. We believe that such documentation is essential to ensure accountability and fairness. As currently written, the summaries do not address the importance of the various criteria to funding decisions. For example, some participants that lack prior market development experience were denied participation in the program while others with a similar lack of experience received TEA funds. This is not to suggest that only those with experience should receive TEA funds, but that sufficient rationale should be provided for approving or denying participation and to explain variations in funding amounts approved. Other criteria which are mentioned most often but the importance of which seems to vary depending on the applicant are (1) the administrative capability of the organization to carry out the program, (2) the amount of damage suffered from unfair trade practices, (3) the extent to which the organization represents U.S. agricultural product interests, and (4) whether the commodity or product is in adequate supply.

The TEA summaries were improved for fiscal year 1990 by incorporating, on a more consistent basis, information on evaluation results and findings from the FAS Compliance Review Office. However, not all summaries included this information and we do not know whether there were no evaluation results or findings from the Compliance Review Office or whether they were not significant enough to be included in the decisions. Since FAS officials told us that these summaries are the main source of documentation for the funding allocation decision process, we believe that sufficient information should be included to enable an objective observer to understand how the process works and why decisions are made.

These summaries do not include information on funding received through the Cooperator program. Approximately half of the 46 not-for-profit TEA participants also receive funding through the Cooperator program and we saw little coordination between the two programs. Also, for fiscal year 1990, the TEA summaries do not include information on past allocations, approved budgets, expenses, and contribution amounts for each participant. While this information may be discussed in closed door meetings with the Assistant Administrator, we believe that it should be included in the summaries to ensure that the histories of the applicants are apparent.

Documentation is an essential part of an adequate system of internal controls. We believe that better documentation of the funding process and of other major program decisions is needed to improve accountability.

Participant contributions

We continue to be concerned that FAS is not requiring participant contributions and is not documenting the rationale for the amount and type of contributions participants are encouraged to provide to the program. Contributions may be in the form of cash or goods and services and may come from a third party as well as from the TEA participant. FAS officials continue to stress that contributions are not legislatively required and that a uniform standard cannot be applied to TEA participants, since their ability to contribute varies. We believe that since FAS is providing significant funding to the participants, FAS officials should explain in writing how they determine contribution amounts for each participant.

FAS officials told us that they are trying to establish a greater degree of consistency in setting contribution amounts without limiting participation; however, these rates continue to vary substantially. Several FAS officials told us that beginning with fiscal year 1989, FAS policy for the generic portion of the TEA program was that all TEA participants should contribute at least 5 percent in cash. However, there are no formal guidelines on this. In the branded portion of TEA, reimbursement rates vary among commodities. While FAS officials have said that they are attempting to establish a 50-percent reimbursement rate for all private firms promoting their own labels, some firms in practice are receiving a preferential reimbursement rate and FAS has yet to provide a suitable explanation for the disparate treatment.

TEA guidelines

During the first 3 years of the program, changes in the guidelines and updates on program operations were primarily communicated to the TEA participants through the Planning, Review, and Operations Committee (PROC) of the U.S. Agricultural Export Development Council. We criticized FAS' use of this committee in our May 1988 report because it did not include all TEA participants. The Council has since disbanded this committee and no alternative formal mechanism for communicating with participants has been established.

Agriculture's OIG, the Office of Management and Budget, and GAO had concluded that FAS should change the TEA guidelines to regulations. We believe that this would be a step toward improving program administration. FAS officials in the past had told us that they did not believe that regulations should be established because flexibility is necessary when managing a market development program. However, GAO maintains that establishing regulations in place of the guidelines would eliminate much of the participants' confusion which is caused by changes made with little notice and by the differing guideline interpretations offered by program specialists. The establishment of regulations would improve communications between FAS and the participants by providing an opportunity for public comment.

Currently, FAS has considerable discretion in the operation of its market development programs. Formal regulations, requiring FAS to evaluate all comments, along with adequate documentation of program decisions, could counter the perception that some commodity organizations are favored over others. Because some commodity organizations have had long-term relationships with FAS and because of the increased funding provided in FAS programs, FAS needs to avoid even the perception of favoritism.

Because of these reasons and other concerns about program management raised by GAO and OIG, FAS has drafted proposed regulations for the TEA program and has submitted them to OMB for review.

FAS Efforts to Evaluate the TEA Program

Our May 1988 report pointed out that (1) FAS was not uniformly requiring participants to evaluate their activities, (2) the TEA guidelines provided no guidance on how to make evaluations, and (3) FAS was not systematically tracking and using evaluation results.

Subsequently FAS established evaluation guidelines, effective for fiscal year 1989. To indicate its commitment to evaluating market development activities, FAS has been delaying approval of participants' activity plans until those plans include an explanation of how the participants will measure the effectiveness of their activities. While the new guidelines indicate types of evaluations and who is responsible for conducting them, they are not specific enough to prevent confusion among many participants. FAS application of the evaluation guidelines does not appear to be consistent. For example, some participants must submit quarterly evaluations while others are required to submit them only once a year.

In August 1988, FAS established an evaluation branch within the Marketing Programs Division. This branch was over a year old before it was fully staffed with 6 professional positions. FAS established this branch to oversee program evaluation of the TEA and Cooperator programs. While it did establish general evaluation guidelines, this branch has done little to track and analyze evaluation results. This branch has no substantial coordinating or enforcing role with respect to the evaluation requirements, and there is no indication that it is planning to evaluate the success of the TEA program overall.

The Department of Agriculture is reviewing a proposed FAS reorganization which would include establishing a new office for planning and evaluation within the Marketing Programs Division. We believe such an office should take the lead in clarifying evaluation requirements, monitoring compliance with such requirements, analyzing the results of all participant evaluations, conducting evaluations of the overall success of the program, and doing cross-commodity and other types of analyses. This office should provide guidance to both the commodity divisions and the participants on using evaluations as an oversight and management tool. By continuously analyzing the impact of the TEA and Cooperator programs in the various markets, FAS may be in a better position to alter program direction to reflect current market conditions.

FAS continues to rely too heavily on an increase in exports as proof that the TEA program is a success. While some level of increased exports would be expected as a result of a large infusion of resources into a targeted market, a simple increase in exports--which can be caused by a large number of other variables--is not sufficient proof of the success of the program.

Combine the TEA and Cooperator Programs

One way for FAS to improve the management of its market development programs could be to combine the TEA and Cooperator programs. Combining the two programs would probably be a more efficient use of FAS resources. Marketing specialists and other FAS officials presently spend their time dealing with the two programs separately since they operate under different deadlines. Little coordination exists between the two programs. When TEA funding levels are being discussed, there is no documentation on Cooperator funding received by the applicant or on the applicant's performance in the Cooperator program. FAS officials said that their staff is so busy with day to day operational and administrative issues that they have little time for documentation. Combining the two programs, or possibly establishing a new program to replace them, may help to overcome such inherent problems.

A combined TEA and Cooperator program would be able to maintain the same types of activities (consumer promotion, technical assistance, and trade servicing) but would continue to tailor them to the commodity or product being promoted. Such a combined program could provide more complete and accurate information to management concerning the scope of market development activities worldwide.

Finally, combining both programs could help prevent duplication of effort, if all activities were under one program with one set of criteria. This, coupled with other corrective action on the part of FAS concerning management oversight, would inevitably lead to a more efficiently managed and more effective program.

Before the two programs could be combined, the following issues would need to be considered:

-- The merits of using generic and/or branded promotion and the percent of total funds that should be allocated to each type.

-- The amount of emphasis to place on exports representing high value products and/or bulk commodities.

-- The priority for providing funds for new market development and/or maintaining established markets.

-- The merits of allowing large, well established private firms to participate and/or focusing resources more on helping small, new-to-market firms establish a foothold in the market.

-- The appropriate balance in the program between compensation for unfair trade practices and market development.

-- The establishment of criteria for the amount of time that participants could remain in the program before they would be expected to maintain their market presence on their own.

THE EXPORT ENHANCEMENT PROGRAM

Our current review is being conducted at the request of the Chairman, House Committee on Agriculture; Congressman Conte, the Ranking Minority member of the House Committee on Appropriations; and Congressman Schumer. It updates and expands upon the issues addressed in our March 1987 report[2].

Since 1987, conditions under which the EEP operates have changed considerably. The number of targeted countries has increased from 40 to 65. Total EEP sales have risen from $1.3 billion to over $9 billion as of February 8, 1990, and the market value of EEP bonus awards has grown from $868 million to over $2.7 billion. Last year, the world supply of wheat became relatively tight due to adverse weather conditions and decisions by some producing countries to reduce production. World prices for wheat have risen as a result. The U.S. government is now using EEP more selectively, and it continues to emphasize the program's importance as a trade negotiating tool.

Preliminary findings resulting from our EEP review were presented in our July 31, 1989 testimony before the Subcommittee on

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[2] Implementation of the Agricultural Export Enhancement Program (GAO/NSIAD-87-74BR).

Wheat, Soybeans, and Feed Grains, House Committee on Agriculture. In September 1989, the Department of Agriculture's Office of Inspector General (OIG) issued a report[3] which contained information on EEP's administration and offered recommendations for strengthening program effectiveness. On November 16, 1989, we testified again on our EEP work to date before the Subcommittees on Department Operations, Research and Foreign Agriculture; Tobacco and Peanuts; and Wheat, Soybeans, and Feed Grains, House Committee on Agriculture.

On February 7, 1990 we issued a letter report[4] to the FAS Administrator on apparent program bonus overpayments resulting from weaknesses in internal controls over the bonus payment process. In addition, on February 12, 1990 we issued a fact sheet[5] containing information on activity under the program from May 1985 through February 28, 1989, which represents the majority of activity under the program to date. At that time, total EEP sales were valued at $6.8 billion, of which wheat represented over 80 percent. Five countries--the Soviet Union, China, Algeria, Egypt, and Morocco--had bought approximately 1.4 billion bushels of wheat under the

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[3]Audit of the Foreign Agricultural Service Export Enhancement Program, Audit Report No. 07099-18 Hy.

[4]INTERNATIONAL TRADE: Export Enhancement Program Bonus Overpayments, (GAO/NSIAD-90-83).

[5]INTERNATIONAL TRADE: Activity Under the Export Enhancement Program, (GAO/NSIAD-90-59FS).

program, about 74 percent of the 1.9 billion bushels sold. The remaining EEP commodity sales were in wheat flour, barley, barley malt, semolina, rice, vegetable oil, sorghum, frozen poultry, table eggs, poultry feed, and dairy cattle. Seventy-three exporters had received over $2.6 billion worth of surplus U.S. agricultural commodities as bonuses. Four exporters--Cargill, Continental, Louis Dreyfus, and Artfer--had each received over $100 million in bonuses (60 percent of all bonus awards); Cargill and Continental each received over $400 million in bonuses.

In response to concerns raised by GAO and OIG, FAS has been working to improve the program. For example, criteria for determining the overall program level and for selecting commodities and countries to target for EEP sales have been revised and were published in the Federal Register on November 27, 1989. In addition, FAS recently drafted proposed regulations dealing with EEP operations and is preparing written policies and guidelines to address some of the identified problems. We are now in the process of finalizing a report on the changing role of the EEP, its effect on world agricultural trade, and the need for program operation and management improvements. As part of this effort, we intend to review the proposed regulations and program changes.

EEP's Impact on U.S. Agricultural Exports

In the last several years, U.S. agricultural exports have increased significantly. However, as we previously reported it is difficult to determine exactly how much of these increases were due to EEP. EEP's effect cannot be easily isolated from that of other policy and economic variables which have contributed to increased agricultural exports--lower loan rates, availability of export financing and other U.S. government assistance, depreciation of the U.S. dollar against major competitor currencies, production shortfalls, and other changes in global economic conditions. Recent studies estimate that U.S. agricultural exports have increased due to EEP, but they differ on the magnitude. The additionality estimates range from 2 to 30 percent and are greatly influenced by the assumptions made and the time period covered.

Furthermore, the fact that the EEP is "targeted" adds more complications in determining its effect. While exports may increase in the targeted markets, the overall effect on U.S. exports worldwide is uncertain. Competing suppliers may respond by displacing potential U.S. sales in untargeted markets. In addition, as the OIG concluded, non-targeted countries may have reduced their U.S. purchases, thereby creating the need to target those countries to regain lost market shares.

EEP does appear to have been critical to making sales in certain markets, such as wheat sales to the Soviet Union and China. During periods of surplus supplies on the world market, these importing countries took advantage of competition among exporters to obtain the best possible price and terms. Without EEP to make U.S. exports competitively priced, it is highly unlikely that these sales would have taken place. In addition, officials in Algeria, Egypt, Jordan, and Iraq told us that EEP was essential to enable U.S. exporters to make sales because these countries are "price buyers" (i.e. they buy at the best price available regardless of the source). They also noted that many EEP sales depended on the availability of U.S. export credit guarantees.

Changes in EEP Targeting Strategies

The EEP was designed to be targeted and discretionary rather than an across-the-board program. Proposals for EEP subsidies were to "target a specific market to challenge only the competitors who overtly subsidize their exports," namely the European Community (EC). Originally, the EEP's primary targets were countries that made significant purchases of subsidized EC exports. However, over time the program expanded to include countries that had a small EC market presence and then to countries where the EC was only contemplating a presence. As the

EEP displaced the EC in one market, the EC turned to another country's market, making that country eligible for EEP benefits as well. The EEP grew to 65 targeted countries in 4 years.

Perhaps the most controversial aspects of the EEP targeting strategy were the administration's decisions regarding the Soviet Union. That country was initially excluded from the program despite the fact that the EC's share of the Soviet wheat market rose from 5 to 22 percent from the 1981 to the 1985 crop year. Agriculture initially claimed that 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. The Soviet Union had been excluded from the program until August 1, 1986, for foreign policy reasons. It was then made eligible for EEP sales and has since become the largest importer under the program.

Impact of EEP on Competitors

During our review, Australian and Canadian officials told us that their countries have been adversely affected by EEP, both in terms of lower prices for their commodities and reduced market shares. Moreover, the OIG found that while the EC's wheat market shares have generally increased since the EEP's inception, those of

Australia, Argentina, and Canada have decreased. While the OIG noted that the decreased market shares could be the result of lower wheat supplies, it cautioned that the continuation of EEP could adversely affect these countries' exports should their production increase.

Australia

Australia has been most vocal in its opposition to the EEP, stating that EEP has adversely affected its wheat exports. While Australian government and farm industry representatives and U.S. Agriculture officials agree that EEP contributed to the depression of world wheat prices between 1985 and 1988 and, consequently, to the reduction in Australian wheat export earnings, there is no consensus on the extent of EEP's effect.

According to a recently released Australian study,[6] the EEP has cost Australian wheat growers between $150 million and $238 million, due to reduced average prices on wheat exports and a consequential decline in wheat production. The study points out that in 1987 the estimated cost to the Australian wheat industry was far greater than to the EC's, because exports to EEP-targeted

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[6] U.S. Grain Policies and the World Market, Policy Monograph No. 4, Australian Bureau of Agricultural and Resource Economics, released in October 1989.

markets constituted a far larger proportion of Australia's total production.

Australian officials told us that the decline in export prices encouraged producers to move out of wheat production; plantings fell from about 12 million hectares in 1984/1985 to about 9 million hectares in 1988/1989. Australian resources previously employed in grain production flowed into the livestock sector and into alternative crops, such as legumes. They acknowledged that the EEP is only one of a number of factors contributing to the decline in Australian wheat export earnings. However, in their opinion the EEP has clearly had a significant adverse impact on Australian agricultural exports.

U.S. Agriculture officials stated that the EEP's effects on wheat prices were minimal to begin with and were mitigated by the Australian government's guaranteed price mechanism and devaluation of the Australian dollar in 1985. They attribute recent declines in Australian wheat production to historically high wool prices during the mid-1980s, which lured farmers out of wheat and into wool production.

Canada

Canadian officials could not demonstrate a loss in market share directly related to EEP; instead they criticized EEP's price depressing effect and the resultant decreased revenue from agricultural exports. They also complained that EEP's targeting strategy was inconsistent and questioned its continued use for commodities which were in short supply. For example, the officials noted that Canada, not the EC, had established major wheat markets in Iraq, Colombia, Mexico, and the Philippines, yet they were all targeted under EEP. In addition, Saudi Arabia was a large importer of barley from many sources, not just the EC. When an EEP initiative for barley was announced, the whole balance of the barley trade was upset.

Canadian officials also questioned EEP wheat sales during the last 2 years when supplies were greatly reduced due to worldwide drought conditions. In their view, the United States was the "only game in town," yet it sold EEP wheat to China and the Soviet Union, the largest importers of wheat in the world. Canadian officials viewed the use of EEP as "overkill" in these cases.

Despite the perceived negative effects of the EEP on export strategies, world price, and the balance of trade, Canada has derived some indirect benefits. In the last year, Canadian exports of rapeseed oil, or canola, have become very competitive in U.S. markets partly because of high U.S. domestic vegetable oil prices driven up (or artificially supported) by EEP. According to Canadian officials, annual sales of vegetable oil to the United States have increased sixfold. In addition, U.S. livestock growers have been paying higher feed grain prices, driving up the cost of U.S. meat products. As a result, Canadian pork products are more competitive in the U.S. domestic market.

Program Operations and Management

We recognize the difficulty in administering a program as complex as the EEP, as evidenced by the number of procedures required to manage program operations. We reviewed these procedures and found problems in four major areas: (1) the proposal process, (2) price and bonus setting, (3) exporter qualification, and (4) the bonus payment process.

Proposal process

FAS processes each EEP targeting proposal through one of three different divisions depending on the commodity. Once these divisions have analyzed a proposal it is sent to FAS management for review, and then to Agriculture's Under Secretary for International Affairs and Commodity Programs. Should the Under Secretary approve the proposal, it is sent through an interagency approval process and, if accepted, announced to exporters.

We found that while each commodity division tracks its own proposals, FAS has not centrally track the progress of these proposals from the moment they are received to the time they are either accepted or rejected. Although some documentation exists which discusses reasons for a proposal's acceptance or rejection, the proposal's origin and the time that it takes to move within the process cannot always be determined. We believe that FAS should establish a centralized tracking system which will document the progress of all proposals from the time they are submitted until the time they are accepted or rejected. This system should allow FAS to provide the full history and current status of any proposal when an inquiry is made.

Setting price and bonus levels

Our ongoing review indicates that FAS does not sufficiently document the specific figures used to calculate the final price and bonus levels. In addition, the OIG reported that FAS "did not have written policies and procedures for, or sufficient documentation to support, world price determinations and bonus calculations." As a result, it is difficult for an independent reviewer to determine whether bonus payments are excessive.

FAS gathers information from a variety of sources to use in calculating price and bonus levels. We interviewed a number of individuals who provide EC price and world freight information and we reviewed documents they sent to FAS. We believe that FAS program officials receive the information necessary to make informed and effective price and bonus decisions; however, they do not document adjustments made to this information when calculating price and bonus levels. Although FAS officials prepare price sheets which list each of the figures used in price and bonus calculations, they do not provide either narrative or statistical support to explain how they arrived at these figures.

The FAS Administrator, in his February 6, 1990 testimony, stated that FAS has developed written policies and guidelines to calculate bonuses. Under these guidelines, any adjustments made to price quotes must be documented. We intend to review these policies and guidelines and evaluate whether they adequately address the problem.

Exporter qualification requirements

FAS has established certain qualification requirements for exporters wishing to participate in EEP. For example, exporters are required to have sales contracts with importers prior to submitting bids on EEP sales. However, prior to July 1988, FAS had not been requiring exporters to submit evidence of sales contracts. Beginning in July 1988, FAS required such proof prior to bidding only on EEP dairy cattle sales. The recent OIG report recommended that FAS define minimum requirements for a properly executed sales contract and extend the requirement for proof to all EEP commodities. In December 1989, FAS clarified the definition of a properly executed sales contract, but did not extend the requirement of proof to sales of the other eleven commodities because FAS contends that it would cause serious delay in the review and award of bonuses and would greatly tax existing staff resources.

We believe that requiring exporters to document the existence of sales contracts prior to submitting bids represents a sound control mechanism. In addition, we believe that FAS should randomly verify that the sales contracts are valid.

Bonus payment procedures

Our review of EEP indicated that internal controls over the bonus payment process were not adequate to ensure that bonus payments were properly made. During our review, we examined contract files kept by the Agricultural Stabilization and Conservation Service (ASCS) in Kansas City. We also obtained and examined a copy of the data base jointly developed by FAS and ASCS which contains contract and payment information and is maintained by ASCS in Kansas City. We found cases where exporters had apparently received overpayments. These overpayments were made because FAS did not have procedures set up to identify and verify when an exporter had received the maximum bonus amount allowed under the contract. We recommended that FAS develop sufficient internal controls over the bonus payment process to safeguard against future overpayments.

The Future of EEP

In today's tighter wheat market, we believe that EEP is appropriately being used more selectively. It remains an important trade policy tool if for no other reason than that unilaterally abandoning it would weaken the U.S. negotiating position with the EC. However, because of large, continuing EC export subsidies, funding EEP at adequate levels is important to maintaining the program's credibility as a trade policy tool. If market conditions change, EEP could again be used aggressively, potentially increasing the cost of the EC's subsidy program and applying pressure to negotiate.

GSM-102/103 EXPORT CREDIT GUARANTEE PROGRAMS

We are currently conducting a review at the request of the Chairman, Subcommittee on Tobacco and Peanuts, House Committee on Agriculture, of the Commodity Credit Corporation's (CCC) GSM-102 and 103 Export Credit Guarantee Programs. These programs are intended to maintain or increase U.S. agricultural commodity exports by guaranteeing exporters or their assignees that they will be repaid for credit sales made to purchasers in foreign countries. Should a foreign buyer default, CCC will make good on the payment and then try to recoup the loss from the foreign buyer.

The two CCC programs are administered by the Foreign Agricultural Service (FAS). In June 1988, we issued a report[7] on these programs in which we concluded that FAS was not adequately managing them. More specifically, we stated that CCC had not adequately (1) accounted for outstanding guarantees, (2) ensured that guarantees were being used for U.S. agricultural commodities, and (3) provided guidance to program users. We recommended that the Secretary of Agriculture direct the General Sales Manager, FAS, to

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[7] Commodity Credit Corporation's Export Credit Guarantee Programs (GAO/NSIAD-88-194).

-- enforce compliance with the requirement that exporters submit complete reports of exports to ensure accurate accounting of outstanding guarantees;

-- design, develop, test, and implement internal controls, including random on-site verifications, to ensure that loan guarantees are used to obtain U.S. agricultural commodities;

-- clarify program regulations with specific definitions for a U.S. agricultural commodity and a firm sale, and require acknowledgement of these requirements on guarantee applications; and

-- provide timely and accurate decisions on document revisions requested by exporters or their assignees.

We are pleased to report that FAS has taken action on some of our recommendations. However, we believe that further FAS action is needed to address our original concerns about implementing internal controls and defining an agricultural commodity. Actions are still needed on our concerns about the timely handling of revisions to GSM documentation. Finally, we have comments to make about the participation of U.S. financial institutions in the GSM programs.

Actions Taken on Previous GAO Recommendations

FAS has acted on our recommendations to improve the accounting of outstanding guarantees and to establish internal controls.

When exporters fail to submit the required export sale loan repayment schedules for GSM-102/103 guarantees outstanding, the Agricultural Stabilization and Conservation Service (ASCS) estimates its own repayment schedules. ASCS officials, who perform CCC's accounting services, use the terms identified on the available GSM sale documentation and the current London Interbank Offer Rate (LIBOR) plus one quarter of one percent, to compute the repayment schedule. If the official repayment schedule is later received, ASCS will make adjustments as necessary. According to ASCS officials, only minor adjustments have been required to date.

FAS has established some internal controls over the programs. Effective October 1, 1988, when exporters register a sale, they must certify that none of the value of that sale is foreign. The validity of the certification statements will be spot-checked by the FAS Compliance Review Office, which has been given additional resources for reviewing compliance with this and other GSM-102/103 regulations.

We believe that the actions taken by FAS are important steps in improving management of the GSM-102/103 programs. However, much more is needed before firm control over program operations is achieved.

Further Improvements Needed in Internal Controls

Recent work conducted by the Agriculture's OIG and GAO has shown that further internal controls over the GSM-102/103 programs are necessary. A September 29, 1989, OIG report[8] stated that compliance review efforts are needed and that suspension and debarment actions should be used whenever exporters are found to be in violation of program regulations. Our review also indicates that controls are not in place to ensure that exporters are complying with applicable regulations.

Additional compliance review efforts are needed

The OIG report stated that "U.S. exporters are participating in a $6 billion program without FAS or CCC conducting a review, or periodic check, to make sure the program is operating in accordance with applicable laws and regulations." However, some compliance review efforts have now been undertaken. Nevertheless,

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[8] Audit of the Foreign Agricultural Service Exports of the Foreign Commodities Under GSM 102/103, Audit Report No. 07099-21-Hy.

our review work indicates that more compliance review efforts are necessary.

Our June 1988 report recommendation on internal controls called for random, on-site verifications to ensure that U.S. agricultural exports are being financed by the guarantee programs. We believe this is an important control because CCC and FAS officials deal only with the paperwork aspects of the guarantee programs. Without physically inspecting the commodities being exported at both U.S. export terminals and foreign import terminals, at least on a spot-check basis, CCC and FAS officials cannot be certain that U.S. agricultural commodities are being financed under the programs.

With assistance from U.S. Customs, we made random inspections at U.S. ports holding seven tobacco shipments destined for export under the GSM programs. In one instance, Customs officials believe that over 80 percent of the tobacco in that sale was of foreign origin. In another instance, we visited an exporter who was participating in the GSM-102 program for grocery items and found that he was preparing for shipment several items that contained foreign origin content, including coffee filters manufactured in Canada.

As a further assurance that U.S. agricultural commodities financed under the GSM-102/103 programs are being delivered to their intended destinations, FAS should conduct periodic spot inspections at foreign ports. This could be accomplished by FAS staff assigned overseas or by FAS officials, for example, compliance review staff, in travel status. In the past, FAS officials have stated that time and resources were not available for this type of monitoring and oversight.

According to foreign government officials, random checks at foreign ports are feasible. While conducting work at four overseas locations this past summer, we asked foreign government officials if it would be possible for FAS officials to inspect the off-loading of GSM commodities. With one exception, we were told that FAS access to the ports for inspection would be allowed. In that one instance, we were advised that obtaining permission for access would be difficult because the port is used for closely guarded military operations as well as civilian operations.

CCC should take suspension or debarment actions where appropriate

The OIG report stated that FAS should use established compliance measures, such as suspension or debarment, to discourage U.S. exporters from blending or combining foreign origin agricultural commodities or products with U.S. commodities for export under the GSM programs.

Considerable attention has been focused on the suspension and debarment issue, because a number of tobacco exporters, who have shipped large quantities of foreign tobacco as U.S. tobacco under the export credit guarantee programs, continue to participate in the programs. In prior testimony we noted that FAS does not intend to initiate suspension or debarment proceedings against those tobacco exporters while the U.S. Attorney's investigation continues, so as not to impair his case. However, in May of last year, the Director of CCC's Operations Division wrote letters to 31 exporting companies, representing 92 different GSM guarantees, stating that as a result of the OIG audit, it had been determined that the exporters may have violated GSM program requirements by exporting non-U.S. commodities. The letters put the exporters on notice that they may be held liable to CCC for any amounts paid or that may be paid by CCC under the guarantees.

When significant GSM program violations occur, we believe that suspension or debarment proceedings would be the appropriate agency response and that Agriculture should be prepared to initiate such actions. According to FAS officials, they will take appropriate actions in the future when evidence is developed that shows that violations have occurred. New compliance review efforts could assist in identifying program violators and documenting the evidence of wrongdoing.

An Eligible Agricultural Commodity Still Needs to be Defined

Our June 1988 report included a recommendation concerning the need for defining eligible agricultural commodities, especially value added products. Agriculture's OIG arrived at the same conclusion.

Until September 21, 1988, FAS general policy was to provide export credit guarantee coverage under the GSM-102/103 programs for only those commodities or products containing 100 percent U.S. origin content. Nevertheless, while this policy was in effect, credit guarantees were provided for exports of tobacco that were subsequently revealed to contain substantial amounts of foreign tobacco. Also other products such as grocery items, leather hides and skins, and soft drink concentrates containing some degree of foreign origin content were provided guarantee coverage under the programs.

On September 21, 1988, FAS announced a new policy that provided credit guarantees for the export of agricultural products that were a mixture of U.S. and foreign origin. The new policy allowed the value of exports under the programs to include up to 25 percent imported agricultural commodities. However, only the value of the U.S. portion of the agricultural commodities could receive the CCC guarantee. This proved to be a highly contentious policy change. Forty members of Congress questioned this new policy and wrote to the Secretary of Agriculture on October 12, 1988, asking that it be reversed.

On February 15, 1989, FAS discontinued the new policy and notified exporters that as of February 16, they are required to certify that none of the value of their commodities is foreign. Otherwise, the commodities are not eligible for program coverage. This policy is still in effect; however, when this change was made, FAS also announced that it would reevaluate the content issue. In a related matter, Agriculture's General Counsel stated in May 1989 that exports which contain small amounts of foreign, but non-agricultural, products could be eligible for program coverage.

Based on our work thus far, we believe that the current zero percent foreign value content policy may be appropriate for exports of bulk commodities such as wheat, corn, barley, and tobacco. However, that policy may be inappropriate for processed agricultural products, many of which may contain small amounts of foreign origin ingredients. For example, powdered infant formula, containing foreign origin ingredients that account for only 2 percent of the total value of the product, is excluded from coverage under the current policy, as is soft drink concentrate with a small percentage of foreign content. A comprehensive evaluation of the foreign content issue should include an assessment of how to handle such products.

One way to achieve a comprehensive evaluation of the policy issues is to establish a working group of representatives of interested parties to review and debate the issues and to develop options for FAS consideration. FAS established an internal working group to deal with the issue. FAS solicited comments in the Federal Register and met once with selected industry representatives to obtain others' opinions. We feel this effort should be expanded to include full participation by these and other interested parties.

Action Still Needed on the Timely Handling of Revisions to GSM Documentation

Our June 1988 report suggested that CCC be more flexible with exporters and financial institutions when changes to GSM documentation are necessary. We cited an example of a U.S. bank that spent 8 months trying to get CCC to correct the name of a foreign bank placed on the guarantee document by CCC officials. This change was very important to the U.S. bank because a CCC official had stated that guarantees could become invalid if the documentation was not properly prepared. CCC, rather than making the correction itself, wanted the U.S. bank to obtain written assurance from the foreign bank that it would honor its obligations even though the bank was incorrectly named on the document. Eventually, CCC did make the correction, but the U.S. bank officials claimed they spent too much time and effort on an error that was made by CCC.

During recent discussions with several exporters and U.S. financial institutions participating in the GSM programs, we were told of several other similar instances that frustrated exporters and bank officials. In one case, documentation prepared by a U.S. bank regarding a repayment due in three equal installments was not accepted by CCC because of the way in which the bank rounded the cents on a whole dollar. Apparently the bank showed that 34 cents would be collected as part of the first installment and 33 cents as part of the second and third installments. CCC returned the documentation and requested that 33 cents be shown as part of the first and second installments and 34 cents on the third.

Participation of Financial Institutions in the GSM Programs

The success of the GSM-102/103 programs depends greatly on the active participation of financial institutions, which pay out the $4 billion to $6 billion in GSM loans each year, providing direct credit to the foreign buyers. According to CCC records, two financial institutions--The National Bank for Cooperatives and the Banca Nazionale del Lavoro--have been significant program participants. Together, they have provided approximately one-third of the money loaned under GSM-102 during the past 5 years and approximately three-fourths of the money loaned under GSM-103 during the past 3 years. The remainder of the program loans have been provided by numerous other financial institutions, each loaning smaller amounts of money.

From discussions with officials of several of these financial institutions, it appears that the government guaranteed loan business is not particularly profitable and is therefore attractive only to (1) U.S. financial institutions specializing in government loans or (2) foreign-owned banks trying to establish themselves in the United States.

The National Bank for Cooperatives

The National Bank for Cooperatives specializes in government loans. Officials there said that over 90 percent of their business involves loans with CCC, the Export-Import Bank, or some other government agency loan program. The Bank was established through federal legislation in 1933 to finance sales by U.S. cooperative farmer organizations. Today it is wholly owned by its cooperative members. The Bank is a member of the Farm Credit System, which has U.S. government agency status. Privileges derived from its agency status allow the Farm Credit System to raise or obtain funds at a lower cost than commercial banks. Therefore, as a member of the Farm Credit System, the National Bank for Cooperatives obtains funds at a lower cost and obtains a higher profit margin in the government loan business than would commercial banks.

Bank officials told us that, in spite of operational problems, they believe the GSM programs are two of the best programs ever established to facilitate the export of U.S. goods. They said that the Bank plans to continue its participation in the programs.

Banca Nazionale del Lavoro

In the near future we will begin a study in response to a request from the Subcommittee on Criminal Justice, House Committee on the Judiciary, to evaluate the extent to which individual financial institutions participate in the GSM programs and to assess the potential impact that such participation may have on CCC's guarantee liability. In particular, we will look at the Banca Nazionale del Lavoro and its involvement with Iraq.

Banca Nazionale del Lavoro is Italy's largest state-owned bank. It is headquartered in Rome but has several branches in the United States. The New York City branch is responsible for North

American operations, and its Atlanta, Georgia, branch has provided the GSM loans. Officials of the Bank's Atlanta branch told us that the majority of their business involves GSM loans to Iraq. In the past, Iraq has imported up to $1.0 billion worth of U.S. agricultural commodities annually under the GSM-102/103 program.

Recently, the bank has been embroiled in controversy. According to bank officials, its Atlanta branch loaned about $2.0 billion to foreign buyers in Iraq of which only a fraction was authorized by higher level bank officials. They told us that some of these loans, amounting to about $830 million, were made under the GSM-102/103 programs and of that amount, only about $130 million were authorized. They said other loans to Iraq were made outside government programs. The unauthorized loans and the adequacy of the bank's internal controls are currently being investigated by several U.S. and Italian agencies. The status of the investigation has not been made public.

Bank officials are concerned about having such a large exposure in one country; they told us that although Iraq has been making regular payments and has never defaulted, it is classified by many banks as a high credit risk due to its war with Iran and the resulting depletion of its foreign exchange reserves.

We were told by officials of the New York branch of Banca Nazionale del Lavoro that officials in Rome will have to decide whether or not the bank will continue to participate in the program, including making new GSM loans to Iraq.

The Banca Nazionale del Lavoro's problems may or may not result in CCC payouts under its loan guarantee programs, but they raise a question concerning the wisdom of allowing one bank to participate to such a large extent in the programs, especially if that bank's loan exposure is going to be concentrated in a single country. In light of these problems, FAS may want to examine the issue of bank participation in the programs.