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Export Enhancement Program's Recent Changes and Future Role

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The Honorable E (Kika) de la Garza
Chairman, Committee on Agriculture
House of Representatives

The Honorable Silvio O. Conte
House of Representatives

The Honorable Charles E. Schumer
House of Representatives

In response to your requests, we have reviewed the Export Enhancement Program. This report, the third in a series, focuses on recent program changes and the program's continued role in fostering the liberalization of agricultural trade. On February 7, 1990, we issued a report that discussed bonus overpayments, and on February 12, 1990, we issued a fact sheet that provided general information on how the program operates and the nature and extent of program activity. We have also testified on the results of our work before various Senate and House Agriculture committees and subcommittees.

The Department of Agriculture's Foreign Agricultural Service has been working to improve program operations. This report identifies several areas where further improvements are needed. It also contains a matter for congressional consideration.

We are sending a copy of this report to the Secretary of Agriculture, and will make copies available to other interested parties upon request.

The report was prepared under the direction of Allan I. Mendelowitz, Director, Trade, Energy, and Finance Issues. He can be reached on (202) 275-4812, if you or your staff have any questions. Other major contributors are listed in appendix II.

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GAO's Analysis

Program Operations and Recent Changes

While relevant commodity divisions maintain files on each proposed program initiative under review, the Foreign Agricultural Service does not centrally track a proposal until the division forwards it for higher level review. As a result, top management cannot be readily aware of all proposals under consideration at any time nor can it systematically monitor the progress of proposals under review in the commodity divisions. Thus it cannot ensure that all proposals get equal treatment.

Exporters are required to certify their program eligibility by submitting documents related to their business activities. Eligible exporters must then provide details of a sales contract to participate in the bidding process. GAO found that FAS files contained the required information, but that agency officials did not verify all categories of information provided, even on a random basis. Better internal control is needed to ensure that only eligible exporters with valid sales contracts are participating in the program.

During this review, GAO found agency officials were receiving the information necessary to make informed decisions but were still not documenting adjustments made when calculating price and bonus amounts. As a result, it was difficult to determine whether bonus calculations were higher than needed to make a sale —of particular concern when bonuses exceeded sales prices. For example, in February 1990 we reported that for dairy cattle, the average bonus value was as high as 146 percent of the average sales price in 1986; for semolina, as high as 140 percent in 1987; and for frozen poultry, as high as 111 percent in 1986. The Foreign Agricultural Service has recently developed written guidelines for determining price and bonus levels and now requires that all relevant price and bonus calculations be fully documented.

The Foreign Agricultural Service is also improving its bonus payment process. Early in its review, GAO found that inadequate internal controls had allowed bonus overpayments to occur and recommended that sufficient internal controls be developed to guard against future overpayments. The Foreign Agricultural Service agreed and is in the process of recouping the overpayments and developing and implementing a new computer program to administer the bonus payment process.

Matter for Congressional Consideration

The Congress, in reauthorizing the program, should condition the level of appropriations on the outcome of the current negotiating round—scheduled to end in December 1990. At that time, Congress should reevaluate the need for the program in light of any agreement reached on liberalizing agricultural trade.

Agency Comments

As requested, GAO did not obtain formal agency comments on a draft of this report. However, its contents were discussed with agency officials, and their views have been incorporated where appropriate.

Abbreviations

EC	European Community
FAS	Foreign Agricultural Service
GAO	General Accounting Office
GATT	General Agreement on Tariffs and Trade
OIG	Office of Inspector General
OMB	Office of Management and Budget
TPRG	Trade Policy Review Group

1989.[2] At that time, 71 exporters had received over $2.3 billion worth of surplus U.S. agricultural commodities as bonuses. (One year later, bonuses had risen to over $2.7 billion.) Four exporters—Cargill, Continental, Louis Dreyfus, and Artfer—had each received over $100 million in bonuses (nearly 60 percent of all bonus awards); Cargill and Continental alone had received over $400 million in bonuses each.

Of the $2.3 billion in bonuses, about $1.6 billion facilitated wheat sales. About $1.7 billion of the total bonuses, or 74 percent, supported sales to 7 countries—the Soviet Union, China, Egypt, Algeria, Saudi Arabia, Morocco, and Iraq.

Total sales under the program through February 1989 were valued at $6.8 billion, of which wheat represented over 80 percent. (One year later, sales had risen to over $10 billion.) Five countries—the Soviet Union, China, Algeria, Egypt, and Morocco—had bought approximately 1.4 billion bushels of wheat under the program, about 74 percent of the 1.9 billion bushels sold. Other commodities sold have been wheat flour, barley, barley malt, semolina, rice, vegetable oil, sorghum, frozen poultry, table eggs, mixed poultry feed, and dairy cattle.

How the Program Works

FAS receives and reviews recommendations, both oral and written, for countries and commodities to target under the program from many sources, including importing countries, U.S. exporters, Agriculture's program experts, U.S. and foreign government officials, and other members of the U.S. agricultural community. The appropriate FAS commodity division[3] reviews each recommendation to determine whether it meets the program criteria. If the program criteria are met, the recommendation becomes an official proposal and is forwarded with comments and recommendations to Agriculture's Under Secretary for International Affairs and Commodity Programs.

If the Under Secretary approves the proposal, an interagency review process begins. The proposal is sent to the Office of the U.S. Trade Representative, which coordinates the final review and approval process

[2] International Trade: Activity Under the Export Enhancement Program, (GAO/NSIAD-90-59FS, Feb. 12, 1990).

[3] Currently three commodity divisions analyze recommendations for new program initiatives—Grain and Feed; Oilseeds and Products; and Dairy, Livestock, and Poultry.

these certificates or redeem them for commodities that Agriculture offers.

The Bidding Process

After FAS announces an initiative, U.S. exporters compete for sales through an FAS-administered bidding process. U.S. exporters negotiate a sales price with an importer, determine the necessary bonus, and submit this information to FAS as a bid. For FAS to accept the bid, it must fall within established minimum price and maximum bonus levels. The minimum price and maximum bonus levels are not publicly announced, primarily to maintain the integrity of the bidding process and to promote competition.

Upon receiving a U.S. exporter's bid, FAS first compares the price to its minimum acceptable price. If the exporter's price is lower, the bid is rejected. If the exporter's price is higher, FAS then compares the requested bonus amount to its maximum acceptable bonus. If the exporter's bonus is higher, the bid is rejected. If the exporter's bonus is lower, the bid is acceptable. FAS compares the requested bonus amounts of all acceptable bids received and awards the contracts in ascending order of bonus bids until the approved quantity is filled.

Recent Changes to Program Criteria

The Export Enhancement Program was established to meet three objectives: to increase U.S. agricultural exports; to challenge unfair trade practices of competitor nations, especially the European Community; and to encourage U.S. trading partners to begin serious negotiations on the liberalization of agricultural trade under the Uruguay Round of the multilateral trade negotiations. According to guidelines established by the Economic Policy Council, each program initiative (targeted country/commodity) was to meet four criteria.

- 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 challenging competitors that were subsidizing their exports.
- Cost effectiveness: Sales were to result in a net plus to the overall economy.
- Budget neutrality: Sales were not to increase budget outlays above those that would have occurred in the absence of the program.

- Trade policy effect: What is the expected contribution of a proposed initiative in furthering the Uruguay Round and other trade policy negotiations? Sales should displace competitors' subsidized exports in targeted countries, thereby furthering the U.S. negotiating strategy of countering competitors' subsidies and other unfair trade practices. Targeted countries are those where U.S. sales have been nonexistent, displaced, or lost because of competition from subsidized exports.
- Export effect: How will the proposed initiative contribute to realizing U.S. agricultural export goals? All initiatives must demonstrate the potential to develop, expand, or maintain markets for U.S. agricultural commodities. The program should concentrate on commodities that would be competitive if competitor subsidies were eliminated.
- Effects on nonsubsidizers: What effect will the proposed initiative have on nonsubsidizing exporters of agricultural products? Agriculture will consult with representatives of targeted countries, where practical and appropriate, to determine if program sales would have more than a minimum effect on nonsubsidizing exporters.
- Subsidy requirements: How do the subsidy requirements (costs) compare to expected benefits? The overall program level and individual bonus decisions will be the minimum necessary to achieve the expected benefits of export expansion and trade policy reform.

The subsidy requirement guideline is meant to replace the budget neutrality criterion. Agriculture recognized the difficulty in measuring budget effects in a changing global market. Additionality was dropped as a criterion and, instead, incorporated into the export effect guideline as a "consideration" when determining the initiative's overall contribution to export expansion. Targeting was also dropped as a criterion, but is identified as one of three principles that should guide both day-to-day and strategic program operations. According to Agriculture, the program will be targeted to challenge subsidizing competitors in markets where U.S. export benefits are greatest, while minimizing bonus outlays and effects on nonsubsidizing competitors. Other operational considerations are designed to minimize market disruption and to ensure timely interagency review.

Objectives, Scope, and Methodology

In response to requests from Congressman E (Kika) de la Garza, Chairman of the House Committee on Agriculture, and Congressmen Silvio O. Conte and Charles E. Schumer, we reviewed the Export Enhancement Program. This report is the third in a series of products resulting from our review.

We also visited 12 countries representing competitors and importers of commodities under the program—Canada, Australia, New Zealand, Hong Kong, Indonesia, Algeria, Egypt, Belgium, the Netherlands, France, West Germany, and the United Kingdom. We interviewed FAS agricultural attaches, foreign government officials, importers, farmers and farm managers, foreign grain trading companies, trade representatives, and FAS contractors who report trade information. We also reviewed FAS files, cables, statistical reports, and other supporting documentation provided by U.S. and foreign government officials.

Our initial fieldwork was conducted between August 1988 and August 1989. As a result of concerns that GAO and Agriculture's Office of Inspector General (OIG) raised at a series of hearings on the Export Enhancement Program and in a number of internal agency studies, FAS made changes to its program operations and management. We conducted additional fieldwork between December 1989 and March 1990 to update our information based on these changes.

We performed our review in accordance with generally accepted government auditing standards.

As requested, we did not obtain formal agency comments on this report; however, we did discuss it with responsible agency officials and have incorporated their comments where appropriate.

In addition, as part of a recently approved reorganization, additional staff will be assigned to the Regulations, Procedures, and Reports Branch of the Commodity Credit Corporation's Operations Division. Their function will be to enhance the branch's operations, including Export Enhancement Program activities such as bid receipt and program activity reporting. Furthermore, a new Planning and Evaluation staff will be established to evaluate FAS market development programs, including the Export Enhancement Program.

The Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512 (b)) requires executive agencies to establish and maintain systems of internal control that are to be consistent with the Comptroller General's Standards for Internal Controls in the Federal Government. These standards call for internal controls to provide reasonable assurance that the use of resources is consistent with applicable laws, regulations, and policies and that reliable data are maintained. We believe that FAS can further improve its internal controls in several areas.

Not all Proposals Are Centrally Tracked

In 1989 and 1990 hearings before Senate and House agriculture committees, we testified that while each commodity division individually tracked relevant proposals for new program initiatives, FAS did not centrally track a proposal until a commodity division forwarded it for further review. We stated that a centralized tracking system would allow FAS to monitor the progress of proposals from initial receipt through final acceptance and would limit FAS vulnerability to claims of inconsistent or unfair treatment. FAS responded in hearings that its current system is adequate and, if needed, can provide information on the history and status of any proposal.

A proposal for a new program initiative is developed in two distinct stages. The first stage involves the recommendation of a new program initiative and its analysis by the appropriate commodity division. If the commodity division finds that the recommendation meets the program's minimum criteria, the recommendation enters the second stage and is forwarded to FAS management, the Under Secretary for International Affairs and Commodity Programs and, eventually, the Trade Policy Review Group for review and approval.

According to FAS officials, each commodity division maintains files on all recommendations being analyzed and on those proposals submitted for further management review and approval. If the commodity division determines that a recommendation for a new program initiative meets audited financial statement showing a positive net worth or a certified statement describing participation in a U.S. government program during the preceding 3 years.

We found that FAS routinely verified experience in trading in the commodity offered and the exporter's financial responsibility, including its participation in other U.S. government programs, if applicable. For example, when exporters certified that they had participated in a U.S. government program during the preceding 3 years, FAS officials made calls to verify the information, and notes were added to the file. However, FAS did not routinely verify the form of doing business or the name and address of the exporter's U.S. agent, even on a random basis.

To participate in the bidding process, an eligible exporter is required to have a sales contract with a buyer in the targeted market. Although the exporter is generally not required to furnish a copy of the sales contract or other proof of its existence, a certified statement outlining the details of the sales contract must accompany the bid. FAS reserves the right to request a copy of the sales contract at any time and routinely does so in cases of nonperformance or other instances where problems have occurred. However, sales contract information generally was not verified, even on a random basis.

In 1989 and 1990 we testified on the need for better documentation and verification of exporter eligibility. In particular, we recommended that FAS randomly verify the sales contract information submitted with the bids. Moreover, the OIG has recommended that FAS require exporters to submit proof of the existence of the sales contract with each bid.

FAS has opposed the OIG's recommendation, stating that it would seriously delay the review and award of bonuses and would greatly tax existing staff resources. Even so, since July 1988, FAS has required that exporters provide proof of the existence of a sales contract prior to bidding on dairy cattle sales. This requirement has not yet been extended to the other 11 commodities sold under the program. In addition, in December 1989, FAS amended all commodity announcements to include a more complete definition of minimum requirements for a properly executed sales contract and for exporter records of sales. We believe that clarifying the definition of a sales contract will not ensure compliance, and that random verification is still needed.

Improvements to the Bonus Payment Process

During the initial stages of our review, we found that internal controls over the bonus payment process were not adequate to ensure that bonus payments were properly made.[5] We identified eight cases of apparent bonus overpayments, totaling about $635,000.

Our February 1990 report to the FAS Administrator outlined the internal control weaknesses and provided the details of the apparent overpayments. We recommended that FAS complete its review of the eight cases and recover any actual overpayments from the exporters. Furthermore, we recommended that FAS develop sufficient internal controls over the bonus payment process to safeguard against future overpayments.

FAS investigated the eight cases and found six of the eight cases, totaling about $306,000, were in fact overpayments; FAS is in the process of recouping these overpayments. FAS determined that the remaining two cases, totaling about $329,000, were not overpayments, but instead were bonus calculation errors that were discovered before the commodities were released. FAS has updated the computer database and relevant hard copy files kept on each contract which, at the time of our review, erroneously reflected payment figures above the tolerance level.

FAS agreed that internal controls over the bonus payment process should be improved to safeguard against future overpayments. According to FAS officials, they are proceeding with the development and implementation of a new computer database program to administer program agreements. An intermediate phase of this system will not allow the processing of bonus payments when the export quantities are over the maximum shipping tolerance, or when the delivery is outside of the agreed period, made from the wrong U.S. coast, or not in accordance with correct commodity specifications. It will also allow FAS to generate a variety of reports, which is currently not possible. According to FAS, this aspect of the system was installed in March 1990 and became fully operational in April 1990 after staff were trained on its use.

[5]Under the program, FAS approves a commodity sales agreement between an exporter and a participating country for a specified quantity of agricultural goods. This agreement can be exceeded by up to 5 percent. If the quantity shipped exceeds 105 percent of the approved sales quantity, the excess is not eligible for a bonus. Any bonus awarded for these excess quantities shipped is considered an overpayment.

Adopt the Commercial Definition of Contract Fulfillment

Four exporters told us that FAS policy on "dockage"[6] does not conform to commercial trade norms. For commercial sales, both importers and exporters judge a contract to be fulfilled if the gross amount has been shipped. Then, payment is made only on the net amount, which is the gross amount less dockage. Under the Export Enhancement Program, FAS also awards bonuses based on the net amount shipped. However, FAS judges contract fulfillment based on the net amount shipped rather than on the gross amount.

The exporters took exception to FAS using the net amount shipped when determining whether the contract was fulfilled. Exporters often cannot add to the shipment to allow for dockage. In these cases, FAS has assessed the exporter damages for failing to ship the contracted amount. Despite appeals to FAS, it has penalized exporters for not delivering the contract amount, even when the buying country has determined that the contract has been fulfilled. The exporters suggested that FAS adopt commercial standards for judging contract performance.

According to FAS, program announcements clearly state its policy on contract fulfillment (i.e., net, rather than gross, quantity delivered). Therefore, exporters know in advance that they should submit a bid based on the expected net quantity to be delivered to avoid the possibility of having liquidated damages assessed for failure to export the required quantity. Any exporter who bases a bid on the gross quantity shipped, rather than the expected net quantity, is knowingly taking a risk.

Accept Alternate Forms of Documentation

For FAS to release a performance bond, an exporter must submit landing certificates and other documentation as proof of delivery. According to three exporters surveyed, landing certificates are often hard to obtain, and FAS will not accept any alternate form of delivery confirmation. Moreover, the exporters said that FAS will only accept a landing certificate from the buying agency that negotiated the sale, yet often the importing company provides the certificate instead.

These exporters told us that as a result of FAS inflexibility, performance bonds and bonus awards are held up unnecessarily while the exporter tries to obtain an acceptable landing certificate. They suggested that FAS reevaluate its definitions of acceptable documents that can be used as

[6]The Department of Agriculture's Dictionary of International Agricultural Trade defines dockage as a factor in the grading of grains and oilseeds. Dockage includes waste and foreign material readily removed by the use of screens, sieves, and other cleaning devices. The term is also used to describe the amount of money deducted due to a deficiency in quality.

Reactivate the Export Enhancement Advisory Group

On July 22, 1985, Agriculture published a notice in the Federal Register proposing the establishment of an Agricultural Export Enhancement Advisory Group to provide advice on the establishment and administration of the program. The group, consisting of eight members representing farmers and the export trade, has met only twice since its establishment.

The majority of exporters we spoke with thought an advisory group made up of representatives of the agricultural trade community and Agriculture would serve a useful and important purpose. Meetings could be held 2 or 3 times a year, when problems encountered by Agriculture and exporters could be voiced and discussed. These exporters stated that they could make useful recommendations and help eliminate many of the problems the program has encountered to date or might encounter in a changing world agriculture market. However, the exporters stated that such an advisory group would be a waste of time for all participants if it had no real influence on agency actions.

According to FAS, the advisory group was originally organized to provide FAS with advice on the establishment and administration of the program. However, as FAS gained experience with the program, daily contact with numerous members of the agricultural trade community provided FAS and exporters ample opportunity to discuss and resolve any concerns.

Conclusions

In response to concerns voiced by GAO and Agriculture's OIG, FAS has taken some action to improve program operations. FAS has recently developed written guidelines detailing the procedures to be used when determining price and bonus levels and instructed commodity divisions to document price and bonus determinations. FAS is also improving its internal controls over the bonus payment process to preclude future bonus overpayments. While we believe that these changes will improve program operations, more can be done.

Currently the General Sales Manager receives a status report on proposals forwarded by the commodity divisions for review and approval, but not on proposals that the commodity divisions are analyzing. Therefore, the General Sales Manager cannot monitor the progress of all proposals to ensure their timely analysis and equitable treatment. In addition, the Under Secretary for International Affairs and Commodity Programs does not provide written justification for decisions to reject official proposals that the commodity divisions forward. This lack of

The Export Enhancement Program's Effect on World Agricultural Trade

The Export Enhancement Program has helped increase U.S. agricultural exports, particularly wheat, in many countries, including the Soviet Union, China, and those in the Middle East. The extent of the program's effect, however, is difficult, if not impossible, to quantify due to the many policy and economic variables that influence exports. Recent studies estimate that the program was responsible for between 2 and 30 percent of the increase in U.S. agricultural exports.

The fact that the program is targeted further complicates the determination of its effect. While exports may increase in the targeted markets, the overall effect on U.S. exports worldwide is uncertain. Originally the program's primary targets were countries that made significant purchases of commodities subsidized by the European Community. Over time the program has expanded to include countries that had a small EC market and then to countries where the EC was only contemplating a presence. As U.S. sales displaced EC sales in one market, the EC moved into another country's market, making that country eligible for program benefits as well.

The program was also designed to challenge unfair trade practices and encourage trading partners to negotiate agricultural trade reforms. Although in its early years the program increased the cost of EC subsidies, it has neither deterred the EC from using subsidies nor hurt its share of the world market. Other U.S. competitors, including Australia and Canada, have been adversely affected both in terms of receiving lower prices for their commodities and in having reduced market shares. Nevertheless, the program was instrumental in bringing the EC to the negotiating table on agricultural trade liberalization.

Impact on U.S. Agricultural Exports

According to original Export Enhancement Program additionality criteria, program sales were supposed to increase U.S. agricultural exports above those that would have occurred in the absence of the program. In the last several years, U.S. agricultural exports have increased in certain markets. However, the program's effect cannot be easily isolated from that of other policy and economic variables that 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.

Additionality is also dependent on the buying and selling decisions of competing exporters and importers. For example, competing suppliers

The price differential was fundamentally resolved in April 1987 when Agriculture again targeted wheat sales to the Soviet Union under the Export Enhancement Program and increased bonuses to enable U.S. exporters to sell wheat at competitive prices. As of May 1990, the Soviet Union had bought over 21 million metric tons of wheat (29 percent of the total wheat sold under the program), making the Soviet Union the largest wheat importer under the program.

China is another country in which the program has been effective in increasing U.S. agricultural exports. The U.S. market share of Chinese wheat imports was less than 10 percent during 1985 and 1986, primarily because of the relatively high U.S. price. In January 1987, China was offered wheat for the first time under the Export Enhancement Program. Sales increased from less than 1 million metric tons in 1985 to about 7.2 million metric tons in 1988. As of May 1990, China had bought over 15 million metric tons of wheat (21 percent of the total wheat sold), making China the second largest wheat importer under the program.

In two countries visited during this review—Algeria and Egypt—U.S. and foreign officials told us that the Export Enhancement Program was essential in enabling 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 sales depended on the availability of U.S. export credit guarantees.[2]

Some Algerian officials singled out the GSM-102 program as the primary reason that U.S. agricultural exports expanded in North Africa. An economic officer in the U.S. Embassy in Algiers told us that the availability of GSM-102 was a very important factor in Algeria's and other Third World countries' exporting decisions. For example, due to falling oil prices, Algeria began to experience budget problems in 1986 and became very interested in the availability of favorable credit terms.

The French agricultural attache in Algiers told us France was only able to compete in the Algerian market by offering export credits. This official added that other countries unable to offer export credit, such as Argentina, could not break into the Algerian market.

[2]FAS has made its short-term export credit guarantee program, known as GSM-102, available for some Export Enhancement Program initiatives. The credit guarantee program allows countries to purchase U.S. commodities when credit guarantees are necessary to secure private financing.

Table 3.1: Major Suppliers' Market Shares of Hong Kong Table Egg Imports (Calendar Years 1984-1989)

Figures in percent

Supplier	1984	1985	1986[a]	1987	1988[b]	1989[c]
United States	6.8	7.6	6.1	10.9	14.9	12.7
The Netherlands	.4	2.9	6.3	3.4	16.8	24.5
China	76.6	75.6	75.0	74.6	59.3	46.3
Others	16.2	13.9	12.6	11.1	9.0	16.5
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

[a]The Export Enhancement Program began to target table egg sales to Hong Kong in November 1986

[b]European Community subsidies increased during 1988

[c]Through March 1989

Source: Compilation of data from Hong Kong government sources

According to FAS officials in Hong Kong, the Export Enhancement Program was responsible for much of the increase in U.S. table egg sales. Cheaper prices allowed U.S. table eggs to regain some of the market share that had been lost to subsidized Dutch table eggs during 1986. The Dutch agricultural attache also attributed the increased sales to the program, but added that after 1987 much of the increase in sales occurred at the expense of the Chinese. According to several egg traders, U.S. table eggs sold because they were competitively priced.

FAS officials and egg traders in Hong Kong agreed that the program would be needed so that U.S. table eggs could continue to compete with cheaper Dutch and Chinese table eggs. EC subsidies were increased in 1988 in response to the program, but U.S. bonus awards apparently did not keep pace. FAS officials acknowledged that the U.S. market share decreased in 1989 because prices were no longer as competitive.

Dairy Cattle Exports to Indonesia

According to Indonesian government officials, dairy cattle have been imported over the last 10 years in a government-backed effort to increase domestic dairy production. Australia and New Zealand had been the primary sources of cattle during the last decade. Prior to 1987, U.S. dairy cattle imports to Indonesia were nonexistent. While U.S. cattle were desirable because of their superior milk-producing potential, they cost at least twice as much as the competition's cattle. The availability of bonuses under the program lowered U.S. prices to within a competitive range. While U.S. cattle were still more expensive, the importers believed that the superior genetics warranted the higher price. By 1988, about half of Indonesia's imports of dairy cattle were from the United States.

Economic Analyses Differ on the Program's Additionality

While U.S. agricultural exports have increased since the Export Enhancement Program's inception, there is debate over how much of the increase can be attributed to the program. Three recent economic studies have attempted to measure the program's additionality. While they agree that the program has contributed to the increase in U.S. agricultural exports since 1985, they differ on the magnitude of its effect. Additionality estimates range from 2 to 30 percent and are greatly influenced by the assumptions made about the international export market, the time period covered, and prevailing market conditions.

Agriculture's Economic Research Service released a study[3] in May 1989 that used a world wheat trade simulation model to identify factors that expanded U.S. wheat exports since the passage of the Food Security Act of 1985. According to the study, U.S. wheat exports grew from 0.9 billion bushels in 1985/1986 to 1.6 billion in 1987/1988, due to the program, lower wheat loan rates, lower competitor yields, and expanded Soviet-Chinese demand. The study estimated that the program was responsible for about 30 percent of the 1986/1987 wheat export expansion and about 20 percent of the expansion through 1988/1989.

Another Economic Research Service study[4] published in April 1989 evaluated the effect of the program, U.S. dollar depreciation, and lower loan rates on U.S. wheat exports for the 1986/1987 crop year. The study estimated U.S. wheat exports under various assumptions about how aggressively the European Community would have subsidized wheat sales in the absence of the Export Enhancement Program. Depending on one's interpretation of the EC motivation for its own targeted subsidy program, the study credited the Export Enhancement Program with increasing U.S. wheat export volume by between 10 and 30 percent.

A 1988 university-based study[5] used a game-theory trade model that simulated actions taken by targeted importers and U.S. exporters participating in the program. The study assigned arbitrary weights to the various objectives of the U.S. government, importers in targeted markets, and foreign competitors in order to predict potential displacements

[3]Kenneth W. Bailey, "Why Did U.S. Wheat Exports Expand?" (U.S. Department of Agriculture Information Bull. No. 564, May 1989).

[4]Stephen L. Haley, "Evaluation of Export Enhancement, Dollar Depreciation, and Loan Rate Reduction for Wheat" (U.S. Department of Agriculture's Economic Research Service, April 1989)

[5]Ann Marie Hillberg, "The United States' Export Enhancement Program for Wheat: A Simulation Model of the U.S. Export Enhancement Program for Wheat Employing Nash's Bargaining Solution" (Diss., Purdue University, May 1988 and updates).

Use as a Trade Policy Tool

When it was established, the program was viewed not only as a means of increasing U.S. exports but also as a means of encouraging U.S. trading partners, especially the EC, to begin serious negotiations on liberalizing agricultural trade. In our March 1987 report, we noted that the program had exerted financial pressure on the EC and had reduced its grain sales in the Mediterranean region. Combined with the decline of the dollar and lower loan rates, the financial cost of the EC export restitution payments had increased. We also stated that the program had contributed to achieving agreement on including discussion of agricultural subsidies in the Uruguay Round of multilateral trade negotiations.

In September 1986, the Uruguay Round of multilateral trade negotiations was launched under the auspices of the General Agreement on Tariffs and Trade (GATT). One of the major agricultural trade issues to be discussed was government agricultural support and its effect on trade.[7] During 1987 and early 1988, the United States, the EC, and other major participants in the Uruguay Round made initial proposals addressing agricultural trade issues.

Proposals for Agricultural Trade Reform

During the first full year of the Uruguay Round negotiations, all major participants in the GATT's Negotiating Group on Agriculture, one of 15 negotiating groups, submitted proposals for liberalizing agricultural trade. In July 1987, the United States proposed the elimination over a 10-year period of all government support to agriculture that distorts trade. In October 1987, the EC submitted a proposal for a gradual reduction in agricultural support and for short-term emergency measures to reduce surpluses in the grain, dairy, and sugar sectors. A Cairns Group[8] proposal, also submitted in October, was seen as a compromise between the U.S. and the EC proposals because it addressed both the long-term concerns of the United States and the short-term concerns of the EC. Other proposals were submitted by Canada, the Nordic countries, and Japan.[9]

[7] Domestic farm price and income support policies in the United States, the EC, and other GATT countries encourage surplus agricultural production. Increased production leads to a buildup of stocks, decreased commodity prices, and more aggressive subsidized competition for export markets.

[8] Established in Cairns, Australia, in August 1986, the Cairns Group is composed of countries that consider themselves to be fair traders in agriculture. It includes Argentina, Australia, Brazil, Canada, Chile, Colombia, Fiji, Hungary, Indonesia, Malaysia, New Zealand, the Philippines, Thailand, and Uruguay.

[9] For more detailed information on these and other major participants' proposals, see our report, Agricultural Trade Negotiations: Initial Phase of the Uruguay Round (GAO/NSIAD-88-144BR, May 5, 1988).

had merely served as a detriment to the negotiating climate. A French government official stated that the program had probably been a factor early in the negotiations, but that its impact had diminished over the years as world market prices had increased.

Foreign industry representatives provided a mixed assessment of the program's effect on the negotiations. Some noted that the program serves as a constant reminder that the United States is serious about competing in world agriculture markets. However, while the program has gotten the EC's attention, foreign industry representatives do not see the program forcing the EC to abandon its obligation to support small, inefficient farmers.

To some extent, the outcome of the Uruguay Round of negotiations in December 1990 will depend on changes in world agricultural markets. Continued tight supplies and higher commodity prices will require less subsidization (lower budget outlays) and reduce pressure on the EC negotiators to reach an agreement. On the other hand, increased supplies and resultant lower prices will increase budget outlays and encourage the EC to negotiate.

Impact on Other Competitors

While the program is aimed at challenging the export markets of subsidizing countries like the EC, it was also designed to avoid competing directly with other competitors not considered direct subsidizers, such as Australia and Canada. The program was to be implemented so as to maintain the traditional commercial trading volume of these other competitors by obtaining assurances from importers that they would continue to import from them. According to the Agricultural Counselor, U.S. Mission to the European Community in Brussels, Agriculture goes to great lengths to avoid disrupting the markets of "nonsubsidizing" competitors. For example, during the initial targeting of Algeria in 1985, U.S. durum wheat was specifically excluded from the program in order to protect Canadian trade interests in North Africa.

Obtaining assurances from importers that traditional trading volumes of non-EC exporters will be maintained does not ensure that market shares will be preserved. As shown in table 3.2, since the program's inception, Argentina, Australia, and Canada have lost market shares for wheat and wheat flour, while the U.S. and the EC market shares have

Australia

Australia has been most vocal in its opposition to the program because of its perceived effect on Australia's wheat exports. While Australian government officials, farm industry representatives, and U.S. government officials agreed that the program contributed to the depression of world wheat prices between 1985 and 1988 and, consequently, to the reduction in Australian wheat export earnings, there was no consensus on the extent of the program's effect.

Australian government officials and grain industry representatives stated that the decline in export prices after the program's inception encouraged some 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 government officials acknowledged that the program is only one of a number of factors contributing to the decline in Australian wheat export earnings, including declining world import demand and acreage shifts from wheat plantings to wool production. However, in their opinion, the program has clearly had a significant adverse impact on Australian grain exports.

According to an October 1989 Australian study,[11] the program has cost Australian wheat growers between $150 million and $238 million, due to reduced average prices on wheat exports and a consequent 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 wheat industry, because exports to Export Enhancement Program-targeted markets constituted a far larger proportion of Australia's total production.

U.S. government officials stated that the program's effects on wheat prices were minimal. A more significant factor in the sharp fall in world grain prices during the mid-1980s was the collapse of world import demand. For example, in 1985/1986, the Soviet Union (the world's largest wheat importer) had a bumper wheat crop. As explained by the U.S. Agricultural Counselor to Australia, world prices were bound to drop after a fifth of the world demand evaporated overnight. Moreover, Australian farmers were protected from the full impact of reduced export earnings by the Australian government's guaranteed price mechanism and the devaluation of the Australian dollar in 1985. The U.S.

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

world prices have risen. There are widely divergent views on the need for the program today and on the way countries and commodities are being targeted. While accurate measurements of the program's additionality have been elusive, the program's importance as a trade negotiation tool is continuing to be emphasized.

The U.S. government views the program as a valuable trade policy tool that has prodded the European Community to negotiate the liberalization of agricultural trade in the current Uruguay Round of the multilateral trade negotiations. The U.S. government has continually reaffirmed its position that any unilateral concession would weaken the U.S. negotiating position.

We agree that the Export Enhancement Program's continued existence is important as a trade negotiation tool. If market conditions change, the program could again be used aggressively, potentially increasing the cost of the EC restitution program. More significantly, abandoning the program now would send the wrong signal to U.S. competitors during the final months of the Uruguay Round. To the extent that the program has had an adverse impact on other competitors, including Australia and Canada, its continued existence has increased their resolve to negotiate an agreement on agricultural trade reform.

Matter for Congressional Consideration

The Congress, in reauthorizing the program, should condition the level of appropriations on the outcome of the current negotiating round—scheduled to end in December 1990. At that time, Congress should reevaluate the need for the program in light of any agreement reached on agricultural trade liberalization.

Targeted country[a]	Commodity[b]
Singapore	Frozen poultry
Soviet Union	Wheat
Sri Lanka	Wheat and wheat flour
Switzerland	Barley and sorghum
Syria	Wheat
Tunisia	Wheat, barley, vegetable oil, and dairy cattle
Turkey	Wheat, barley, rice, vegetable oil, and dairy cattle
Venezuela	Barley malt
West Africa (Benin, Cameroon, Cote d'Ivoire, Gabon, Ghana, Guinea, Liberia, Senegal, Sierra Leone, and Togo)	Frozen poultry
West Africa (Benin, Burkina Faso, Cameroon, Congo, Cote d'Ivoire, Ghana, Gabon, Liberia, Mali, Niger, and Togo)	Wheat
West and Central Africa (Angola, Benin, Burundi, Cameroon, Central African Republic, Congo, Gabon, Ghana, Guinea, Liberia, Mali, Mauritania, Niger, Rwanda, Sierra Leone, Togo, Zaire, and Zambia)	Wheat flour
Yemen	Wheat, wheat flour, and mixed poultry feed
Yugoslavia	Wheat
Zaire	Wheat, wheat flour, and frozen poultry
Zanzibar (Tanzania)	Wheat flour

[a]Total number of targeted countries is 69 Syria is not counted because the initiative was subsequently cancelled

[b]The Export Enhancement Program has targeted 12 commodities under 107 initiatives.

Source Based on U S Department of Agriculture's Foreign Agricultural Service data

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Total Program Activity by Country and Commodity as of May 31, 1990

Targeted country[a]	Commodity[b]
Algeria	Wheat, wheat flour, barley, barley malt, semolina, vegetable oil, table eggs, and dairy cattle
Bangladesh	Wheat
Benin	Wheat and wheat flour
Brazil	Wheat and barley malt
Bulgaria	Wheat and barley
Burundi	Wheat and barley malt
Cameroon	Wheat flour and barley malt
Canary Islands	Wheat, frozen poultry, and dairy cattle
Central African Republic	Wheat flour
Central America (Costa Rica, El Salvador, Guatemala, and Honduras)	Barley malt
China	Wheat and dairy cattle
Colombia	Wheat and barley malt
Cyprus	Barley
Dominican Republic	Frozen poultry and table eggs
East Germany	Wheat
Egypt	Wheat, wheat flour, semolina, frozen poultry, and dairy cattle
Finland	Wheat
Gulf states (Bahrain, Kuwait, Oman, Qatar, and United Arab Emirates)	Frozen poultry and dairy cattle
Hong Kong	Table eggs
Hungary	Barley
India	Wheat and vegetable oil
Indonesia	Dairy cattle
Iraq	Wheat, wheat flour, barley, barley malt, frozen poultry, table eggs, and dairy cattle
Israel	Wheat and barley
Jordan	Wheat, barley, frozen poultry, and rice
Kenya	Wheat
Lebanon	Wheat
Mexico	Wheat
Morocco	Wheat, vegetable oil, and dairy cattle
Near East (Bahrain, Kuwait, Oman, Qatar, United Arab Emirates, Yemen)	Table eggs
Nigeria	Wheat and barley malt
Peru	Barley malt
Philippines	Wheat, wheat flour, and barley malt
Poland	Wheat, barley, and sorghum
Romania	Wheat and barley
Saudi Arabia	Barley, frozen poultry, and dairy cattle
Senegal	Wheat

(continued)

Counselor attributed 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 the program. However, they stated that the program's price-depressing effect resulted in decreased revenue from agricultural exports. They also stated that the program's targeting strategy was inconsistent. For example, the officials noted that Canada, not the EC, had established major wheat markets in Iraq, Colombia, Mexico, and the Philippines, yet all these countries were targeted under the program. In addition, Saudi Arabia was a large importer of barley from many sources, not just from the EC. When an Export Enhancement Program initiative for barley to Saudi Arabia was announced, the whole balance of the world barley trade was upset.

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

However, Canadian officials added that despite the negative effects of the program on export strategies, world price, and the balance of trade, Canada has derived some indirect benefits. In 1988, Canadian exports of rapeseed oil, or canola, became very competitive in U.S. markets partly because of high U.S. domestic vegetable oil prices, driven up (or artificially supported) by the Export Enhancement Program. According to Canadian officials, annual sales of vegetable oil to the United States had 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 have become more competitive in the U.S. domestic market.

Conclusions

Today the Export Enhancement Program is operating in an environment that contrasts sharply with the world agricultural situation in 1985, when U.S. agricultural exports were decreasing and government-owned grain surpluses were rising. In the past year, the world supply of wheat has become relatively tight, due to adverse weather conditions and decisions by some producing countries to reduce production. As a result, increased. The loss of these countries' market shares is not solely attributable to the program. Other factors, such as adverse weather conditions, availability of export credit, and competing land uses, can all contribute to decreased market share.

Table 3.2: Major Exporters' World Market Shares for Wheat and Wheat Flour Exports (Crop Years 1984/1985-1989/1990)

Figures in percent

Country	1984/ 1985	1985/ 1986	1986/ 1987	1987/ 1988	1988/ 1989[a]	1989/ 1990[b]
United States	35.6	29 4	31 3	41.4	38.7	35.9
Canada	18.1	19.8	22 9	22 5	13 8	17 5
Australia	14.8	18.8	16 3	11.6	10 9	10 2
EC	17 3	18.4	18.1	14.1	21 5	21 6
Argentina	7.5	7 2	4.7	3.5	3 7	6 6
Other	6.3	5 8	6 1	6.4	10 8	7 3
Total[c]	**99.6**	**99.4**	**99.4**	**99.5**	**99.4**	**99.1**

[a]Estimated

[b]Forecast November 1989

[c]Totals do not add to 100 percent due to rounding.

Source GAO analysis of data contained in Agriculture's Wheat Situation and Outlook Report, November 1989

The September 1989 OIG report noted that since the program's inception, the EC wheat market shares have generally increased, while those of Argentina, Australia, and Canada have decreased. While the OIG noted that the decreased market shares could have been the result of lower wheat supplies, it cautioned that the program's continuation could adversely affect these countries' exports, should their production increase. The OIG's analysis showed an inverse relationship between the U.S. wheat market share and these three countries' total market shares. More importantly, changes in the U.S. market share appear to have relatively little effect on the EC market share. OIG thus questioned the program's ability to challenge EC export markets without harming other competitors.

We were told by Australian and Canadian government officials and representatives of grain marketing boards, trade associations, private traders, and farmers that their countries have been adversely affected by the program, both in terms of lowering prices for their commodities and reducing market shares.

At a midterm review of the negotiations held in Montreal in December 1988, the United States and the European Community were unable to reach agreement on agricultural issues. Informal negotiations continued and resulted in the adoption of a framework agreement on agriculture in April 1989. The agreement called for substantial reductions in agricultural support over the long term. For the short term, GATT participants agreed to hold domestic and export support at or below the 1989 levels. According to a government source, the short-term agreement does not affect the U.S. use of the Export Enhancement Program or the EC use of export restitutions under its Common Agricultural Policy.

In October 1989, U.S. trade negotiators submitted a comprehensive proposal for agricultural reform. One aspect of this proposal called for the elimination of export subsidies over a 5-year period. The EC was highly critical of the proposal and continued to maintain its position that agricultural support should be decreased but not totally eliminated. In December 1989, other GATT participants, including the EC, also submitted comprehensive proposals.

Effect on the Negotiations

U.S. officials have given the program much credit for bringing the EC to the negotiating table and for maintaining pressure on trading partners during the negotiations. According to an October 1989 Agriculture study,[10] the program has focused attention on agriculture in the Uruguay Round and encouraged U.S. trading partners to support agricultural trade liberalization. The study states that there is a continued need for the program to maintain pressure on trading partners during the final months of the negotiations.

We were told by agricultural counselors at the U.S. Mission to the European Community in Brussels and at the U.S. embassies in Bonn, West Germany, and Paris, France, that the program has been an effective tool in furthering trade negotiations. Its use has shown that the United States is serious about efforts to eliminate trade-distorting subsidies.

The EC officials we contacted generally stated that the program has had little or no effect. A West German government official noted that any pressures from the program on the EC have been negligible. He stated that the EC began to reform its Common Agricultural Policy long before the Export Enhancement Program's enactment. In his view, the program

[10] "Export Enhancement Program Issues and Proposals for Future Programming" (U.S. Department of Agriculture, Oct. 6, 1989).

in the wheat export market resulting from the use of the program. The study reported probable bilateral trade flows and predicted resulting additional U.S. sales to the targeted markets. This study estimated the program's additionality for wheat exports at 2 to 3 percent for 1986 and 12 to 14 percent for 1987 (due to large purchases under the program by the North African countries and the Soviet Union).

Changes in Targeting Strategies

The Export Enhancement Program was designed to target specific market opportunities, especially those that challenge competitors which subsidize their exports. In practice, Agriculture has implemented the program to have the greatest impact on the European Community. According to Agriculture officials, however, the program was not intended to be limited just to those markets where the EC was a major exporter. Over time, the program was expanded to include countries that had a small EC market presence, and then to countries where the EC was only contemplating a sale. As the EC was displaced in one market, it turned to another, thus making that country eligible for the program. The program grew from 4 targeted countries in 1985 to 69 by 1990 and has included 12 commodities.

Perhaps the most controversial aspects of targeting were the administration's decisions regarding the Soviet Union. As reported in our March 1987 report, the Soviet Union was initially excluded from the program, despite the fact that the EC share of the Soviet wheat market rose from 5 to 22 percent from the 1981 to the 1985 crop year. Agriculture initially stated that the Soviet Union had been excluded from the program because nonsubsidizing competitors had about a 48 percent share of the market in crop year 1985. However, nonsubsidizers had equal or greater shares of other markets targeted under the program, such as Egypt, Iraq, Jordan, and Sri Lanka. Clearly the Soviet Union had been excluded until August 1986 for foreign policy reasons. The Soviet Union was then made eligible for sales under the program and has since become the largest importer under the program.

In May 1989, Agriculture released the results of an internal study assessing past performance under the program. The analysis focused on wheat sales, which had historically constituted about 85 percent of the program's export volume. It illustrates how the targeting strategy has evolved over time.[6]

[6] "The Export Enhancement Program: Review of Program Criteria and Objectives" (U.S. Department of Agriculture, May 15, 1989).

Although dairy cattle exports did increase, it is unclear how much of the increase was due to the program. One major importer told us that they would probably have bought some U.S. cattle even without the program; however, the higher U.S. price might have affected the number purchased.

At the time of our review, it was not clear that the U.S. market would be sustained, with or without the program. We were told that U.S. cattle were not producing as much milk as expected, were experiencing problems with impregnation, and were not adapting to Indonesia's climate. Moreover, high transportation costs would always necessitate a subsidy to keep U.S. dairy cattle competitive.

In our February 1990 report on Export Enhancement Program activity, we reported that as of February 1989, U.S. exporters had received over $18 million in bonuses for sales of 15,297 head of cattle to Indonesia. We noted that the amount of bonus needed to make U.S. dairy cattle exports competitive varied over time and, in some years, greatly exceeded the sales price. For all dairy cattle sales under the program, the average bonus value was 146 percent of the average sales price in fiscal year 1986 and 121 percent in 1987. A complete comparison of average bonuses as a percent of average sales by commodity is included in appendix VII of our February report.

The OIG's September 1989 report on the program stated that FAS did not effectively manage its dairy cattle program during initial implementation. The OIG found that FAS did not have sufficient cost data to compute bonus amounts. Instead of computing bonuses based on actual costs under current market conditions, FAS had established bonus ceilings at 50, 100, or 150 percent of the contracted sales prices. Other problems also plagued the dairy cattle program. The OIG found that FAS did not anticipate some of the difficulties that were encountered when exporting live animals. In addition, participating exporters did not always have the necessary expertise or financial means to operate, nor were they always aware of significant import restrictions.

Due to the large bonuses being paid, in April 1988 FAS suspended the dairy cattle program, and then in July 1988 it announced two new dairy cattle initiatives with pre-set bonuses. These new initiatives expired in December 1988, and since then no new dairy cattle initiatives have been announced.

Further evidence of GSM-102's importance to market expansion was discussed in a 1989 report that the U.S. Agricultural Trade and Development Mission in Algeria and Tunisia prepared. The report stated that because of Algeria's increasing need for financing, the U.S. export credit guarantee program had become one of the most important factors in expanding U.S. agricultural exports to Algeria. The report noted that the GSM-102 program had grown from $97 million available for fiscal year 1986 to $750 million available for fiscal year 1989.

Long-Term Market Expansion Is Questionable in Two Markets

We analyzed two markets targeted under the Export Enhancement Program—table eggs to Hong Kong and dairy cattle to Indonesia—and found that the program had increased exports of U.S. agricultural commodities in these markets. However, we question whether long-term market expansion can be sustained. In Hong Kong, where price was an important buying decision determinant, it appeared that the continued competitiveness of U.S. table eggs depended on the program's continuation. In Indonesia, further dairy cattle sales were unlikely because of other problems unrelated to price.

Table Egg Exports to Hong Kong

The U.S. share of the Hong Kong table egg market increased significantly after sales began under the program in 1986. U.S. table eggs compete primarily with Chinese and Dutch table eggs for the Hong Kong market. Chinese table eggs have historically dominated the market because they are cheaper and because Hong Kong's Chinese population generally prefer their taste and color. Dutch table eggs are closer to U.S. table eggs in quality, taste, and appearance. Subsidized sales of Dutch table eggs began gaining momentum during the mid-1980s. According to Hong Kong egg traders, price is the most important determinant of whether consumers will buy Dutch or U.S. table eggs.

The U.S. share of the Hong Kong market increased from 6 percent in 1986, when the program was initiated in response to Dutch subsidies, to about 13 percent as of March 1989. At one point, the U.S. share was as high as 18 percent. Table 3.1 illustrates changes in the relative market shares for the three main suppliers since 1984.

may respond to U.S. competition by displacing potential U.S. sales in untargeted markets. Moreover, when prices decline, it is unclear how much more importers will buy of the lower-priced commodities or whether they will use the resources saved to buy other commodities, either U.S. or foreign. Nontargeted countries may respond by reducing their U.S. purchases, thereby creating the need to target those countries to regain lost market shares. Thus, while exports may increase in the targeted markets, the overall effect on U.S. exports worldwide is uncertain. If this displacement occurs, the use of targeted subsidies may merely reroute trade flows, and total export volume would not necessarily increase.

U.S. Agricultural Exports Increased in Certain Markets

The program 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 the program to make U.S. exports competitively priced, it is highly unlikely that these sales would have taken place.

For example, when the Export Enhancement Program was established in 1985, it lowered the price of wheat to many importers but not to the Soviet Union. This exacerbated ongoing United States-Soviet differences over the price of U.S. grain. In 1983, the Soviets had entered into a long-term bilateral grain agreement with the United States and had agreed to purchase a minimum of 4 million metric tons of U.S. wheat annually for 5 years.[1] Beginning in 1985, the Soviets bought significantly less wheat from the United States—2.9 million metric tons in 1985 and a mere .15 million metric tons in 1986—because of continuing differences over price. To encourage the Soviets to purchase the minimum quantities of U.S. grain specified in the agreement, Agriculture offered wheat to the Soviet Union under the Export Enhancement Program on August 1, 1986. The offer expired on September 30, 1986, without the Soviets purchasing any U.S. grain. According to Soviet trade representatives, the U.S. price was too high despite the $15 bonus per metric ton offered to U.S. exporters. The Soviets did purchase wheat from the European Community during this time.

[1]For more information on the agreement, see Agricultural Trade: Long-Term Bilateral Grain Agreements with the Soviet Union and China (GAO/NSIAD-89-63, Mar. 22, 1989).

documentation leaves FAS vulnerable to allegations of impropriety and favoritism.

We believe that all information required to prove exporter eligibility should be at least randomly verified. For example, FAS was not routinely verifying sales contract information. We believe that without verification, FAS cannot ensure that only eligible exporters with valid sales contracts were participating in the program.

Participating exporters were generally satisfied with FAS program administration, but they identified areas that could be improved. They suggested that FAS decrease its performance bond requirements, adopt the commercial definition of contract fulfillment, accept alternative forms of documentation to prove contract fulfillment, simplify the bidding process, and reactivate the Export Enhancement Advisory Group. FAS officials do not agree that these suggested changes are necessary.

Recommendations

We recommend that the Secretary of Agriculture continue to improve the Export Enhancement Program's operations by directing the FAS Administrator to

- require the Commodity and Marketing Programs section to expand its status report on proposals by including those being analyzed in the commodity divisions so that the General Sales Manager can monitor their progress and ensure their consistent, fair, and timely treatment;
- require written justification for each decision to reject an official proposal for a new program initiative, including decisions made by the Under Secretary for International Affairs and Commodity Programs; and
- randomly verify all categories of information needed to prove exporter eligibility to help ensure that only eligible exporters with valid sales contracts participate in the bidding process.

proof of contract fulfillment and allow for alternative documents that are more easily acquired.

According to FAS, the targeted nature of the program demands a strict requirement for proof of delivery to the specified destination. FAS has considered other alternatives to landing certificates, but none has been deemed viable. Landing certificates can be issued by one of several importing country officials, including a customs or port official, in addition to the actual buyer. Even so, FAS acknowledged that landing certificates are sometimes difficult to obtain. In these cases, FAS agricultural attaches can assist the exporters in getting certificates from importing country officials. Further, according to FAS officials, FAS has released performance bonds when unwarranted delays have occurred due to exporter difficulty in obtaining landing certificates.

Simplify the Bidding Process

In order to compete for a sale under the program, each exporter must submit a bid through the FAS-administered bidding process. Each bid includes the negotiated sales price and required bonus amount. In order to be acceptable, bids must fall within FAS predetermined minimum price and maximum bonus levels, which are not publicly announced.

While exporters recognized that the bidding process enhances competition, several of them noted that it puts them in an unusual position. In a commercial sale, the exporter and the importer negotiate and agree on a price. In a sale under the program, an exporter often has to return to the purchaser several times to renegotiate because FAS has turned down the bid. We were told that this process gives the sale an unprofessional appearance and frustrates the buying officials. These exporters suggested that FAS eliminate the minimum price, and that FAS need only ensure that the maximum bonus allowed reflects the difference between the U.S. and the competition's delivered prices.

FAS acknowledged that the bidding process can often be time consuming and cumbersome. However, the competition generated by setting a minimum price is important to the credibility of the bidding process.

Exporters' Comments and Suggestions for Program Improvements

We previously reported that as of February 1989, 71 exporters had participated in the program. We spoke with 16 of these exporters, who together received 65 percent of the total bonuses awarded, to obtain their views on how well the program was being administered. These 16 exporters had sold 9 of the 12 commodities targeted under the program. In general, these exporters were satisfied with how FAS was administering the program and stated that FAS management was competent and fair. The consensus was that FAS had generally done a good job running a complicated program with limited resources. However, the exporters raised a number of concerns about program operations and made several suggestions for improvement. Their suggestions addressed performance bond requirements, contract definition, documentation, bidding procedures, and the need for an export advisory committee.

Decrease the Performance Bond Requirements

To participate in the program, an exporter must post a performance bond in favor of Agriculture's Commodity Credit Corporation. Performance bonds can equal either 55 percent or 155 percent of the total bonus requested, plus 5 percent for shipping tolerance, depending on when the exporter wants the bonus award. The 155 percent bond allows the exporter to receive the bonus upon proof of shipment. The 55 percent bond allows an exporter to receive the bonus award only after submitting proof of delivery. However, under either option, performance bonds are not released until the exporter provides FAS with a landing certificate as proof of delivery.

According to several exporters, both options are often too highly priced for many of the smaller exporters to handle on their own. Obtaining outside financing is difficult and, when found, the outside financier requires compensation. This compensation adds to the smaller exporter's bonus bid and generally makes it too high to be acceptable and competitive.

The exporters suggested that FAS reevaluate the performance bond requirements, with particular attention to whether equal opportunity exists for small and large exporters to post bonds. They stated that lowering the percentage of the requested bonus to be secured by a bond could allow more exporters to participate in the program.

According to FAS, the offering of either a 55 percent or 155 percent performance bond gives smaller exporters an opportunity to participate, while limiting the risk to the Commodity Credit Corporation should the exporter not perform.

Improvements to the Price- and Bonus-Setting Process

FAS sets minimum prices and maximum bonuses for commodities sold under the Export Enhancement Program. These parameters are then used as the criteria for accepting exporter bids for sales under the program. In March 1987, GAO reported that the price- and bonus-setting process involved considerable subjective judgment.

During our current review, we reexamined this process. We found that the data collection efforts and methodology for price- and bonus-setting can vary by commodity, due to the nature of the market, the availability of commodity price information, and the need to consider other factors, such as quality, packaging, processing, and transportation rates. We determined that FAS program officials were receiving the information necessary to make informed price and bonus decisions. However, they were not documenting adjustments made to this information when calculating price and bonus levels. Although FAS officials were preparing price sheets that listed each of the figures used in price and bonus calculations, they were not providing either narrative or statistical support to explain how they arrived at these figures. As a result, it was difficult to determine whether bonuses were higher than needed to make sales. This inability was of greatest concern when bonuses exceeded sales prices. For example, in February 1990, we reported that for dairy cattle, the average bonus value was as high as 146 percent of the average sales price in 1986; for semolina, as high as 140 percent in 1987; and for frozen poultry, as high as 111 percent in 1986.

During 1989 and 1990 hearings, we outlined these problems and emphasized the need for better documentation of price- and bonus-setting decisions. The OIG also found problems with FAS documentation of price- and bonus-setting decisions.

In response to GAO and OIG concerns, in December 1989, FAS developed written guidelines detailing the procedures to be followed by each commodity division when determining price and bonus levels. Further, in April 1990, FAS instructed commodity divisions to document all relevant price and bonus determinations and adjustments to price information. We support these FAS actions because we believe that price- and bonus-setting determinations must be well documented in order to strengthen the integrity and credibility of the price- and bonus-setting processes. In turn, the bidding process, which relies on price and bonus levels for its criteria, will be less vulnerable to claims of unfair or inconsistent treatment.

the minimum program criteria, it is forwarded to FAS top management for further review. The Commodity and Marketing Programs section establishes a central file on each proposal forwarded by a division, tracks its progress, and compiles a weekly status report containing information on all proposals forwarded by the divisions and currently under review. This report contains market-sensitive information[4] and, therefore, its distribution is restricted to the General Sales Manager and a few selected staff.

During our review of the Commodity and Marketing Programs section's central files, we found that they contained information forwarded from the divisions, including documentation of how the proposal met the program criteria, and signatures collected during the review and approval process. However, when a proposal was rejected by the Under Secretary for International Affairs and Commodity Programs, written justification was not provided. Generally accepted internal control practices dictate that key decisions be clearly documented. FAS lacks the complete documentation necessary to defend its decisions to accept or reject proposals. Therefore, we believe that FAS is vulnerable to allegations of impropriety and favoritism, particularly by those whose proposals are rejected.

Exporter Eligibility not Verified on a Random Basis

Currently FAS internal controls over the exporter qualification and bidding processes are not adequate to ensure that only eligible exporters with valid sales contracts participate in the bidding. We reviewed FAS files on 71 participating exporters and found that they contained the required information. However, we found that while FAS verified some categories of information submitted by exporters, information on the form of doing business, name and address of U.S. agent, and sales contract was not routinely verified, even on a random basis.

To be eligible to participate in the program, exporters must provide the following types of information no later than 3 days before submitting a bid: (1) evidence of having traded in the commodity offered during the preceding 3 years, (2) the name and address of the exporter's U.S. agent, (3) a certified statement of the form of business under which the exporter practices (e.g., U.S. corporation, foreign entity), and (4) evidence of the exporter's financial responsibility either in the form of an

[4]According to Agriculture, market-sensitive information includes production estimates, trade and economic forecasts, acreage reduction and price support programs, export sales, all activity under the Export Enhancement Program and Targeted Export Assistance Program, and all actions by the General Sales Manager that might influence or affect the market value of any agricultural product traded on a commodity market.

Program Operations Can Be Further Improved

The Foreign Agricultural Service manages the Export Enhancement Program's day-to-day operations. The difficulty in administering such a complex program is reflected in the number of activities required to carry out its objectives. Our review focused on four of these administrative activities: tracking proposals, ensuring exporter eligibility, setting price and bonus levels, and monitoring bonus payments. We found that FAS did not (1) centrally track all proposals, (2) adequately verify information used in the exporter qualification and bidding processes, and (3) adequately document price- and bonus-setting decisions. In addition, we identified several cases where bonuses had been overpaid.

Background

Past reviews by GAO and by Agriculture's OIG have criticized the program's operations and management. In March 1987, we reported that FAS had not set appropriate guidelines for applying program criteria and had not developed procedures to properly document price and bonus determinations.[1] In addition, in 1989 and 1990 we testified before congressional agriculture committees on improvements still needed in program operations. In September 1989, the OIG reported that internal controls were not adequate to ensure that the program was meeting its stated objectives in the most cost-effective manner.[2] Among its findings, the OIG reported that FAS had not (1) developed written guidelines to further define program criteria established by the Economic Policy Council, (2) evaluated the program to determine if program objectives were being met, (3) established written policies and procedures for price and bonus calculations, and (4) adequately documented these calculations. In February 1990, we reported on internal control weaknesses that had resulted in bonus overpayments.[3]

In response to GAO and OIG concerns, FAS has been working to improve Export Enhancement Program operations. It is developing written policies and guidelines for many aspects of the program, establishing new procedures, and strengthening internal controls to help ensure that program objectives will be met.

[1] International Trade: Implementation of the Agricultural Export Enhancement Program (GAO/NSIAD-87-74BR, Mar. 17, 1987).

[2] Audit of the Foreign Agricultural Service's Export Enhancement Program (U.S. Department of Agriculture's Office of Inspector General Audit Report No. 07099-18-Hy, Sept. 29, 1989).

[3] International Trade: Export Enhancement Program Bonus Overpayments (GAO/NSIAD-90-83, Feb. 7, 1990).

We have also testified on our preliminary findings on three occasions before Senate and House agriculture committees.[5] In addition, an April 1990 GAO report on the 1990 farm bill contains a summary of the issues addressed in our testimony and suggestions for congressional consideration.[6]

Our objectives were to (1) review program operations, including recent changes, and (2) examine the program's effect on world agriculture trade and its use as a trade policy tool during the ongoing agricultural trade negotiations.

To assess program operations and management, we identified written guidelines and procedures used in all phases of program implementation. We examined program operations to determine whether internal controls were adequate to ensure that established guidelines and procedures were followed in tracking proposals, ensuring exporter eligibility, setting price and bonus levels, and monitoring bonus payments. We reviewed program documents at FAS headquarters in Washington, D.C., and at the Agricultural Stabilization and Conservation Service in Kansas City, Missouri. We also interviewed officials in both locations who were responsible for administering the program. In addition, we discussed the program with officials from the State Department and OMB. To obtain the exporters' perspective on program operations, we conducted a telephone survey of 16 participating exporters, 3 of which accounted for over half of the total bonuses awarded through February 1989.

To determine the program's effect on world agricultural trade and the ongoing multilateral trade negotiations, we interviewed U.S. government officials; representatives of U.S. trade associations; farmers' cooperatives and unions; grain exporters; transportation entities; and other members of the U.S. agricultural trade community. In addition, we reviewed documents and studies provided by these parties as well as those prepared by Agriculture's Economic Research Service and other independent researchers.

[5] On July 31, 1989, we testified on the status of our review of the Export Enhancement Program before the Subcommittee on Wheat, Soybeans, and Feed Grains, House Agriculture Committee (GAO/T-NSIAD-89-45). We also testified on November 16, 1989, at a joint hearing of the House Agriculture Committee's Subcommittees on Department Operations, Research, and Foreign Agriculture; Tobacco and Peanuts; and Wheat, Soybeans, and Feed Grains (GAO/T-NSIAD-90-12). We testified before the Senate Committee on Agriculture, Nutrition, and Forestry on February 21, 1990 (GAO/T-NSIAD-90-02).

[6] 1990 Farm Bill: Opportunities for Change (GAO/RCED-90-142, Apr. 10, 1990).

Measuring the program's success based on the achievement of these criteria has proved difficult. Problems with measuring the program's additionality and with the targeting strategy are discussed in detail in chapter 3. Cost effectiveness and budget neutrality also proved to be troublesome criteria. In November 1988, as part of its fiscal year 1990 budget review of Agriculture programs, the Office of Management and Budget (OMB) requested that Agriculture examine the program's performance based on the above criteria, concentrating on the program's budgetary effect under a range of market conditions.

In February 1989, Agriculture and OMB staff agreed to the scope, outline, and schedule for Agriculture's review of the program criteria and objectives. The first phase of the review, completed in May 1989, focused on the program's past performance, budget effects, and additionality, with emphasis on wheat sales. While Agriculture acknowledged the difficulty of measuring program compliance with program criteria, particularly the additionality and budget neutrality criteria for specific targeted markets, it generally concluded that the program had met its objectives. The program had enhanced exports, challenged unfair trade practices, and been an important factor in encouraging U.S. trading partners to begin serious negotiations on agricultural trade reform under the Uruguay Round of the multilateral trade negotiations.

The second phase of the review, completed in October 1989, addressed future operation of the program. Agriculture concluded that at times, operational criteria rather than program objectives had driven the decision-making process for approving program initiatives. This might have affected the program by constraining the approval of initiatives that would have met program objectives, but did not meet operational criteria. Agriculture clarified the program's objectives and reestablished their primary importance in program operations. It identified support for trade policy goals as the Export Enhancement Program's primary objective. According to Agriculture, this focus on trade policy would also provide the basis for increasing agricultural exports through the eventual elimination of trade-distorting policies and practices.

The second phase resulted in proposed new guidelines to replace the original operating criteria. The guidelines would be used when determining annual program levels and in reviewing and selecting proposal initiatives. On November 27, 1989, Agriculture published a notice in the Federal Register proposing interrelated guidelines, which would be considered together when selecting countries and commodities to target under the program.

and distributes the proposal to member agencies of the Trade Policy Review Group (TPRG).[4]

Members of the TPRG's informal working group are given 5 working days to express concerns about the proposal. When members of the working group raise concerns or objections to the proposal, subcabinet members of the full TPRG meet to discuss the problems. If the TPRG cannot reach consensus on the proposal, it is forwarded to the Economic Policy Council. If the Council cannot agree, the proposal can be sent to the President for approval or rejection.

After a proposal is approved, it is sent back to Agriculture and announced as an initiative. Each initiative specifies a fixed quantity of a commodity (e.g., 100,000 metric tons) approved for sale. Once the initial quantity is awarded, new allocations can be approved through the interagency process and announced under a revised initiative.

Setting Minimum Price and Maximum Bonus Levels

FAS sets minimum prices and maximum bonuses for commodities sold under the program. Price and bonus amounts are calculated separately for each destination, type of commodity (e.g., hard red winter wheat, soft winter wheat, durum wheat), and time of shipment.

FAS collects information on competitor selling prices from daily and weekly market intelligence reports and from overseas sources such as agricultural attaches, private contractors, and trade contacts. It then sets a minimum acceptable price that is competitive with the delivered price of the subsidizing supplier. FAS also estimates the U.S. domestic price plus freight and special handling to the same destination. Information is collected from trade publications, trade contacts, freight companies, and other Agriculture divisions. The difference between the U.S. and the competitor's delivered prices becomes the maximum acceptable bonus.

With few exceptions, bonus payments are made to exporters in negotiable "generic" commodity certificates, with specified expiration dates and dollar amounts. The Department of Agriculture's Agricultural Stabilization and Conservation Service issues the commodity certificates and maintains documentation on contract fulfillment. The exporter may sell

[4]The Trade Policy Review Group is chaired by a deputy U.S. Trade Representative and is made up of representatives from the Departments of Agriculture, State, Commerce, Labor, Treasury, and Transportation; the Office of Management and Budget; the Council of Economic Advisers; and other agencies with interest in the proposal.

Program Activity and Focus

In May 1985, the Export Enhancement Program was established by the Secretary of Agriculture in reaction to continuing declines in U.S. agricultural exports. Under the program, government-owned surplus agricultural commodities were to be made available as bonuses to U.S. exporters to enable them to lower the prices of U.S. agricultural commodities and make these commodities competitive with subsidized foreign agricultural exports, particularly those of the European Community (EC). According to guidelines established by the cabinet-level Economic Policy Council,[1] sales were to be targeted at specific market opportunities where U.S. agricultural exports could be increased above those that would have occurred without the program.

The Food Security Act of 1985 codified the Export Enhancement Program as a 3-year export subsidy program providing $2 billion worth of surplus agricultural commodities as bonuses. The Food Security Improvements Act of 1986 limited the overall amount of bonuses to be awarded during the 3-year period to not less than $1 billion nor more than $1.5 billion. In July 1987, the Department of Agriculture announced that the program would continue under the provisions of the Commodity Credit Corporation Charter Act of 1948 once the $1.5 billion of authorized commodities had been exhausted. The Omnibus Trade and Competitiveness Act of 1988 authorized the continuation of the program and an additional $1 billion in commodities through fiscal year 1990, thus raising the ceiling to $2.5 billion. This level was reached in late fiscal year 1989. Through the Omnibus Budget Reconciliation Act of 1989, Congress limited the amount of commodities available during fiscal year 1990 to $566 million.

Nature and Extent of the Program

The Export Enhancement Program is managed and administered by the U.S. Department of Agriculture's Foreign Agricultural Service (FAS). Since its inception, the program has grown dramatically—as of May 31, 1990, FAS had announced 107 initiatives targeting 12 commodities in 69 countries. The targeted countries and commodities are listed in appendix I. In February 1990, we issued a fact sheet containing information on activity under the program from May 1985 through February 28,

[1]The Economic Policy Council is chaired by the Secretary of Treasury and includes the Secretaries of Agriculture, Commerce, Labor, State, and Transportation; the U.S. Trade Representative; the Director of the Office of Management and Budget; the Chairman of the Council of Economic Advisers; the Vice President; the Assistant to the President for National Security Affairs; and the White House Chief of Staff.

Contents

Effect on World Agricultural Trade

The Export Enhancement Program has helped to increase U.S. agricultural exports, particularly wheat, to many countries. The extent of the program's effect is generally difficult to quantify. Studies published in 1988 and 1989 have estimated that the program was responsible for between 2 and 30 percent of the increase in wheat exports, depending on the assumptions made and the time period covered by the study. However, in a few cases, the program has been critical to making sales in certain markets, specifically wheat sales to the Soviet Union and China. In addition, GAO found that the program, coupled with U.S. export credit guarantees, was essential to U.S. sales in Algeria and Egypt.

The program's targeting strategy has evolved over time. Originally its primary target markets were in countries that made significant purchases of subsidized exports from the European Community. However, over time the program changed and expanded to include countries that had a small Community presence and then to countries where the Community was only contemplating a presence. The program grew from 4 countries in 1985 to 69 countries in 1990.

Agriculture has reestablished the program's importance as a trade policy tool to maintain pressure on some trading partners during the final months of the Uruguay Round of multilateral trade negotiations on agricultural trade reform. U.S. officials have given the program much credit for pressuring the European Community to begin negotiations on agricultural reform. However, the Community has resisted major concessions to the United States on the elimination of agricultural subsidies.

GAO agrees that the program is an important trade policy tool. Abandoning the program now would undermine any progress made thus far. Once the Uruguay Round of multilateral trade negotiations is completed, the Secretary may need to reevaluate the program in light of any agreements reached on agricultural subsidy issues.

Recommendations

GAO makes several recommendations to improve program operations, including expanding the central proposal tracking system and establishing better internal controls over exporter eligibility.

Executive Summary

Purpose

In preparation for drafting the 5-year 1990 farm bill, Chairman of the House Agriculture Committee E (Kika) de la Garza, Congressman Silvio O. Conte, and Congressman Charles E. Schumer asked GAO to review the Export Enhancement Program, including its operations and recent changes, its effect on world agricultural trade, and its use as a trade policy tool during ongoing trade negotiations.

Background

Established in May 1985, the program provides government-owned surplus agricultural commodities as bonuses to U.S. exporters to help lower the prices of U.S. agricultural commodities and make them competitive with subsidized foreign agricultural exports. The program was designed to increase U.S. exports and encourage U.S. trading partners, particularly the European Community, to begin serious negotiations on liberalizing agricultural trade.

As of May 1990, over $2.7 billion worth of surplus commodities had been made available as bonuses to eligible U.S. exporters for sales to 69 countries. These sales totaled over $10 billion. The primary commodity sold under the program has been wheat, accounting for over 80 percent of total export sales. The Soviet Union and China have bought about 50 percent of the wheat sold; Algeria, Egypt, and Morocco have accounted for another 25 percent. Other commodities sold have been wheat flour, barley, barley malt, dairy cattle, table eggs, frozen poultry, mixed poultry feed, rice, semolina, sorghum, and vegetable oils.

Results in Brief

Today the Export Enhancement Program is operating in an environment that contrasts with 1985's world agricultural situation. At that time, U.S. agricultural exports were decreasing and government-owned grain surpluses were rising. Since then, agricultural exports have increased and grain surpluses have diminished, but accurate measurements of the program's effect have been elusive due to the many policy and economic variables that also influence exports. However, the U.S. government continues to emphasize the program's importance as a trade negotiation tool. The Department of Agriculture's Foreign Agricultural Service has been working to improve program operations in response to GAO and Office of Inspector General concerns, but further improvements in management controls are still needed.