CBO TESTIMONY

Statement of
Eileen M. Manfredi
Principal Analyst
Budget Analysis Division
Congressional Budget Office

before the
Subcommittee on Department Operations,
Research, and Foreign Agriculture
Committee on Agriculture
U.S. House of Representatives

July 28, 1992

NOTICE

This statement is not available for public release until it is delivered at 9:30 a.m. (EDT), Tuesday, July 28, 1992.

CONGRESSIONAL BUDGET OFFICE
SECOND AND D STREETS, S.W.
WASHINGTON, D.C. 20515

I am pleased to appear before the Committee today to discuss the budgetary impact of H.R. 4279, a bill to enhance the competitiveness of U.S. processed and high-value agricultural products in export markets and expand domestic employment opportunities. The Congressional Budget Office (CBO) estimates that this bill would cost about $85 million over fiscal years 1993 and 1994, though it could be carried out in ways that would cost substantially more.

WHAT THE BILL DOES

H.R. 4279 would require the Secretary of Agriculture to run the Export Enhancement Program (EEP) so that, to the extent practicable, 25 percent of the subsidies went to processed agricultural products and high-value products. Similarly, the bill would mandate that the Secretary run the Export Credit Guarantee Program so that at least 35 percent of the credits would be for processed and high-value products. Each of these targets is 10 percentage points above the levels assumed in the baseline used for the 1993 budget resolution.

According to the bill, a processed agricultural product is one derived from a bulk or raw agricultural commodity that, by processing, is increased in value and made more appropriate for human consumption and use. Such

products include livestock and poultry products; wheat flour; milled rice; refined sugar; vegetable oil; and prepared, preserved, canned, frozen, refrigerated, and other processed food products.

High-value agricultural products have a value per unit that is substantially higher than that of bulk or raw agricultural commodities, such as grains or oilseeds. Such products include fresh, chilled, or frozen meats and other livestock and poultry products, eggs, breeder stock, plant seeds, and tobacco.

The two export programs included in the earmarks are the Export Enhancement Program and the Export Credit Guarantee Program. The EEP began in 1985 and was reauthorized by the Food, Agriculture, Conservation, and Trade (FACT) Act of 1990. Under this program, the U.S. government provides cash subsidies to exporters of specified commodities to selected countries. The Secretary of Agriculture has discretion over the countries to which subsidies are offered, the commodities for which subsidies are available, and the amount of subsidy provided. Most of the EEP subsidies are for wheat, but subsidies for wheat flour, feed grains, vegetable oils, eggs, and other commodities have also been offered. Under current law, the Secretary is required to establish an objective that 25 percent of EEP subsidies be used

for processed and high-value products. That percentage has not been achieved.

Under the Export Credit Guarantee Program, also reauthorized in the 1990 FACT Act, the government guarantees export financing for U.S. agricultural commodities. Current law mandates that a minimum of $5 billion be made available annually through 1995 for short-term guarantees (up to three years) and a minimum of $0.5 billion for intermediate-term guarantees (three to 10 years), plus $1 billion over fiscal years 1991 through 1995 for guarantees to emerging democracies. The sales are made on commercial terms, but the importing country benefits from the advantageous credit terms that the U.S. guarantee makes possible. The Secretary of Agriculture determines which commodities receive guarantees in consultation with the recipient countries. In order to induce a country to purchase a specific product, an EEP subsidy may be necessary. Recently, the republics of the former Soviet Union have been given EEP subsidies in addition to export credit guarantees for wheat purchased from the United States.

Currently, raw commodities appear to be more appealing to recipient countries than high-value or processed products. Such countries most often request bulk commodities under the Export Credit Guarantee Program, and a large share of outstanding and unused offers of EEP subsidies are for high-

value products. Therefore, the Department of Agriculture (USDA) might have to offer significant subsidies in order to create sufficient demand for high-value or processed products to meet the targets the bill specifies.

THE COST OF H.R. 4279

Current law requires the Secretary of Agriculture to establish an objective of providing 25 percent of EEP subsidies for processed and high-value products. H.R. 4279 would create a stronger mandate, requiring the Secretary to run the two export programs so as to achieve specified percentages of processed and high-value products. CBO believes that the bill's targets can be met and assumes that the Department of Agriculture would make the efforts necessary to attain them.

One can meet these earmarks in two ways. One method would be to expand the size of the two export subsidy programs by adding extra subsidies for processed and high-value products. This strategy would lead to increased outlays each year for these programs. The other option is to substitute processed and high-value products for other commodities, while maintaining the same amount of export subsidies. This method would leave export subsidy

costs unchanged, but would increase outlays for federal price support programs in 1993 and 1994.

Expanding the Export Programs

CBO estimates that expanding these export programs would increase outlays by more than $200 million a year--about $130 million in 1993 for the EEP and about $90 million for export credit guarantees. The volume of export credit guarantees, which have a subsidy rate of 12 percent, would increase by $785 million a year.

If the Secretary of Agriculture uses this method of meeting the earmark, then CBO would anticipate no significant impact on commodity prices or on the cost of the government's price support programs. The cost of such programs could be reduced because additional exports of some processed and high-value products, such as meats and poultry, would lead to greater use of corn and other program commodities for animal feed. But we expect that the Secretary would offset any possible increase in market prices induced by increased feed demand by lowering the required acreage reduction percentage announced annually for corn and other program commodities. Additional exports of other high-value products, such as fruits and vegetables,

would not affect the cost of commodity programs. Thus, we project that market prices and deficiency payment rates, which move with market prices, would not change significantly.

Substituting High-Value Products for Bulk Products

Alternatively and, we believe, more likely, the Secretary could attain the bill's objectives by substituting processed and high-value agricultural products for bulk products, such as wheat or corn. If the targets are met in this way, the amount spent for export subsidies would not change. Costs for price support programs would increase, however, because the reallocation of export subsidies would result in reduced demand for commodities with price supports.

This cost increase would occur because, in general, a dollar of subsidy for the export of processed or high-value products creates much less demand for a raw commodity than a dollar of subsidy for exporting the commodity itself. As a result, the market price of that commodity would fall. Moreover, if it is covered by the government's price support program, the cost of that program would increase.

For example, the EEP subsidy for wheat flour is typically around $100 per ton, and the subsidy for raw wheat is about $50 a ton. Thus, the cost of the subsidy for an equivalent of each ton of raw wheat is substantially greater for wheat flour than for raw wheat, even after taking into account that a ton of wheat flour is derived from 1.36 tons of wheat. As a result, a shift of subsidies from wheat to wheat flour would cause overall wheat use and the price of wheat to fall and the cost of the government's wheat program to rise.

Substituting meat for feed grains would generally cause an even greater drop in grain prices because much of the value of the meat derives from factors other than feed. (In the case of beef, for example, these factors include the costs of the feeder steer, hay, other feeds, farm labor, interest, transportation, and marketing.) For beef, pork, and poultry, the EEP subsidies or the export prices for the guarantee program are significantly greater than those for corn and other feed grains for which they might be substituted. Thus, the dollar-for-dollar substitution of meats for corn in the export programs would result in decreased corn use because the reduction in corn exports would far outweigh the increase in corn consumption caused by increased meat exports.

CBO expects that increased subsidies for high-valued products would largely displace subsidies for wheat. This shift could lead to a drop of more

than four cents per bushel in the market price for wheat in crop years 1992 and 1993. That price reduction would result in an increase in deficiency payments--support payments paid to farmers who participate in specified commodity programs--of about $85 million, spread over two fiscal years. Since the acreage reduction percentages for 1992 commodity programs and for the 1993 wheat program have already been announced, the Secretary could not adjust the percentage to offset this short-term price effect. In contrast, the loss of exports in future years could be offset by raising the acreage reduction percentage. The cost of H.R. 4279 could vary significantly, depending on which high-value or processed commodities receive the subsidies and what raw commodities they would replace.

Although proponents argue that this bill could have beneficial effects on other aspects of economic activity--by increasing employment, for example--those do not have a direct budgetary impact. CBO has no basis for estimating any economic effects that might result from a change in the mix or volume of agricultural exports as a consequence of H.R. 4279.